

Enhancing audit quality in the public interest: A focus on professional scepticism, quality control and group audits

A public consultation issued by the International Auditing and Assurance Standards Board (IAASB)

Comments from ACCA to the IAASB
May 2016
Ref: TECH-CDR-1370

ACCA is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people around the world who seek a rewarding career in accountancy, finance and management.

ACCA has 178,000 members and 455,000 students in 181 countries, with approximately 75,000 members and over 70,000 students in the UK, and works to help them to develop successful careers in accounting and business, with the skills required by employers. We work through a network of 95 offices and centres and more than 7,110 Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote appropriate regulation of accounting and conduct relevant research to ensure accountancy continues to grow in reputation and influence.

Further information about ACCA's comments on the matters discussed here can be requested from:

Andrew Gambier
Head of Audit and Assurance
andrew.gambier@accaglobal.com
+ 44 20 7059 5558

ACCA



+44 (0)20 7059 5000



info@accaglobal.com



www.accaglobal.com



The Adelphi 1/11 John Adam Street London WC2N 6AU United Kingdom

ACCA welcomes the opportunity to comment on the proposals issued by the IAASB in its Invitation to Comment (ITC). The ACCA Global Forum for Audit and Assurance has considered the matters raised and their views are represented in the following. Our response has also been informed by the roundtable ACCA hosted in Kuala Lumpur, Malaysia on 14 and 15 April.

SUMMARY

SUPPORT FOR THE IAASB'S OBJECTIVES

We support the IAASB's overall objective to enhance audit quality. The ITC brings together a number of important auditing issues and presents a full and thorough analysis. The feedback from stakeholders will be helpful in translating this analysis into meaningful improvements to auditing standards. We hope that our comments, which reflect feedback from our Global Forum for Audit and Assurance and our other outreach activities, are a helpful contribution to this process.

In many of the areas identified, clarified ISAs already set out clear expectations of auditors. To the extent that more guidance might be helpful, this could be via application material or other forms of communication, such as thematic blogs or speeches. Such informal communication methods can be helpful in shedding light on the IAASB's intentions, as an alternative to revising standards.

COMPLEXITY OF THE ITC

While we recognise that these issues are very important for audit quality, the structure of the consultation is complex and, in particular, some questions are split across several sub-questions. Accordingly, in some areas we have aimed to respond to the spirit of the question rather than addressing each piece in turn.

Given the complexity of the ITC and its questions, we would encourage the IAASB to be alert to important constituents who might be underrepresented in the final set of written responses. The IAASB should continue outreach and dialogue with stakeholders to ensure that important perspectives have not been missed.

A REGULATORY APPROACH TO AUDIT QUALITY

In drawing up the list of issues to enhance audit quality, the IAASB has been led by feedback from regulators and audit oversight bodies. While this ensures that the IAASB's proposals are responsive to the concerns of regulators, it means the proposals within the ITC might be seen as being wholly regulatory-led. This reinforces a regulatory

view of audit quality, where audit quality can be eroded by a failure to follow ISAs to the satisfaction of audit oversight bodies while there may be limited recognition of innovations which boost audit quality.

A symptom of the regulatory approach to audit quality is that many of the proposed actions relate to 'strengthening documentation requirements' in order that audit work undertaken, for example as it relates to group audit situations, can be reviewed by regulators. We would encourage the IAASB to develop a broader vision in its approach. To the extent that there are deficiencies in communications between group and component auditors, we believe it is extremely unlikely that introducing new requirements for further written communications will overcome them. We would support and encourage the IAASB in its development of a wider concept of audit quality which seeks to go beyond simply minimising the number of deficiencies identified by regulators. This would involve discovering from audit firms what innovations they have introduced to streamline their audit processes and improve audit quality. Audit oversight body observations, which tend to focus on (non-)compliance with ISAs may be an unsuitable source. In this vein, we support the proposal for the Quality Management Approach, which we believe recognises the positive contribution firms have made in seeking to improve audit quality.

Given that audit oversight bodies rightly take a risk-based approach in deciding which audits to inspect, their findings are skewed towards larger entity audits undertaken by larger firms. As a result, changes to standards that prioritise their findings may focus on issues that are less relevant to small and medium sized practices. In addition, the number of audits inspected is a small proportion of the total number of audits, so it may not always be easy to distinguish pervasive issues from isolated incidents.

AREAS FOR SPECIFIC COMMENT:

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 scepticism, quality control, and group audits. In that context:

(a) Are these public interest issues relevant to our work on these topics?

