Survey of Stakeholder Perspectives of Audit Quality – Detailed Discussion of Survey Results
This document was prepared by the Staff of the International Auditing and Assurance Standards Board (IAASB).

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A Framework for Audit Quality
Survey of Stakeholder Perspectives of Audit Quality – Detailed Discussion of Survey Results

1. Some academics have observed that audit involves both a technical component and a service component. The relative importance of these two components is likely to vary between different stakeholder groups.

2. The technical component of audit quality is often considered as having been achieved when there is a high probability that an auditor will both (a) discover a misstatement in the client's financial statements, and (b) report that misstatement. The technical component is most likely to be of greatest importance to users of financial statements, those charged with governance and regulators.

3. The service component of audit quality is more likely to be of importance to management who will likely focus on the efficiency of the audit and its cost. Management is likely to have an interest in ensuring that the cost of the audit is constrained, the audit is completed as quickly as possible and that the disruption to the entity’s ongoing operations is minimized.

4. In order to understand better the different perspectives on audit quality, the IAASB undertook a survey of stakeholders in nine countries (Australia, Canada, Germany, Japan, Netherlands, New Zealand, South Africa, UK, US) as well as some members of the IAASB’s Consultative Advisory Group.

5. Stakeholders were provided with a list of possible factors that they might take into account in forming a view on the likely quality of an audit and asked to indicate whether the factors were (a) important, (b) less important or (c) not important. Stakeholders were also requested to add other factors not on the list and provide comments.

6. 169 responses were received from the following stakeholder groups:

<table>
<thead>
<tr>
<th>Stakeholder Group</th>
<th>#</th>
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<tbody>
<tr>
<td>Audit committee members</td>
<td>32</td>
</tr>
<tr>
<td>Institutional investors</td>
<td>43</td>
</tr>
<tr>
<td>Senior management of larger entities</td>
<td>32</td>
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<tr>
<td>Senior management of smaller entities</td>
<td>33</td>
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<tr>
<td>Primary public sector users</td>
<td>29</td>
</tr>
<tr>
<td>Total</td>
<td>169</td>
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7. The results demonstrate that perceptions of audit quality vary amongst stakeholders. This, in itself, is not surprising as the level of their direct involvement in, and access to information relevant to, an audit varies greatly.
Management

8. Management of both large entities and owner-managed entities place particular importance on:
   - Engagement efficiency.
   - The quality, timeliness and usefulness of communications from senior team members.
   - The competence and continuity of the engagement team.

Engagement Efficiency, Including, Where Appropriate, Coverage of Subsidiaries

9. Management has an interest in ensuring that the audit is completed as quickly as possible and the disruption to the entity’s ongoing operations is minimized. Factors that contribute to audit efficiency include:
   - Early notification of potential audit and financial reporting issues, including those arising from changes in standards and regulation.
   - Proactive and timely engagement with management on resolving issues identified during the audit.
   - Effective issue resolution, drawing on expert input in specialized areas where appropriate.
   - Meeting agreed timelines and reporting deadlines.
   - Timely submission and clear articulation of information requests.
   - Avoidance of duplicate inquiries of management on the same matter from different engagement team members.
   - Effective interaction between the external auditor and the internal audit function (when one exists).
10. These same factors apply on group audits and group management expects the group auditor to coordinate the work undertaken on components efficiently. This can be facilitated if the audits of components are undertaken by the same audit firm or firms within the same audit network. The firm’s geographic reach, and therefore its ability to provide efficient audit coverage for subsidiaries and other components of the group are therefore important.

Quality, Timeliness and Usefulness of Communications

11. The quality, timeliness and usefulness of communications from the engagement team, whether through informal discussions with management or a formal ‘management letters’, all add to the value of the service that management perceives it receives. Apart from communications on financial reporting issues, management may particularly value:

- Insights into and recommendations for improvement in particular areas of the entity’s business.
- Observations on regulatory matters.
- Global perspectives on significant industry issues or trends.

Competence and Continuity of the Engagement Team

12. The professional competence, including technical skills and experience, of engagement team members contributes to management’s forming a view on the quality of the audit work.

