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Washington, DC 20548

May 16, 2016

Ms. Kathleen Healy
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, New York 10017

**GAO's Response to the International Auditing and Assurance Standards Board's
December 2015 Invitation to Comment, *Enhancing Audit Quality in the Public Interest***

Dear Ms. Healy:

This letter provides the U.S. Government Accountability Office's (GAO) responses to the International Auditing and Assurance Standards Board's invitation to comment entitled *Enhancing Audit Quality in the Public Interest*. GAO promulgates generally accepted government auditing standards, which provide professional standards for auditors of government entities in the United States.

We support audit quality improvement and believe improvements to professional skepticism, quality control, and group audits will result in significant improvements to overall audit quality. We have provided our responses to the specific questions in the enclosure to this letter.

Thank you for this invitation to comment. If you wish to discuss any of our responses or need further information, please feel free to contact me at (202) 512-3133 or dalkinj@gao.gov or Eric Holbrook, Assistant Director, at (202) 512-5232 or holbrooke@gao.gov.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James R. Dalkin".

James R. Dalkin
Director
Financial Management and Assurance

Enclosure

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Enclosure – Answers to Invitation to Comment Questions

General Questions

G1. Table 1 describes what we believe are the most relevant public interest issues that should be addressed in the context of our projects on professional skepticism, quality control, and group audits.

We agree that the issues described in table 1 are the most relevant public interest issues that should be addressed in the context of your projects on professional skepticism, quality control, and group audits.

G2. To assist with the development of future work plans, are there other issues and actions (not specific to the topics of professional skepticism, quality control, and group audits) that you believe should be taken into account? If yes, what are they and how should they be prioritized?

The International Auditing and Assurance Standards Board (IAASB) should consider requirements for a peer review process that includes requirements for determining who is competent to lead or participate in a peer review team. Peer review can be an effective means of monitoring an audit organization's system of quality control, including the audit organization's application of skepticism, particularly for audit organizations with limited staff.

G3. Are you aware of any published, planned or ongoing academic research that may be relevant to the three topics discussed in this consultation? If so, please provide us with relevant details.

We are currently updating *Government Auditing Standards*.¹ In addition, we are aware of the following published reports on quality and professional skepticism:

- The U.S. Department of Labor issued a report in 2015 that identified quality concerns in employee benefit plan audits and made recommendations to improve audit quality.²
- Professors at Brigham Young University issued a report in 2013 related to professional skepticism.³

Professional Skepticism

PS1. Is your interpretation of the concept of professional skepticism consistent with how it is defined and referred to in the ISAs? If not, how could the concept be better described?

¹GAO, *Government Auditing Standards: 2011 Revision*, GAO-12-331G (Washington, D.C.: December 2011).

²U.S. Department of Labor, *Assessing the Quality of Employee Benefit Plan Audits* (Washington, D.C.: May 2015).

³Stephen M. Glover and Douglas W. Prawitt, *Enhancing Auditor Professional Skepticism* (Provo, Utah: November 2013).

Our interpretation of the concept of professional skepticism is consistent with how it is defined and referred to in the International Standards of Auditing (ISA). However, we believe that professional skepticism can be applied on a continuum, where the nature, timing, and extent of related audit procedures are determined by the risk level of the area of the audit, as described by Glover and Prawitt's report, *Enhancing Auditor Professional Skepticism*. For example, the auditor should search for conflicting evidence in higher risk areas, such as significant judgements.

PS2. What do you believe are the drivers for, and impediments to, the appropriate application of professional skepticism? What role should we take to enhance those drivers and address those impediments? How should we prioritize the areas discussed in paragraph 37?

The root causes of audit deficiencies are complex and vary in nature.

We believe the drivers for professional skepticism include the following:

- Adequately documenting the application of professional skepticism for the nature, timing, and extent of procedures based upon the risk level of the area.
- The competence and experience of the staff both at the junior and senior levels at the audit organization, in general and for any specialized audits the audit organization undertakes, such as government audits.
- Training in professional judgment and fundamental and specialized knowledge, such as industry-specific training, fraud training, and conflict resolution training, to enhance professional skepticism.
- Adequate understanding of the concept of professional skepticism.

We believe impediments to professional skepticism include the following:

- Difficulty of documenting professional skepticism in determining the nature, timing, and procedures of the audit, especially in regard to addressing conflicting evidence.
- Lack of training of the staff both at the junior and senior levels at the audit organization, in general and for any specialized audits the audit organization undertakes.

