

19 April 2013

Mr James Gunn  
Technical Director  
International Auditing and Assurance Standards Board  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, NY 10017 USA

Dear Mr Gunn,

**IAASB Consultation Paper - *A Framework for Audit Quality***

Attached is the Australasian Council of Auditors-General (ACAG) response to the Consultation Paper referred to above. The views expressed in this submission represent those of all Australian members of ACAG.

ACAG strongly supports the IAASB initiative to raise awareness of the key drivers of audit quality, encourage stakeholders to explore ways to improve audit quality, and facilitate and inform dialogue between stakeholders on the topic.

The opportunity to comment is appreciated and I trust you will find the attached comments useful.

Yours sincerely



Simon O'Neill  
**Chairman**  
**ACAG Financial Reporting and Auditing Committee**

## Specific questions

**1 Does the Framework cover all of the areas of audit quality that you would expect? If not, what else should be included?**

ACAG believes the Framework covers all expected areas affecting audit quality and does not propose any other areas be included. ACAG identifies in answer to the second question, that some elements which would benefit from greater context might be explored in more depth or repeat matters explored in other Standards or Pronouncements.

ACAG's view is that a clear definition of audit quality is an appropriate starting point for the Framework.. ACAG's analysis of the Consultation Paper is that a definition is given at paragraph 18. However, ACAG makes the following observations:

- The definition at paragraph 18 is not readily identifiable as such, partly because it follows a section entitled "The Challenges of Defining Audit Quality".
- The bullet points at paragraph 18 setting out the attributes and actions of the engagement team are quite generic and, with the exception of the third bullet point, could be applied to any profession. ACAG considers that the bullet points could be made more specific to audit.

**2 Does the Framework reflect the appropriate balance in the responsibility for audit quality between the auditor (engagement team and firm), the entity (management and those charged with governance), and other stakeholders? If not, which areas of the Framework should be revised and how?**

The first question implies stakeholders other than auditors and audit firms are responsible for audit quality. Other stakeholders have important roles in promoting audit quality within a Framework while not being responsible for quality of an individual audit (as noted at paragraph 18). However, ACAG notes the role non-auditors can contribute to and promote audit quality is only expanded upon much later in the document

Given that the intended audience for the Framework includes the identified non-auditor stakeholders, ACAG believes that greater prominence might be given to the importance of their respective roles and interactions as a means of promoting audit quality. In part, this might require addressing the length of the document and the extent to which the considerable space devoted to auditor inputs is necessary, as these are dealt with comprehensively elsewhere (ISQC 1, the ISAs and the IESBA *Code of Ethics for Professional Accountants*). It may be appropriate to refer directly to these other documents to maintain a broader focus within the Framework.

ACAG believes it would be useful to introduce the importance of non-auditors and the role they play in promoting audit quality as a theme earlier in the document. This would give some of the material expanded later in the document more context. Non-auditors with whom auditors have important interactions include:

- those charged with governance (TCWG), including audit committees
- professional bodies
- legislators
- regulators.

There are also some aspects of the descriptions of non-auditor roles that should be expanded upon. These are detailed below.

**i) Those Charged with Governance, including audit committees**

The Consultation Paper acknowledges the role of TCWG, including audit committees, in promoting audit quality. The audit committee's contribution to strong corporate governance, through having members independent of management with an appropriate degree of financial literacy is identified in paragraph 222. The ability of TCWG to influence the quality of an audit by ensuring sufficient audit resources will be allocated for an effective audit and that the audit fee reflects this and creating an environment where management is not resistant to being challenged by auditors and is not overly defensive is identified in paragraph 185.

ACAG believes that the financial literacy and independence of the audit committee should be extended to recognise the resultant capacity to challenge the preparation of the financial statements, including critically examining significant judgements, assumptions, explanations and decisions of management, as well as the adequacy of the audit process. These aspects were at the forefront of a recent case of financial reporting failure in Australia (the Centro case).

ACAG believes it is also desirable to expand on paragraph 185 in relation to the environment created by TCWG and their role in identifying and moderating some of the situations that cause tension between management and auditors e.g. aggressive audit tendering, opinion shopping, imposing unrealistic time constraints and insufficient and/or untimely responses to information requests.

**ii) Regulators**

The Consultation Paper addresses interactions between management and regulators at paragraph 199 and between TCWG and regulators at paragraphs 202-203. These mentions are somewhat brief and general.

ACAG believes that there is scope for the Consultation Paper to expand on how regulators can influence audit quality in their interactions. For instance, regulators may promote audit quality by:

- reviewing the reasons and circumstances that cause a company to change auditors

- promoting proper governance and conduct of audit tender processes
- ensuring company officers and directors individually and collectively have suitable skills, competence and qualifications
- ensuring legislation and other instruments of regulation allow sufficient time for required audit work to be done
- ensure inspection programs focus on key risks rather than only compliance with requirements.

### **3 How do you intend to use the Framework?**

ACAG envisage using the Framework:

- in training programs for staff
- when developing policy to promote quality in audit offices
- to inform discussions with client management and TCWG
- when developing quality assessment criteria
- when conducting internal quality reviews and peer reviews of other audit offices.

