

17 May 2016

Submitted electronically to kathleenhealy@iaasb.org

Ms Kathleen Healy
Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue
New York
10017 USA

Dear Kathleen

Comments on the IAASB's Invitation to Comment, Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits

The Independent Regulatory Board for Auditors (IRBA) is both the audit regulator and the national auditing standard-setter in South Africa. One of its statutory objectives is the protection of the public by regulating audits performed by registered auditors, and the promotion of investment and employment in the Republic. The IRBA, through its Statutory Committee for Auditing Standards, is also responsible for adopting, developing, maintaining, issuing and prescribing auditing pronouncements.

We appreciate this opportunity to comment on the Invitation to Comment, *Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits* (ITC), developed by the International Auditing and Assurance Standards Board (IAASB).

The format of our comment letter is that of a general response rather than a comment letter that responds to each question contained in the ITC. Where appropriate, we have cross-referenced our comments to specific questions raised in the ITC in ***bold italic text***.

Our comments are presented under the following sections:

1. Introduction;
2. The IRBA's approach to responding to the IAASB's ITC;
3. Findings from the clarified ISAs post-implementation review;
4. Findings from the audit inspection bodies and regulators;
5. Public interest and public interest issues;
6. Audit quality;
7. Professional scepticism;

8. Quality control; and

9. Group audits.

In our comments, where a recommendation to the IAASB has been made it has been highlighted in **bold text**.

Kindly e-mail me at bagulhas@irba.co.za or Nicolette Bester at nbester@irba.co.za or call us directly on +27 87 940 8796 and +27 87 940 8862 respectively, if further clarity is required on any of our comments.

Yours faithfully



Bernard Peter Agulhas

Chief Executive Officer: IRBA

Introduction

1. As the audit regulator and standard-setter in South Africa, we welcome the IAASB's focus on public interest issues and audit quality in the ITC, with a goal to strengthen auditor performance. We encourage the IAASB to weigh each comment received on the ITC and ensure that those comments that serve the public interest and enhance audit quality are used as input into its standard-setting processes that follow the ITC.

The IRBA's Approach to Responding to the IAASB's ITC

2. We formed an internal task group whose objectives were to contribute to and formulate the IRBA comment letter on the IAASB's ITC.
3. The task group consisted of representatives from the Executive, Standards, Inspections, Investigations and Legal departments and was led by the Standards Department.
4. The Standards Department consulted with representatives (audit, quality control and technical firm leaders) from a variety of auditing firms in South Africa in order to obtain their firm views on the following topics discussed under the Quality Control section of the ITC:
 - Quality management approach.
 - Engagement quality control review.
 - Transparency reporting.
 - Firm governance and audit quality indicators.
5. We also raised awareness about the ITC with the Auditor-General South Africa, various regulatory bodies and universities in South Africa and encouraged them to submit comments directly to the IAASB.
6. The views we express in our comment letter incorporate our responses as both the audit regulator and standard-setter in South Africa. While our consultations with individual registered auditors and other interested parties have also informed our comments, the final comments represent the views of the IRBA.

Findings from the Clarified ISAs Post-Implementation Review

7. In July 2013, the IAASB issued its report, *Clarified International Standards on Auditing – Findings from the Post-Implementation Review*, which summarised the findings from the post-implementation review of the clarified ISAs and identified the main themes (key, important and other) that emerged. We welcome the IAASB's approach to monitor implementation of the standards in the market, and to respond to findings which arise from such monitoring.
8. We are pleased to see that three of the four "key themes" identified in the report – ISA 200¹

¹ ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing

(professional scepticism); ISQC 1² and ISA 220³ (engagement quality control review); and ISA 600⁴ (group auditor's involvement in work of component auditor and component materiality) – are the very topics addressed in the ITC. We are also pleased to see that the other “key theme” identified in the report, being ISA 315 (Revised)⁵ (significant risks and obtaining an understanding of internal control), was at the “initial discussion” stage on the IAASB March 2016 agenda.

9. However, only two of the “important themes” identified in the report are addressed as part of the ISA 600 and ISA 315 (Revised) projects mentioned above.
10. The remaining four of the six “important themes” identified in the report – ISA 240⁶ (inconsistency of practice relating to the presumed significant fraud risk for revenue recognition and testing journal entries); ISA 320⁷ (inconsistencies in determining materiality and performance materiality and request for more guidance); ISA 520⁸ (ISA does not sufficiently demonstrate the work effort needed to place reliance on analytical procedures); and ISA 620⁹ (inconsistencies in the auditor's work effort in relation to the auditor's expert work) – are still to be addressed by the IAASB.
11. **We encourage the IAASB to not lose sight of these “important themes” in its decision-making on future projects it will undertake.**

Findings from the Audit Inspection Bodies and Regulators

International Forum of Independent Audit Regulators

12. We welcome the IAASB's outreach towards audit inspection bodies and regulators to better understand their expectations and receive feedback on potential gaps in the standards.
13. The IRBA is a founding member of the International Forum of Independent Audit Regulators (IFIAR) and a contributing member to the IFIAR's annual survey of inspection findings.
14. While the IFIAR recognises that inspection findings do not on their own mean that changes are necessarily needed to the ISAs, the IFIAR comment letters encourage the IAASB to pursue efforts to consider the themes identified by the IFIAR's surveys in defining and conducting its standard-setting projects, with a perspective towards identifying how the ISAs might further contribute to improving the quality of audits globally. The IRBA has been an active participant in contributing to the development of these comment letters.
15. In 2014¹⁰ and 2015¹¹ the common areas of audit deficiencies for the inspections of quality