13. Management may develop an appreciation of the engagement team’s professional competence in a number of ways, such as:

- How the engagement team has dealt with significant unusual or complex issues during the engagement.
- Whether the engagement team has asked probing questions on significant issues.
- Whether the engagement team has effectively applied technical expertise in resolving highly complex financial reporting issues.
- The timely involvement of partners and experienced staff.

14. In addition, continuity in the engagement team from year to year influences management’s perception of audit quality. Accumulated prior knowledge of the entity and its business amongst the engagement team will likely be valued by management. Not only does this contribute to the conduct of an effective and efficient audit but it is also likely to lead to the most insightful recommendations for improvement in particular areas of an entity’s business operations. Conversely, having to provide the same information to new team members each year is seen as creating inefficiency.
15. Other factors that the survey indicated can be of importance to management are:

<table>
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<tr>
<th>Factor</th>
<th>Description</th>
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<tr>
<td>Good working relationship with engagement partner</td>
<td>Personal relationships impact how management perceives audit quality. In particular, good “chemistry” and a “cultural fit” between management and the engagement partner are likely positive factors influencing management’s view of audit quality. However, while seeking a good relationship between the auditor and management is understandable, if audit quality is to be achieved for other stakeholders, it is vital that this relationship does not result in over-familiarity or a loss of skepticism on the part of the auditor. The survey demonstrates that both audit committees and institutional investors place particular importance on auditor independence.</td>
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<tr>
<td>Accessibility of engagement partner and others within the engagement team</td>
<td>Accessibility to management of the engagement partner and others within the engagement team helps to build rapport and mutual understanding. It also helps to demonstrate to management that the entity’s audit and its business are valued by the audit firm. Frank and open dialogue between the engagement partner and management on a regular basis is seen as an aspect of accessibility. A number of respondents to the survey commented on the importance of the engagement partner being empowered to take decisions without over-referral to technical specialists within the firm.</td>
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<tr>
<td>Knowledge of, and experience with, the entity and its industry</td>
<td>The extent to which the auditor can demonstrate knowledge of, and experience with, the entity and its industry can be a powerful influence over management’s perception of audit quality. This factor is particularly important in specialized industries, such as the financial services or the oil and gas sectors, where prior industry knowledge and experience are almost invariably prerequisites for an auditor to be appointed.</td>
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<td>Audit firm reputation</td>
<td>Management, especially of larger entities, value public reputation of the firm and its brand recognition. A number of larger audit firms have a very high public profile and this is thought to be associated in the public’s mind with high audit quality. Reputations are seen as being damaged by poor external inspection reports, disciplinary proceedings or regulatory sanctions. Client failures can also damage a firm’s reputation.</td>
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Audit Committees

16. While many of the factors that influence audit committees’ perceptions of audit quality are the same as those of management\(^1\) others differ. In particular audit committees appear to place greater emphasis on the robustness of the audit and the auditor’s independence from management and less on efficiency.

17. Based on the survey the factors that are of most importance to audit committees when evaluating audit quality are:
   - The robustness of the audit;
   - Quality, timeliness and usefulness of communications; and
   - Independence from management.

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\(^1\) Important factors include:
- Professional relationship with the engagement partner
- The quality, timeliness and usefulness of communications
- Accessibility of the engagement partner and others within the engagement team
- Knowledge of, and experience with, the entity and its industry
- Competence of senior engagement team members
- Efficient use of management’s time and resources
- Firm reputation
The Robustness of the Audit

18. The engagement team’s audit approach is a major factor in the audit committee’s overall evaluation of the effectiveness of the audit and therefore audit quality. Factors that audit committees are likely to consider include whether:

- The audit is appropriately focused on the higher risk areas;
- The engagement team is properly structured and sufficient time has been spent by partners and experienced staff;
- The group auditor has been sufficiently involved in the audit of components.

19. Equally, in forming a view on audit quality, the audit committee considers whether the engagement partner has challenged management in a robust way on contentious issues, and displayed conviction in taking a principled position on those issues, including modifying the audit opinion where deemed necessary. These actions demonstrate to the audit committee professional skepticism, auditor independence from management and the conduct of a robust audit.

