



May 16, 2016

Mr. Arnold Schilder,
Chairman
International Audit and Assurance Standards Board
529 Fifth Avenue
New York 10017

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

Dear Arnold,

The International Federation of Accountants® (IFAC®) Professional Accountants in Business (PAIB) Committee values the opportunity to comment on the International Audit and Assurance Standards Board (IAASB)'s [Invitation to Comment, Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits](#) (ITC). This response reflects the views of the PAIB Committee and, in particular, a preparer's perspective on enhancing audit quality. We use the term preparer to include those charged with governance and/or management and finance leaders in their finance and accounting functions.

At its recent meetings, the PAIB Committee discussed enhancing audit quality, in particular the preparer's role. We recognize that since the financial crisis, serious questions are being asked of the audit profession, which is to be expected given the public interest dimension of audit quality. However, in making improvements to audit and assurance related standards and regulations, the IAASB should recognize that many of the issues that drove organizational failure or wrongdoing were not necessarily due to poor audit quality. Instead, the failures and resulting impacts on financial statements were primarily the responsibility of those charged with governance, and executive management.

Consequently, we recommend that further development of audit and assurance related regulations and standards prioritize driving the right behavior among auditors, in particular their relationship and engagement with the organizations they audit (referred to as the audit client in the ITC). The basis for changing standards should be the result of an empirical vetting of actual audit failures. Changes should not be made to the audit because of governance and management failures. Doing so is, at best, simply an effort to appear to take action on a particular matter. At worst, it is a misdirected effort to influence governance and management practices indirectly through audit standards rather than directly through other means.



Our response focuses on providing general business perspectives on audit quality and answers a few questions in which we believe a preparer perspective would be most useful. It also reflects the discussions and points raised by PAIB Committee members. We have not focused on specific suggestions for potential standard-setting activities related to the three topic areas. If you require additional clarification, please do not hesitate to contact me.

Yours sincerely,

A handwritten signature in black ink that reads "Charles Tilley". The signature is written in a cursive style with a long, sweeping tail on the letter "y".

Charles Tilley
Chair, IFAC Professional Accountants in Business Committee



Overall Comments on Enhancing Audit Quality

Recognizing that Enhancing Audit Quality is a Shared Responsibility

- Responsibility for a quality audit cannot be the sole responsibility of the auditor. In our view, a key issue is raising awareness of the need for high-quality audits as a critical element in enhancing trust in business and financial markets to combat the "commoditization" of audit, which most visibly involves organizations, often under pressure from investors, trying to drive down audit costs. The profession's communication on audit quality need to clearly highlight the requirements of high-quality audits, and what is needed from both auditors and the organizations being audited to enhance professionalism and audit quality.
- Pressure on audit fees and the implications for how audits are carried out merits further investigation. There are interesting developments, for example, investors encouraging audit tenders on a "fee blind" basis, so that choices can be made in the first instance on audit quality criteria.

Audit Expectation Gap Continues

- The auditing expectation gap continues to be a challenge in the market. There continues to be a difference between what the public and other financial statement users perceive auditors' responsibilities to be and what auditors believe their responsibilities entail. For example, research in some jurisdictions shows that investors have higher expectations for the audit than what the auditor's role actually is. Therefore, in the context of audit quality, communicating the limits of what a financial statement audit can achieve and, more importantly, does not achieve is extremely important. While this is covered in audit opinions, many stakeholders do not understand, or perhaps do not agree with, an audit's limits. Greater focus might be needed by the profession to close this expectation gap if we are to realistically achieve higher levels of confidence in what audits achieve, and also lead to a more constructive discussion of change.
- There is evidence to show that audit committees and their chairs generally value the external audit for the assurance it provides on the reliability of the financial statements prepared by management. Research also indicates that CFOs typically value the external audit on various other grounds, including the incentive it provides to encourage their company and its subsidiaries to build and maintain robust financial reporting processes. Finally, the suggestions auditors can provide on complex accounting matters contributes significantly to management in organizations.

Focus on Process Rather than Outcomes

- In our view, audits are increasingly focused on procedural issues driven at least in part by an over-focus on quality control procedures rather than on those significant matters that would enable a high-quality audit. Further increases in regulation or changes to standards might have the unintended effect of decreasing audit quality rather than improving it. Over-regulation, and standards focused on process and procedures rather than outcomes, can make auditors more compliance focused—a situation that also confronts audit committees in many jurisdictions.