(b) Are there other public interest issues relevant to these topics? If so, please describe them and how, in your view, they relate to the specific issues identified.

(c) Are there actions you think others need to take, in addition to those by the IAASB, to address the public interest issues identified in your previous answers? If so, what are they and please identify who you think should act.

We are aware that the ITC and other ongoing projects will mean that the IAASB has a virtually full agenda for the next 18-24 months while this important work is finalised. As such, consideration of any additional topics and actions should be balanced against its impact on these important workstreams.

In this spirit, we foresee some value in remaining mindful of some high level concepts that could guide the IAASB's public interest work:

- The interaction between ISAs and materiality in IFRS; and
- The application of ISAs to the audits of smaller entities and the need to react and be appropriately responsive to developments such as that of the Nordic Federation, while maintaining the integrity of the standards, irrespective of the size and complexity of the audit.

We are pleased that the IAASB identifies the need to consider the actions others might take to support audit quality. Audit quality is the responsibility of all, not just the IAASB or auditors, so we agree with a holistic approach in which all stakeholders play a part. For example, this could include:

- Guidance on how to run an audit tender in a way that enhances audit quality;
- Advice for audit committees on how they can support audit quality;
- Help for preparers on how to comply with specific IFRSs in a way that considers how disclosures will be audited;
- Observations from regulators that refer to specific standards rather than general references to professional scepticism.

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

Please see our response to G1.

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

ACCA will be publishing a short report, by the end of 2016, into professional scepticism and how to respond to regulatory observations that auditors are insufficiently sceptical

when undertaking audits. We look forward to sharing our preliminary findings with you in due course.

PROFESSIONAL SCEPTICISM

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

Our interpretation of the concept of professional scepticism is consistent with how it is defined and referred to in the ISAs. However, we find that some audit oversight bodies are sometimes perceived to use professional scepticism as a ‘catch all’ for areas of an audit where, with hindsight, more audit fieldwork could have been done, rather than providing a more targeted observation that explains how following ISAs would have produced better outcomes. As a result, we would welcome some clarification over how professional scepticism should be practised and documented, to help auditors to better understand what is expected of them, perhaps by reference to the application material in ISA 200 (ISA 200.A18 – ISA 200.A22).

The IAASB could also consider developing a framework for auditors to demonstrate the process they follow in arriving at their professional judgement. Such a framework could be linked to wider audit quality, including the proposed Quality Management Approach.

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

At the December IAASB meeting, the IAASB received a presentation from Professors Joe Brazel and Tammie Schaefer on the state of academic research on professional scepticism. This presentation identified a number of factors that affect the application of professional scepticism. While many of those factors are identifiable in paragraph 37, we would recommend a more in-depth consideration to ensure that nothing is overlooked. For example, the presentation identified as major issues time pressure and a bias towards outcomes, but neither appears in the list of areas being explored in paragraph 37.

We also believe that any analysis of professional scepticism is unlikely to be complete unless it considers professional scepticism from a psychological perspective. For example, the 2013 report on professional scepticism from the Center for Audit Quality identified that group brainstorming sessions, required by both US auditing standards and ISAs, may actually inhibit professional scepticism. This is even though the auditor is aware of the overarching requirement to be professionally sceptical. There may be

other areas in ISAs where a consideration of human factors and psychology may reveal other social impediments to the appropriate application of professional scepticism. In our view, such insights are much more likely to transform auditor behaviour than attempts to strengthen standards.

In respect of the role of audit oversight bodies in influencing professional scepticism, we would welcome a recognition within ISAs that the appropriate application of professional scepticism might sometimes involve not seeking further explanation and evidence from management in non-contentious or unrisky parts of the audit. For example, this could be achieved by highlighting the links between ISA 315 and ISA 240 and professional scepticism.

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 area to be considered?

In paragraph 38(a)(ii), we caution that there are limits to the extent to which firms can reward and incentivise auditors who demonstrate sceptical behaviour. Professional scepticism requires the auditor to challenge ‘just enough’ of management’s assertions. By focusing on areas where auditors didn’t demonstrate enough scepticism, audit oversight bodies risk encouraging auditors to always be more sceptical, even in areas not identified as a high risk of material misstatement. However, spending time challenging the wrong areas of the audit might mean this additional scepticism actually damages rather than improves audit quality. Deciding in advance whether to challenge management’s assertions and evidence requires the exercise of professional judgement in limited time in situations of uncertainty. Sometimes, with the benefit of hindsight, this judgement may turn out to be wrong.

