Approach to the Combined Discussion Paper

Objective of Agenda Item

1. To highlight how information-gathering on the IAASB’s key projects of quality control, group audits and special considerations in auditing financial institutions will be addressed in a combined Discussion Paper (DP).

   Agenda Items 12, 6/9, and 11 will facilitate more in-depth discussions related to these projects respectively, and Agenda Item 10 represents the IAASB’s initial work on the topic of professional skepticism.

Audit Quality Enhancements Coordination Group (AQECG)

2. The AQECG comprises:
   - Megan Zietsman, Overall Chair and Chair of the Group Audits Working Group (GAWG)
   - Karin French, Chair of the Quality Control Working Group (QCQG)
   - Annette Köhler, Chair of the Professional Skepticism Working Group (PSWG)
   - Rich Sharko, Chair of the Financial Institutions Working Group (FIWG)
   - Brendan Murtagh, IAASB Member, serving as the Liaison to the International Ethics Standards Board for Accountants (IESBA) and the IFAC Small and Medium Practices (SMP) Committee
   - Correspondent Member: Merran Kelsall, IAASB Member, currently the Audit Quality Liaison as a former member of the Audit Quality Task Force

3. The purpose of this group is to develop the “forepart” of the DP and overarching questions, as explained in more detail in paragraph 5 of this paper, and to coordinate the various inputs to the DP developed at the individual working group (WG) level. The AQECG has also developed a draft outline of the DP, which is included in the Appendix to this paper. The AQECG does not intend to override the decisions of the individual WGs in terms of recommendations for matters to include in the DP as they relate to specific topic-related issues, but rather intends to analyze the individual issues and take a holistic approach as to how the matters are presented in the DP. This approach is intended to demonstrate the extent to which there is commonality across or crossover between WGs or topics, thereby enabling respondents to the DP to understand such connections and to comment more effectively.
Proposed Approach to the Discussion Paper

4. Following a brief discussion at its March 2015 meeting, the IAASB discussed the proposed coordinated approach to consultation to the DP at its April 2015 meeting and agreed that there is merit in such a coordinated approach to consultation in relation to a number of key projects on the Board’s agenda. The AQECG was therefore formed and one teleconference has been held to discuss the matters in this paper, in particular the proposed approach to, and form and content of, the DP.

5. The AQECG proposes that the DP be organized primarily in two sections:

   (i) The forepart, which is intended to be a user-friendly, relatively brief summary of the broad overarching audit quality-related issues that have been identified individually and collectively by the various WGs, as well as proposals for the possible ways in which these issues could be addressed by the IAASB, and others as necessary. Initial views as to the possible approach to the forepart of the paper, including the areas for inclusion, are set out in the Appendix.

   (ii) The second part, which will likely be divided into different sub-sections that include a more detailed analysis of issues relating to the three key projects, including:

   a. Details of the IAASB’s understanding of the most significant issues that have been identified to date and considered by the IAASB—including issues identified through the ISA Implementation Monitoring project, inspection findings, other outreach activities (including meetings of the National Auditing Standards Setters (NSS) and the IAASB Consultative Advisory Group (CAG)), and WG and Board discussions. Stakeholders will be requested to confirm that all relevant issues have been identified, and that all relevant aspects of those issues have been considered.

   b. A description about how the existing ISAs are relevant to the identified issues—intended to effectively facilitate the solicitation of feedback from stakeholders on actual or perceived gaps in the ISAs in the areas affected by the issues identified.

   c. The IAASB’s views about possible actions that could be taken to address the issues identified and thereby enhance audit quality—including presenting actions the IAASB believes may be appropriate, or necessary for others to take. The DP will solicit stakeholder views on these possible actions, and the IAASB will use the input as the basis for scoping the project proposals for the individual projects and assessing the relative prioritization of the projects and the issues identified in relation to them.

   d. A call for respondents to share views to assist the IAASB in understanding the “root causes” of the underlying issues—to help the IAASB weigh the necessary actions in the public interest and determine whether the standards themselves need to be revised.

