

**PRELIMINARY DRAFT CONSULTATION PAPER
FOR DISCUSSION PURPOSES ONLY**

AUDIT QUALITY: AN INTERNATIONAL FRAMEWORK

[DATE]

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Acronyms and Key Terms

Acronyms in This Paper

CPD	Continuing Professional Development
IAASB	International Auditing and Assurance Standards Board
IAESB	International Accounting Education Standards Board
ICAEW	Institute of Chartered Accountants in England & Wales
IES	International Education Standard
IESBA	International Ethics Standards Board for Accountants
IESBA Code	Code of Ethics for Professional Accountants issued by the IESBA
IFAC	International Federation of Accountants
IFIAR	International Forum of Independent Audit Regulators
INTOSAI	International Organization of Supreme Audit Institutions
ISA	International Standard on Auditing
ISQC	International Standard on Quality Control
NAO	National Audit Office

Key Terms Used in This Paper in the Public Sector Context

In the public sector environment, the terms “client,” “engagement,” “engagement partner,” and “firm” should, where relevant, be read as referring to their public sector equivalents as defined in International Standard of Supreme Audit Institutions (ISSAI) 40, *Quality Control for Supreme Audit Institutions*, Section 7.

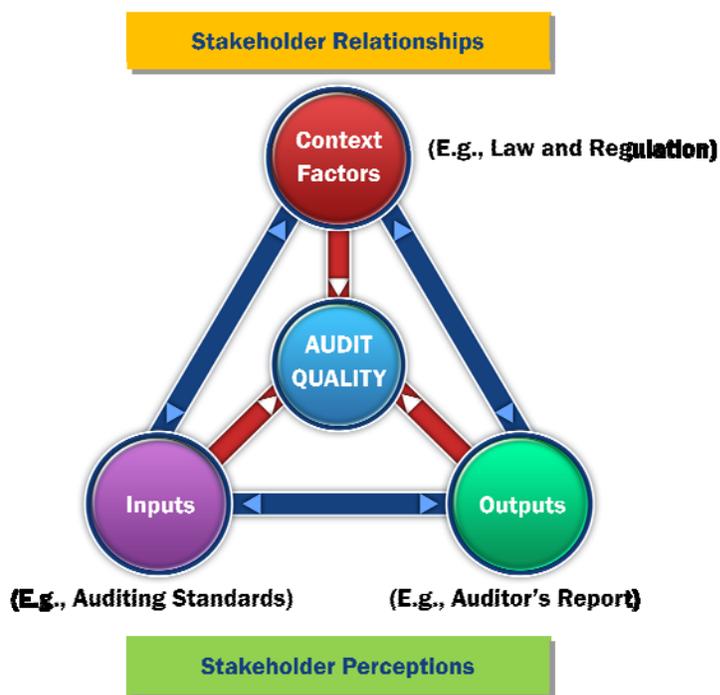
1. Introduction¹

1.1 Background

- Recap main messages from Audit Quality Thought Piece²
- Summary of recent IAASB discussions
- Relevant external developments

1.2 Purpose and Overview of Consultation Paper

- The IAASB hopes that an international audit quality framework will be used to facilitate closer working relationships and dialogue both between IAASB and key stakeholders and between those stakeholders, including investors, those charged with governance, regulatory and oversight bodies, and audit firms.
- Overview of paper and intended audience
 - Conceptual view of influences on audit quality



1.3 Guide for respondents

- Invitation to comment on the proposed framework
- Questions for respondents [to be determined in due course]

¹ The introductory section will be completed after IAASB discussion of all other sections of the paper.

² The thought piece, *Audit Quality: An IAASB Perspective*, issued by the IAASB in January 2011, can be accessed at: <http://web.ifac.org/media/publications/3/audit-quality-an-iaasb-per/audit-quality-an-iaasb-per.pdf>.

2. Key Relationships within the Financial Reporting Supply Chain Influencing Audit Quality

1. In its 2008 report titled *Financial Reporting Supply Chain: Current Perspectives and Dimensions*,³ IFAC describes the financial reporting supply chain in the following broad terms:

The financial reporting supply chain refers to the people and processes involved in the preparation, approval, audit, analysis and use of financial reports. All links in the chain need to be of high quality and closely connected to supply high quality financial reporting.