In paragraph 39, we support the IAASB’s current approach to ISA 540 to separate the concepts of estimation uncertainty and complexity. The increasing prevalence of accounting estimates in financial reporting standards creates challenges for auditors, particularly where these estimates are highly uncertain, as in these circumstances auditors must choose between accepting management’s estimate and taking further action. Where there is a wide range of possible outcomes as a result of financial reporting standards and that range is adequately explained by management’s disclosures, the action to be undertaken by auditors is already well defined within ISA 540. However, it is in areas of high complexity where there are likely to be the biggest risks of material misstatement, particularly as new IFRSs introduce much more complexity.

In paragraph 40(a), we support the IAASB’s project on data analytics in the context of professional scepticism because, where the auditor has significant data at their disposal, the consideration of possible alternative outcomes takes on a different

perspective. The IAASB is right to consider how ISAs might respond to these and other external technological changes.

In paragraph 40(b), we see ISA 315 and ISA 240 as vital in helping auditors identify the audit issues in relation to which the exercise of professional scepticism should be prioritised. Areas where there is a higher risk of material misstatement or where there is a perceived higher risk of fraud would require a higher degree of professional scepticism than other areas. Conversely, other areas might not require a high degree of professional scepticism.

Overall, however, we believe the IAASB should take care not to seek to standardise the approach to professional scepticism. It is not possible to exercise professional scepticism 'by checklist'.

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 scepticism? If not, why?

Within quality control, we see scope for integrating a consideration of the engagement and firm factors that might enhance or inhibit the application of professional scepticism into the firm's Quality Management Approach. In the context of group audits, this could include consideration of threats to professional scepticism at the component level.

PS5. What actions should others take to address the factors that inhibit the application of professional scepticism and the actions needed to mitigate them (e.g., the IAESB, the IESBA, other international standards setters or NSS, those charged with governance (including audit committee members), firms, or professional accountancy organizations)? Are there activities already completed or underway of which we and the Joint Working Group should be aware?

We believe audit committees have a very important role in ensuring that the auditor's appropriate exercise of professional scepticism is supported and encouraged, especially in countering management pressure and, to a lesser extent but still importantly, in relation to concerns about time and cost pressure on auditors. Recognition that time is a critical factor in the appropriate application of professional scepticism may help convince preparers and investors that auditors should be given more time, and possibly more resources, to complete their audits rather than insisting upon tight reporting deadlines.

As noted above, some audit oversight bodies are sometimes seen to use professional scepticism as a 'catch all' for situations where, with hindsight, the auditor could have undertaken more fieldwork. We believe it would contribute to greater audit quality if audit oversight bodies were more specific about areas where more professional scepticism is needed. Otherwise, there is the risk that auditors may feel pressured to

document extensively their disagreement with management's evidence even in low risk areas that do not enhance audit quality.

QUALITY CONTROL (INCLUDING QUESTIONS EXPLORING CROSSOVER ISSUES/ISSUES RELEVANT TO MORE THAN ONE PROJECT)

The following questions relate to quality control matters set out in paragraphs 45–190. If you believe actions relating to quality control beyond those discussed in these paragraphs should be prioritized, please describe such actions and your supporting rationale as to why they require priority attention.

QC1. We support a broader revision of ISQC 1 to include the use of a QMA as described in paragraphs 45–67.

- (a) Would use of a QMA help to improve audit quality? If not, why not? What challenges might there be in restructuring ISQC 1 to facilitate this approach?**
- (d) If ISQC 1 is restructured to require the firm's use of a QMA, in light of the objective of a QMA and the possible elements described in paragraphs 64 and Table 3, are there other elements that should be included? If so, what are they?**
- (e) In your view, how might a change to restructure ISQC 1 impact the ISAs, including those addressing quality control at the engagement level?**
- (f) If ISQC 1 is not restructured to require the firm's use of a QMA, do you believe that we should otherwise address the matters described in paragraph 59 and table 2, and if so, how?**

We agree that the use of a QMA would help improve audit quality. Feedback from our members is that larger firms have already mostly adopted a QMA and that smaller firms could benefit from it. While it is envisaged in the ITC that a QMA will provide a scalable approach to quality management, the fact that it has, to date, been predominantly used by large firms means the implementation will need to be accompanied by specific guidance to show how it can be applied to practices of different sizes and complexities. Given that a common criticism of the existing ISQC 1 is that it does not scale well to smaller practices, it is important that any changes explicitly address this perception, perhaps by preparing robust transition and implementation guidance for smaller firms. The requirement will have to be outcomes-driven, with guidance and illustration to help practitioners meet the objective instead of getting overburdened by the costs of transition.