PS3. Is the listing of areas being explored in paragraph 38–40 complete? If not, what other areas should we or the Joint Working Group consider and why? What do you think are the most important areas to be considered?

The areas being considered for quality control, group audit, and accounting estimates do offer opportunities to improve professional skepticism, but the concept of professional skepticism is broader than those projects. Future projects, such as the project to address issues with the auditor's identification and assessment of risks in ISA 315, should consider a professional skepticism continuum based on the risk of material misstatement and other factors.

PS4. Do you believe the possible actions we might take in the context of our current projects relating to quality control and group audits will be effective in promoting improved application of professional skepticism? If not, why?

The proposed actions for the projects related to quality control and group audits may improve the application of professional skepticism, but the concept of professional skepticism is broader than those projects.

PS5. What actions should others take to address the factors that inhibit the application of professional skepticism and the actions needed to mitigate them (e.g., the International Accounting Education Standards Board, the International Ethics Board for Accountants, other international or national standards setters, those charged with governance (including audit committee members), firms, or professional accountancy organizations)?

The actions others should take to address the factors that inhibit the application of professional skepticism and the actions needed to mitigate them include the following:

- Education: We believe additional action can be taken in initial and continuing education to develop the role of the auditor working in the public interest.
- Inspection and peer review: The inspection and peer review processes are important to providing feedback on the application of professional skepticism by the auditor during an audit engagement. The processes also make auditors aware that their judgements may be reviewed and evaluated.
- Standard setters: We encourage the IAASB to coordinate with standard setters on the issues discussed in the Invitation to Comment within and among jurisdictions, as these matters are relevant to all jurisdictions.

Quality Control

QC1. We support a broader revision of International Standard of Quality Control (ISQC) 1 to include the use of a Quality Management Approach (QMA) as described in paragraphs 45–67. Would use of a QMA help to improve audit quality?

We believe that a QMA should encompass consideration of root causes of quality control issues across audit organizations. The proposed changes to ISQC 1 are focused on financial statement audits, but ISQC 1 covers many other engagements performed in accordance with IAASB standards, so changes should cover other engagements, including direct engagements and attestation engagements. In addition, if ISQC 1 is updated, we believe it would be helpful to update ISA 220 at the same time to ensure proper integration of the changes.

QC2. Engagement Partner Roles and Responsibilities
Paragraphs 69–86 set out matters relating to the roles and responsibilities of the engagement partner. Which of the actions outlined in paragraphs 85–86 would be most meaningful to address issues related to engagement partner responsibilities?

We believe that additional application guidance should be provided in ISA 220, *Quality Control for an Audit of Financial Statements*, to further clarify what is meant by performance, direction, and supervision and review by the engagement partner. This should include providing more emphasis on the collective competence of the engagement team and adequacy of time and resources (i.e., audit experts) to complete the engagement by the reporting deadline. The IAASB should consider clarifying the responsibilities of the engagement partner in the performance and reporting phases of the audit, as well as in the planning of the audit.

QC3. Others Involved in the Audit
Paragraphs 87–104 set out matters relating to involvement of others in the audit. Which of the actions outlined in paragraphs 100–104 would be most meaningful to address issues related to others participating in the audit? Should we develop further requirements or application material for circumstances when other auditors are involved

in an audit engagement (i.e., auditors that don't meet the definition of component auditors)?

We support additional requirements and application guidance for circumstances when other auditors or experts are involved in an audit engagement (i.e., auditors that don't meet the definition of component auditors).

QC4. The Firms' Role in Supporting Quality

Paragraphs 106–123 set out matters relating to networks of firms and use of Audit Delivery Models (ADMs). Which of the actions outlined in paragraphs 114–116 and 122–123 would be most meaningful to address issues related to firms operating as part of a network of firms and firms' changing business models and structures?

We are not providing comments relating to networks of firms and the use of ADMs.

QC5. Governance of the Firm, Including Leadership Responsibilities for Quality

Paragraphs 125–135 set out matters relating to governance of firms, including leadership responsibilities for quality. Which of the possible actions outlined in paragraphs 131–135 would be most meaningful in addressing issues related to firm governance and leadership responsibility for quality? Would the use by firms of a QMA provide better support or context for the importance of quality-related responsibilities for firm leadership, and related accountability, and therefore better facilitate the ability of firms to address these matters?