² ISQC 1, Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements

³ ISA 220, Quality Control for an Audit of Financial Statements

⁴ ISA 600, Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)

⁵ ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment

⁶ ISA 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

⁷ ISA 320, Materiality in Planning and Performing an Audit

⁸ ISA 520, Analytical Procedures

⁹ ISA 620, Using the Work of an Auditor's Expert

¹⁰ IFIAR's [2014 survey results](#)

¹¹ IFIAR's [2015 survey results](#)

control systems were Engagement Performance (including the failure to establish policies and procedures for engagement quality control reviews [EQCR] that provides an objective evaluation of the significant judgements made by the engagement team and conclusions reached); Independence and Ethical Requirements; and Human Resources (including how the audit firm evaluates audit quality as part of partner performance evaluations and partner admissions).

16. In 2014¹², the IFIAR survey results revealed that the top three findings from listed public interest entity (PIE) audits related to procedures for Fair Value Measurement (ISA 540¹³), Internal Control Testing (ISA 330¹⁴) and Revenue Recognition (ISA 240). In addition, the survey results revealed that the top three findings from systemically important financial institutions (SIFI) audits related to the audit of the Valuation of Investments and Securities (ISA 540), Internal Control Testing (ISA 330) and the audit of the Allowance for Loan Losses and Loan Impairments (ISA 540).
17. In 2015¹⁵, the IFIAR survey results revealed that the top three findings from listed PIE audits related to procedures for Internal Control Testing (ISA 330), Fair Value Measurement (ISA 540) and Risk Assessment (ISA 315 (Revised)). In addition, the survey results revealed that the top three findings from SIFI audits related to Internal Control Testing (ISA 330), the audit of Allowance for Loan Losses and Loan Impairments (ISA 540) and the Valuation of Investments and Securities (ISA 540).
18. A factor underlying many audit deficiencies, as determined through root cause analysis and the evaluation of practices behind successful audit engagements as well as those that fall short, is insufficient exercise of professional scepticism during the performance of the audit.
19. Audit engagement findings imply that the auditor's performance falls below the expected level of diligence to satisfy the public interest role the audit is meant to fulfil, and that the audit failed to provide the level of assurance about the financial statements that it purported to do and that is required by professional standards.
20. **We are pleased to see that the majority of common areas of audit deficiencies for the inspections of quality control systems and the top audit engagement findings from the 2014 and 2015 surveys are addressed by the IAASB in its current and near-future projects and support the IAASB's outreach to IFIAR, as well as the IAASB's willingness to continue engagement with IFIAR.**

Independent Regulatory Board for Auditors

21. The IRBA issued its first *Public Inspections Report 2014/2015: Striving for Consistent, Sustainable High Audit Quality* in December 2015. This report provides an analysis of key findings arising from firm and engagement inspections performed by the IRBA's Inspections Department for the year ended 31 March 2015, and also includes an overview of the scope

¹² IFIAR's *2014 survey results*

¹³ ISA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures

¹⁴ ISA 330, The Auditor's Responses to Assessed Risks

¹⁵ IFIAR's *2015 survey results*

of the IRBA's inspections.

22. The key area, at firm level, that requires urgent improvement is the engagement file quality level. The most unsatisfactory firm findings were raised under the Relevant Ethical Requirements (Independence), Engagement Performance and Monitoring elements of ISQC 1.
23. The report revealed that the top three findings at engagement level related to procedures for Fair Value Measurement, Valuations and Estimates (ISA 540), Financial Assets and Liabilities (various ISAs), and Risk Assessment (ISA 315 (Revised)) and Response (ISA 330).
24. The report also revealed that the possible root cause for many of the findings is a lack of the application of professional scepticism.
25. **Again, we are pleased to see that the majority of the common areas of audit deficiencies for the inspections of quality control systems and the top audit engagement findings from the report are being addressed by the IAASB in its current and near-future projects, and support the IAASB'S initiatives to monitor reports from inspection bodies and regulators.**
26. **We also encourage the IAASB to engage with firm networks to understand actions that are being undertaken to address the specific audit quality issues most frequently identified by regulators and the "root" causes of their systemic findings, and to communicate these to the IAASB.**

Public Interest and Public Interest Issues

27. The IAASB chairman, Professor Arnold Schilder, in his Chairman's Report to the IAASB's 2014/2015 Biennial Report states: "We believe that audit and assurance standards are fundamental to the way our modern societies work. They enhance credibility and trust in a society's external reporting, which is undertaken in the interests of the public at large, from the core financial statements right through to elements of sustainability, ethics, and integrity. High-quality external reporting, in turn, contributes to the stability of companies and economies, and that, in the end, is what we are working for. We call this the public interest."¹⁶
28. As the audit regulator in South Africa, we welcome the IAASB's commitment to ensure that public interest is served in its standard-setting process and that public interest issues have been identified for the topics addressed in the ITC.
29. Table 1 in the ITC highlights the seven most relevant public interest issues related to the topics of professional scepticism, quality control and group audits.
30. We believe that these public interest issues are relevant to the work of the IAASB on these topics **[ITC question G1(a)]**.
31. **However, we believe the following three public interest issues are also relevant to these topics and the IAASB should consider and explore these issues further in relation to professional scepticism, quality control and group audits [ITC question**