The cycle both starts and ends with the investors and other stakeholders, who want to make informed economic decisions about a company and, therefore, require financial information to do so. Subsequently, it is management that, under the general direction of the board of directors (supervisory board), prepares the financial information for eventual approval by the board and, in some countries, the general meeting of shareholders. The auditor interacts with management and the board while auditing the financial information and provide independent opinions. The media and others distribute the financial information, and analysts and credit-rating agencies evaluate it, to be used by the investors and other stakeholders.

Also within the chain there are the various standard setters in the areas of corporate governance, financial reporting and auditing; the regulators, who enforce those standards; and professionals, such as investment bankers and lawyers, who provide advice to the other participants.

2. While each separate link in the supply chain plays an important role in supporting high quality financial reporting, the interactions between the links are also important. From an audit perspective, the key relationships in the supply chain that influence audit quality are those between:
 - a) Auditors and management;
 - b) Auditors and those charged with governance;
 - c) Management and those charged with governance;
 - d) Auditors and users of financial statements; and
 - e) Auditors and audit regulators.

2.1 Relationship between Auditors and Management

3. Management is responsible for the preparation of the financial statements and for such internal control as management determines is necessary to ensure that the information for preparing the financial statements is reliable and available on a timely basis. Management is also responsible for ensuring that the financial statements comply with the applicable financial reporting framework and, where relevant, represent the underlying transactions and events in a manner that achieves fair presentation.
4. Auditors depend on management providing them with full and timely access to the information and individuals within and outside the entity necessary for them to effectively

³ The report can be accessed at: <http://web.ifac.org/media/publications/9/financial-reporting-supply/financial-reporting-supply.pdf>.

carry out their audit. They also depend on management to freely disclose information that is relevant to the audit. In the absence of cooperation and open dialogue it is unlikely that an efficient and effective audit can be performed. Importantly, the willingness of management to engage in open dialogue with auditors positively influences the auditors' ability to identify, assess and respond to the risks of material misstatement, particularly with regard to significant complex or unusual transactions, or matters involving significant judgment or uncertainty.

5. An open and constructive relationship also helps create an environment in which management can benefit from auditors' observations on such matters as:
 - Possible improvements to the entity's financial reporting practices;
 - Identified and suspected misstatements in the financial statements; and
 - Deficiencies in internal control over financial reporting.

2.2 Relationship between Auditors and Those Charged with Governance

6. Those charged with governance are responsible for overseeing the strategic direction of the entity and obligations related to the entity's accountability. This includes overseeing the financial reporting process. Effective two-way communication between auditors and those charged with governance can positively influence audit quality and assist those charged with governance.
7. Specifically, those charged with governance can make an important contribution to audit quality through:
 - Providing views on financial reporting risks and areas of the business that warrant particular audit attention;
 - Considering the robustness and adequacy of the audit plan, including whether sufficient audit resources will be allocated for the audit to be effectively performed;
 - Creating an environment in which management is not resistant to being challenged by the auditors and not overly defensive when discussing difficult or contentious matters; and
 - Providing views on how subsequent audits can be improved.
8. In turn, constructive dialogue with the auditors may inform the actions and perspectives of those charged with governance regarding specific matters pertaining to the entity's financial reporting process. For example, the auditor's communications on such matters as significant findings from the audit, the quality of the entity's financial reporting practices, and significant deficiencies in internal control, may stimulate those charged with governance to take actions that lead to improvements in the financial reporting process.

2.3 Relationship between Management and Those Charged with Governance

9. A strong commitment to honesty and integrity within the entity has a positive bearing on the quality and reliability of its financial reporting, and therefore on the effectiveness of the audit. Such a culture, which is established and nurtured by those charged with governance working in conjunction with senior members of management, promotes the development

and maintenance of appropriate accounting policies and processes as well as the open sharing of information that is necessary for high-quality financial reporting.

10. To achieve this, those charged with governance depend on a transparent and constructive relationship with management in assisting them to effectively discharge their responsibility for oversight of the financial reporting process. This requires a willingness by management to come forward to discuss with those charged with governance such matters as:
 - Identified and potential significant financial reporting, regulatory and audit issues;
 - Performance pressures relative to the achievement of market expectations and what responses may be appropriate; and
 - Areas where the financial reporting process may be strengthened.
11. The lack of a transparent and constructive relationship between management and those charged with governance can lead to deficiencies in internal control not being addressed, a greater risk of errors in the financial reporting process and possibly fraud.

