



# PITCHER PARTNERS

ACCOUNTANTS • AUDITORS • ADVISORS

Level 19  
15 William Street  
Melbourne  
Victoria 3000

Postal Address:  
GPO Box 5193  
Melbourne Vic 3001  
Australia

Tel: 03 8610 5000  
Fax: 03 8610 5999

[www.pitcher.com.au](http://www.pitcher.com.au)  
[partners@pitcher.com.au](mailto:partners@pitcher.com.au)

Pitcher Partners is an association of independent firms  
Melbourne | Sydney | Perth | Adelaide | Brisbane

J BRAZZALE  
C J TATTERSON  
I D STEWART  
M W PRINGLE  
D A THOMSON  
M J LANGHAMMER  
S SCHONBERG  
M D NORTHEAST  
P A JOSE  
M J HARRISON  
T SAKELL  
G I NORISKIN  
B J BRITTEN  
K L BYRNE  
S D WHITCHURCH  
D J HONEY  
G J NIELSEN  
N R BULL  
A M KOKKINOS  
G A DEBONO  
R H SHRAPNEL

D B RANKIN  
A R FITZPATRICK  
R RIGONI  
G M RAMBALDI  
D A KNOWLES  
M C HAY  
V A MACDERMID  
S DAHN  
A R YEO  
P W TONER  
D R VASUDEVAN  
S D AZOOR HUGHES  
A T DAVIDSON  
C D WHATMAN  
A E CLERICI  
P MURONE  
A D STANLEY  
D C BYRNE  
P B BRAINE  
R I MCKIE  
F V RUSSO

Ref: DAH

15 May 2013

Mr James Gunn  
Technical Director  
International Auditing and Assurance Standards Board  
Via website: [www.ifac.org](http://www.ifac.org)

Dear Mr Gunn

## A FRAMEWORK FOR AUDIT QUALITY

Thank you for the opportunity to provide comment on this consultation paper.

Pitcher Partners is an association of independent firms operating from all major cities in Australia. Our clients come from a wide range of industries and include listed and non-listed disclosing entities, large private businesses, family groups, government entities, small to medium sized enterprises and not-for-profit entities. Consequently we provide audit and assurance services to a wide range of business structures and issue auditors' reports which are used by a broad range of stakeholders ranging from largely anonymous groups of investors in capital markets, to clearly identifiable and mainly closed groups of private investors and other stakeholders in the non-listed market.

Over the past decade Australian business has developed closer ties with businesses in the Asia-Pacific region. Consequently audit firms in the Pitcher Partners network in Australia also work with businesses in the Asia-Pacific region, and with our international network firms and other auditing practices in the region. Our comments on the IAASB's proposed framework draw on this broad depth of experience of audit in our region of the world.

The auditing profession has been under considerable scrutiny over the past 10-15 years. There are clear indications from both regulators and public opinion, as voiced by the media in a global arena that uncertainty exists regarding audit quality. In our view this extensive debate has increased the audit expectation gap and there is confusion amongst stakeholders as to the value added to businesses and the financial information that has been the subject of external audit. We concur with the IAASB's view that development of a framework will be in the public interest as it aims to contribute to improving audit quality. However, we consider that there are some **serious omissions** in the proposed Framework that need to be addressed before that objective will be achieved. Our concerns are explained further below under the IAASB's specific questions for comment.

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

We consider that there are two important constructs that should underlie the development of a Framework for Audit Quality. These are firstly, the construct that “an audit is an audit” and secondly, recognition of the fact that an entity is not “born” with an established governance structure and internal control practices. As drafted, the Framework does not appear to recognise that an *audit is shaped* to respond to the business environment in which it operates. This means that the factors driving audit quality must be directly linked to the environment in which the service is provided. **In our view the Framework reflects aspects of audit quality that are expected by regulators in established economies with mature markets, rather than the principles that apply to audit quality whenever audit services are delivered.**

An external audit is an important aspect of governance for all growing businesses, and particularly when a business reaches a size where an owner-manager can no longer exercise effective oversight across all business activities unless a management structure and internal controls are established. The application of numerous auditing standards by the external auditor informs management where “gaps” exist and prompt recommendations from the auditor as to how controls might be implemented (in particular consider ISA 250, ISA 260, ISA 265, ISA 315 and ISA 402). An external audit is concerned with *organisational behaviour* and has significant influence in shaping corporate culture if it is introduced at an appropriate stage in the life cycle of a business.