Reducing Inefficiency and Duplication

- A number of matters appear to drive inefficient practices and duplication, rather than enhancing audit quality. For example, greater alignment between auditing standards and the requirements on organizations for implementing internal control systems would help avoid auditors requiring organizations to document procedures at greater levels of detail. In practice, the experience can be that auditors are forcing their documentation requirements on management, which can lead to additional and unnecessary cost. This can be particularly true where auditors request management documentation on matters that are not part of the company's internal control framework, or subject to reporting requirements. In addition, poor coordination between auditor, audit committee, and internal auditor often leads to duplication of effort, increased cost, and poor effectiveness.

Audit Quality Depends on Understanding of the Business

- Understanding the audit client's business model(s) and its external environment is fundamental to applying professional judgment and skepticism. The committee highlighted the challenge of communicating and working effectively with audit teams where the engagement team lacked the sustained involvement of an experienced engagement partner or manager. Coordination of an audit team is particularly important in situations where the engagement involves a range of experts covering specialist areas, such as valuation, financial instruments, and tax, who do not all necessarily work in the same geographic location.

Greater Use of Technology and Analytics Should Improve Audit Quality

- Technology and data analytics have the potential to greatly improve audit quality but brings issues that need further consideration, for example, the impact on professional skepticism.

The Effect of the New Arrangements for the Audit Report Needs To Be Taken into Account

- Communication between the audit committee and management is often cited as challenging to audit quality. Although the enhanced audit report and introduction of key audit matters (KAM) is designed primarily to share valuable insights about the audit to investors, it will improve communications between the auditor and those charged with governance given that KAM are intended to improve user transparency of audit content and not just output. Their discussion on the matters that are the most likely candidates for KAM should result in ISA 260 being better implemented. However, there has not been sufficient time to understand the impact of the new arrangements on the drivers of audit quality. Within its standards, we encourage the IAASB to reinforce the effective communication and interaction with audit committees and management.

Group Audits

- Although the PAIB Committee has not fully considered the proposed actions that will be explored in relation to group audits and ISA 600, we are of the view that enhancing audit quality through networks is important. Given many companies and audits are global, there is a need for common policies, procedures, and monitoring across networks. Consequently, group engagement teams need to demonstrate the basis for their reliance on common policies and procedures in determining whether to use the work of component auditors.



Questions Addressed By the PAIB Committee

Question G2: *To assist with the development of future work plans, are there other actions (not specific to the topics of professional skepticism, quality control, and group audits) that you believe should be taken into account? If yes, what are they and how should they be prioritized?*

- The IAASB should recognize that audit quality, although the primary responsibility of the auditor, cannot be their sole responsibility. Achieving a quality audit is, in reality, a shared responsibility with those charged with governance and executive management. The auditor and the audit engagement partner have the responsibility in accordance with International Standards on Auditing (ISAs). The IAASB's *Framework for Audit Quality* is important in highlighting the many factors and interactions involved that determine audit quality—and standards can only play one part.
- Audit committees, together with management and the independent auditor, are one of the three pillars that support appropriate financial disclosure. An effective audit committee is first among equals in this process. However, the presence of effective audit committees is limited to only some jurisdictions around the world, and often limited to organizations of a certain type and size. Audit committee transparency is also a key part of understanding audit committee effectiveness. Insightful reporting by audit committees on their work will enable investors to see what the audit committee has done in relation to audit quality and how they execute their audit oversight role. Enhanced transparency of the oversight role of audit committees can provide investors the information they need to assess the independence and effectiveness of the audit committee and the external auditor.
- Preparers often suggest that important issues in the eyes of the auditor are often not communicated in a timely manner to the audit committee and management. This may improve with the introduction of the enhanced audit report and key audit matters (KAM). This is a major change. To enable appropriate evaluation of this change, as well as any subsequent change for audit quality, there first needs to be sufficient time to understand its impact on the drivers of audit quality, particularly relating to communication between the auditor and entity, before additional changes are implemented in this regard. Early experience from the UK suggests that KAM can drive alignment of focus for the auditor and the organization being audited.
- Poor coordination between auditor, audit committee, and internal auditor often leads to duplication of effort, increased cost, and poor effectiveness. Several things can be done to improve this situation including clarifying ISA 610, *Using the Work of an Internal Auditor*. The standard currently doesn't permit the internal auditor to be considered a member of audit team, but is unclear how much of their work can be used by the external auditor. Clarifying the respective roles and responsibilities of each group will help determine the extent to which the external auditor can use the work of the internal auditor and thus impact audit cost without sacrificing audit quality.
- Another important area highlighted in the ITC is use of technology and data analytics, which is already a current IAASB project. Deployed properly, these can improve both audit quality and efficiency. However, while some accountancy firms use these systems, many are behind the curve. The impact of technology is also unclear in some areas, for example in terms of the potential effect on how professional skepticism is applied in audits.