2.4 Relationship between Auditors and Financial Statement Users

12. Although the relationship between auditors and financial statement users is often indirect, user support can be an important buttress for audit quality. For example active users, such as institutional investors, can take an active interest in exploring with the entity matters on which the auditors have taken a public position – such as by modifying the audit opinion, withdrawing from the engagement, not seeking reappointment, or issuing a statement to shareholders explaining the relevant matters.
13. Auditors, in turn, need to recognize that the audit is being performed for the users and endeavor to communicate in the audit report, or by other means, matters that are relevant to them. The IAASB acknowledges that some users do not believe that the binary nature of the current audit reporting model fully meets their information needs. The IAASB is therefore undertaking a separate initiative to explore how to enhance the quality, relevance and value of auditor reporting.⁴

2.5 Relationship between Auditors and Regulators⁵

14. Regulators impact the financial reporting process in two main ways: through regulation of the financial markets and the financial statements used in those markets, and through direct oversight of the audit function.

⁴ In May 2011, the IAASB issued a consultation paper, *Enhancing the Value of Auditor Reporting: Exploring Options for Change*, setting out possible options for change to the auditor's report. The consultation paper seeks input as to whether such options might be effective in enhancing auditor reporting and the communicative value of the auditor's report. The consultation paper can be accessed at: <http://www.ifac.org/Guidance/EXD-Details.php?EDID=0163>.

⁵ In the public sector, national audit offices (NAOs) are usually not subordinated to external regulatory oversight. They answer to parliament, who from time to time may question the quality of the NAOs' activities. Some NAOs have experienced situations where parliaments have carried out special examinations concerning the general quality of the NAOs' audit work. However, it is difficult to draw any general conclusions from such examinations.

15. Audit is an important element of the regulation of the financial markets and additional dialogue between auditors and financial regulators can assist those regulators achieve their goals. Financial regulators can assist audit quality through the establishment of a clear and robust financial reporting framework and by creating an environment where high-quality audit is valued.
16. The formation of national independent audit oversight bodies in many parts of the world in recent years has been a positive development for audit quality. In many countries, independent audit regulators are now responsible for inspecting audits, evaluating auditors' compliance with auditing and ethical standards, and taking appropriate action to address any breaches of those standards. The publication of results of audit inspections in a number of jurisdictions has led to greater awareness amongst auditors and other stakeholders of areas of weaknesses in relation to the gathering and evaluation of audit evidence. It has also generated increased accountability by auditors for their work.
17. A further positive development has been the establishment of the International Forum of Independent Audit Regulators (IFIAR) to facilitate knowledge sharing and promote greater coordination amongst audit regulators.
18. Effective audit regulation is facilitated by mutual trust and open communications between the regulators and the auditors. Trust is developed when the auditors are confident that the audit regulator has adequate resources, both in terms of quality and experience, to undertake their responsibilities, and when the inspection activities are properly focused.
19. While the focus of regulatory inspections will be on compliance with the standards and the sufficiency and appropriateness of audit evidence, it is important that regulatory feedback to auditors focus on matters of substance. A regulatory approach that adheres strictly to the letter of the standards, without regard to their spirit and intent, may lead to undue and excessive documentation, to the detriment of audit quality. Audit regulators, in turn, depend on auditors adopting an open and constructive approach to feedback from them.

3. National Context Factors

20. The performance of an audit does not take place in a vacuum. Various environmental factors – context factors – can impact the robustness of the processes underlying the preparation of financial statements and the auditor’s ability to carry out an effective audit. A number of context factors are explored in a paper dealing with the global challenges to consistent auditing issued by the Institute of Chartered Accountants in England & Wales’ (ICAEW) Audit Quality Forum (ICAEW Paper).⁶ These context factors, which will vary from one country to another, include:

- Business practices;
- The legal and regulatory environment applicable to the entity;
- The educational environment for accountants and auditors; and
- Broader cultural issues.

3.1 National Business Practices

21. National business practices can influence the reliability of financial reporting. Issues relating to the nature and complexity of business relationships and the manner and formality in which transactions are undertaken present challenges for auditors and influence audit quality.

