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This is one of a series of articles where experts in assurance, reporting and regulatory matters discuss recent technical and policy developments in these areas.



Enhancing Audit Quality

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In a world of increasing business complexity, rapid rate of technological change and evolving audit delivery models, it is a constant challenge to ensure the auditing and assurance standards adapt to our changing environment. The International Auditing and Assurance Standards Board (IAASB) is determined to tackle this challenge head-on. It has recently released an Invitation to Comment (ITC), [Enhancing Audit Quality in the Public Interest](#) that focuses on professional scepticism, quality control and group audits, three areas that are key to delivering high quality audits now, and in the future.

Audit quality is a multifaceted concept, therefore to address audit quality it must be approached from a variety of angles. Different stakeholders are likely to have different perspectives about the nature of audit quality and the factors that impact it and these views need to be balanced in any response by the IAASB. This is why the IAASB is seeking feedback from all stakeholders, not just auditors, and has published an [overview](#) of the ITC for non-auditors.

In this article, we highlight some of the key issues and questions raised by the ITC for feedback from business and separately from the audit profession. It is important for the IAASB to hear views so they are able to appropriately assess the cost and benefits of additional requirements and ensure standards meet the needs of markets. So have a read and let us know your views.

Professional scepticism

Professional scepticism is a skill considered by many as the cornerstone of audit quality. It is a complex area requiring behavioural and cognitive attributes as well as considerable judgement relevant to individual circumstances, which is acquired through experience. Audit inspection findings from regulators around the world repeatedly cite that audit files often fail to provide evidence of professional scepticism being exercised

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by the auditor. There is no doubt that it is difficult to tangibly demonstrate the application of professional scepticism in an audit file. However, fostering an appropriately independent and challenging sceptical mind-set across the profession is undoubtedly key to negating the possibility of mistakes in audits. The ITC is thus seeking to explore how the issues both in relation to application and documentation relating to professional scepticism can be addressed.

Some issues raised for business participants to consider are:

- Do you think that the concept of professional scepticism clearly defined and well enough understood?
- What impact do you consider the increasing use of technology by business has on professional scepticism?
- What would you expect to see if your auditors were applying professional scepticism properly?

Matters for consideration by the audit profession include:

- Should the concept of professional scepticism, and how its application is documented, be more clearly articulated in the auditing standards and if so how?
- Could more be done to align the concepts of professional scepticism, professional judgement, integrity and objectivity?
- Should standards be changed to emphasise the need for a questioning mind-set, rather than the current approach which references corroboration?
- Should there be more explicit documentation of discussions on areas of judgement with the Engagement Quality Control reviewer. While the current standards require documentation of significant matters and judgements made in reaching conclusions, they are not prescriptive as to how these judgements should be documented.
- How can professional scepticism be incorporated into your firms' performance management system and/or be a core part of incentivising staff?

A joint working group of representatives from the IAASB, International Accounting Education Standards Board (IAESB) and International Ethics Standards Board for Accountants (IESBA) has been established to explore such questions and develop joint solutions. The IAASB is also contemplating developing a professional scepticism framework to specifically recognise the many factors impacting on the application of professional scepticism. The feedback from the ITC will direct both of these work programs.

Quality control

An effective system of quality control supports consistent quality. How firms providing audit services manage quality control is one of the fundamentals of audit quality. The IAASB standard, ISQC 1, provides the foundation for a



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firm's approach to quality. Through the ITC, the IAASB is exploring the possibility of incorporating a Quality Management Approach (QMA) into the quality control requirements. While the present standard requires leadership, the QMA approach emphasises the responsibility of firm leaders in delivering a more proactive, scalable and robust response to managing the risks to consistent delivery of quality audits.

Feedback sought from business includes:

- Should the IAASB require audit firms to provide transparency reports explaining their quality control processes for audit work? Some countries already have this requirement in legislation.
- Would you be interested in this report, or is it sufficient for you to know that the audit firms are required to follow standards for quality control?
- Would you benefit from knowing the details of inspection findings?

Proposals for the audit profession to consider include:

- Should the IAASB mandate which audit documentation must be reviewed by the engagement partner, and the nature of the review procedures?
- Should an engagement quality control review partner be required for audits other than listed entities?
- Should audit reports include commentary on the role of the engagement quality control reviewer?
- Should there be a separate standard for the engagement quality control review? (similar to the PCAOB standard in the US)
- Should the standards require the engagement partner's remuneration to be linked to audit inspection findings?