We agree that ISQC 1 should include commonly used language in its requirements and application guidance, including familiar terminology such as tone at the top and leading by example.

QC6. Engagement Quality Control Reviews and Engagement Quality Control Reviewers

Paragraphs 136–146 set out matters relating to engagement quality control reviews and engagement quality control reviewers. Which of the possible actions outlined in paragraphs 143–146 would be most meaningful in addressing issues related to Engagement Quality Control (EQC) reviews and EQC reviewers? Specifically should ISQC 1 mandate the performance of EQC reviews beyond audits of listed entities? Do you believe it is necessary for ISQC 1 to require that firms define the minimum period of time between when an individual has been the engagement partner and when that individual would be eligible to serve as the EQC reviewer on the same engagement? Would you support the development of a separate EQC review standard?

We support the development of a separate EQC review standard. The standard should include the following:

- Flexibility for small- and medium-sized practices, which would allow alternatives, including possibly peer review instead of the EQC review. The standard should be developed keeping in mind the restrictions that small or medium sized practitioners would face.
- Requirements for an EQC or alternative review, such as a peer review, that would evaluate quality control for all engagements complying with IAASB's standards, not just audits of listed entities.
- Examples of how an audit organization can structure the EQC review process for nonlisted entity audits and engagements.

- A cooling off period⁴ for an individual serving as the EQC reviewer after being on the audit team for the same engagement.

We do not support the proposal to communicate in the auditor's report whether the engagement was subject to an EQC review. The EQC review is only one possible action or procedure applied to address risks to audit quality.

QC7. Monitoring and Remediation

Paragraphs 147–159 set out matters relating to monitoring and remediation. Which of the possible actions outlined in paragraphs 156–159 would be most meaningful in addressing issues related to monitoring and remediation?

In addition to creating a separate EQC review standard, we believe the auditor should analyze and summarize the results of the audit organization's monitoring process at least annually, identifying any systemic or repetitive issues needing improvement, and recommend corrective actions. We believe the auditor should evaluate the effects of deficiencies noted during monitoring of the audit organization's system of quality control to determine and implement appropriate actions to address the deficiencies. The audit organization should communicate, at least annually, the results of the monitoring of its system of quality control to engagement managers and other appropriate individuals within the audit organization, including the audit organization's leadership. This communication should enable the audit organization and these individuals to take prompt and appropriate action, when necessary, in accordance with their defined roles and responsibilities. Information communicated should include the following:

- a description of the monitoring procedures performed;
- the conclusions drawn from the monitoring procedures; and
- when relevant, a description of systemic, repetitive, or other significant deficiencies and of the actions taken to resolve or amend those deficiencies.

The monitoring and remediation process would also have to allow flexibility for small and medium sized practices (SMPs).

QC8. Engagement Partner Performance and Rewards Systems

Paragraphs 160–170 set out matters relating to engagement partner performance and rewards systems. Do you believe that establishing a link between compensation and quality in ISQC 1 would enhance audit quality?

In our view, consistently high audit quality should be expected of all engagement partners regardless of compensation. Consequently, we do not see a benefit in linking compensation to audit quality.

QC9. Human Resources and Engagement Partner Competency

Paragraphs 171–187 set out matters relating to human resources and engagement partner competency. Which of the possible actions outlined in paragraphs 176–178 and 187 would be most meaningful in addressing issues relating to human resources and engagement partner competency?

⁴ A cooling off period is a period of time between when the individual is on the engagement and is allowed to be the EQC.

Changes in ISQC 1 and ISA 220 should consider changes in the revised International Education Standard 8, *Professional Competence for Engagement Partners Responsible for Audits of Financial Statements (Revised)*, including those related to professional skills and personal competencies.

QC10. Transparency Reporting

Paragraphs 188–190 set out matters relating to transparency reporting. Do you believe we are able to positively contribute to the evolving developments related to transparency reporting?

We are not providing comments related to transparency reporting.

QC11. Are there any other issues relating to quality control that we have not identified? If yes, please provide details. What actions should we take to address these issues?

The IAASB should consider quality control issues that occur in specialized audits, such as audits of governments and employee benefit plans.

QC12. Are there any other specific actions that others could take in relation to quality control? If yes, please provide details.