22. In addressing this aspect, the ICAEW Paper notes:

In some countries, business relationships may be conducted on a less formal basis than others. Terms of agreements may be vague or not followed and what ultimately determines the commercial outcome of an arrangement might be the relationship of trust between the parties and not what is written on paper. Trading with family members may be common and some audited entities may rely on this. Agreements may only be made orally.

A lack of formal documentation poses problems for auditors in terms of risk assessment and obtaining sufficient appropriate audit evidence.

23. The ICAEW paper also notes:

The cultural characteristics and complexity of business structures and relationships might also affect the completeness and detail of accounting records in audited entities.

24. In countries where it may be the norm rather than the exception for entities to engage in transactions with related parties and family members of management, auditors may find it difficult to evaluate whether all transactions have been recorded and whether such transactions are undertaken on an arm’s length basis.

⁶ The ICAEW paper, *International Consistency – Global Challenges Initiative: Providing Direction*, can be accessed at: <http://www.icaew.com/~media/Files/Technical/Audit-and-assurance/audit-quality/audit-quality-forum/audit-quality-international-consistency.ashx>.

3.2 The National Legal and Regulatory Framework

General Legal Environment

25. Laws and regulations set expectations for proper behavior by market participants and provide greater certainty when parties enter into transactions and commit to contracts. The strength of the legal and regulatory framework in protecting investor and creditor rights and the sanctity of contracts is an important contributing factor to the reliability of financial reporting and audit quality.
26. In particular, the ICAEW Paper notes the following:

The audit risk assessment process may be affected by the nature of national legal systems. If property ownership rights are not clearly established or enforced in the laws of a country and if the government or other bodies have the power or authority to seize property, then this can prove challenging for auditors in making judgments about asset recognition and confirming ownership rights and obligations relating to assets and liabilities.

Legal protection issues such as the extent of recourse provided to investors or creditors who have been harmed as part of the country's legal and regulatory system may indirectly impact the audit. In business environments where investors have limited powers of recourse, it may lead to the creation of a dominant position for management to exercise influence, abuse power, override controls and distort the assessment of liabilities.

The Corporate Governance Framework

27. As noted above, the existence of a robust corporate governance framework at the national level can support audit quality through setting the right tone regarding the importance of high-quality financial reporting. An effective framework establishes specific responsibilities for those charged with governance regarding the oversight of the financial reporting process, which may include evaluating and reporting on the effectiveness of the audit. It also communicates expectations for behaviors and attitudes and provides motivations for those charged with governance relative to the fulfillment of those responsibilities.
28. Such responsibilities may be embedded in law or regulation, or codified as best practice. Regardless of how they are specified, they form the framework against which those charged with governance can be held accountable in their governance roles. Where corporate governance practices are weak or non-existent, there may be greater challenges to the quality of the financial information that the entity prepares.
29. In some countries the relationship between the auditors and those charged with governance is established by law, regulations and/or codes of conduct.⁷

⁷ The Task Force is undertaking an informal survey on audit committees (or equivalent) in the G-20 countries to understand whether they have responsibilities regarding the oversight of the external audit and, if so, whether they report publicly on their oversight work and in which areas. The findings from this survey will be summarized in the next draft of the consultation paper.

The Applicable Financial Reporting Framework

30. National law and regulations will also determine the financial reporting framework to be applied. The financial reporting framework is a critical factor in the quality of financial reporting and is also a contributing factor to audit quality. For example, where the framework does not promote robust and transparent disclosures of related party relationships and transactions, it will be challenging for auditors to identify such transactions and ensure that they are appropriately accounted for and disclosed.
31. A further influence on audit quality is whether the applicable financial reporting framework strikes the right balance between being principles-based or rules-based. Some believe that an accounting framework that is overly principles-based allows management too much latitude to account for transactions in a manner that suits management's objectives and makes it difficult for auditors to challenge this. On the other hand, others believe that over-emphasis on rules encourages a strict compliance approach to financial reporting, which may mean that it is difficult for auditors to focus on the substance of transactions and the fair presentation of the financial statements. It may also provide opportunities for management to work around the rules for fraudulent financial reporting purposes.
32. In addition, over-complexity in the applicable financial reporting framework may make it difficult for management to understand the accounting requirements and for those charged with governance to provide oversight of the financial reporting process. Overly complex financial reporting frameworks can also detract from audit quality by absorbing too much of the time of senior members of the audit team on accounting complexities rather than on the fundamentals of the audit such as obtaining evidence regarding the existence of assets and the completeness of liabilities.

