



OICV-IOSCO

International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
Organização Internacional das Comissões de Valores
Organización Internacional de Comisiones de Valores

5 May 2014

Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, NY 10017 U.S.A.

Our Ref: 2014/JE/C1/IAASB/04

Subject Line: IAASB's Consultation Paper: *IAASB's Proposed Strategy for 2015–2019 and the IAASB's Proposed Work Program for 2015–2016*

Dear Sir:

The International Organization of Securities Commissions' Committee on Issuer Accounting, Audit and Disclosure (Committee 1) appreciates the opportunity to comment on the International Auditing and Assurance Standards Board's (the IAASB or the Board) Consultation Paper: *IAASB's Proposed Strategy for 2015–2019 and the IAASB's Proposed Work Program for 2015–2016* (the Paper). As an international organization of securities regulators representing the public interest, IOSCO is committed to enhancing the integrity of international markets through the promotion of high quality accounting, auditing and professional standards, and other pronouncements and statements.

Members of Committee 1 seek to further IOSCO's mission through thoughtful consideration of accounting, disclosure and auditing concerns, and pursuit of improved global financial reporting. Unless otherwise noted, the comments we have provided herein reflect a general consensus among the members of Committee 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

Focus of the Board

We believe the integrity of both the audited financial statements and the auditor's opinion are integral to an investor's decision making. As such, we support the Board's initiative to put the next phase of its plan in place to develop and maintain high-quality International Standards on Auditing (ISAs) as a basis for high-quality financial statement audits. We suggest that in doing so the Board focus its strategy on three key areas, as follows:



OICV-IOSCO

International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
Organização Internacional das Comissões de Valores
Organización Intemacional de Comisiones de Valores

1. Obtaining sufficient, appropriate audit evidence;
2. Exercising an appropriate level of professional skepticism; and
3. Using the work of other auditors and experts.

We have prepared our letter to reflect how the IAASB's strategy and work plan could best address these three key themes in light of our experiences. Our concerns and observations noted below are based on our collective experiences in conducting enforcement proceedings as part of our responsibilities as securities regulators as well as in inspecting audit files as audit oversight regulators, as appropriate.

Obtaining Sufficient, Appropriate Audit Evidence

We have concerns about the sufficiency and appropriateness of audit evidence obtained by auditors to support their conclusions on significant areas of the audit. We have observed significant diversity in practice regarding the adequacy of audit evidence obtained by auditors. In specific instances, we have noted that auditors seemingly either did not obtain an adequate level of audit evidence, or did not sufficiently document the basis for their conclusion that they had done so, in order to obtain reasonable assurance that financial statements are free of material misstatements.

ISA 315, Identifying and Assessing Risks of Material Misstatement through Understanding the Entity and Its Environment

We believe the Board should develop requirements and guidance that remind auditors of their responsibilities in reviewing and assessing internal controls. We have observed several issues relating to ISA 315, *Identifying and Assessing Risks of Material Misstatement through Understanding the Entity and Its Environment*, including a lack of understanding of the purpose of internal control testing in the context of a particular audit plan. For example, we have noted decisions by auditors to not assess and test internal controls over financial reporting in many audits in favor of reliance solely on substantive testing though internal control testing may be more effective particularly for entities with large numbers of automated transactions. We have also noted a lack of recognition of the limitations of entity-level controls and their effectiveness in relation to specific account assertions. For example, it may be difficult to observe the operation of some high level review processes, such as where the process involves past meetings between officers of the audited entity. In such circumstances the auditor should re-consider the effectiveness of relying solely on entity-level control testing.



OICV-IOSCO

International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
Organização Internacional das Comissões de Valores
Organización Internacional de Comisiones de Valores

While we would like to see issues relating to ISA 315 addressed with the commencement of an IAASB project earlier than 2017, we support the Board's approach in engaging in information gathering activities beginning in 2016 to assist in scoping this project.

ISQC 1, Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements

We have observed seemingly inadequate and inconsistent levels of involvement of engagement partners and Engagement Quality Control Reviewers (EQCRs) at all stages of the audit, including planning and reviewing key judgments and the conclusions reached. Accordingly, we support the Board's prioritization of a Quality Control project commencing in 2015 to consider improving the function of the EQCR, the criteria for eligibility of the EQCR and other issues related to ISQC 1.

Audit Sampling

An increasing number of Committee 1 members have observed issues related to ISA 530, *Audit Sampling*. Our concerns stem from what seem to be a lack of understanding among auditors regarding the appropriate use of audit sampling, including choosing the appropriate sampling technique to obtain a representative sample and documenting the auditor's thought process that demonstrates a logical and thoughtful approach and basis for the audit sampling work performed. ISA 530 leaves the determination of sample sizes to the professional judgment of the auditor which, when coupled with a lack of understanding of the proper thought processes associated with audit sampling causes significant diversity in practice. This concern is heightened with the growing trend of audit firms using data analytics for audits in high data volume circumstances.