Question PS1: *Is your interpretation of the concept of professional skepticism consistent with how it is defined and referred to in the ISAs? If not, how could the concept be better described?*

- We agree that it is important to explore what can be done to re-emphasize the importance of professional skepticism in audits of financial statements. The 2012 IAASB staff Q&A on professional skepticism provides a good basis for providing additional thinking and clarification of the ISAs and starts to provide additional information outside of standards that is more accessible and useful.
- The ISAs do not address at what point the application of professional skepticism becomes unprofessional or unacceptable. One way of looking at the application of professional skepticism is as a continuum between complete distrust and complete trust. In different situations and scenarios, it is necessary for the auditor to find the right spot along that continuum.
- It has been suggested that the level of professional skepticism applied could be distinguished on the basis of the source of client information. It would seem reasonable to also include a discussion of different levels of skepticism that can be applied, for example, when the auditor is dealing with a professional accountant in business who adheres to the same code of ethics as the auditor (such as the *Code of Ethics for Professional Accountants*). We recognize that the Public Interest Oversight Board noted in its [discussions](#) that “professional skepticism, as a state of the mind and attitude, should govern the performance of auditors, and inspire the attitude of other accountants, e.g., accountants in business. When accountants (practitioners, non-practitioners, accountants in business) do not display proper professional skepticism it is recognized as a barrier to effective performance.” However, this perspective does not recognize that it is necessary to distinguish between those accountants in business who are members of the profession and adhere to common ethical standards and those accountants in business who do not follow a specific code of ethics and/or are not members of an IFAC member organization.
- The concept of professional skepticism is difficult to apply consistently given it is behavioral and based on a state of mind. Therefore, it is difficult to ascertain when it has been appropriately applied or not, and how much is enough. ISA 230, *Audit Documentation*, takes an effective approach by requiring the auditor to prepare sufficient audit documentation to enable an experienced auditor, having no previous connection with the audit, to understand the critical decisions made regarding key matters arising during the audit, the conclusions reached thereon, and significant judgments made in reaching those conclusions. Although an auditor’s documentation cannot fully capture how the auditor applied professional skepticism throughout the audit, it is important in demonstrating significant judgments. Ultimately, the ability to express professional skepticism and judgment will be determined by the education, training, and experience of auditors. As recognized in the ITC, this has implications for the International Education Standards and the education and training provided by professional accountancy organizations.
- Providing guidance rather than additional, or amended, ISAs might be the best mechanism to help auditors apply professional skepticism. Guidance could include examples, scenarios, and/or case studies to bring the definition to life and help auditors apply it.



- In considering next steps, the objective of standard setting should be kept in mind. While regulators might seek standards that allow them to assess compliance with ISAs, audit professionals might require and seek practical guidance that cannot be easily incorporated into the standards. Encouraging healthy professional skepticism requires moving beyond a box-ticking approach, and might not be fulfilled by adding more to the ISAs.

Question PS2: What do you believe are the drivers for, and impediments to, the appropriate application of professional skepticism? What role should we take to enhance those drivers and address those impediments? How should we prioritize the areas discussed in paragraph 37?

Key drivers of professional skepticism include:

- Culture of the accountancy firm. As part of their efforts to enhance professional skepticism, accountancy firms should evaluate how rewards can influence certain behaviors, and how they can be used to encourage greater transparency and collaboration with the organization being audited. For example, junior audit staff can be positively rewarded for identifying errors that lead to findings. Equal attention and reward should also be given in situations where audit staff validate a management assertion. Rewards may be broader than compensation, which is the focus of paragraph 160 in the ITC.
- How professional skepticism is encouraged and facilitated in ISAs, quality control requirements, and in additional guidance provided by the IAASB.
- Internal accountancy firm quality reviews.
- The confidence and professional skills and competence of individual practitioners, which is linked to professional licensing requirements, and the training received. Some jurisdictions report a narrow pipeline of talent into the profession, which may hinder the diversity of skills and perspectives in the profession.
- An open dialogue with audit clients involving those charged with governance and management, supported by professional accountants in business, allows for a healthy exchange between the auditor and organization on the key judgements of the auditor.