The Reporting Timetable

33. An additional contributing factor to audit quality is the timeframe within which the audit has to be completed. While timeframes are sometimes imposed by regulators or by market practice, there seems to be an ongoing trend for entities to wish to report their annual results more quickly. Very tight reporting deadlines threaten audit quality and drive greater reliance on audit procedures performed before the period end. In such circumstances there is greater need for reliance on internal control and less opportunity for detailed substantive work after the period end. Importantly, time pressures may undermine auditors' ability to adequately consider significant financial reporting issues, discuss them with management and those charged with governance, and appropriately consult on them.

The Liability Regime for Auditors

34. A robust mechanism for taking punitive action in relation to poor quality auditing provides auditors with a compelling motivation to perform high-quality work. Punitive mechanisms can include disciplinary action undertaken by audit regulators, legal action for professional negligence or a mixture of the two.
35. Disciplinary activities have been undertaken by professional bodies for many years. More recently, in some countries, this work has been transferred to independent audit regulators.

Regulatory actions vary but can include fines and the withdrawal of licenses of audit firms and individuals.

36. Legal action for professional negligence, or fear of legal action, has long been a feature of the audit environment in a number of countries and there have been concerns that an overly litigious environment can undermine audit quality by fostering a compliance-focused audit mentality at the expense of the proper application of professional judgment. It can also result in what has been called “defensive auditing” where auditors’ resources are allocated away from actions that enhance audit quality towards efforts to manage the litigation risk. In a broader context, a highly litigious environment can act as a significant disincentive for the brightest graduates to consider a career in auditing. It may also discourage the best of those already in practice from considering a long-term career in the profession.

3.3 The Educational Environment for Accountants and Auditors

37. The strength of the educational system for accountants and auditors can be an important factor contributing to quality financial reporting and to audit quality. This applies to all levels of education including primary, secondary and tertiary, as well as the specific training requirements related to obtaining an accountancy qualification.
38. The need for management to have accountancy expertise is critical for the preparation of reliable financial statements irrespective of whether the financial reporting framework is principles-based or rules-based.
39. Auditors need to have accountancy expertise as well as additional skills and knowledge related to auditing. This is generally obtained through an initial qualification and subsequent continuing professional development (CPD). The quality of the individuals attracted to a career in the auditing profession as well as the robustness of national examination and CPD processes are important factors in audit quality.
40. The quality of the individuals attracted to a career in the auditing profession will be influenced by a number of factors including remuneration levels, perceptions of career opportunities, and the status of auditing in society more generally. In this regard, the ICAEW Paper notes the following:

... a poor perception of the auditing profession may mean that a career in auditing does not attract enough high-quality candidates. This might be especially so if there is a perception that auditing is just about ticking boxes and complying with regulation and not about performing a valuable activity.
41. Attracting high-quality individuals to the auditing profession is not, however, the end of the story – there is a need to retain them. In some countries, it is customary for large numbers of newly qualified accountants to leave the profession and take jobs in industry. While this probably has a beneficial impact on financial reporting, it can limit the number of experienced staff available to audit firms and thereby jeopardize audit quality.
42. An additional contributing factor to audit quality is the availability of appropriate implementation guidance and tools for auditors relative to the application of auditing standards. The needs in this area may be more keenly felt amongst smaller firms that do not have the capacity to develop their own support. Addressing resource capacity constraints in this regard may therefore present opportunities for enhancing audit quality.

3.4 Broader Cultural Issues

43. Broad cultural differences are also likely to impact the attitude of both accountants in business and auditors. These differences may impact the quality of financial reporting and audit quality. Two factors that are noted in the ICAEW paper are:
- Deference to authority; and
 - Secrecy.

Deference to Authority

44. Some national cultures value, or perhaps just tolerate, more junior people challenging the views of more senior people in organizations. In other cultures, it is difficult for junior people to challenge the views of senior people. Differences in the degree to which people in senior positions within an entity are deferred to can impact the reliability of financial reporting and audit quality.
45. Auditing is a process that involves challenge and this is embedded in auditing standards. In particular, auditors may not interpret key concepts such as professional skepticism and professional judgment as intended by auditing standards, especially in environments that do not have a culture of questioning authority. The ICAEW Paper notes the following in this regard:

The acceptability of communication between people of different levels of authority varies greatly between countries. There are different views of what might be deemed acceptable. Auditors face a challenge in knowing how to react and deal with this inequality particularly in situations where cultural assumptions may preclude the audit team from interacting directly with senior management. The audit team and, in some circumstances, the engagement partner may be unable to ask sensitive questions of management or request supporting evidence. Differences in levels of respect have implications for auditors' assessment of management integrity and the trust they place in information provided and judgments made by management.