The IAASB should consider whether requirements may be necessary for determining who is competent to lead or participate in a peer review team. Such a process might include regular evaluations of peer review leaders' and other team members' competency to perform peer reviews through a periodic certification program.

QC13. Are there any specific considerations for SMPs related to the issues and potential actions described in this section? Are there any other considerations for SMPs of which we should be aware? If so, please provide details and views about these matters.

For SMPs, the IAASB should consider the scalability of the potential engagement quality control standard, ensuring any additions to the requirements or application guidance to address quality control concerns appropriately consider the impact of implementation from the single practitioner level to the large audit organization level. This may be accomplished by alternative procedures or examples in the application guidance for SMPs to follow. A peer review program might enhance consistency of audit quality without requiring EQC reviews of audit organizations without the resources to conduct them. The focus of a peer review should be on the audit organization's system of quality control rather than individual engagements.

QC14. Are there any specific public sector considerations related to the issues and potential actions described in this section? Are there any other public sector considerations of which we should be aware? If so, please provide details and views about these matters.

A significant number of engagements that occur in the U.S. public sector are performed by SMPs, so considering the impact of the changes to quality control standards on SMPs is critical when evaluating any action that could directly or indirectly affect public sector audit practice.

Group Audits

GA1. We plan to revise ISA 600 (and other standards as appropriate) to respond to issues with group audits. Should we increase the emphasis in ISA 600 on the need to apply all

relevant ISAs in an audit of group financial statements? Will doing so help to achieve the flexibility that is needed to allow for ISA 600 to be more broadly applied and in a wide range of circumstances (see paragraphs 194–198)? If not, please explain why. What else could we do to address the issues set out in this consultation?

We support the IAASB's interest in increasing the emphasis in ISA 600 on the need to apply all relevant ISAs. We believe that improving the emphasis in the requirements and application guidance of ISA 600, particularly referring to the application of relevant ISAs such as ISA 220, ISA 315, ISA 320, and ISA 330, would improve the guidance for group audit.

GA2. Acceptance and Continuance of the Group Audit Engagement
Paragraphs 204–217 set out matters relating to acceptance and continuance of the group audit engagement. Which of the possible actions outlined in paragraphs 215–217 would be most meaningful in addressing issues related to acceptance and continuance procedures?

Because of law or regulation, auditors in government do not necessarily have the option to not accept or not continue an audit. It is important to ensure that if a group auditor must accept or is unable to withdraw from a group audit, the group auditor is able to disclaim an opinion on the group financial statements.

In our view, ISA 600 should include application guidance referring to all relevant ISAs in considering acceptance or continuation of the group audit.

GA3. Communications between the Group Engagement Team and Component Auditors
Paragraphs 218–225 set out matters relating to communications between the group engagement team and component auditors. Which of the possible actions outlined in paragraph 224 would be most meaningful in addressing issues relating to communication between the group engagement team and the component auditor?

Adding application guidance related to competency of the group engagement team, particularly having staff and an engagement partner within the group auditor who are able to effectively work with component auditors who use a different language, set of standards, or regulatory framework, could address some of the issues related to group and component auditor communication. Instead of creating an additional standard for the component auditor, we suggest the following to improve the quality and timeliness of communication and documentation access to meet the needs of the group auditor:

- create additional application guidance to improve the timely and effective two-way communication between the group and component auditor, including clear presentation of component auditor responsibilities;
- provide additional guidance and examples in the required and additional matters included in the group engagement team's letter of instruction, specifically related to the timeliness of the communications and access to documentation; and
- in the Communication with the Component Auditor section of the application guidance, expand the guidance on the nature, timing, and extent of expected component auditor cooperation with the group auditor, in paragraph A59, to include examples of the types of documentation and timeframes for the access to the documentation.

GA4. Using the Work of the Component Auditors
Paragraphs 226–242 set out matters relating to using the work of the component auditors. Which of the possible actions outlined in paragraph 234 and 242 would be most

meaningful in addressing issues related to using the work of the component auditor? Should ISA 600 be strengthened to require the group engagement partner to make an explicit determination about whether the group engagement team can use the work of a potential component auditor?

In our view, ISA 600 should require an explicit determination about whether the group engagement team can use the work of a potential component auditor, and its application guidance should include examples of when to do so. Use of the work of a component auditor should be based on the group engagement team's understanding of the component auditor and the nature and extent of the work the component auditor will be asked to perform. The IAASB should also consider including more specific examples, related to ensuring the component auditor's compliance with relevant ethical standards, competence, and capacity.