It is important to recognise that the greater flexibility and principles-based structure of the QMA may mean a variability of approaches, particularly in the early years of adoption. Firms must be given time to implement the QMA in a way that works best for them but also complies with the objectives of the standard.

QC2. Engagement Partner Roles and Responsibilities

(a) Paragraphs 69–86 set out matters relating to the roles and responsibilities of the engagement partner.

(i) Which of the actions outlined in paragraphs 85–86 would be most meaningful to address issues related to engagement partner responsibilities?

(ii) Why do you believe these actions are necessary?

(iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.

(iv) Describe any potential consequences of possible actions that you believe we need to consider further.

(b) Do you think it is necessary for the ISAs to include requirements or otherwise address the circumstances described in paragraph 79 in which an individual other than the engagement partner is required to or otherwise customarily sign(s) the auditor's report or is named therein? If yes, please explain why, and provide your views about how this could be done (including describing the work effort you believe would be necessary for such an individual).

It is difficult to envisage what more could be done in relation to engagement partner responsibilities. The engagement partner is responsible for the engagement. Providing more direction and specificity risks extending audit compliance checklists at the expense of audit quality.

We do not think it is necessary for the ISAs to include further requirements in relation to the circumstances described in paragraph 79. There may be specific issues, which we would recommend addressing individually rather than by amendments to the ISAs.

QC3. Others Involved in the Audit

(a) Paragraphs 87–104 set out matters relating to involvement of others in the audit:

(i) Which of the actions outlined in paragraphs 100–104 would be most meaningful to address issues related to others participating in the audit?

(ii) Why do you believe these actions are necessary?

(iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.

(iv) Describe any potential consequences of possible actions that you believe we need to consider further.

(b) 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)?

Without underplaying the scale of difficulties faced by the engagement partner in some audits as outlined in paragraphs 87-104, in the overwhelming majority of audits there are no such issues. We caution against further complicating ISAs to take account of a small number of fringe issues or guidance. Such issues could instead be dealt with in supporting material, such as in staff notes, rather than by amending ISAs.

We note that the ITC draws comparisons to the PCAOB's proposals to require disclosure of the involvement of 'other auditors'. This analysis should take account of the fact that the PCAOB uses the term 'other auditors' to refer to any auditor that is not the engagement partner's own firm, including component auditors. By contrast, in QC3(b) the IAASB is not using 'other auditors' to refer to component auditors. In responding to this question, we restrict our comments to disclosure of 'other auditors' in the sense of QC3(b).

Our outreach event in Malaysia, which included audit firms, investors and audit committee members, identified mixed views on the issue of referring to the involvement of others in the group audit, with some supporting the status quo and others calling for disclosure of all firms materially involved in the group audit. While we would resist moves to mandate the disclosure of other auditors in the audit report, we note that ISA (UK and Ireland) 700 requires a description of audit scope. This may include number of locations visited and the coverage of revenue, total assets and profit before tax within the scope of the audit. Such disclosures, which do not undermine the group engagement partner's responsibility for the audit, have been felt to be useful.

QC4. The Firms' Role in Supporting Quality

(a) Paragraphs 106–123 set out matters relating to networks of firms and use of ADMs.

(i) 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?

(ii) Why do you believe these actions are necessary?

(iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.

(iv) Describe any potential consequences of possible actions that you believe we need to consider further.

(b) Specifically:

(i) What could we do to address the issues identified in the context of networks of firms? For example, should we develop more detailed requirements and application material to address reliance on network-level policies and procedures at a firm or engagement level?

(ii) Do you think it would be feasible for us to develop requirements and guidance for networks? Please provide a basis for your views.

(iii) Paragraphs 117–123 set out matters relating to the use of ADMs and related issues.

a. How should our standards emphasize the importance of appropriate quality control processes in relation to use of ADMs?

b. Are you aware of ADMs that raise issues not discussed in paragraphs? If so, please provide details.

We see ADMs as having the potential to make a positive contribution to audit quality. Provided the firm institutes a proper system of quality control and monitoring procedures over the ADM and the engagement team retains responsibilities for the direction, supervision, performance and review of work undertaken, ADMs can boost efficiency and audit quality. We encourage the IAASB to continue to support ADMs and

other innovations and suggest it might be worth exploring whether there are parallels to the 'service organisation' concept in ISA 402/ISAE 3402 to address ADMs.

