



ICGN

International Corporate Governance Network

By web submission: www.iaasb.org

James Gunn
Technical Director
International Auditing and Assurance Standards Board
(IAASB)
545 Fifth Avenue
New York, NY10017
USA

9th May 2013

Dear Mr Gunn,

Re: Invitation to Comment (ITC) on IAASB's Consultation Paper – A Framework for Audit Quality

Thank you for the IAASB's Invitation to Comment (ITC) on the Consultation Paper – A Framework for Audit Quality (hereinafter 'the Framework' or 'the Paper').

We are writing on behalf of the International Corporate Governance Network (ICGN). The ICGN is a global membership organisation of over 600 institutional and private investors, corporations and advisors from 50 countries. Our investor members are responsible for global assets of US\$18 trillion.

The ICGN's mission is to raise standards of corporate governance worldwide. In doing so, the ICGN encourages cross-border dialogue and influences corporate governance public policy through its Committees. It promotes best practice guidance, encourages leadership development and keeps members informed on emerging issues in corporate governance through publications and the ICGN website. Information about the ICGN, its members and activities is available at: www.icgn.org.

The Accounting and Auditing Practices Committee (A&A Practices Committee) addresses and comment on accounting and auditing practices from an international investor and shareowner perspective. The Committee through collective comment and engagement strives to ensure the quality and integrity of financial reporting around the world: http://www.icgn.org/policy_committees/accounting-and-auditing-practices-committee/

The ICGN wishes to express our support for the IAASB's continuing endeavour to enhance the quality of audits and the value of the audit for users. The ICGN also recognizes the other work the IAASB has undertaken in order to strengthen the value of audit and audit quality, including that on the audit report. We believe enhancing auditor reporting is related to audit quality and increasing the relevance and value of the audit but do not comment on this aspect in this response.

Significant work has been undertaken by various national oversight bodies and regulators with the aim of improving audit quality. For example in the UK by the Financial Reporting Commission (FRC)¹, in Canada by the Canadian Institute of Chartered Accountants (CICA)² and in the US by the Center for Audit Quality (CAQ), the AICPA³ and the PCAOB⁴. The IAASB Framework should work with relevant organizations to ensure alignment and produce one global Framework for Audit Quality. The IAASB is well placed to take this leadership role and the Framework as presented is a good start to a global model. Business is international and the Framework should take an international perspective and be applicable in various legal and regulatory environments.

The ICGN agrees with the key statement in the Paper that the “primary responsibility for performing quality audits rests with auditors”. In particular, the ICGN is encouraged to see the IAASB exhort audit firms to “challenge themselves about whether there is more they could do to increase audit quality”.

Financial statements are prepared primarily for investors, the holders of ordinary shares, to provide them with the information they need for the purposes of deciding to buy, sell or hold their shares and to fulfil their responsibilities as owners – assessing company management and the strategies adopted, stewardship. The role of the external independent auditor is unique and should provide an unbiased view on the financial statements. The auditor plays a critical role in ensuring the integrity, efficiency and confidence of the capital markets. Quality, robust audits are pivotal to investor decision-making and for ensuring markets value the information reported.

Following the financial crisis, concerns have arisen about a perceived “disconnect” between what was reported in some companies’ annual reports and the companies’ subsequent failure or need for liquidity. Some suggest this questions the relevance and value of the audit, and has led to several initiatives to explore additional transparency into the audit process and how auditors could better serve the needs of investors. In this respect, we welcome this initiative by the IAASB to shed more light on the factors that contribute to audit quality.

In reviewing the Framework, the ICGN wishes to note that institutional investors rely heavily on management’s disclosures so as to make sound investment decisions and act as engaged shareholders. Much information can be found in the annual financial statements and the auditor report thereon, as well as in other sources of information. Investors need robust and accurate information to assist in their research and determination of their capital allocation. The quality of the audit is of paramount importance.

Other stakeholders can contribute to audit quality, including company management, those charged with governance and especially the Audit Committee of the board, regulators and audit oversight bodies. Inputs such as auditing standards, auditor skills and attributes, including people and processes also have a role and are important contributors to audit quality.