Impediments include:

- Budget and time pressures linked to tight reporting deadlines, and heavy workloads.
- Performance management and systems of rewards and recognition in accountancy firms, or from regulators, that do not drive the right behaviors and are not conducive to the application of professional skepticism.
- An over-focus on meeting the audit client's budget and engagement requirements rather than competing on audit quality. Driven by the market, accountancy firms typically compete on price, which is more tangible than demonstrating audit quality. Additional requirements related to audit quality could result in greater cost, which would need to be clearly communicated.



- Understanding the audit client’s business model(s) and its environment is fundamental to applying judgment, particularly understanding linkages between operational and financial reporting risk. A lack of experience of an audit client and its environment can significantly impair the level of professional skepticism and judgment applied by auditors. Without sufficient awareness and understanding, it is difficult for an auditor to determine what answers and results are unusual, and which they should be challenging. Given that in-house finance and accounting teams are the main point of contact for auditors, professional accountants in business can help provide a necessary overview of the business model(s). A greater dialogue around the business model should be seen as a key component of an audit, which can help direct the attention of group engagement teams as well as component auditors to relevant risks of material misstatement.
- Professional skepticism and judgment are generally enhanced with experience. This means that audit teams need to be properly supervised and staffed with the right balance of experience. For example, an experienced audit partner or manager should be accessible and present during the engagement. Some PAIB Committee members report that the sustained involvement of an experienced auditor throughout an engagement does not always occur. This also leads to related problems of coordination of audit teams, particularly where the engagement involves a fragmented range of experts covering specialist areas, such as valuation, financial instruments, and tax. Currently, the ITC refers to concern about the group engagement team’s understanding of the planned use of experts by component auditors when obtaining an understanding about the competence and capabilities of the component auditor, including challenging situations where there is no planned involvement of experts. The ITC also recognizes that engagement team members may not all work in the same geographic location. Coordination of fragmented audit teams involving experts also presents its own challenges for audit quality that might need further recognition.
- As the ITC explains, a joint approach by the IAASB, International Accounting Education Standards Board, and International Ethics Standards Board for Accountants should provide a better basis for understanding what more the IAASB and others could do in this area. There appears to be great opportunity to work with others to provide further discussion and guidance on professional skepticism that supplements what is already included in the ISAs. For its part, the PAIB Committee intends to continue highlighting the important aspects of the preparer’s role in enhancing audit quality, and supporting the application of professional skepticism by auditors.

Question QC1(a): We support a broader revision of ISQC 1 to include the use of a QMA as described in paragraphs 45–67. (a) Would use of a QMA help to improve audit quality? If not, why not? What challenges might there be in restructuring ISQC 1 to facilitate this approach?

- Broadly, a quality management accounting (QMA) approach that positions the key elements of fostering audit quality at the accountancy firm level, linked to the firm’s strategic objectives, and under the direct responsibility of firm leadership could lead to a greater focus on the key aspects that can drive audit quality. However, the objective of the QMA, and the implications for practice, are unclear.



- Alignment to governance and risk management frameworks suggests that the objective of this proposed work stream is akin to establishing good governance and accountability in accountancy firms, which might extend well beyond issues of quality management that exist currently. The comparison to other frameworks, such as the Organisation for Economic Co-Operation and Development (OECD) Principles of Corporate Governance and Committee of Sponsoring Organizations of the Treadway Commission (COSO) might be misleading as their scope and objectives are much broader than what the IAASB appears to be seeking to achieve with QMA. (For completeness, it could also be necessary to refer to other international risk management frameworks, such as International Organization for Standardization 31000, *Risk Management, Principles and Guidelines*.)
- The difference between the QMA and International Standard on Quality Control (ISQC) 1 approaches and the implications needs to be clearer. A QMA would need to be firm-wide, with certain elements centralized. There would need to be a clear and broad-based understanding that it applies beyond audit to all lines of the firm's business. It will also need to address how small- and medium-sized practices apply it proportionately.

Question:QC1(b): *If ISQC 1 is restructured to require the firm's use of a QMA, in light of the objective of a QMA and the possible elements described in paragraphs 64 and Table 3, are there other elements that should be included? If so, what are they?*

- The QMA does not include any assessment of client or other stakeholder communication practices throughout the audit.