

## A Framework for Audit Quality

A Consultation Paper issued by the International Auditing and Assurance Standards Board

Comments from ACCA  
15 May 2013

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Further information about ACCA's comments may be obtained from:

**David York**  
Head of Auditing Practice, ACCA  
Email: [david.york@accaglobal.com](mailto:david.york@accaglobal.com)

ACCA welcomes the opportunity to comment on *A Framework for Audit Quality* issued by the International Auditing and Assurance Standards Board (IAASB). The ACCA Global Forum for Audit and Assurance<sup>1</sup> has considered the Consultation Paper and the views of its members are represented in the following.

Our comments draw upon our world-wide membership, which includes significant numbers of members working in all aspects of the financial reporting supply chain in a wide range of industries, the public sector and small and medium-sized entities.

In addition, we have had regard to our outreach events concerning the value of audit. These aim to bring together preparers, auditors, investors and regulators. During April, prompted by the IAASB Consultation Paper, aspects of audit quality and other topical issues, such as audit competition, were discussed at events in Barbados, Jamaica, New York and Trinidad.

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## GENERAL COMMENTS

ACCA is pleased to participate in the growing debate on audit quality by responding to the Consultation Paper.

Audit plays a very important role in the economy and society. It increases user confidence in the credibility of financial reporting and facilitates the efficient allocation and use of capital. The benefits of audit are also strongly felt in the public and not-for-profit sectors. ACCA believes that a holistic approach, involving coordinated action, is increasingly necessary to ensure that the corporate reporting supply chain delivers value globally. Users need to be provided with information that enables them to achieve a balanced and long-term understanding of the financial health of an entity. Standard setters and regulators need to work towards a framework that allows this goal to be achieved.

It is implicit in the above that audit must be of a consistently high quality. ACCA therefore supports the actions of those in the corporate reporting supply chain and wider who enhance audit quality. We are committed to playing our own part as an accountancy body in the education, qualification, support and regulation of audit professionals and firms and in furthering the profession's contribution to society in the wider sense.

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<sup>1</sup> <http://www.accaglobal.com/en/research-insights/global-forums/audit-assurance.html>

The central difficulty facing the IAASB on this issue is that there are marked differences in the way key stakeholder groups perceive the quality of audit work. A recent study concludes: 'Audit quality is much debated but little understood. Despite more than two decades of research, there remains little consensus about how to define, let alone measure, audit quality.'<sup>2</sup> It is significant that the draft does not try to address this situation head-on by offering a clear definition of what is involved in the term 'audit quality'. As long as there is a lack of a shared understanding of the term, this will impose constraints on the Framework and its use.

That being said, we believe that, properly used, the Framework will help to address this problematic situation and lead to an increasingly shared understanding of audit quality which will facilitate positive action. Ideally the Framework would be used objectively, for example to provide a basis to set standards, underpin education of auditors, allow comparative evaluation of audit firm quality and inform legislators about the likely effect of changes in the law. Instead, because of the qualitative nature of audit quality, the Framework can only seek to inform subjective judgements. In our answers to the specific questions in the Consultation Paper we suggest, nevertheless, that the Framework would be more useful to stakeholders if it provided informed views on the relative importance of the contributory factors to audit quality and on the effects of the ways in which they interact with each other.

On specific elements of the draft Framework, we believe that more attention needs to be given to the specific issues of innovation and sustainability, and how they contribute to the achievement of audit quality.

Although the Consultation Paper lays claim to modest objectives that concentrate on the Framework's communication role, the success of the Framework will ultimately be judged by its contribution to the continual improvement of audit quality to meet the needs of society. We invite the IAASB to put in place some objectives that allow it to assess how the Framework is helping in that regard.

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<sup>2</sup> So commences *Audit Quality: Insights From the Academic Literature* Knechel, W. Robert, Krishnan, Gopal V., Pevzner, Mikhail, Shefchik, Lori B. and Velury, Uma, *Audit Quality: Insights from the Academic Literature* (October 31, 2012). *Auditing: A Journal of Practice & Theory*, Forthcoming. Available at SSRN: <http://ssrn.com/abstract=2040754> )

We recognise that in order to engage key stakeholder groups, the Framework concentrates on audit, rather than the full range of engagements to which IAASB standards apply, and on larger entities where there are, for example audit committees and institutional investors. Although a section is devoted to audits of smaller entities, the sector is poorly served by the Framework. We suggest that this be recognised in the positioning of the Framework so that room is left for an IAASB or other IFAC document dealing with quality in relation to the range of engagements that may be carried out on smaller entities.