The procedures outlined in paragraph 123 look sensible, however we would caution against excessive prescription. Audit quality is most likely to be achieved from permitting a flexible approach to component audits, while ensuring the engagement partner has a full understanding of the nature and timing of work being undertaken.

The impact of changes to the laws on auditor rotation in the European Union is currently unclear. One result could be that more audits of public interest entities will be carried out by firms from more than one network. While there are already examples of such audits being conducted well, it might be helpful for more best practice guidance to be made available. However, we do not consider this necessarily will involve changes to ISAs.

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

(a) Paragraphs 125–135 set out matters relating to governance of firms, including leadership responsibilities for quality.

(i) 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?

(ii) Why do you believe these actions are necessary?

(iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.

(iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.

(b) Specifically:

(i) Do you believe it is necessary for us to explore how the governance of a firm could be addressed in ISQC 1?

(ii) Should ISQC 1 specifically address accountability of firm leadership, or appropriate personnel within firm leadership, for matters related to quality, including independence related matters? If so, how should this be done, and what direction should ISQC 1 provide to firms in appointing appropriate individuals to assume these responsibilities?

(iii) 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?

The UK has the Audit Firm Governance Code, which seeks to address the issues raised in paragraphs 131-135. We recommend that the IAASB reflect on the FRC's experience, including building in experience of its recent update to the Code.

We would not support an explicit requirement in ISQC 1 for firm leadership to act in the public interest, as referenced in paragraph 135. In our view, the public interest is served by complying with global auditing and ethics standards. As such, there is no need for an additional requirement to act in the public interest. Indeed, given that views as to what constitutes the public interest are so broad, such a requirement might be misused to undermine the accountancy profession for commercial decisions that, while complying in full with global standards, fail to meet some notions of the public interest.

QC6. Engagement Quality Control Reviews and Engagement Quality Control Reviewers

(a) Paragraphs 136–146 set out matters relating to engagement quality control reviews and engagement quality control reviewers.

(i) Which of the possible actions outlined in paragraphs 143–146 would be most meaningful in addressing issues related to EQC reviews and EQC reviewers?

(ii) Why do you believe these actions are necessary?

(iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.

(iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.

(b) Specifically:

(i) Should ISQC 1 mandate the performance of EQC reviews beyond audits of listed entities? If yes, what other entities should be considered and how could we best define these entities? If no, please explain your reasoning.

(ii) 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? If yes, how do you think this should be done and why? If no, please explain why.

(iii) Would you support the development of a separate EQC review standard? Please explain the reasoning for your response.

We agree that the engagement quality control reviewer (EQCR) is an important contributor to audit quality. However, we caution that changes to the EQCR requirements must be measured and proportionate to ensure that the EQCR's contribution to quality is maintained and enhanced.

In particular, we recognise the challenges for SMPs in paragraph 140 and would advise against arbitrary extensions to the engagements which require an EQCR as these will discriminate against SMPs.

While it's important that the EQCR role is performed well, new requirements may not necessarily increase audit quality. If the requirements become too onerous, it may be that firms are unable to identify enough qualified candidates for the role, limiting their ability to undertake public interest audits.

We would expect there to be a cooling-off period between being engagement partner and EQCR. While there are advantages to knowing the industry, the former engagement partner would be subject to the threat of self-review to his/her independence. A former engagement partner should only become EQCR once sufficient time has passed for this threat to independence to be overcome. A longer period might be appropriate for larger public interest entities.

We would not support the development of a separate EQCR standard. While the role is undoubtedly important, there is no equivalent standard for any other role on the audit, including the engagement partner. A separate standard would risk overstating the relative importance of the EQCR compared to these other roles.

QC7. Monitoring and Remediation

(a) Paragraphs 147–159 set out matters relating to monitoring and remediation.

(i) Which of the possible actions outlined in paragraphs 156–159 would be most meaningful in addressing issues related to monitoring and remediation?

(ii) Why do you believe these actions are necessary?

(iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.

(iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.

(b) Specifically:

(i) Do you support the incorporation of a new requirement(s) in ISQC 1 for firms to understand the causal factors of audit deficiencies relating to inspection findings and other reviews? If not, why? Are there any potential consequences or other challenges of taking this action that you believe we need to consider?

(ii) Do you support the incorporation of a new requirement(s) in ISQC 1 for the results of the firm's monitoring of the effectiveness and appropriateness of the remedial actions to be considered in the design and assessment of the effectiveness of the firm's system of quality control? Please provide further detail to explain your response.