Whether information is required to be publicly reported or not, the cost of establishing and maintaining an effective quality control system is extensive and a large element of the cost of audit. It is important to hear the feedback of those impacted on the benefits and focus for increasing requirements.

Group audits

One consequence of the increased complexity of financial markets and business practices is that corporate structures become more sophisticated. Audits of groups of entities who may operate in vastly different regulatory and economic environment has always been challenging. The degree of difficulty will only increase as business structures continue to evolve. The IAASB has recognised this by targeting group audits as the third aspect being addressed by the ITC.

ISA 600 establishes the relative responsibilities of the group auditor and the component auditors and how the relationship between them should be managed. Broadly this standard allows the use of other audit firms as long as the signing auditor retains responsibility for considering the value of the



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work as appropriate evidence for their opinion on the group financial statements. The IAASB is exploring whether to detail more precisely the responsibilities of each party.

Business participants are asked to feedback on matters such as:

- What would you expect an auditor signing an opinion for a global group of companies to have considered in relation to component parts of your business, particularly if they are overseas?
- Do you support the use of other audit firms in other countries and what would expect your auditor to have to do to satisfy themselves of the quality of that other auditors' work?
- What standards would you expect to be in place for how a group auditor, or a local component audit firm, deals with local management at component, especially if that management is not under the control of your group management?

Auditor are asked to consider possible changes to the standards such as:

- Should the group engagement partner decline a group engagement if they cannot document that they can get all the information they require to obtain sufficient audit evidence prior to acceptance? In practice can this determination be made prior to accepting an engagement?
- Should there be a separate standard for component auditors to assist them to perform their role? This could cover the interaction of the component role and any local statutory audits which may have different risks and materiality levels.
- Should the IAASB set requirements on how to achieve a mutual understanding on expectations, with guidance on addressing different cultural considerations, laws and regulations (and auditing standards) in different jurisdictions, differing levels of sophistication and/or dealing with non-related firms or networks?
- Does the definition of a component need to be clarified to explicitly address specific situations such as shared service centres or joint ventures?

Concluding remarks

As can be seen there are potentially a number of issues which could be addressed by increased requirements and many inter-relate. The value of the ITC process is to explore these issues and gain feedback from all participants in the financial reporting process. Understanding concerns, expectations, and priorities from a range of stakeholders will enable additional requirements to be the most effective. It may also provide an opportunity to be more innovative with solutions and look at combination of responses and not just increased regulation.

For example, perhaps one of the most significant risks to audit quality is time and resource constraints. Many entities have a balance date which is largely driven by the local tax authority's fiscal year. Removal of mandated balance dates would provide variation in year ends and hence smooth out reporting



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deadlines. Are there wider changes needed that would have an impact on audit quality which the IAASB (and local standard setters or regulators) should be considering?

At this stage there are more questions than answers, which is why it is so important that all stakeholders get involved and have their say. We are keen to hear your thoughts via [email](#)¹ by 29 April.

Resources

There are already a number of resources available to assist application of the existing standards in these three areas. We set out a few examples below and all can be found through our websites:

Professional scepticism

- We developed a [professional scepticism online training programme](#) that explores inherent cognitive biases and delves into the thinking processes underpinning judgement and challenges auditors to avoid judgement traps.
- We partnered with the Chartered Professional Accountants of Canada to produce a practical guide for members on reflecting the exercise of professional scepticism in auditing; [Practical Ways to Improve the Exercise and Documentation of Professional Scepticism in an ISA Audit](#).

Quality Control

- We published [Clearer Transparency: Assessing the second year of Audit Firm Transparency Reports in Australia June 2015](#). The paper reviews the information contained in transparency reports and explores how firms can utilise their transparency reports to communicate information about audit quality more effectively.
- We produced [Sharing Experiences on Audit Quality](#) with input from six audit firms who have undertaken enhancements to their own audit quality control systems. The paper's key message is the importance of understanding the root cause of any quality concerns before considering what may best improve an issue.
- We established a [Quality Control Guide](#) to support members in practice through the process of developing a quality control system. It offers a pro-forma toolkit designed for practitioners to download and tailor to their individual practices.

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