¹⁶ Extract from the Chairman's Report, IAASB 2014/2015 Biennial Report, *Championing Change in the Public Interest*

G1(b):

- Reinforcing the value of an audit to those charged with governance and, in particular, to audit committees and their members:
 - The IAASB's Framework for Audit Quality (AQF)¹⁷ states that in larger entities, especially listed companies, audit committees often exist to oversee the relationship between the entity and the auditor. This can include the appointment of the auditor, the assessment of the independence of the auditor (including the provision of non-audit services), and the approval of audit fees. As long as they are motivated to maximise the quality of an audit rather than minimise cost, audit committees provide a way of helping to ensure that sufficient, appropriate resources are allocated to the audit. There is usually a relationship between the quality of an audit and the quality and quantity of the resources used in its performance, and this will usually be reflected in the audit fee. However, a low audit fee can never be a justification for failure to adequately resource an audit and obtain sufficient appropriate audit evidence. It is important that audit committees consider whether sufficient audit time is planned.
 - The auditor is required to maximise the quality of an audit regardless of the cost of that audit. However, if the audit committee understands the value of an audit, and supports the auditor in that process, it provides a way of helping to ensure that sufficient, appropriate resources are allocated to the audit and the quality of the audit is maximised, including the appropriate application of professional scepticism, which should ultimately result in the auditor arriving at the correct opinion.
- Exploring and enhancing the governance process followed by those charged with appointing an auditor:
 - Various organisations¹⁸ have issued guidance on audit quality indicators (AQIs) that could provide an opportunity to enhance discussions between auditors and audit committees and benefit audit committees in fulfilling their responsibilities relative to the oversight of an audit.
 - The IAASB's AQF¹⁹ states that some audit committees also have a responsibility to consider audit quality directly and do this as part of the process for the reappointment of auditors or when considering audit fees. It can also help if the audit committee has a formal process and criteria for describing the attributes of audit quality. Audit committee consideration of audit quality will be influenced by the interactions with the auditor and, in particular, by an assessment of the professional scepticism applied.

¹⁷ Framework for Audit Quality, Contextual Factors, paragraphs 108 and 110

¹⁸ For example: US Center for Audit Quality – *CAQ Approach to Audit Quality Indicators*, April 2014 and Federation of European Accountants (FEE) – *Overview of Audit Quality Indicators Initiatives* Information Paper, November 2015

¹⁹ Framework for Audit Quality, Contextual Factors, paragraphs 109

- The development of audit firm governance codes and quality frameworks, including the development and use of audit quality indicators, can assist audit committees in their auditor appointment/reappointment decision-making processes.
- The above will contribute to the integrity of the audit and audit opinion, enhance credibility of reporting and thereby protect the public who can rely on audit reports.
- Reinforcing the independence of the IAASB’s Consultative Advisory Group (CAG), its Board membership and the task forces they serve on:
 - The IAASB’s CAG, in its independent capacity, provides valuable public interest input into the IAASB’s strategy, agenda, priorities and technical issues, and all IAASB Board members (the selection of whom is independently monitored by the Public Interest Oversight Board [PIOB]) are required to act in the public interest.
 - We believe that the independence of the CAG and the IAASB Board members who act in the public interest contributes to the enhancement of audit quality in the public interest for all the topics in the ITC.
 - We encourage the IAASB and PIOB to continuously monitor their definition of public members on the structures, in the light of the changing needs of the public and the evolving nature of public interest.

Audit Quality

32. The term audit quality encompasses the key elements that create an environment which maximises the likelihood that quality audits are performed on a consistent basis²⁰.
33. However, audit quality does not necessarily result from a quality audit having been performed. The performance of a quality audit by an engagement team is dependent on many factors, such as their competence, ethical values and their application of a rigorous audit process and quality control procedures.
34. **We believe that audit quality can be enhanced by, among others, making changes to the ISAs in key areas with a goal to strengthen auditor performance.** As such, we support the IAASB’s focus on professional scepticism, quality control and group audits in the ITC as well as its current project to revise ISA 540 with special attention to the application to audits of financial institutions.
35. **Although we do not discourage the development of audit manuals, software tools or other forms of standardised documentation by audit firms, we believe that audit quality and auditor performance can be enhanced by encouraging and teaching auditors to be “thinking auditors” who perform “thinking audits”.**
36. The ITC highlights that broader environmental factors have the potential to directly or indirectly impact audit quality. . **We support the IAASB in its standard-setting activities**

²⁰ A Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality, Overview, paragraph 1

in keeping the ISAs “fit for purpose” to help auditors appropriately react to the challenges of the evolving environment.