Consequently, while we concur with the nature of the factors that contribute to increasing the likelihood of quality audits being consistently performed (being inputs, outputs, interactions and contextual factors), we consider that the discussion provided is ‘one dimensional’ and cannot easily be ascribed to growing businesses, privately owned businesses in contrast to listed entities (often referred to as SMEs), or to those jurisdictions where the judicial system is not strongly established. In fact some comments display a distinct **lack of understanding** of the market dynamics **that drive audit quality** in these “other circumstances”.

It is our experience that the audit profession is thriving in jurisdictions which are experiencing relatively higher economic growth on a global basis, including many countries in the Asia-Pacific region, yet which may *not* exhibit all the factors purported to promote audit quality in this Framework. At a basic level this may indicate that there is limited or no correlation between audit quality and economic growth, or it may indicate that the discussion concerning audit quality is incomplete. In our view the discussion concerning audit quality is incomplete.

For example paragraph 263 refers to corporate governance in ‘many smaller entities’ and makes the bold statement that “Audit committees are rare and when they exist, members are often not independent or financially literate.” We would be interested to know whether this statement is based on empirical evidence, as it is contrary to our experience. Pitcher Partners has a significant client base across family business and we have found that when a private company *chooses* to incorporate a more formal governance structure, they will actively seek suitably qualified individuals that are able to bring the range of skills and expertise needed to govern the business. If there is no obligation to establish an audit committee, and no desire to see an improvement in governance, then no action is taken.

There would be an adverse cost-benefit ratio to implement a governance committee that has no meaning and adds no value.

In contrast, it is when an audit committee is required by regulation but the organisational behaviour is not advanced to a stage where the value of internal controls is properly understood, that we have observed the *form* of audit committees take precedence over *substance* in the governance of the business.

Pitcher Partners is currently working through its international network, Baker Tilly International (BTI), on a global research project on succession planning. We have observed that succession planning is a key issue for family businesses around the world; in the next decade an unprecedented number of owners will retire, leading to a massive shift in wealth, ownership, and control. The process of succession includes the introduction of formal governance structures in these businesses. The scale of impending succession and the way in which the ownership of these family businesses is transferred will impact not only the individual families involved, but the future prosperity of the economies in which they operate. Independent external audit has a significant role as new governance structures are established in these entities.

We have observed the introduction of formal governance structures into growing family businesses not only in Australia, but also in countries in the Asia-Pacific region. At the recent BTI Asia-Pacific Conference held in Mumbai we received reports on the ever increasing numbers of family businesses which are transitioning from control by family members, to a more formal internal control structure employing personnel with the experience and expertise to improve business performance.

The section on national cultures is also somewhat superficial and the auditor's role in respect of auditing related party transactions is not discussed. Related party transactions have an important role in *risk mitigation* in certain situations; for example consider:

- Entities which do not have the expertise, resources or appetite to pursue satisfactory contract execution in the courts (such as smaller entities in established, mature economies); or
- Entities operating in jurisdictions where contracts are unlikely to be upheld in the judicial system.

In situations where a contract has little value beyond documenting expected behaviours, the strength of personal and professional relationships is fundamental to the success of business. Thus related party transactions may in fact mitigate business risk; the auditor's role is important in ensuring the adequacy of systems to identify these transactions and to ensure there is sufficient, appropriate disclosure in the financial statements.

Further, in those jurisdictions where there are problems with bribery and corruption, transparency of disclosures is becoming fundamental to promoting better business practices. Again, the auditor has an important role in assessing the sufficiency of such disclosures with an understanding of how transparency contributes to audit quality.

If audit quality is to be considered on a global basis, with the understanding that "an audit is an audit" these aspects of audit quality are fundamental to the public interest at this current time. These are not aspects of audit quality that warrant deferral for future consideration but critical aspects that require in- depth consideration in the proposed Framework. While an audit firm may operate in a highly regulated jurisdiction with extensive audit oversight and disclosure, the drivers of audit quality in respect of the group audits that they carry out

across the globe need equal emphasis. Audit quality in any engagement will be undermined by its weakest link and therefore drivers of audit quality across all operating environments needs equal emphasis in the Framework.