Quality, Timeliness and Usefulness of Communications

20. In relation to the quality, timeliness and usefulness of communications, audit committees value auditor communications that provide:

- Unbiased insights regarding the performance of management in fulfilling its responsibilities for the preparation of the financial statements.
- Insight into the entity’s financial reporting practices.
- Recommendations for improvement to the entity’s financial reporting process.
- Information that enable them to effectively fulfill their governance responsibilities.

Independence from Management

Audit committees value the objectivity of the auditors and their willingness, where necessary, to take differing views from management and perhaps the audit committee itself.
Institutional Investors and Public Sector Stakeholders

21. Based on the survey, it seems that the most important factors that are likely to influence the perceptions of audit quality of institutional investors and public sector stakeholders are:
   - Firm Reputation and Perceived Industry Expertise;
   - Perception of Independence; and
   - The Strength of the Regulatory Framework Surrounding Audit.

Firm Reputation and Industry Expertise

22. From an institutional investors’ perspective, a firm’s reputation and perceived industry expertise may be gauged through the firm’s branding, its client list, and whether it is has clients in the same industry.

23. The firm’s client list can have an important impact on investors’ perceptions of audit quality. A roster of high profile clients may be seen by investors as an implicit endorsement of quality on the presumption that such clients would not engage the firm if it did not offer a high-quality audit.

24. Investors may also view a firm that has many audits in the same industry as indicative of audit quality. This is on the presumption that entities competing in the same industry would not engage the same firm if it did not have the industry expertise and experience to meet their audit needs.

Perception of Independence

25. Institutional investors may form their perceptions of auditor independence in a number of ways, such as:
• The existence of a designated role for audit committees to consider auditor independence, including the provision of non-audit services.
• The magnitude of fees for non-audit services
• Robust regulatory requirements governing auditor independence, e.g. periodic rotation of audit engagement partners.
• Reports from audit regulators of the results of their monitoring of regulatory requirements.
• Firms resigning from the audit engagement if there are independence issues or withdrawing from other client relationships where appropriate.

Strength of the Regulatory Framework Surrounding Audit

26. The strength of the regulatory framework that surrounds the audit can be a significant influence on investor perceptions of audit quality. Investors look for robust mechanisms for ensuring adequate oversight of the audit firms, including provisions for adequate sanctions for poor quality or negligent audit work.

27. A strong system of corporate governance is also valued. Effective audit committees are thought likely to lead to effective audits. A number of investors observed that a strong audit committee gave them reassurance about the likely quality of the audit undertaken. This was particularly the case when the audit committee had described the work undertaken by them on audit effectiveness in the entity’s annual report.

Other Factors

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<th>Factor</th>
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| Quality of Clients’ Periodic Financial Reports, Including Disclosures | The overall quality of the entity's financial report can lead to perceptions of audit quality, including
- The understandability and transparency of disclosures in significant areas, for example, going concern, measurement uncertainty, and transactions involving difficult substance-over-form issues.
- The quality of the entity's accounting policies and practices. |
| Regulatory inspection reports | Findings from published regulatory inspection reports influence investors’ perceptions of audit quality as do the results of disciplinary findings. |
| Transparency reports | A number of investors responded to the survey by observing that transparency reports (see paragraphs 159-160) can influence their perceptions of the quality of the audit firm. |

Public Sector Stakeholders

28. Many of the factors affecting perceptions of audit quality for institutional investors and audit committees are likely to influence in similar ways perceptions of audit quality for primary public sector users. However, the latter’s expectations may differ in the sense that these often go beyond the financial aspects of the audit.
In addition to the factors applicable to audit committees as described above, the following aspects of reporting and communication by Public Sector Audit Institutions can contribute to primary public sector users’ views on audit quality:

- Insight into the operations and financial reporting practices unique to public sector entities;
- Constructive and timely recommendations in areas of performance (including value for money) and compliance with relevant mandates;
- Fair, unbiased and politically neutral reporting;
- Well-balanced and educational reports in the appropriate contexts.

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