37. We support the IAASB’s contention that the primary responsibility for audit quality rests with auditors. The IFIAR has in the past year set a measurable target for the reduction of audits with findings – a reduction of at least 25% in the next four years in audits with at least one finding as reported by the members of the IFIAR working group that engages regularly with the largest global audit firms. **We believe that the reduction in audit findings can be achieved by targeted enhancements to specific application material, in particular ISAs that address the root causes of the most prevalent inspection findings.**
38. Some examples of possible root causes to the key findings from the IRBA’s Public Inspection Report 2014/2015 (refer to paragraph 21-26 above where the findings are discussed) are as follows:
- Firm level:
 - Engagement performance: Failure to allocate sufficient resources, enough time and an experienced, competent engagement team (including engagement quality control reviewers).
 - Relevant ethical requirements: Failure to fortify the importance of professional scepticism and the independence of the engagement team so as to overcome the threats that could develop as a result of their relationship with clients.
 - Human resources: Failure to incorporate and recognise audit quality in performance reviews (KPIs).
 - Monitoring: The firm’s leadership underestimates the importance of monitoring as an imperative in driving consistent high audit quality by measuring the level of implementation of policies and procedures.
 - Engagement level:
 - Fair value measurement, valuations and estimates: Apart from having the capacity and competence in place before accepting an engagement, professional scepticism is another key factor of a quality audit. Auditors and their staff should not simply accept management (including internal or external experts) views without challenge. They should also assess those views against their knowledge of the client’s business and the environment in which it operates. By doing so, auditors can evaluate management’s views in the context of both internal and external evidence and formulate an independent view that may or may not corroborate management’s position.
 - Internal control testing: Failure to review the audit methodology and/or software to determine if there are clear links between risks (and levels) identified and related responses (including extent of tests), and to then amend the methodology as necessary. Also, failure to fully understand the linkages and clearly articulate the audit responses to assessed risk. These considerations should be part of the

planning process and the implementation thereof should be closely monitored by the engagement partner.

- Revenue recognition: Failure to consider or document the reasons for concluding that revenue recognition is not a significant risk in the circumstances of the engagement.
 - Risk assessment: Failure to identify and sufficiently respond to significant risks (higher than high risks that require special consideration) such as revenue recognition, journals and related parties.
39. The ITC, many times, makes reference to the IAASB's AQF. The IAASB says in the AQF that it expects that it will generate discussion and positive actions to achieve continuous improvement to audit quality. **We encourage the IAASB to embed the applicable inputs, processes and outputs described in the AQF in its current and future projects.**
40. **Further, we do encourage the IAASB to continue working at achieving the objectives of its Framework for Audit Quality, which include:**
- Raising awareness of the key elements of audit quality.
 - Encouraging key stakeholders to explore ways to improve audit quality.
 - Facilitating greater dialogue between key stakeholders on the topic.

Professional Scepticism

41. Since professional scepticism is one of the topics identified in the results of the post-implementation review of the clarified ISAs (refer to paragraphs 7-11 above), in the IFIAR's 2014 and 2015 survey results (refer to paragraphs 12-20 above) as well as in the IRBA Public Inspection Report 2014/2015 (refer to paragraphs 21-26 above), we support the IAASB's commitment to address the topic of professional scepticism in order to find actions that it and others can take to enhance the application of professional scepticism.

Improvement in the Application of Professional Scepticism Driven by Enhancements to the ISAs

42. **We believe the ISAs can be further strengthened with respect to professional scepticism by including in each ISA specific requirement(s) for the documentation of the auditor's application of professional scepticism. This would strengthen the audit evidence of the auditor's application of professional scepticism and the exercising of professional judgement that will also assist those who perform internal monitoring reviews and internal/external inspections in understanding the auditor's thought process [ITC question PS3].**
43. **In addition, we believe that the auditor's behaviour would be enhanced by including more emphasis on professional scepticism *throughout the audit process* in conjunction with further exploring behavioural, training and other issues [ITC question PS3].**
44. For example, we believe that more emphasis on professional scepticism is needed in the following ISAs **[ITC question PS3]:**

- ISA 315 (Revised), ISA 330, ISA 500²¹ and ISA 520 – The auditor should apply professional scepticism when performing risk assessment procedures, in designing and implementing appropriate responses to those risks as well as when performing audit procedures (including substantive analytical procedures and analytical procedures near the end of the audit) so as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor’s opinion.
- ISA 320 and ISA 450²² – The auditor should apply professional scepticism when applying the concept of materiality in both planning and performing the audit, and in evaluating the effect of identified misstatements (including any uncorrected misstatements).
- ISA 620 – The auditor has a responsibility to apply professional scepticism when using the work of an expert.
- ISA 600 and ISQC 1 – The ITC²³ states that the IAASB’s current efforts on quality control and group audits provide opportunities to reinforce the concept of professional scepticism. However, the quality control section of the ITC (and in particular paragraphs 125-135) does not directly deal with how firm leadership responsibility and accountability, firm culture and strategy, as well as actions by the engagement partner and engagement quality control reviewer can better promote the application of professional scepticism in audits. **We draw the IAASBs attention to the need to ensure that those topics are included in the scope of the revision of ISQC 1.**
- ISA 540 – The ITC²⁴ sets out how the IAASB will stress the importance of professional scepticism as part of its work to revise ISA 540. Accounting estimates generally involve a high level of management judgement and therefore there is an increased risk of unintentional or intentional management bias. We support the IAASB in investigating further how ISA 540 can be strengthened to improve the focus on auditors approaching accounting estimates with a more questioning mind-set and in highlighting the need to consider the effect of contradictory audit evidence that comes to the auditor’s attention, rather than an approach overly focused on corroboration.