We have observed that the Board has allocated resources for the commencement of one project in 2018-2019 that could be filled from a list that includes ISA 520, *Analytical Procedures*, ISA 620, *Using the Work of an Auditor's Expert*, ISA 530, ISA 402, *Audit Considerations Relating to an Entity Using a Service Organization*, or a project on audit evidence. We believe that a project on ISA 530 should receive greater priority in comparison with ISA 520 and ISA 402 in terms of timing of the commencement of the project. We have separately discussed our views on ISA 620 in the section below titled "Using the Work of Other Auditors and Experts".

Special Considerations Relevant to Banks and Other Financial Institutions

We note that for the 2015-2016 work program the Board has prioritized a project to address special considerations relevant to financial institutions. We also note that the Board will concurrently address issues affecting both banks and other financial institutions which would consider enhancements to the ISAs, including ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates*,



OICV-IOSCO

International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
Organização Internacional das Comissões de Valores
Organización Internacional de Comisiones de Valores

and Related Disclosures, or development of further implementation guidance; and auditing issues related to fair value accounting and accounting estimates, such as auditing of impairment and loan loss provisioning. We support the prioritization and objective of this project but we believe the expected output should be in the form of enhancements to the current ISAs due to the importance and complexity of these issues. We also believe the Board should make it clear that the project scope is intended to encompass banks, insurance companies, financial intermediaries and other similar financial institutions while noting the applicability to all types of companies, as appropriate.

ISA 505, External Confirmations

We have noted an absence of guidance in ISA 505, *External Confirmations*, regarding how to assess the reliability of external confirmations received by the audit engagement team that may be indicative of potential fraud. Separately, ISA 505's provisions for alternative procedures to be performed if a reply to a previous confirmation request has not been received could be improved in terms of articulating more completely how the auditor is to respond. We believe the Board could include a narrowly-scoped project in the latter part of its 2015-2019 strategy to address concerns with external confirmations.

Materiality

We have observed that there is diversity among audit firms regarding percentage ranges for determining the quantitative dimension of both overall materiality and performance materiality. This situation may result in the auditor performing less audit work than it should in the circumstances, at least in relation to entities of similar size and risk profiles. We believe the Board should include a project to address materiality considerations that guide auditors in setting both overall and performance materiality.

Exercising an Appropriate Level of Professional Skepticism

ISA 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

Exercising professional skepticism is a critical part of conducting quality audits. We have questioned whether auditors routinely exercise an adequate level of professional skepticism in areas of significant risk. We are concerned that not doing so could contribute to auditors not detecting misstatements or appropriately following-up on potential misstatements. Our sensitivity to these concerns continues to escalate with the increasing complexity of business structures and the related financial reporting.

Considering the above, we support the Board commencing a project in 2015 to address professional skepticism. While we recognize that professional skepticism by auditors involves behavioral aspects



OICV-IOSCO

International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
Organização Internacional das Comissões de Valores
Organización Internacional de Comisiones de Valores

as the Board has indicated, we believe clear requirements and guidance regarding the expectations of auditors throughout the ISAs including ISA 240 would contribute to improvements in the exercise of professional skepticism.

Using the Work of Other Auditors and Experts

ISAs Related to Using the Work of Other Auditors and Experts

We have observed that auditors do not seem to consistently utilize other auditors and experts appropriately. Our concerns include auditors not assessing the professional competence of component auditors or experts; the uncertainty related to the extent of work to be performed by component auditors as well as the setting of component materiality; the lack of clarity regarding when to engage the auditor's own expert; and the use of internal auditors in a direct assistance capacity, among others.

We believe that the issues noted above should be addressed by improvements to the related standards, including ISA 600, *Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors)*, ISA 620, *Using the Work of an Auditor's Expert*, and ISA 610 (Revised), *Using the Work of Internal Auditors*.

Relatedly, we appreciate the Board's view that "a project to revise ISA 600 would involve significant strategic and technical debates about the approach to a group audit, and is likely to take longer than 36 months to complete." Nonetheless, while information gathering is valuable, due to the current and increasing importance of group audits, we believe the commencement of a project to address issues related to ISA 600, at a minimum, including "letterbox audits" should occur prior to 2017 with work to address the additional ISAs mentioned above commencing later within the 2015-2019 strategy period.

Offshoring

We have observed an increasing use among audit firms of assigning certain audit procedures to off-shore centers (or similarly situated centers established domestically) in an effort to drive efficiency, cost savings or other benefits. We believe more guidance would be appropriate to help guide auditors in evaluating such an approach to performing audit procedures and the audit risks that may result.



OICV-IOSCO

International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
Organizaç o Internacional das Comiss es de Valores
Organizaci n Internacional de Comisiones de Valores

Thank you for the opportunity to comment on the Paper. If you have any questions or would like to further discuss these matters, please contact either Nigel James or me at 202-551-5300.

Sincerely,

Julie A. Erhardt
Chair
Committee on Issuer Accounting, Audit and Disclosure
International Organization of Securities Commissions