**Are there changes that need to be made to the form or content of the Framework to maximise its value to you?**

ACAG suggests that the IAASB acknowledge in the section ‘Considerations Specific to Public Sector Audits’ (refer section 5.1) the role that a strong legislative mandate plays. Ideally, to ensure high quality public sector audits, the legislative mandate should ensure the Auditor-General:

- is independent of government
- has security of tenure
- can report findings directly to Parliament
- is adequately resourced for his or her functions.

The information in the footnote to 3.4.2 Audit Regulators may be misleading. Public sector auditors can be subject to regulatory oversight, such as where the regulator’s powers apply to classes of audits (for example audits of Corporations.)

### **4 What are your views on the suggested Areas to Explore? Which, if any, should be given priority and by whom?**

**Area 1 — Establishing global guidance against which audit firms can assess their governance arrangements.**

ACAG believes that ISQC 1 provides appropriate coverage in this area. Audit firms range from global firms to sole practitioners. It would be difficult to conceive a prescriptive governance assessment model that goes beyond the principles established in ISQC1 that would suit all such firms.

**Area 2 — Establishing a common understanding of capabilities, and how they are demonstrated and assessed, as they relate to audit quality for use by audit firms when recruiting, evaluating, promoting, and remunerating partners and staff.**

ACAG believes much of this is the role and responsibility of individual firms and audit offices, although guidance by the IAESB establishing a common understanding of capabilities and how they are demonstrated would be appropriate. Legislative requirements, regulatory oversight, standard setting processes, education programs and employment arrangements vary in different countries. Similarly there are differences in how staff are recruited, promoted and remunerated between the public and private sectors. Therefore it is difficult to see how this information could be compiled other than in the most general sense.

**Area 3 — Improving information sharing between audit firms when one firm decides to resign from, or is not reappointed to, an audit engagement.**

ACAG agrees that improving information sharing between audit firms is a worthwhile area to explore for the reasons given in the Consultation Paper. ACAG notes this is not often an issue for Auditors-General who are the mandated auditor of government bodies. For many Auditors-General, secrecy provisions may limit the type of information that can be shared in their jurisdictions. If this area is to be explored, it would be necessary to acknowledge that information sharing may be limited to the extent allowed by laws and regulation.

**Area 4 to 6 — Audit inspection activities and reporting thereon**

ACAG supports further exploration of “root causes” and “best practices” as a means of learning from past audit deficiencies and to identify and address systemic issues. This exploration could include addressing whether audit methodologies are focussing excessively on compliance with auditing requirements to the detriment of risk assessment and the application of professional judgement. This would appear to be a joint role for the IAASB and audit regulators.

ACAG believes there is value in information sharing between national regulators, on the proviso that regulators are bound by reasonable secrecy and confidentiality restrictions, and that legislative limitations on the ability of Auditors-General to make certain information available are acknowledged.

**Area 7 — Increasing the informational value of auditor’s reports and improving perceptions of the value of the audit.**

ACAG believes that this issue will be adequately addressed in the separate project being undertaken by the IAASB on auditor reporting.

**Area 8 — Achieving improved two-way communication between auditors and financial and prudential regulators, particularly in the financial services sector.**

ACAG believes that two-way communication between auditors and financial and prudential regulators should be pursued, however this is a matter for individual country regulators as it is facilitated and enforced by legislation.

**Area 9 — Striving for greater international harmonization in the role of audit committees with regard to the evaluation of the quality of the external audit.**

ACAG believes that greater international harmonisation in the role of audit committees, with regard to the evaluation of the quality of the external audit, is an area that should be explored. Greater international harmonisation and focus on the role of TCWG and the audit committees in increasing audit quality is, in ACAG's opinion, a key driver necessary in raising audit quality. Harmonisation should also be extended beyond the audit committee's "evaluation of the quality of the external audit". This might extend to encouraging an evaluation of the audit committee's governance processes that impact on the quality of the audit by TCWG and/or regulators.

**Area 10 — Encouraging audit committees to provide more information to users of the financial statements on the work they have undertaken, the main issues they have addressed, and the reasons for their conclusions.**

ACAG agrees that this area should be explored.

Greater transparency about audit committee activities will not only provide useful information to financial statements users and increase their perception of audit quality, it may also:

- encourage a 'tone at the top' that promotes audit quality
- encourage better governance processes at audit committees
- stimulate audit committee members into gaining a deeper understanding of significant areas in the financial statements where management has exercised judgement and made assumptions
- encourage audit committee members to approach their work with a more sceptical mindset and challenge management decisions, where appropriate.

ACAG believes it would help users of the financial statements understand the role of the audit committee if audit committees also communicated:

- the key responsibilities of their committee
- the nature and frequency of their communication with external auditors
- how the audit committee reports back to TCWG
- their reasons for putting an audit out to tender
- reasons for significant decreases, increases or cost overruns in annual audit fees
- the nature and quantity of non-audit services provided by the auditor or audit firm
- how the audit committee encourages the independence of both the internal and external audit function.

**Are there additional Areas to Explore?**

ACAG has not identified additional areas to explore. Some areas of the Framework need to be further developed – i.e., paragraphs 41, 172 and 217 merely seem to put alternative views forward. While the inclusion of alternate views can assist general discussion, it can be confusing within the context of a “Framework” document where a clear conclusion or preference is not expressed.