Professional Scepticism and Professional Judgement

45. Professional scepticism and professional judgement are closely related but are two distinct concepts contained in the ISAs and should not be used interchangeably.
46. **We believe that it is necessary for the ISAs to clearly distinguish the two concepts and provide clear guidance on the interaction between the two concepts as well as clear guidance on the documentation requirements relating to the two concepts.**

²¹ ISA 500, Audit Evidence

²² ISA 450, Evaluation of Misstatements Identified During the Audit

²³ ITC, paragraph 38

²⁴ ITC, paragraph 39

Timing of the Projects

47. The ITC indicates that the way forward for both quality control and group audits will result in the tabling and approval of project proposals between September and December 2016. However, for professional scepticism, the IAASB only expects to decide on a way forward by late 2016. **We draw the IAASB's attention to the need to remain committed to an integrated approach in addressing professional scepticism within other current projects.** The difference in timelines should not result in delayed enhancements of the consideration of professional scepticism in ISQC 1, ISA 220, ISA 600 and ISA 540.

Quality Control

48. In line with the objectives of both ISQC 1²⁵ and ISA 220²⁶, we believe that quality control is the cornerstone to all audit engagements.
49. The IAASB has received a great deal of feedback on the issues and concerns with regards to quality control, most notably through feedback received in developing its 2015-2016 Work Plan (which includes results of the post-implementation review of the clarified ISAs) and from its subsequent exploration and deliberations, both internally and externally, on the issues.
50. The Quality Control section of the ITC provides a comprehensive exploration of the quality control issues and possible actions to address them.
51. In general, we are in agreement with the actions the IAASB has outlined in response to the issues identified. We also re-emphasise the need for the IAASB to reinforce the concept of professional scepticism in ISQC 1 and ISA 220.
52. However, below we provide a more detailed response to the following areas:
- Quality management approach (QMA).
 - Engagement quality control review.
 - Firm networks.
 - Engagement partner roles and responsibilities.
 - Engagement partner performance and rewards system.
 - Transparency reporting.
 - Firm governance and audit quality indicators.

Quality Management Approach [ITC question QC1]

53. The ITC proposes the introduction of a Quality Management Approach (QMA) to be incorporated into ISQC 1 and, possibly, ISA 220.
54. Proposals around the QMA serve to address the quality control and ultimately the public interest issues. These proposals on the QMA follow landmark initiatives such as ISQC1 (including EQCR), the AQF, the IESBA Code and the layers of reforms and changes those

²⁵ ISQC 1, paragraph 11

²⁶ ISA 220, paragraph 6

initiatives brought about at the firm and engagement levels. These were global, multi-year initiatives, with implications on firm infrastructure, costs, training, fees, and, in many cases, auditor remuneration or the basis of investigations into misconduct.

55. Before embarking on a new initiative (such as the QMA) of a similar magnitude, it is vital to ask questions about the efficacy of the initiatives (mentioned above) that we have supported and introduced to date. We need to ask whether the evidence tell us that the standard-setting activities have been successful in addressing and improving audit quality - the ITC does not present such evidence, but does not explore that lack of data either.
56. In the absence of data about the efficacy of recent reforms (mentioned above), the ITC is proposing a very significant and wide-ranging initiative in the form of the QMA. This leaves us with a few questions:
 - Should the QMA be superimposed onto the quality ecosystem we already have?
 - Should some elements of the current system be repealed or strengthened?
 - Will another layer (in the form of the QMA) give the industry vastly better quality results it searches for?
 - Will the investment be worth it?
 - Are there competing investments which cost less but will deliver more, or vice versa, that need to be considered before the mechanics of the QMA are debated?
57. In the absence of a clear measurement on the impact over time of past standard-setting quality improvement measures, what insight can the IAASB share that will confirm the obvious value of the QMA over other proposals?
58. As such, although we do not have any specific objections to the proposal, the ITC does not provide sufficient detail for us to properly assess the impact of and the potential unintended consequences of the QMA on the revisions of ISQC 1 and ISA 220, firms, those charged with governance, audit regulators and ultimately the public interest.
59. **As a result, we provide the IAASB with our high-level views on the QMA as well as our views on where further clarity is required:**

Audit quality

- The most important question to be answered by the IAASB and by respondents to the ITC is whether they believe that the QMA will help to improve audit quality.
- At this stage, we cannot confidently forecast or conclude that the adoption of the QMA will help improve audit quality.
- Our biggest concern is that if the QMA is adopted, whether the IAASB will be able to retain the robust requirements in ISQC 1 and ISA 220 and possibly introduce conditional requirements while still improving the scalability and flexibility of these two standards. We also wish to understand clearly how the QMA could be developed and implemented so that it can serve the quality needs for non-audit services, in addition to audit services.

- The IAASB needs to carefully consider how it incorporates the QMA into ISQC 1 and ISA 220 so that audit quality is achieved by creating an environment which maximises the likelihood that quality audits are performed on a consistent basis.

Impact on other ISAs

- Even though the ITC notes that the IAASB will consider the implications of the QMA on ISA 220 and ISA 600, the IAASB, in considering the implications, needs to ensure consistency in managing audit quality at an engagement level and in a group audit context respectively.