We support firms taking steps to understand the causal factors of audit deficiencies. However, we believe this analysis should be undertaken solely with a view to enhancing audit quality. With respect to deficiencies, this would mean focusing on those audit deficiencies that led to the wrong audit judgement being taken on a material misstatement. Indeed, to the extent that this analysis identifies audit procedures that do not lead to the identification of material misstatements, consideration could be given by the IAASB to downgrading or even removing these procedures. We would encourage any requirements in this area to be introduced in a way that avoids unnecessary prescription. It would be beneficial for best practices to be allowed to develop rather than seeking to impose standards on firms.

We believe it is important that analysis of causal factors adopts a 'human factors' approach that seeks to understand why people behaved the way they did. Audit is primarily a human discipline and it is vital that analysis of why auditing standards were not followed looks to find out why rather than apportion blame for not having done so. A further factor in fostering a culture conducive to effective root cause analyses is the identification and investigation of 'near misses': in other words, situations that did not lead to a failure to follow ISAs but which might have done. Our perception is that currently audit regulation may sometimes hinder rather than foster such candour towards 'near misses'. Similarly, we understand some firms perform a root cause

analysis on good audits to understand whether there are innovations that can be replicated on other audits.

A holistic approach to root cause analysis, that takes account of the role every stakeholder must play in encouraging and fostering audit quality, is most likely to deliver the best results. Helpful examples of how a human factors approach has worked in other industries can be found in the health and airline sectors.

QC8. Engagement Partner Performance and Rewards Systems

Paragraphs 160–170 set out matters relating to engagement partner performance and rewards systems.

- (a) Do you believe that establishing a link between compensation and quality in ISQC 1 would enhance audit quality? Why or why not?**
- (b) What actions (if any) do you believe we should take in this regard? Are there potential consequences of possible actions that you believe we need to consider?**

From a human factors point of view, it seems possible that too rigid a link between quality and personal compensation could incentivise engagement partners to hide issues rather than deal with them. Such a link may also be wholly impractical for small and medium-sized practices. Accordingly, while we are aware that some larger firms have incorporated such a link into their partnership agreements, we would advise against mandating it within ISQC 1.

QC9. Human Resources and Engagement Partner Competency

- (a) Paragraphs 171–187 set out matters relating to human resources and engagement partner competency.**
 - (i) 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?**
 - (ii) Why do you believe these actions are necessary?**
 - (iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.**
 - (iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.**

(b) Specifically, which of the possible actions outlined, or other actions not described, in paragraphs 176–178 and 187 would most positively impact audit quality:

(i) Arising from issues related to knowledge, skills, competence and availability of a firm’s partners and staff?

(ii) Related to engagement partner competency?

(iii) Why do you believe these actions are necessary? If you would not support a particular action, please explain why, including any potential consequences of those actions that you believe we need to consider.

We do not support the possible actions in paragraphs 176-178. We do not see how the IAASB could introduce new requirements without making them either overly prescriptive or unsuitable for all sizes of firm.

We can see some value in highlighting the ways in which firms can link the spirit of IES 8 (Revised) with ISQC 1 and ISA 220. As before, we would encourage the IAASB to approach this in a way that emphasises best practice rather than introduces more detailed rules.

QC10. Transparency Reporting

Paragraphs 188–190 set out matters relating to transparency reporting.

(a) Do you believe we are able to positively contribute to the evolving developments related to transparency reporting? If so, what, in your view, would be the most appropriate action we could take at this time?

(b) If you would not support us taking actions as described in paragraph 190(b), please explain why, including any potential consequences of those actions that you believe we need to consider.

We agree with the analysis in paragraphs 188-190(a). We support the IAASB’s conclusion that it is best for regulators and audit oversight bodies to establish their own requirements that take account of local requirements.

We are supportive of the actions in paragraph 190(b).

The following questions are overall questions relating to quality control:

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?

We have no other issues to raise.

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

As highlighted in our answers above, we see specific actions for regulators in relation to root cause analysis.

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.

We are satisfied that considerations specific to SMPs have been adequately reflected in the IAASB's analyses. However, we suggest that more is done to articulate how the transition will work for SMPs.

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.

We are not aware of any specific public sector considerations.

GROUP AUDITS

The following questions relate to group audit matters set out in paragraphs 191–305. If you believe actions relating to group audits beyond those discussed in these paragraphs should be prioritized, please describe such actions and your supporting rationale as to why they require priority attention.

GA1. We plan to revise ISA 600 (and other standards as appropriate) to respond to issues with group audits.

(a) 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?

