

Audit Quality – Finalization of Audit Quality Framework

Background

1. Feedback from discussions with the IAASB's Consultative Advisory Group (CAG) and the IAASB in September 2013 about the Task Force's revisions made to the draft Framework for Audit Quality in response to respondents' feedback indicated a need to reconsider certain matters. This paper summarizes the Task Force's further considerations and recommendations as a follow up to these discussions.

General Observations

Length of the Document

2. In response to comments received on consultation that the Framework document was too long, the Task Force proposed splitting the Framework into two separate documents – a condensed Framework, and a separate Guide with the detailed explanation of the input factors. A number of CAG Representatives and IAASB members expressed a preference for keeping the Framework a single document and instead suggested the use of an appendix for presenting the detailed discussions about input factors.

Response

3. The Task Force supports this approach and has moved the detailed explanation of the input factors to an appendix.

Status and Title of the Document

4. A number of respondents to the consultation voiced concerns about the status of the document, and whether it should be described as a "Framework." In response, the Task Force proposed at giving further emphasis within the document to the words that describe its non-authoritative nature, but did not propose changes to the IAASB Preface. IAASB members broadly supported this approach although some concerns remain about how best to communicate the non-authoritative nature of the document and future non-authoritative documents more broadly.
5. In response to concerns about whether the document should be called a "Framework" the Task Force had proposed adding a sub-title "*A Discussion of Key Elements that Create an Environment for Audit Quality*." IAASB members broadly supported the use of a sub-title but some remained uneasy with use of the word 'Framework' and it was agreed that the Task Force would give this further consideration.

Response

6. The Task Force considered a number of alternatives. Most members remain strongly of the view that it is appropriate to use the term "Framework" as:
 - The original terms of reference were to develop a Framework and this was what was consulted upon;
 - Calling the document a "Discussion Paper" would significantly weaken perceptions as to its value and reduce the chance of it achieving its objectives; and
 - It believes that it does represent the principles underlying standards.

One member of the Task Force was of the view that it could be titled, "*Audit Quality: A Discussion of the Key Elements*."

Balance of the Document

7. Responses to the consultation on whether the Framework was fairly balanced varied. Some thought it was fairly balanced; a number thought more emphasis should be placed on management responsibilities and others thought more emphasis needed to be placed on interactions and contextual factors.
8. Given the amount of discussion on this topic that had preceded the issuance of the Consultation Paper, the Task Force did not suggest changes in this area to the CAG or IAASB in September. However, the Task Force noted that issuing a “condensed” version of the Framework would likely mitigate some of the concerns. This approach was broadly supported by IAASB although some IAASB members saw benefit in the Task Force further exploring the various diagrams to see if more emphasis could be given to the interactions and contextual factors.

Response

9. The Task Force remains of the view that overall the document is appropriately balanced but does recommend a change to the main diagram so as to give more visual emphasis to interactions and contextual factors. To retain the “brand” of the initial diagram the Task Force proposes separating out “process” from “inputs.” This had been proposed by a number of respondents to the consultation.

Definition of ‘Audit Quality’

10. A number of respondents to the consultation called for the IAASB to define audit quality. Given the inherent difficulties involved in developing a concise definition of audit quality, the Task Force proposed maintaining the approach taken in the Consultation Paper, whilst giving greater emphasis to the two paragraphs that described audit quality and a quality audit. A few CAG Representatives were of a view that the IAASB should continue to explore defining audit quality. The IAASB generally supported the Task Force’s proposed approach, but suggested that the order of the two paragraphs be reversed as well as a number of wording changes to the paragraphs concerned. Some IAASB members asked that the Task Force clarify the linkage between the Framework and the ISAs¹ and ISQC 1.²

Response

11. The Task Force remains of the view that it is difficult to define either “audit quality” or “a quality audit” for the reasons set out in Appendix 1 of the Framework. However, based on the IAASB’s discussions at its September 2013 meeting, the Task Force proposes a number of changes to paragraphs 1 and 2 of the document to:
 - Reverse the order of the paragraphs to give greater emphasis to audit quality;
 - Move the location of the word “likely” in paragraph 2; and
 - Provide a stronger linkage between paragraph 2 and the ISA 200 objectives of the auditor.