GA5. Identifying and Assessing the Risks of Material Misstatement in a Group Audit
Paragraphs 243–253 set out matters relating to identifying and assessing significant risks in a group audit. Which of the possible actions outlined in paragraphs 251–253 would be most meaningful to address issues relating to identifying significant risks for the group audit?

We prefer support providing examples in ISA 315 and ISA 330 related to group audit materiality and the risk of material misstatement, but could support inclusion of such examples in ISA 600 application material. The IAASB should consider adding application guidance related to significant risks identified at the component level to ensure that these risks are considered by the group auditor, as listed in paragraph 253(b).

GA6. Issues Relating to Component Materiality and Other Aspects of Materiality Relevant to Group Audits

Paragraphs 254–261 set out issues relating to applying the concept of materiality in a group audit. Do you agree with the possible actions recommended in paragraph 261 to clarify the different aspects of materiality in a group audit? Recognizing that significant changes to ISA 320 will not be contemplated until a review of ISA 320 has been performed in its entirety (potentially as part of a future project to address materiality more broadly), please describe any other relevant issues or additional actions that you think may be appropriate relating to component materiality, component performance materiality or the clearly trivial threshold at the component level.

We believe that adding application guidance in ISA 600 reflecting different levels of component materiality would help clarify issues related to materiality. The guidance should also link to ISA 320. However, we prefer including in ISA 320 additional guidance and examples to reflect the materiality considerations at both the group and component auditor levels.

GA7. Responding to Identified Risks of Material Misstatement in a Group Audit (Including Issues Relating to the Group Engagement Team's Involvement in the Consolidation Process)

Paragraphs 262–292 set out matters relating to responding to identified risk of material misstatement in a group audit (including the group engagement team's involvement in the consolidation process). Which of the actions outlined in paragraphs 272–273, 279, 288 and 292 would be most meaningful to address issues relating to responding to identified risks of material misstatement in a group audit?

The group auditor is responsible for identifying risk and ensuring adequate communication with the component auditor. We also believe that the application guidance should include an

example related to having a large number of nonsignificant components in an audit, to show how the group auditor can reevaluate significance when a large number of individually nonsignificant components make up a significant amount in the aggregate.

GA8. Review and Evaluation of the Work of Component Auditors by the Group Engagement Team

Paragraphs 293–303 set out matters relating to the review and evaluation of the work of component auditors by the group engagement team. Which of the actions outlined in paragraphs 299 and 303 would be most meaningful in addressing issues relating to the review and evaluation of the work of component auditors by the group engagement team?

We support adding information and examples to the application guidance to provide more clarity on when group engagement team review of a component auditor’s audit documentation would be appropriate, as well as procedures that the group engagement team would perform as part of the review.

GA9. The Impact of New and Revised Auditing Standards

How should the matters set out in paragraphs 304–305 be addressed in our plans to revise ISA 600? Are there any other implications from our new or revised standards that should be considered?

We support developing additional requirements and application guidance for group engagement teams on the consideration of key audit matters reported by component auditors in the auditor’s report on the group financial statements.

GA10. Are there any other issues relating to group audits that we have not identified? If yes, please provide details. What actions should we take to address these issues?

We support the consideration of creating additional guidance, such as an audit guidebook, for group audits that better links the ISAs with the group audit. This will help expand on the application guidance and address other ISAs that a group audit includes, such as those related to materiality, competence, quality control, as well as the requirements and guidance provided in ISA 600.

GA11. Are there any other specific actions that others could take in relation to group audits? If yes, please provide details.

In our view, standards should be sufficiently informative that action by others is unnecessary. Consequently, we believe that the proposed standard changes should be the only necessary actions taken in relation to group audits.

GA12. Are there any specific considerations for SMPs related to the issues and potential actions described in this section? Are there any other considerations for SMPs of which we should be aware? If so, please provide details and views about these matters.

Communication of component auditor responsibilities is important for SMPs.

GA13. Are there any specific public sector considerations related to the issues and potential actions described in this section? Are there any other public sector considerations of which we should be aware? If so, please provide details and views about these matters.

We have no additional specific public sector considerations related to group audit issues that were not covered in our other responses.