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## SPECIFIC COMMENTS

In this section of our response we answer the questions set out in the Consultation Paper.

### THE FRAMEWORK

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

#### **Factors included in the Framework**

The Framework appears to us to include most of the areas that are likely to be relevant to audit quality. Having said that, however, we believe that it is important to set the boundaries for the factors to be considered by reference to their proximity to, and impact on, audit quality. We see little point in analysing factors that have no material effect on audit quality. The Framework has addressed this to some extent as the analysis (Appendix 2) demonstrates that factors are included that are perceived as 'important' or 'less important' by the groups surveyed.

Some factors that could be regarded as having a large impact on audit quality are not dealt with in the Framework because they are treated as a given, for example a stable and consistent supply of electricity that facilitates the use of modern technology and communications. We agree with this approach but would have appreciated (perhaps in a supporting document) some discussion of such factors, because their existence cannot be taken for granted in all jurisdictions.

There are, of course, fundamental problems in attempting to define any boundary conditions that could determine the inclusion or exclusion of factors. Firstly, quality is not capable of precise definition and, secondly, it is not capable of quantitative measurement. The Framework includes factors that are considered important in two dimensions: technical and service (as explained in the *Detailed discussion of survey results*). Notwithstanding the wording of paragraph 18 of the Framework ('A quality audit is likely to be achieved when . . . '), service elements are included. While there is some argument that there is no such thing as a purely service matter, the Framework does not express a view on the primacy of the components. This we believe adds to the difficulty of defining and measuring audit quality (insofar as that is possible) and to the difficulty of using the Framework to communicate about audit quality.

We would have preferred the Framework to take a clear line on quality by adopting the perspective of shareholders (and increasingly others who demand accountability from an entity) so as to determine quality by reference to what delivers the best value to such stakeholders. By this we do not mean that the Framework should focus exclusively on user perceptions of quality as, while these are important, they are only indirectly associated with what actually drives audit quality. For users, it is the technical component that ultimately delivers the value of audit – reflecting the value to them of the information and the added confidence in it that audit provides.

Users may not actually form a view on the value of audit, but their perception of what is necessary to deliver adequate value is an indirect measure. The mechanisms for transmitting that valuation back to the audit are complex and include those where society can be thought of as the instigator, for example through legislation or the bringing into being of standard setters and regulators. This itself responds to user demands. Price – whether the fee for an audit or the cost of audit failure – is a key recognition of the value of audit. We believe it is possible to talk in terms of the concept of the overall value of audit to a society, though that does not mean that every audit has equal value; individual circumstances differ. In general the price of audit is not set at individual entity level, other than to accommodate certain entity-specific factors (such as the difficulty of audit of a particular industry). Instead, it reflects judgements made at a degree of aggregation, such as on the listing status of a company or even the availability of exemption from statutory audit.

The audit needs to be of sufficient quality to deliver the value determined as above. But what are the constituents of the audit that determine value? Auditors employ the concepts of materiality and reasonable assurance. These are themselves complex concepts but essentially an audit opinion conveys assurance to users at a level of accuracy of the underlying information (whether there are any material misstatements) and a level of assurance (how confident the auditor is in the opinion). In general these concepts do not vary significantly between audits: the law and technical standards accept that the accuracy of the audit opinion may be about the same as the accuracy of the information audited and the confidence is high, albeit nowhere near the (say) 99.99999% chance of surviving a single jet flight.

In practice, at a particular time, in a particular place, the necessary level of audit quality is also fixed. It is achieved by conformity to law, regulation and standards determined by society (as part of the mechanism of communicating value back to the auditor).

Stakeholders can also misread the signals of value. This imprecision can result in 'expectations gaps' where stakeholders interpret the value of audit differently and their actions fail to coordinate with those of other stakeholders. In so subjective a domain, the effects of actions relevant to audit quality are themselves difficult to assess. Thus, one area where the Framework can assist is through promoting a common understanding.

### **Limitations on analysis of individual factors**

Although the framework analyses the factors into categories and levels, and in some cases the stakeholders that are the most relevant, it does not attempt to analyse for each factor:

- the degree of its impact on audit quality
- its interactions with other factors
- the timespan over which a factor is relevant
- the rate of change of the factor

Indeed, other than explain what a factor is, the Framework often does not explain how a change in the factor would affect audit quality.