- (b) Would the actions we are exploring in relation to ISA 600 improve the quality of group audits? If not, why?**
- (c) Should we further explore making reference to another auditor in an auditor's report? If yes, how does this impact the auditor's work effort?**
- (d) What else could the IAASB do to address the issues highlighted or other issues of which you are aware? Why do these actions need priority attention?**

We see no reason to increase the emphasis in ISA 600 on the need to apply all relevant ISAs in an audit of group financial statements.

As noted in our response to QC3, while we are aware the IAASB has considered recently the issue of making reference to another auditor in an auditor's report and concluded it was not conducive to audit quality, we believe this should be kept under review. While we agree with the IAASB's view, we believe that the changes announced by the PCAOB on providing transparency of 'other auditors' – the PCAOB definition is wider than the IAASB's definition in QC3(b) – may create an expectation of disclosure to which the IAASB will need to respond.

GA2–GA9 address the more significant issues relating to group audits in greater detail.

GA2. Acceptance and Continuance of the Group Audit Engagement

- (a) Paragraphs 204–217 set out matters relating to acceptance and continuance of the group audit engagement.**
 - (i) Which of the possible actions outlined in paragraphs 215–217 would be most meaningful in addressing issues related to acceptance and continuance procedures?**
 - (ii) Why do you believe these actions are necessary?**
 - (iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.**
 - (iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.**

(b) Specifically:

- (i) Are access issues as described in paragraph 207(a) still frequently being experienced in practice? If yes, please provide details and, where possible, explain how these are being addressed today.**
- (ii) Do you agree that ISA 600 can or should be strengthened in relation to addressing access issues as part of acceptance and continuance?**
- (iii) Would expanding the understanding required for acceptance and continuance, as described in paragraph 215(b), be achievable in the case of a new audit engagement?**

In general, while such issues may have been identified in inspection findings, we do not see that their impact on audit quality is either widespread or significant. As such, we would not consider actions in this area to be a priority. We distinguish here between audit access to components and regulatory access to component auditors' working papers.

With respect to the issue of audit access to components, which can occasionally be problematic given legal restrictions in some countries, we agree that access should be an explicit consideration during the acceptance and continuance process. However, in some cases, it may only become apparent that there is insufficient access once the group audit has been accepted. Should this be the case, we would recommend that firms are encouraged to explore alternatives to resigning the engagement, given that legal restrictions are likely to apply to any potential audit firm. For example, the firm could seek to influence those charged with governance to see whether any restrictions can be lifted. In exceptional circumstances, reference could be made in the audit report.

GA3. Communications between the Group Engagement Team and Component Auditors

- (a) Paragraphs 218–225 set out matters relating to communications between the group engagement team and component auditors.**
 - (i) 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?**
 - (ii) Why do you believe these actions are necessary?**
 - (iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why?**

(iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.

We recognise the issues raised by the IAASB. However, we believe any action needs to take into account other forms of communications beyond written communications. While it is reasonable to expect workpapers to reflect the audit work undertaken and the judgements made by the engagement partner, we can envisage written instructions to component auditors to be supplemented by non-written communications. Indeed, such non-written communications are a vital part of the process, to ensure that written instructions have been properly understood. Although significant changes to audit planning would be expected to be documented, we believe there are limits to how far written documentation can reasonably capture all aspects of the two-way communication process between firms.

We believe all the possible actions in paragraph 224 would be considered best practice and, accordingly, these could be encouraged without amendments to ISA 600. We would encourage the IAASB to explore different and innovative ways to communicate its thinking, such as through social media, blogs, position papers, news articles, guidance for firms and infographics.

We do not see a need for a separate standard for component auditors. We believe it is sufficient for the group auditor to explain that the work should be conducted in accordance with ISAs, as modified according to the group instructions. These instructions should make it clear that there is a need for timely and comprehensive two-way communications between group and component auditors on matters that might be salient to their audits.

In relation to paragraph 219(c), standardisation of audit instructions contributes to positive audit quality by encouraging a consistent approach to centrally-identified group audit issues. However, there should be tiered instructions that classify components according to the perceived risk and importance to the group audit, customised as appropriate to cater for any unique situation that individual component may face. The need for customisation and for documentation of any group auditor-agreed deviations from these instructions could be reinforced in the application materials. Additionally, in relation to paragraph 219(e), ISA 600 could be amended to require the group auditor to raise directly with the component auditor any issues identified centrally that might be relevant to the work being done by the component auditor. This obligation could be communicated in the group audit instructions.

GA4. Using the Work of the Component Auditors

(a) Paragraphs 226–242 set out matters relating to using the work of the component auditors.