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1 The IAASB considers possible areas on which standard-setting may be an appropriate response in developing its Work Plans. As noted in the IAASB’s Due Process, a proposal to start a new project is prepared based on research and appropriate consultation (e.g., feedback from a DP), with consideration given to the costs and benefits of the anticipated output of the proposed project. Project proposals identify the objectives of the project and explain how achievement of those objectives would serve the public interest. The IAASB CAG comments on project proposals and the IAASB approves project proposals. The approval of a project proposal marks the commitment of the IAASB to a standard-setting project, and the project proposal serves as the basis for the future ED.
to provide greater clarity (including through strengthened or clarified requirements or additional guidance) or whether other actions (such as the development of non-authoritative material) by the IAASB or others may be more effective in enhancing auditor performance.

The Appendix provides more detail about possible areas that could be included in both sections of the DP. Soliciting feedback through the DP will help the IAASB confirm its understanding of the issues, its views about possible ways to address the issues and its understanding of the underlying causal factors, which will help the IAASB affirm whether its preliminary thinking about how to address the issues is workable and responsive.

6. Both sections would include specific questions for respondents, although those in the forepart would be at a higher level and could also be specifically tailored or directed to particular stakeholder groups. The AQECG is of the view that it should be made clear in the DP that respondents are welcome to respond to any of the questions where they have relevant input to provide. It might also be useful within the DP to explain how specific questions may be relevant to the individual WGs.

7. This proposed organization of the DP intentionally recognizes the concern that a combined DP may be too unwieldy to navigate and therefore may not result in effective responses from a wide range of stakeholders. Equally, it is important that sufficient details and targeted questions are provided within the forepart to provide respondents with a sufficient basis on which to provide informed responses, i.e., rather than simply providing feedback based on perceptions of problems within the ISAs or with auditor behavior generally. Notwithstanding the concerns about the overall length of the DP, the AQECG continues to believe that a coordinated approach to consultation is preferable, rather than an approach involving multiple DPs from individual WGs that would be issued concurrently or shortly following one another.

8. The DP is expected to be issued in December 2015, with a 150-day comment period.

Professional Skepticism

9. In finalizing the Work Plan for 2015–2016, the IAASB acknowledged that further consideration of the topic of professional skepticism was needed, i.e., to enable the IAASB to further explore what could be done in this area before committing to a standard-setting project on the topic. It was also agreed that initially this topic would also be explored through the planned projects on quality control, group audits and financial institutions rather than as a separate and discrete project. At the June 2015 IAASB meeting, the IAASB will commence its work on the topic, with a panel session focused on exploring views as to how professional skepticism can be enhanced in an audit of financial statements (see Agenda Item 10).2

10. Accordingly, the AQECG is of the view that the DP also provides an opportunity for the Board to set forth initial views on the topic of professional skepticism, by (i) explaining the underlying expectation of the ISAs with respect to professional skepticism; (ii) highlighting the more behavioral aspects; and (iii) summarizing the feedback from the panel presentation.

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2 A Working Group comprised of representatives from the IAASB, the IESBA, and the International Accounting Education Standards Board (IAESB) has been formed to explore the topic of professional skepticism, enabling the three Boards to consider what actions may be appropriate within their collective Standards and other potential outputs to strengthen auditor behavior and enhance professional skepticism.
Financial Institutions