Risk-based approach

- The ISAs require that the auditor follow a risk-based approach when performing an audit engagement.
- Businesses are usually managed using a risk-based approach. The concept of “risk management” is a sound principle and has been proven to work in business environments.
- However, auditors are not familiar with establishing objectives for audit quality, identifying and assessing quality risks and responding to those risks. Any error or omission at the quality risk assessment stage could lead to significant quality risks at the audit firm level or audit engagement level that are not properly addressed.
- In fact, even though ISQC 1 contains elements of a system of quality control set as requirements, auditors often request additional guidance on how to implement ISQC 1. The question that needs to be answered is: How will auditors respond to a flexible QMA?
- As a result, if the QMA is adopted, it will be necessary for ISQC 1 and ISA 220 to include:
 - Detailed requirements and application material on how audit firms and audit engagement teams should implement the QMA (establishment of quality objectives, performance of quality risk assessment, design and implementation of responses to quality risks, communication and monitoring) at audit firm and audit engagement level respectively.
 - Minimum (presumed) quality element requirements.
 - A requirement that if an audit firm or an audit engagement team concludes that one or more of the minimum (presumed) quality elements are not applicable in the circumstances of the audit firm or the audit engagement, the firm leadership or the engagement partner, respectively, shall include in the audit documentation the reasons for those conclusions.
 - Clear documentation requirements.
 - Guidance on the transitional arrangements between the extant ISQC 1 and ISA 220 requirements and the adoption of the QMA.

Business model

- It is argued that the adoption of the QMA will allow audit firms to incorporate quality management into their already developed business models.
- This being said, application material will need to be included in ISQC 1 to provide guidance to audit firms on:
 - How audit quality needs to be entrenched into the audit firm's business model.
 - How balance needs to be maintained between business and audit quality objectives.

Impact on external inspection process

- If the QMA is adopted and each audit firm develops and implements its own responses to quality risks, there will be an impact on external inspections.
- As the audit regulator in South Africa, we have the following concerns about the impact the QMA can have on external inspections:
 - External inspectors will be required to inspect a non-standardised system of quality control at each audit firm, which will be more time-consuming, more costly and require more resources.
 - Lack of consistency and comparability in the system of quality control established and implemented by audit firms.
 - Possible poor documentation of how the audit firm implements its QMA (establishment of quality objectives, performance of quality risk assessment, design and implementation of responses to quality risks, communication and monitoring).
- If the QMA is adopted, we believe that the additional requirements to be included in ISQC 1 and ISA 220 suggested above under the heading *Risk-Based Approach* will elevate some of our concerns.

Engagement Quality Control Review [ITC question QC6]

60. Since the Engagement Quality Control (EQC) review is one of the topics identified in the results of the post-implementation review of the clarified ISAs (refer to paragraphs 7-11 above), in the IFIAR's 2014 and 2015 survey results (refer to paragraphs 12-20 above) as well as in the IRBA Public Inspection Report 2014/2015 (refer to paragraphs 21-26 above), we support the IAASB's commitment to address the topic of an EQC review in order to find actions that it can take to enhance the effective performance of EQC reviews.
61. An effective EQC review is an important engagement-level quality control and may positively contribute to enhancing audit quality.
62. Our comments on the matters contained in the ITC on an EQC review are discussed below.

Scope

63. **The scope of EQC reviews should be expanded beyond audits of listed entities.**

64. **As such, we believe that:**

- The application material in ISQC 1 and ISA 220 concerning criteria for selecting those engagements subject to an EQC review should be elevated to requirements.
- The requirements and application material in ISQC 1 in relation to establishing criteria by the firm for selecting those engagements that require an EQC review should be strengthened.
- A new requirement should be added to ISQC 1 to focus the selection of engagements that require an EQC review to be based on identified risks from the engagements, such that engagements with higher audit risk or, if the QMA is adopted, those that pose a greater risk of negatively affecting the firm's ability to meet its quality objectives would be more likely to be selected.
- A new requirement should be added to ISQC 1 to require an EQC review of particular public interest entities (PIEs). Although it is difficult to develop a globally acceptable definition for PIEs, for South Africa we have developed a definition that is contained in the IRBA Code of Professional Conduct for Registered Auditors²⁷. This may assist in developing a globally acceptable definition.

65. This being said, we draw the IAASB's attention to the International Ethics Standards Board for Accountants' (IESBA) *Limited Re-exposure of Proposed Changes to the Code Addressing the Long Association of Personnel with an Audit Client* that includes proposed wording that may appear to mean that all audits of PIEs require an EQC review. This is contrary to the extant ISQC 1 and could be confusing.

66. **In addition, the scope of an EQC review should be expanded to require the EQC reviewer to review and challenge the application of professional scepticism by the engagement partner in respect of the judgemental and higher risk areas in the engagement.**

Roles and responsibilities of an EQC reviewer versus that of an engagement partner

67. **An appropriate distinction should be made between the roles and responsibilities of the EQC reviewer and the engagement partner. As such, we believe that the roles and responsibilities of the EQC reviewer in relation to the engagement partner should be clarified in ISQC 1 and ISA 220, and the engagement partner's role not be diluted.**

Need for a separate standard

68. The ITC sets out both the advantages and the disadvantages of developing a separate EQC review standard.

69. **We believe that the disadvantages outweigh the advantages and therefore believe that an EQC review should be retained in ISQC 1:**

- An EQC review forms part of a firm's system of quality control under the element of Engagement Performance and should not be separated from this.