There are some notable exceptions to this. For example in paragraph 41, the involvement of senior personnel over a number of years may be a threat to independence but that should be balanced against the potential benefits to audit quality that arise from the senior personnel's detailed knowledge of the entity and its business. Paragraph 172 discusses the publishing of individual audit firm inspection reports and notes that auditors may adopt a more defensive approach to inspection findings which may reduce the appetite to welcome and respond constructively to criticism.

We would like to see the Framework conduct more analysis in relation to the most significant factors, as that would assist readers in making choices between alternative policies and actions. For example, some will see independence as being so crucial to audit quality that regular rotation of audit firms needs to take place, whereas others regard client knowledge possessed by a long-serving auditor as being a more important contributor to audit quality.

Some factors have a natural rate of change, while change in others can be managed; for example, a standard setter may accelerate or delay the updating of standards. Auditing has a natural annual cycle matching the financial reporting period and that cycle is characterised by peak activity for audit firms relating to the bunching of year ends at a calendar or fiscal year end. The fact that so much audit work is concentrated in the same period of the year is likely to impose strains on the resources of even the largest audit firm and could thus in itself be a factor in the achievement of audit quality. The Framework does not recognise this issue, nor does it offer any suggestions to companies, auditors, regulators and legislators about how they might in their different ways seek to minimise the potential adverse effect of such concentration.

In what appears to us to be an otherwise comprehensive approach to the factors relevant to audit quality, we were disappointed that the Framework did not emphasise innovation or sustainability, as elaborated on below.

### **Innovation**

The Framework refers to the evolution of the audit firm's audit methodology and tools to respond to changes in professional standards and findings of internal reviews and regulatory inspections. The Framework stops at that, however, and does not explore the wider aspects of innovation and its impediments; the removal of which could do much to increase audit quality. In ACCA's view, promotion of innovation should be at the forefront of actions for quality.

In a rapidly changing business environment, the ability of the auditor to be flexible and innovative may be an extremely important contributor to audit quality. Similarly, legislators and standard setters must strive to overcome the inertia imposed by resource constraints and the need to achieve a degree of consensus and transparency in due process.

ACCA outreach, via roundtables held across the world, has shown that fear of litigation has had a detrimental effect on innovation in audit. Although fear of litigation can encourage auditors to carry out a robust audit, it can also drive them to be defensive and to resist improvements in process, scope and transparency.

### **Sustainability**

We are disappointed that the Framework has not made any connection between audit quality and the maintenance of a sustainable environment, economy and society. We believe that it is important to judge audit quality in relation to all the dimensions of business activity.



IAASB should take into account, in framing the audit environment, the increasing focus of corporate reporting on non-financial reporting, including integrated reporting, the purpose behind this trend being to provide users with a more rounded impression of a company's performance and prospects than is provided by traditional financial reporting. A recent ACCA research report concluded that: 'Business all over the world, including firms of auditors, are seeing the link between sustainability and performance, . . . the exercise of measuring and reporting sustainability activities to stakeholders with clear, accurate data is increasingly relevant and quickly becoming a priority.'<sup>3</sup>

**Question 2 Does the Framework reflect the appropriate balance of responsibilities 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?**

The Framework categorises factors relevant to audit quality. That categorisation includes attribution to those responsible for, or able to influence, a factor, but we do not believe that form of presentation allows conclusions to be drawn about the balance of responsibilities. Moreover, the Framework does not attempt to assess the relative importance of the factors it explores, which would be a necessary step before judging the degree of responsibility of a stakeholder.

The Framework correctly asserts that the primary responsibility for performing quality audits rests with auditors. A key message that the Framework successfully communicates is that other stakeholders have a role to play.

Ultimately it is the shareholders (and increasingly others who demand accountability from an entity) that determine the value of audit – reflecting the value to them of the information they see and the added confidence in it that audit provides. Other than acknowledging the primacy of the shareholder, we see no particular merit in trying to assign places in a hierarchy of responsibility: it is only important that the Framework acknowledges the existence and role of the various stakeholders that influence audit quality; this it does.