¹ Promoting audit Quality, 2008. <http://www.frc.org.uk/Our-Work/Codes-Standards/Audit-and-assurance/Promoting-audit-quality.aspx>

² Enhancing Audit Quality Canadian Perspective, <http://www.cica.ca/enhancing-audit-quality-canadian-perspective/item64401.aspx>

³ Audit Quality and Auditor Selection 29 March 2013. <http://www.aicpa.org/interestareas/employeebenefitplanauditquality/resources/plansponsorresourcecenter/pages/auditqualityandauditorselection.aspx>

⁴ Driving Change to Achieve Independent and High Quality Audits, 3 May 2012. <http://www.aicpa.org/interestareas/employeebenefitplanauditquality/resources/plansponsorresourcecenter/pages/auditqualityandauditorselection.aspx>

Our general comments as well as our answers to the specific questions raised in the document are set out below.

General Comments

We are committed to best practices that contribute to the efficiency and effectiveness of the capital markets, including credible, high quality financial reports which serve the needs of investors and other users of financial information. The integrity and quality of financial reports is supported and strengthened by a robust external audit, carried out objectively and undertaken with professional scepticism on the part of the auditor.

Any developments/additions suggested in this response or that follow from the Consultation Document should not detract from our prime view of the current responsibilities of an auditor – to give an opinion as to whether the financial statements present a true and fair view of the position of the entity. The external auditor can challenge management’s judgement on accounting estimates and assessment of risk.

In the ICGN’s earlier responses to consultations related to the Auditor’s Report, it agreed with the IAASB that it is time to address the call for change. The ICGN then suggested that: ‘reforming the audit report alone would not be sufficient. The provision of relevant, reliable and understandable information within and outside the financial statements by the management as well as a meaningful role of the audit committee is of the same order of paramount importance⁵’. Therefore we are pleased to see consideration of these stakeholders in the Framework.

The Framework discusses at some length the difficulty of defining ‘audit quality’. Albeit difficult, the ICGN believes it is important to have a clear, agreed definition of audit quality. We also suggest that the Framework refers to and encourages the adoption of the “Audit Firm Governance Code⁶” which it alludes to in Output 2.2.

In this context, we welcome the Framework.

Specific Questions

ICGN believes that IAASB’s analysis is comprehensive and its structured approach of input factors, output factors, key interactions, contextual factors and special considerations aids the understanding of the complexity and drivers of audit quality, and any comments set out below relate to points of detail.

Question 1

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

⁵ ICGN, Letter in response to consultation of IAASB on “Enhancing the Value of Auditor Reporting”, September 2011 <https://www.icgn.org/policy-committees/item/1092-consultation-input-on-enhancing-the-value-of-auditor-reporting>

⁶ FRC and International Chartered Accountants of England and Wales, The Audit Firm Governance Code, January 2010 <http://www.icaew.com/en/technical/corporate-governance/audit-firm-governance-code>

The ICGN believes that audit quality is primarily dependent on the objectivity, independence and professional scepticism of the auditor. The framework recognises the role of the IESBA Code (paragraph 62, 63 and 64) which requires all auditors to comply with fundamental principles of professional ethics. However the ICGN believes such professional rules and the Code are insufficient to deal with the threat of familiarity between the auditor, the entity and management. This is not only perception but a matter of fact. Some discussion of how to deal with this is recommended, including a discussion of the benefits of audit partner and audit firm rotation in addressing this issue. We believe this should consider competitive tendering with an outer limit on audit firm tenure, as remedies to familiarity and lack of auditor independence.

In addition, the Framework should include some consideration of the benefits of identifying the responsible audit partner by the audit report referring to him/her by name. The ICGN believes that investors need to know who specifically is responsible for the audit in order to better judge his/her independence, especially when considering the appointment or re-appointment of the auditor.

A number of oversight bodies, especially when considering the recent financial crisis, have commented on a lack of auditor scepticism. The UK's Audit Inspection Unit (AIU) commented on this in its Annual Report 2009 - 2010. The UK's Financial Services Authority has also commented on a 'worrying lack of scepticism'.