11. The AQECG also recognizes that the FIWG is exploring a wide range of issues, some of which are quite specific to the financial institutions industry, and also matters where the IAASB is being encouraged to take action as quickly as possible. The AQECG and the FIWG acknowledge that the combined DP will likely not be the most effective means to adequately address all the issues related to audits of financial institutions, in particular the demands for the IAASB to consider the implications on IFRS 9\(^3\) on an accelerated basis (see Agenda Item 11). Rather, in relation to financial institutions, the AQECG believes that the DP should focus more on the topics initially identified by the Basel Committee on Banking Supervision that are likely to be relevant for a wider range of entities (see Agenda Item 5-B from the March 2015 IAASB meeting), and may also be topics where it would be relevant to seek input about the implications for group audits or even all audits more generally. In particular, the AQECG is of the view that the DP could usefully highlight potential areas for improvement within ISA 540\(^4\) relating to auditing fair values, including recognizing the increasing significance of using auditor's experts, the approaches to auditing management's estimates, and situations when estimation uncertainty may be multiples of audit materiality.

Matter for IAASB Consideration

1. The IAASB is asked for its views on the matters set out above and the outline in the Appendix.

Outreach

12. Initial discussions with the Steering Committee and the IAASB have highlighted the need for outreach on the combined DP, as well as more targeted discussions with certain stakeholder groups. The IAASB's experience from an event held in April 2015 with audit committee members suggests that more targeted meetings (maximum of 15–20 participants) generally provide a greater opportunity to probe specific issues with certain stakeholder groups. Equally, it is often helpful for stakeholders of differing views to have an opportunity to interact.

13. The AQECG is therefore of the view that "roadshows" could be quite useful as a means of soliciting feedback on the DP and standard-setting projects throughout 2016. The intent would be that a consistent format could be developed, using the questions in the forepart of the DP, for a group of no more than 20 participants. However, variability could be useful depending on the jurisdiction and attendees (e.g., a roadshow for audit committee members, a financial institutions roadshow, an SMP roadshow, a country roadshow with a diverse group of participants etc.). These events could be organized / co-hosted with other organizations or in coordination with other planned events to leverage travel.

14. The DP would also be used as the basis for discussions with the IAASB Consultative Advisory Group and the IAASB-NSS Liaison Group, more recurring-type outreach events,\(^5\) such as annual

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\(^3\) International Financial Reporting Standard (IFRS) 9, *Financial Instruments*

\(^4\) ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

\(^5\) Including meetings of the International Organization of Securities Commissions' (IOSCO) Committee 1 and its Auditing Subcommittee, the International Forum of Independent Audit Regulators (IFIR) and its Standards Coordination Working Group, the European Audit Inspections Group, the Forum of Firms, the IFAC Small and Medium Practices Committee, the
meetings of regulators and audit oversight bodies, firms, IFAC Boards and Committees and, where possible, as the focus of speaking engagements for which the IAASB would seek to be invited (see paragraph 16).

15. The following represents the AQECG’s high-level view of a possible program of events already anticipated in 2015 and future IAASB “roadshows” to be planned:

- **June – November 2015:**
  - Board member and Technical Advisor outreach with stakeholders at the jurisdiction level using a standardized slide deck. These activities would also serve to identify participants for events planned in 2016.
  - Roundtables with audit committee members in Toronto and Singapore on the topics of Auditor Reporting and Audit Quality
  - Presentation at the PIOB 10th Anniversary Seminar on the topic of “Standard Setting in the Public Interest” in Madrid, Spain
  - IAASB leadership visits to India, Nordic Federation, Turkey, Japan, Russia, South Korea, Australia and New Zealand, including presentations at external events in these countries

- **January – May 2016 to solicit feedback on the DP:**
  - Roadshows in Latin America and South America (in coordination with CReCER or former CReCER participants)
  - Roadshow in Paris at the Organisation for Economic Co-Operation and Development (OECD)\(^6\)
  - Other roadshows in Europe in connection with NSS, regulators and others (e.g., Copenhagen, Netherlands, UK)
  - Roadshows and other stakeholder meetings in Africa (to be coordinated with Pan African Federation of Accountants’ Annual Meeting)
  - Meetings with the Global Public Policy Committee (GPPC)

- **Events planned after the close of the DP, aimed at validating feedback thereon and commencing the standard-setting projects (for which project proposals will be put forth to the IAASB in September 2016):**
  - Roadshow(s) in North America, potentially in coordination with the PCAOB, CPAB, CAASB, and CAQ
  - Roadshow in Abu Dhabi or other location in the Middle East
  - Roadshow or other outreach events in Hong Kong and possibly other areas in Asia

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IFAC Professional Accountants in Business Committee, the IFAC Board and Council, and events of NSS and professional accountancy organizations at the regional and national level.