²⁷ IRBA Code of Professional Conduct for Registered Auditors – [Final Amendments relating to Public Interest Entities](#), paragraphs 290.26 and 290.26(a)

- Undue prominence may be given to an EQC review in relation to other important factors in quality control, in particular the role of the engagement partner.

EQC review transparency in the auditor's report

- **We do not believe that providing transparency in the auditor's report by communicating whether an engagement was subject to an EQC review is an appropriate response to providing more prominence to an EQC review. The possible negative consequences, discussed in the ITC, outweigh the possible positive consequences.**

Cooling-off period

70. **ISQC 1 and ISA 220 should include a requirement for a "cooling-off" period for an EQC reviewer that has previously been involved in the engagement.**²⁸

Documentation

71. **Documentation requirements in ISA 220 should be strengthened to include:**
- The objective of, scope of and areas subject to the EQC review;
 - The timing and substance of the EQC review procedures performed; and
 - The significant discussions between the engagement partner and the EQC reviewer.

Firm Networks [ITC question QC4]

72. As the audit regulator in South Africa, we share the concerns of regulators and audit oversight bodies as set out in paragraph 110 of the ITC.
73. **We believe that it is necessary for the requirements in ISQC 1 to be strengthened in relation to inspections that have taken place across firm networks and any communications related thereto.**

Engagement Partner Roles and Responsibilities [ITC question QC2]

74. **Further clarity should be provided in ISA 220 by strengthening the requirements and clarifying what is meant by performance, direction, supervision and review by the engagement partner, including:**
- Providing more direction and specificity as to what audit documentation is required to be reviewed by the engagement partner and the nature of the related review procedures.
 - Placing more emphasis on the need to consider whether there are adequate resources for the engagement, including the suitability of the engagement team members' skills, competence and experience, the need for auditors' experts and the sufficiency of time available to perform the engagement before the reporting deadline.
 - Clarity that, as part of their responsibilities, engagement partners should be

²⁸ The International Ethics Standards Board for Accountants (IESBA) has indicated in paragraph 28 of its *Limited Re-exposure of Proposed Changes to the Code Addressing the Long Association of Personnel with an Audit Client* that the IAASB will consider this as part of its current revisions of ISQC 1

appropriately involved in all stages of the audit.

- The roles and responsibilities of the engagement partner for an audit in which the engagement partner is not located where the majority of the audit work is performed.
- The roles and responsibilities of the engagement partner for an audit in which evolving audit delivery models are used.

75. In addition, an appendix should be added to ISA 220 (and ISA 600 for group audits) indicating where the responsibilities of the engagement partner are articulated within the requirements and the application material in the ISAs.

Engagement Partner Performance and Rewards System [ITC question QC 8]

76. There is a strong link between audit quality and engagement partner performance and reward systems.
77. Although we do not believe that the IAASB can mandate the structure of an engagement partner's remuneration, we do believe that ISQC 1 can specifically require firms to have a policy in place that governs the remuneration of partners and other key staff with particular attention to individuals within the firm leadership that have a responsibility for audit quality. We also recommend that such a policy can include a provision for incentives for partners and other key staff to address audit quality.

Transparency Reporting [ITC question QC 10]

78. Transparency reporting by firms can contribute to improving audit quality by facilitating external scrutiny of a firm's quality control arrangements and enhancing their accountability to external stakeholders. Transparency reporting serves the public interest.
- 79. We believe that the IAASB has a role to play in the developing area of transparency reporting (having regard for experience in those jurisdictions where transparency reporting is already required).**
- 80. As part of the IAASB's considerations of the role it can play in this developing area, we believe that it should:**
- Carefully consider the evolving landscape of governance.
 - Perform or commission research to be undertaken on matters relating to transparency reporting, such as who are the users of transparency reports, what information is useful to users in transparency reports and what education needs are there to inform stakeholders about transparency reporting.
 - In identifying the elements/content of the transparency report, be mindful of what elements/content could be most valuable to the user of the transparency reports, bearing in mind the cost to accumulate such elements/content.
 - Perform a comparison of current practices and requirements relating to transparency reporting in order to understand the varying practices and requirements among jurisdictions with an aim to achieve global consistency in transparency reporting.
 - Determine what type of assurance is needed over a transparency report and who

should be the provider of that assurance.

81. **In dealing with transparency reporting, the IAASB should explore setting requirements for transparency reporting at a principle level, as other matters of principle are dealt with in ISQC 1. The local independent regulatory bodies can expand on these requirements to suit local legislation and the business environment.**

Firm Governance and Leadership Responsibilities for Quality [ITC question QC5]