Professional scepticism is critical to investor confidence and is about having a challenging, questioning approach to the audit by all on the audit team. The ICGN AAPC submitted a response to the UK's Financial Reporting Council's paper "Auditor Scepticism: Raising the Bar, which outlined many studies that support the requirement of professional scepticism as a crucial skill for auditors⁷. This is referred to in the Framework (paragraphs 43 to 45). However, the ICGN believes this sceptical approach should be evident from audit approach, be documented and inspected by audit oversight bodies. The ICGN recommends the Framework refers specifically to this.

The ICGN considers the time and on-site contributions of the lead audit partner and the senior audit manager is important. The ICGN would like to see greater emphasis (paragraphs 67 to 69 and paragraphs 79 and 80) on the on-site time and input these individuals have. A reasonable proportion of on-site attendance is vital if these responsible individuals are to see, understand and report on issues arising during the course of the audit.

The ICGN would like to see greater emphasis on the depth of industry knowledge (paragraph 73) of the engagement team, particularly in the financial services sector, in order to ensure an adequate review and report on complex businesses and transactions. If this does not occur we may well see a repeat of the position demonstrated in the financial crisis where banks' financial statements provided an unqualified opinion and the banks' concerned were assessed as 'going concerns' only a few months before some sought fundamental financial support for their continuity.

As an audit progresses, problems may arise, requiring further review. The audit scope, plan and budget should allow some flexibility for the auditor to delve deeper

⁷ ICGN Letter to FRC, Discussion Paper " Auditor Scepticism: Raising the bar" – Auditing Practices Board (APB) and Professional Oversight Board (POB), 5 November 2010, <https://www.icgn.org/policy-committees/item/1083-frc-auditor-scepticism-raising-the-bar>

into matters arising. Recognition of the need for flexibility is warranted in the Framework and in particular when setting the audit fee.

The ICGN also recognises that there is also a part to play in promoting audit quality by the board and in particular the board's Audit Committee. There needs to be a mutually respectful relationship between the auditor and the audit committee, each recognising the other's contribution to audit quality. We support the views expressed in paragraphs 180, 182 and 184 in particular. On-going dialogue between the auditor and the audit committee is recommended, including an effectiveness review of the auditor and the audit. The ICGN recommends best practice in this area is encouraged, rather than provided for in regulation. Though we fully support the PCAOB's adoption of auditing Standard No. 16 (AS 16) and the related amendments on Communications with Audit Committee as it strengthens the audit committee's oversight function by clarifying the types and timing of communications an auditor has with the audit committee. We believe a balanced approach is required as mandating specific activities for audit committees is likely to reduce the committee's effectiveness and its ability to respond to changing needs. Audit committees should be left unfettered to apply their discretion and judgment.

In many circumstances the Audit Committee may lack sufficient knowledge and skills to challenge the auditor. Financial literacy for audit committee members should be required. However, we recognise that in a number of markets there may be a limited supply of directors with these skills. Therefore, tools for communicating with the auditor, and assessing the auditor and the quality of the audit, such as that developed by the Center for Audit Quality⁸ and others, are a valuable start and will assist audit committee members. A particular challenge for audit committees is in developing the performance indicators to assess audit quality. We support developing key performance indicators (KPIs) to foster quantitative building blocks of audit quality⁹. Audit firms should disclose KPIs such as number of staff per engagement, average level of senior and junior staff per audit, per cent of funds spent on training compared to the fees received for the audit, etc. Such tools would not only assist audit firms to assess their governance arrangements but would also provide qualitative factors for audit committees to review in their auditor selection process.