(i) 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?

(ii) Why do you believe these actions are necessary?

(iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.

(iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.

(b) Specifically:

(i) Should the nature, timing and extent of involvement of the group engagement team in the work of the component auditor vary depending on the circumstances? If yes, how could changes to the standard best achieve this objective?

(ii) 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?

Our interpretation of paragraphs 19 and 20 of ISA 600 is that the actions outlined in paragraph 234 are largely already expected, and we see group auditors already making these kinds of judgement routinely during their audits. Given the complexity of factors that influence professional judgement in this area, we cannot see how 'stronger' standards can hope to document them fully. However, some of the material within paragraph 234 may be very helpful guidance for group auditors within application material.

GA5. Identifying and Assessing the Risks of Material Misstatement in a Group Audit

(a) Paragraphs 243–253 set out matters relating to identifying and assessing significant risks in a group audit:

(i) 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?

(ii) Why do you believe these actions are necessary?

(iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.

(iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.

We agree with the analysis in paragraph 251. We would prefer examples being made available of what a proper application of ISA 600 in complex scenarios looks like, rather than more detail being added to ISAs.

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

(a) 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? If not, please indicate which actions are not appropriate and describe why.

(b) 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 agree with the analysis in paragraph 260, which concludes that many of the issues stem from the requirements of and guidance in ISA 320. We would encourage the IAASB to develop guidance as mentioned in paragraph 261(a) as there is some diversity and inconsistency in practice. There is an opportunity for the IAASB to drive better understanding and application of the requirements through targeted guidance.

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)

(a) 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).

- (i) 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?**
- (ii) Why do you believe these actions are necessary?**
- (iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.**
- (iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.**

(b) Specifically:

- (i) What are your views on scoping the audit based on identifying and assessing the risks of material misstatement for the group as a whole, rather than focusing the determination of the necessary work effort on the determination of whether components are considered significant or non-significant? Are there any practical challenges that we need to consider further?**
- (ii) Are there other possible actions related to auditing groups where there are a large number of non-significant components that we should explore? Are there other approaches to auditing such groups that need to be considered? Do the possible actions presented lead to any additional practical challenges?**
- (iii) Should the standard be strengthened for the group engagement team to be more involved at the sub-consolidation level in the appropriate circumstances? Are there further issues or practical challenges that have not been considered?**
- (iv) Should the requirements or application material relating to subsequent event procedures be strengthened or clarified? Are there further issues or practical challenges that have not been considered?**

We believe the approach to identifying and assessing the risks of material misstatement will depend on the facts and circumstances of the particular audit client. While for many groups it may be appropriate to plan for the group as a whole and then communicate that decision to component auditors, this may not be applicable to all group audits. We

think engagement partners should be encouraged to adopt the most appropriate approach based on their knowledge of the client.

In paragraph 276, we are sympathetic to the concerns raised by regulators and audit oversight bodies. It would be appropriate to refer to the need for the engagement partner to consider whether 'residual balances' may contain material misstatements and to determine appropriate actions.

Where a group contains a material sub-consolidation undertaken at a component level, we would expect the component auditors' instructions to be designed so as to allow the group auditor to understand the nature of sub-consolidation journal entries.

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

(a) Paragraphs 293–303 set out matters relating to the review and evaluation of the work of component auditors by the group engagement team.

(i) 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?

(ii) Why do you believe these actions are necessary?

(iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.

(iv) Please also describe any potential consequences of those actions that you believe we need to consider further.

We disagree with the suggestion to 'strengthen documentation requirements' in paragraphs 299 and 303. With proper evaluation of the competency of the component auditor and well-written instructions, we believe more detailed documentation requirements in respect of the review and evaluation of the component auditor's work is likely to have limited impact.

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 have no comment on this question.

The following questions are overall questions relating to group audits:

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 are not aware of any other issues.

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

Many of the identified issues in group audits stem from the structure of group audits. Namely, that the engagement partner is responsible for the entire audit opinion but that the work of component audits is undertaken by other audit firms (even if part of the same network) that may be based in other countries, making regulatory oversight difficult. While we are sympathetic to these regulatory concerns, we believe it is important not to drive the group audit process solely from a regulatory perspective. We perceive an overemphasis on written communications in the ITC which may, perversely, reduce audit quality given the superiority of non-written communication in conveying and confirming understanding. While certainly there are improvements that can be made in some areas, we urge the IAASB to be alert to these risks.

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.

We are not aware of any specific considerations 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 are not aware of any specific public sector considerations.