\(^6\) The OECD is currently conducting a [review of its Corporate Governance Principles](http://www.oecd.org/enterprise/corporategovernanceprinciples/) to ensure their continuing high quality, relevance and usefulness, taking into account recent developments in the corporate sector and capital markets. The review is scheduled for release in September 2015.
Roadshow in coordination with the IFAC Board and Council meetings in Brazil

16. The AQECG is of the view that, where possible, the IAASB should also seek to participate in annual events held by significant stakeholders, e.g., CFA Institute, the International Corporate Governance Network, United Nations Conference on Trade and Development / Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting, Fédération des Experts Comptables Européens, Financial Industry Regulatory Authority, World Bank, International Monetary Fund and others.

Matters for IAASB Consideration

2. The IAASB is asked to share views about the planned outreach plan, on outreach activities that may be useful and in particular, the proposal to hold roadshows. The AQECG is also interested to learn about recurring events at which the IAASB should seek to present its views on enhancements to audit quality.
Draft Outline of the DP – Responding to Calls to Enhance Audit Quality

The purpose of this Discussion Paper is to explore how the IAASB might best respond in the public interest to calls to enhance audit quality, in particular to respond to:

- Inspection findings highlighted by regulators and audit inspection bodies; and
- Developments and practical challenges noted by accounting firms, including small and medium practices (SMPs) and others.

It builds upon the topics set out in the IAASB’s Work Plan for 2015–2016, in support of the IAASB’s strategic objective to ensure that International Standards on Auditing (ISAs) continue to form the basis for high-quality, valuable, and relevant audits conducted worldwide by responding on a timely basis to issues noted in practice and emerging developments. It also recognizes the input factors set out in the IAASB’s Framework for Audit Quality (the Framework), and the possibility of more closely aligning the International Standards with the Framework.

Forepart

I. Message from the Chairman

- Explain that the key projects identified in the DP are as a result of the findings from the IAASB’s ISA Implementation Monitoring project, input from regulators and audit oversight bodies, and others (such as firms and national standard setters), and from outreach
- Highlight why the Board has considered it appropriate to issue a combined DP, and briefly explain the overall approach taken (i.e., use of a forepart together with a second part for more detailed and topic-specific questions).
- Explain the outreach that had been conducted to date that supports this approach
- Encourage respondents to provide detailed comments and input to all matters that are relevant to them

II. Why are Enhancements Needed to Audit Quality?

- Explain the IAASB’s role as a global standard setter and our focus on audit quality
- Mention the IFIAR inspection findings, specifically the IFIAR view that there are persistent deficiencies in important aspects of audits and that there is a basis for ongoing concerns about audit quality, as well as the encouragement for evaluation of whether and how the IAASB’s standards could be enhanced and therefore contribute to reducing the level of recurring inspection findings
- Also note the need for a continued focus, primarily by audit inspection bodies and firms, on understanding the “root causes” of inspection findings – including whether this suggests further changes are needed to the standards (in the form of clarification or strengthening of requirements and guidance, or whether other actions by the IAASB (or others) are needed to facilitate effective, high-quality implementation of the standards in order to achieve their intended effects
• Briefly highlight ISA Implementation Monitoring project and link to the reports, explaining that this was the basis for the focus in the strategy and the prioritization of topics in the first WP in the 5-year strategy.