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<sup>3</sup> From: <http://www.accaglobal.com/en/research-insights/environmental-accountability/KPMG-Sustainability.html>

## USE OF 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 its value to you?

### **Intended use – as the global body for professional accountants**

Over the last five years, as part of our wider exploration of public value<sup>4</sup>, ACCA has examined, through research, events and publications, the value of audit to society<sup>5</sup>. Such representation and dialogue with other stakeholders in audit quality is increasingly necessary to advance the interests of the profession and serve the public interest.

The Framework gives preparers, auditors, shareholders, regulators and others a shared understanding of audit quality. As a public document with global relevance, we will use it to facilitate communication with those with whom we engage.

The Framework will also inform the development of our professional standards, and our inspection and monitoring of auditors. In line with the Framework's aim of raising awareness of the key elements of audit quality, we certainly envisage including it in our qualification.

The existing standards on quality control, ISA 220 *Quality Control for an Audit of Financial Statements* and ISQC 1 *Quality Control for Firms That Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*, are already included in our Advanced Audit and Assurance syllabus. The Framework will help students to understand audit quality, its elements and contributing factors, in a broader context. Even before it is finalised, we will consider, therefore, adding the Framework to our Advanced Audit and Assurance paper as a 'current issue and development'.

Once the Framework is finalised, we will also consider bringing it into our Fundamentals level audit and assurance syllabus, where the overview of the contributing factors to audit quality could be linked to a range of syllabus areas and encourage awareness of the importance of audit quality at an early point in students' studies.

<sup>4</sup> See <http://www.accaglobal.co.uk/en/discover/public-value.html> and, for a recent study, see <http://www.accaglobal.com/content/dam/acca/global/PDF-technical/human-capital/tech-tp-ctvg.pdf>

<sup>5</sup> 'Audit and Society' is an ACCA Research and Insights theme <http://www.accaglobal.com/en/research-insights/audit-society.html>

**Intended use – in general**

The ACCA Global Forum for Audit and Assurance was firmly of the view that the concept of a framework for audit quality would be understood in all the jurisdictions represented on it.

The members of the Forum believed that the Framework will be used widely, by: inspection bodies, auditors, standard setters, those charged with governance, financial statement users, educators, researchers/academics, legislators, management and others (such as in connection with litigation).

While the Framework could improve the understanding of audit quality, it is not of itself suitable for direct use to assess audit firms in a tendering process, or the quality of a firm's work in an inspection, nor should it be used for such purposes.

**Changes to form or content**

In our answer to question 1, we discussed some ways in which the analysis could be made more informative and suggested that innovation and sustainability were factors that should be included.

In the context of the ACCA qualification, we do not think that any changes need be made to the form and content of the Framework to enable us to use it. The structure of the Framework is very helpful from the point of view of designing syllabus content, as the elements and attributes are clearly categorised and organised into levels.

For general use of the Framework, we would like to see:

- certainty as to the status that the IAASB proposes it to have
- segregation of aspects better dealt with elsewhere (eg areas to explore)
- a principles-based treatment and an overall reduction in length (eg through reviewing the structure to remove duplication in the tables)

**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?**

As we explained in our general comments, the ultimate objective of the Framework will be furthered if stakeholders act to improve audit quality. The material on Areas to Explore provides a call to action for some key stakeholders but such a call does not readily fit within a document that principally explains the factors that contribute to improving audit quality. We suggest that a different document (or process) should be used to monitor, report, re-evaluate and originate actions to further enhance audit quality.

Given the global reach of ACCA as an accountancy body, we expect to focus on the following areas as listed in Appendix 1 to the Framework. In some cases we may take direct action (see for example our answer to question 3 concerning improvements to education), in others we would seek to influence in a positive fashion those better placed to achieve improvements:

- establishing global guidance against which audit firms can assess their governance arrangements
- establishing a common understanding of capabilities, and how they are demonstrated and assessed, as they relate to audit quality for use by audit firms when recruiting, evaluating, promoting and remunerating partners and staff
- considering whether audit inspection activities can do more to improve audit quality and to make audit quality more transparent to users
- considering 'root causes' and best practices by regulators, audit firms, and the wider audit profession in order to learn from past audit deficiencies and to identify and address systemic issues
- increasing the informational value of auditor's reports and improving perceptions of the value of the audit
- striving for greater international harmonization in the role of audit committees with regard to the evaluation of the quality of the external audit

In support of the suggestions we make in our answer to question 1 above, we would also suggest exploration of:

- drivers and impediments of innovation in auditing
- wider aspects of quality, including sustainability and diversity