82. Firm leadership has a vital role to play in promoting a culture that emphasises the importance of the role of audit in the public interest and therefore the importance of audit quality. Good firm governance arrangements enhances accountability to stakeholders.
83. The extant ISQC 1 requires the firm to establish policies and procedures that require the firm's chief executive officer (or equivalent) or the firm's managing board of partners (or equivalent) to assume ultimate responsibility for the firm's system of quality control²⁹. Furthermore, the extant ISQC 1 requires that the firm shall establish policies and procedures such that the person(s) assigned operational responsibility for the firm's system of quality control has sufficient and appropriate experience and ability, and the necessary authority to assume that responsibility³⁰.
84. We have found that in some instances, the operational responsibility for the firm's system of quality control is assigned to persons who do not have sufficient or appropriate experience or the necessary authority.
85. **As a result, we are supportive of the IAASB evaluating whether and, if so, how firm governance can be addressed in ISQC 1, for example by:**
- Requiring a firm to develop and implement its specific governance code.
 - Requiring accountability of firm leadership, at the appropriate level, for audit quality.
 - Requiring the firm to identify appropriate personnel, at the appropriate level, within firm leadership to be responsible for and accountable for independence matters.
 - Audit quality being clearly written into the firm's strategic objectives.
 - Introducing audit quality indicators (AQIs) that could provide an opportunity to enhance discussions between auditors and audit committees, and benefit audit committees in fulfilling their responsibilities relative to the oversight of an audit. We also believe that the introduction of AQIs will enable audit firms, audit regulators and audit standard-setters to better track and assess improvements in audit quality over time.
86. **This being said, each person within the firm should be responsible for audit quality and be held accountable for independence, not just the leadership of the firm.**
87. We believe that there would be a strong connection between firm governance and the QMA, should the QMA be adopted by the IAASB.

²⁹ ISQC 1, paragraph 18

³⁰ ISQC 1, paragraph 19

Group Audits

88. Since Group Audits is one of the topics identified in the results of the post-implementation review of the clarified ISAs (refer to paragraphs 7-11 above) we support the IAASB's commitment to address this in order to find actions that it can take to strengthen its standards in this regard.
89. The Group Audits section of the ITC provides a comprehensive exploration of the group audit issues and possible actions to address them.
90. **In general, we are in agreement with the actions the IAASB has outlined in response to the issues identified. We also re-emphasise the need for the IAASB to reinforce the concept of professional scepticism in ISA 600.**
91. **However, below we provide a more detailed response to the following areas:**
- ISA 600: Special considerations – Audit of group financial statements.
 - Communication between the group engagement team and component auditors.
 - Using the work of component auditors.
 - Component materiality.
 - New standard on the roles and responsibilities of component auditors

ISA 600: Special Considerations – Audit of Group Financial Statements [ITC question GA1(a)]

92. ISA 600 deals with special considerations that apply to group audits. As such, all other relevant ISAs also apply to a group audit engagement.
93. Although we agree that ISA 220 and other ISAs relevant to the planning and performance of a group audit are important, we do not believe that ISA 600 should only focus on these ISAs. **We believe that ISA 600 should make it clear that the auditor needs to apply all other relevant ISAs during a group audit engagement.**

Communication between the Group Engagement Team and Component Auditors [ITC question GA3]

94. Appropriate communication between the group engagement team and component auditors is vital to a group audit engagement.
95. **Strengthening the requirements and enhancing the related application material in ISA 600 regarding communication between group engagement teams and component auditors is needed.**
96. **We also believe that it is very important to add application material to ISA 600 in order to emphasise the importance of applying the requirement of ISA 230³¹ in documenting significant communication between the group engagement team and the component auditor (including two-way dialogue), and not just focusing on the inclusion of written communication in the audit documentation.**

³¹ ISA 230, Audit Documentation

Using the Work of Component Auditors [ITC question GA4]

97. The group engagement team uses the work of component auditors when obtaining audit evidence on which to base the group audit opinion.

Understanding the independence, competence and capabilities of component auditors

98. **We believe that it is necessary for the IAASB to strengthen the requirements and enhance the application material in ISA 600 for a more robust challenge by the group engagement team as to whether the component auditor possesses appropriate competence and capabilities.**

99. **In addition, we believe that the application material in ISA 600 should be enhanced to address clearly how group engagement teams can demonstrate the basis for their reliance on common network policies and procedures in determining the necessary levels of involvement in the work of component auditors.**

Group engagement team's involvement in the work of component auditors

100. **We believe that it is necessary for the IAASB to strengthen the requirements and enhance the application material to provide more clarity as to how the group engagement team determines the nature, timing and extent of the necessary involvement in the work of the component auditors.**

Component Materiality [ITC question GA6]

101. There is confusion and significant variation in practice relating to the auditor's understanding of component materiality and component performance materiality.

102. Although many of the issues related to component materiality are linked to ISA 320, we believe that the application of the concept of materiality, specifically in a group audit context, requires clarification.

103. While we understand that the work currently being undertaken by the International Accounting Standards Board (IASB) on materiality may give rise to further implications to the ISAs related to materiality, we do not believe that action from the IAASB in this regard should depend solely on the progress of the IASB's project on the issue.

104. **Since component materiality is one of the topics identified in the results of the post-implementation review of the clarified ISAs (refer to paragraph 8 above), we encourage the IAASB to move forward on a timely basis to address component materiality in ISA 600.**

New Standard on the Roles and Responsibilities of Component Auditors

105. The ITC mentions that the IAASB may find it necessary to develop a new standard for auditors who serve as component auditors, and this might contain specific requirements and application material directed at component auditors.

106. **We believe ISA 600 could be strengthened in this regard and that the IAASB could consider developing a new standard for component auditors at a later stage.**