**2. Does the Framework reflect the appropriate balance in the responsibility for audit quality between the auditor (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?**

An external audit of a business and its financial statements has significant influence over the organisational behaviour of that business. The strength of an external audit is that deficiencies in a client's internal control environment will be identified and reported to management, and the auditor will adopt alternative procedures in the audit to mitigate the risks arising through those deficiencies. In addition the auditor will report the impact of such deficiencies on the financial statements, including quantifying that impact where appropriate. This process enables stakeholders to understand the reliability of financial information produced by an organisation, while enabling the organisation to improve its governance and internal control environment over time. We consider that a quality audit *can be* delivered in such circumstances. In our view it is in the public interest that a quality audit must be delivered in such circumstances.

However, this aspect of how an auditor interacts with the business environment is only considered where optimal circumstances are present. An organisation is rarely "born" with excellent governance and internal control, but rather these attributes are embedded over time. We consider that where the external audit contributes to this process of continuous improvement, a quality audit is delivered together with significant value added. This discussion is entirely omitted in the proposed Framework.

Further, the suggestion that a quality audit can only be delivered when certain attributes are present in the client environment immediately restricts quality audits to certain segments of the marketplace. While management and those charged with governance have a part to play in assisting the delivery of a quality audit, it is a dangerous proposition to imply that quality audits are not possible in differing circumstances.

**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 its value to you?**

The auditing profession is already governed by ISQC 1, comprehensive auditing and ethical standards, and is subject to both regulatory and professional oversight of audit quality in many jurisdictions. It is unclear as to why audit firms would need another over-arching document which repeats requirements from other sources.

The Foreword refers to how the IAASB considers that the Framework will operate in the public interest and we had anticipated that this document would be useful to provide information and explanation about audit quality to the broader group of stakeholders. However, the content appears best suited for use by regulators to direct their attention to the various aspects of auditing which relate to the environment in which the auditor operates. We consider that the style of writing and the length of the document reduce its useability for the broader stakeholder group.

We would like to see a document written succinctly in “plain and simple language” rather than using audit-technical language, so that directors, investors, employees, customers, suppliers and other interested parties understand how audit quality is delivered. We consider that the Framework as drafted, has limited use beyond the auditing profession and its regulators. In particular, the Framework does not explain how an audit firm applying international standards for auditing in any client circumstance, is able to achieve audit quality pursuant to the view that “an audit is an audit”. We consider that the Framework as drafted contradicts the widely held view that “an audit is an audit” and promotes a proposition that “low quality” audits are inevitable in certain circumstances.

Consequently we consider that this Framework will provide little insight into audit quality for our clients who operate in emerging economies across the globe and therefore would be of limited use to our firms.

**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’?**

We generally concur with the suggested “Areas to Explore”.

In addition, we consider that regulatory oversight is reaching a level where it may be inhibiting audit quality by the use of regulatory checklists of audit quality, which drive mechanical responses from auditors. It would be appropriate for the IAASB to consider this aspect of a “mechanical approach to auditing” and how an adverse impact on audit quality can be mitigated.

We also have concerns about the informational value of auditor’s reports and the proposals to enhance the nature and extent of information provided. We consider that more information is not always *better* information; there is also potential for the blurring of responsibilities between those charged with governance and the auditor in respect of disclosures to stakeholders. Where those charged with governance do not have explicit responsibility to assess their governance practices and internal control environment, it is questionable as to whether an auditor should be reporting publicly on such matters, beyond their impact on the financial statements. We are concerned that this aspect of “audit quality” is not well-defined and requires further debate in respect of governance responsibilities before it is considered to contribute to audit quality.

Please do not hesitate to contact us if there are matters arising from this submission which you would like to discuss further. In particular we would be willing to contribute further to this project in respect of the drivers of audit quality when audit services are provided to growing businesses. We consider that the audit process enables growing businesses to examine their governance and internal controls, and therefore is fundamentally in the public interest. The impact of audit on organisational behaviour is an essential element of audit quality, as it drives the next wave of economic prosperity in all regions of the globe.

Yours sincerely



S D AZOOR HUGHES  
Partner