Question 2

Does the Framework reflect the appropriate balance in the responsibility for audit quality between the auditor (the 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 ICGN believes broadly that the balance of the responsibilities for audit quality is appropriate. Each responsible individual or group should have clearly expressed statements of accountability in relation to the audit and contributions to audit quality in order to preserve distinct governance roles. The ICGN believes the Framework does not undermine the distinction between the responsibilities of management and

⁸ Center for Audit Quality, Audit Committee Essentials: The Annual Auditor Assessment, October 2012, <http://www.thecaq.org/resources/pdfs/AuditorAssessment.pdf>

⁹ ICGN letter to the FRC regarding the Interim Report of the Market Participants Group on 'Choice in the UK Audit Market', 6 July 2007. <https://www.icgn.org/policy-committees/item/1045-letter-to-the-financial-reporting-council-re-the-interim-report-of-the-market-participants-group-on-choice-in-the-uk-audit-market>

those charged with governance of the entity on the one hand, and the audit firm and the engagement team on the other.

In several places, the Framework states the prime responsibility for audit quality is the auditor. The ICGN agrees with this and no part of the Framework should indicate otherwise. The role of other stakeholders, weak or strong, should not change this focus.

In several countries it is required that the auditor attend the general meeting of shareholders. Some countries go further and require the auditor to explain the conduct of the audit, the preparation and content of the audit report and accounting and audit issues arising from the audit. Countries, such as Australia and Hong Kong, require the auditor to receive and respond to questions related to the audit and the audit report. These mechanisms increase auditor accountability. The ICGN suggests there is a need for better clarity and perhaps guidance in relation to the auditor's role at general meetings and how this should be handled, in order to prevent blurring of responsibilities.

The ICGN supports strengthened accountability of the external auditor to the audit committee and to shareholders. The audit committee plays a critical role in overseeing the audit process on behalf of shareholders. We support requirements for the audit engagement partner to report directly to the Audit Committee. It is very important that the Audit Committee (not management) retains control over audit firm and partner selection and fee negotiation discussions and decisions.

A report from the company's audit committee to the shareholders and other users on its activities and communications with the auditor would complement an expanded Auditor's Report and should reflect the responsibilities of those charged with governance.

The ICGN considers the role of regulators in ensuring audit quality is not addressed sufficiently. Strong independent national regulators should oversee the audit profession, including checking that auditors comply with laws, regulations and professional requirements, especially those related to independence. Regulators should have a formal role in driving audit quality, such as those more evident in the interactions between financial and prudential regulators and auditors. Regulators may also encourage broad discussion of current audit issues and possible remedies for those issues. We recommend consideration of regulators assuming a more proactive approach to audit quality and issues be included in the Framework.

Question 3

How do you intend to use the Framework? Are there changes that need to be made to the form or content of the Framework to maximize value to you?

The ICGN will review the Framework in its final form and determine subsequent actions for its members. The ICGN has in the past developed 'Best Practice Guidance' and 'Tools' for the use of investors and is likely to undertake this again in the light of the importance of the Framework and of audit quality to its members.

The ICGN held a breakfast roundtable on issues arising from the Framework and to elicit members' views as a part of its mid-year conference in Milan in March, 2013. The ICGN intends to canvass its members' views again at its annual conference in New York in June 2013.

Question 4

What are your views on the suggested Areas to Explore? Which, if any, should be given priority and by whom? Are there additional Areas to Explore?

The ICGN supports additional work in the 'Areas To Explore'. In particular, the ICGN believes that work in Area 2 'Establishing a common understanding of capabilities' should be prioritised. Work in this area would clarify a deeper understanding of audit quality on the part of auditors and how audit quality relates to individuals' daily work.

The ICGN suggests that Area 3 'Improving information sharing between audit firms' should also be prioritised. Information pertaining to a particular company from the previous auditor, shared with the in-coming auditor, is likely to reduce the audit risk associated with a change of auditor and enhance the work and focus of the in-coming auditor.

We also agree with Area 4 for exploration 'Considering whether audit inspection activities can do more to improve audit quality and more transparent to users.' We support elevating this area for exploration as well as elevating inspection reports to a possible central database.

If you would like to discuss any of these points, please do not hesitate to contact Kerrie Waring, ICGN Chief Operating Officer, at +44 207 612 7079 or kerrie.waring@icgn.org. Thank you for your attention and we look forward to your response on the points above.

Yours sincerely,



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Auditing Practices Committee



Michelle Edkins
Chairman of the ICGN Board of Governors

Cc: ICGN Board Members
ICGN Accounting and Auditing Practices Committee