¹ International Standards on Auditing

² International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

12. In relation to the linkage between the Framework and ISAs/ISQC1 the Task Force proposes adding:

- A new sentence in paragraph 6:

Auditors are required to comply with relevant auditing standards and standards of quality control within audit firms, as well as ethics and other regulatory requirements. In particular, **ISQC 1 addresses a firm's responsibilities for its system of quality control for audits.** The Framework is not a substitute for such standards, nor does it establish additional standards or provide procedural requirements for the performance of audit engagements; and

- A new Paragraph 82 in Appendix 2:

Auditing standards serve a fundamental role in underpinning audit quality and users' confidence in the audit. The ISAs are designed to support the auditor in obtaining reasonable assurance and require that the auditor exercise professional judgment and maintain professional scepticism throughout the planning and performance of the audit and, among other things:

- Identify and assess risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, including the entity's internal control.
- Obtain sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to those risks.
- Form an opinion on the financial statements based on conclusions drawn from the audit evidence obtained.

Contextual Factors

13. The contextual matters described in the Consultation Paper were those considered likely to impact the nature and quality of financial reporting. A number of respondents to the consultation indicated that there was a need to also describe those contextual factors that specifically impact audit quality – such as the attitude of those charged with corporate governance towards audit; litigation; audit regulation; education; and competitive pressures impacting fees.
14. The IAASB discussed additional wording on the contextual factors that more directly relate to audit quality at its IAASB meeting, taking into account views expressed by its CAG. The IAASB was generally supportive of the revised wording and expressed the following views for the Task Force's further consideration:
- There was concern expressed about the wording dealing with audit fees. One CAG member in particular thought it was necessary to clarify that a low fee could never be an excuse for a poor quality audit;
 - One IAASB member asked for a broader approach to auditors being under pressure;
 - One IAASB member expressed concern about whether the emphasis on recruitment of talented individuals was appropriate; and
 - One IAASB member observed that corporate governance was featured in both the financial reporting and audit quality sections of the Framework.

Response

15. The Task Force has refined the wording of the Framework in a number of areas. It has also discussed the observation that corporate governance featured in both the financial reporting and audit quality sections and noted that a split between the two is perhaps over simplistic as a number of the contextual factors impact both financial reporting and audit quality. The Task Force proposes to combine the factors and, as described in paragraphs 17 and 97 to clarify that these matters have the potential to impact audit quality and, where appropriate, auditors need to respond to such factors when determining how best to obtain sufficient appropriate audit date evidence.

Contextual Factors – Broader Cultural Factors

16. A few respondents to the consultation were of a view that the section addressing the broader cultural factors needed further work. This view was echoed by a few members of the CAG.

Response

17. The Task Force has had access to some interesting recent research³ that demonstrates that culture is likely to impact a number of auditor judgements using a sample of young auditors in Australia and Egypt. The Task Force has redrafted this section of the paper (see section 4.6 of **Agenda Item 4-C**) to show that the broader cultural factors apply to both preparers and auditors and welcomes IAASB comments on it.

Root-Cause Analysis

18. The IOSCO comment letter encouraged IAASB to build in the concept of “root-cause analysis” into the Framework by “providing clear guidance on how to identify root causes of audit deficiencies and how to develop relevant solutions including remediation and preventive steps.”

Response

19. The Task Force has added a reference to root cause analysis in section 1.8.1 paragraph 98 of Appendix 2 to **Agenda Item 4-C**. The Task Force thinks it is appropriate not to write more because there are a number of complex issues relating to root cause analysis which need further thought. Rather than delaying the finalisation of the Framework the Task Force believes this topic should be considered as, and when, ISQC 1 is revised.

³ Medhat Endrawes and Gary Monroe, *Professional Scepticism of Auditors: A Cross-Cultural Experiment*