III. Where Could the IAASB Take Steps to Strengthen its Standards or Provide More Relevant Guidance to Enhance AQ?

• An important theme coming out of the inspection findings globally is the view that auditors are not exercising sufficient professional skepticism. What does this actually mean? Summarize views from June 2015 discussions and highlight components of definition/guidance in ISA 200

• Flag actions that could be helpful, for example, the manner in which specific requirements in key standards are drafted (e.g., by suggesting that more needs to be done to challenge management’s judgments rather than seek to corroborate them, considering alternative sources of evidence or contradictory evidence or more independent development of estimates by specialists or experts)

• A firm’s system of quality control is at the heart of a high-quality audit, but important also for quality at the engagement level – Explain how the ISAs address responsibilities at all levels and the need therefore to look holistically across quality control requirements at the firm, engagement, engagement partner and engagement quality control reviewer (e.g., by summarizing key recommendations from the detailed analysis of the paper)

• Explain the evolving world of business and the fact that the IAASB needs to ensure the ISAs remain fit for purpose – Raise the question of whether the standards need to recognize these developments more or whether more guidance is needed to acknowledge these developments (bring up key recommendations from the detailed analysis of the paper)

Detailed Analysis

The AQECG believes the work by the QC group will likely serve as the basis for the overarching messaging in the detailed analysis of the paper. Outreach to date has confirmed that this approach resonates with stakeholders in terms of the various interactions in audit quality.

This section will include issues and analysis related to:

• Roles and responsibilities of the engagement partner, as the person taking responsibility for the overall quality of the audit

• Engagement quality control reviews (EQCRs) / engagement quality control reviewers and their role in audit quality. This may also include questions about special considerations for group audits, as well as audits of financial institutions

• The role of the firm in audit quality, both at the engagement and firm levels (includes “tone at the top,” monitoring of firms quality control policies and procedures and firm governance)

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7 ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing

8 Agenda Papers for the IAASB’s June 2015 meeting for individual projects more fully describe these matters: Quality Control (Agenda Item 12), Group Audits (Agenda Item 9) and Update on Financial Institutions (Agenda Item 11).
• Involvement of others in performing or supporting the audit engagement, including the effects on audit quality. This section may include:
  o Exploring what enhancements may be needed to strengthen or supplement the existing ISAs, including ISA 220, ISA 600, and ISA 540
  o Describing the way in which audits may be conducted in a global business environment, including the various audit delivery models used to perform audits
  o Discussion of the evolving need for specialists or experts in particular areas such as increasingly complex financial instruments
  o Obtaining sufficient appropriate audit evidence and documenting conclusions to support the opinion on the financial statements. This includes exploring whether improvements are needed related to:
    ▪ Planning and executing group audits, including aspects of component materiality and the approach to a group audit, the procedures performed by the group engagement team in relation to the component auditor, communications with component auditors, and the group engagement team’s evaluation of the work of the component auditor
    ▪ Auditing fair values, expected losses, other estimates

Within these topics, the paper will explore the issues and their underlying causes, as well as a discussion about the existing requirements and guidance in the ISAs relating to the issue. The paper will also include specific considerations that may be particularly relevant to:
• SMPs, in light of the need to consider how possible changes to the ISAs may affect them, including the ability for any changes to be applied on a proportionate basis
• Public sector
• Financial institutions, in light of their importance to global financial stability

The DP will also set out possible actions for stakeholder views, which may include:
• Changes to the ISAs or ISQC may be needed (whether in the form of new Standards, or strengthened requirements or additional guidance in existing Standards).
• Other outputs (e.g., an International Practice Note) or activities that may be appropriate to enhance audit quality in relation to the key topics explored in the paper.
• Activities that may be needed by others in coordination with the IAASB’s possible actions (e.g., enhanced role of audit committees, areas of improvement in financial reporting standards, efforts by other independent SSBs, etc.)

The IAASB will also be interested in respondents’ views as to the relative prioritization of the topics addressed in this paper.

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9 ISA 220, *Quality Control for an Audit of Financial Statements*
10 ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*