Secrecy

46. A further aspect of national culture that may have an influence on audit quality is the extent to which secrecy or confidentiality is expected in business dealings. The ICAEW Paper notes the following in particular:

The secretiveness of cultures where information is closely guarded and seen as confidential can affect the auditor's assessment under ISA 315⁸ of the risk of material misstatement. Unwillingness of management (or lack of incentives) to provide transparent financial information in financial statements increases risk in a number of areas and may affect the audit process. ... A secretive culture may generate concerns about the adequacy of disclosures in financial statements. ... Auditors might be fully aware of a particular issue and what the appropriate disclosures should be but may find the audited entity unwilling to make them as they consider the information to be confidential.

In a different vein, the secretiveness of some cultures may make it difficult for some audit firms to form or join international networks, or to experience other cultures and share information and

⁸ ISA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

experience. This lack of global connectivity can hinder the development of skills such as the ability to challenge and think of alternative solutions to problems and to make professional judgments.

4. Input Factors

47. While auditors cannot significantly change the national context factors described in Section 3, they do have direct influence over the inputs to the audit itself. In this Section, the main inputs are described within the categories of:
- The culture within an audit firm;
 - The knowledge, skills and personal qualities of audit partners and staff; and
 - The effectiveness of the audit process.
48. Appendix 1 lists possible threats to audit quality relative to these input factors and possible actions in response to such threats.

4.1 The Culture within an Audit Firm

Input	Indicators
The firm’s leadership creates a culture where audit quality is valued.	The firm’s culture is likely to make a positive contribution to audit quality where: <ul style="list-style-type: none"> • The firm has recruitment, promotion and reward systems for partners and staff that promote the personal characteristics essential to audit quality. • Financial considerations do not drive actions and decisions that have a negative effect on audit quality. • Partners and staff have sufficient time and resources to deal with difficult issues as they arise. • The firm provides partners and staff with access to high-quality technical support. • The firm promotes the merits of consultation on difficult issues. • Robust systems exist for making client acceptance and continuance decisions. • Audit quality is monitored within firms and across international networks and appropriate consequential action is taken.

The Importance of the Culture within an Audit Firm

49. The culture within a firm is an important input to audit quality because the environment in which the audit team works can materially affect the mindset of partners and staff, and consequently the way they discharge their responsibilities. Audit firms are commercial entities. Each firm’s culture will be an important factor in determining the extent to which its partners and staff function in the public interest as opposed to merely achieving the firm’s commercial goals.

50. There is a significant public interest in audits, especially of public interest entities. This needs to be recognized by the firm’s leadership who has a responsibility for actively creating an environment to ensure that audit quality is valued. The task of creating an appropriate environment can be especially challenging where the audit does not provide the main source of income to the firm. It is important that a firm has effective internal corporate governance arrangements to safeguard the public interest nature of the audit function and to avoid the firm’s commercial interest in promoting other practice areas (such as tax, corporate finance and consultancy) to the detriment of audit quality.
51. In order to strengthen effective internal corporate governance arrangements, a number of countries are exploring whether larger audit firms should be required to appoint independent, non-executive members to their governing boards.
52. Creating an appropriate environment within audit firms includes encouraging adherence to the principles underlying ethical requirements that apply to auditors. No ethical standards can cater for every situation – particularly as business relationships become increasingly complex. Consequently, the firm’s leadership has a vital role in avoiding situations that might compromise that firm’s objectivity or independence.
53. Audit firm cultures are not always apparent to investors and others with an interest in the effectiveness of the audit. However, some firms publish on their websites “transparency reports” about their internal governance and quality control processes.
54. Some of the principal indicators of whether a firm has an appropriate culture from the perspective of enhancing audit quality are described below.

The Firm has Recruitment, Promotion and Reward Systems for Partners and Staff that Promote the Personal Characteristics Essential to Audit Quality

55. This indicator applies to firms except sole practitioners. Appropriate personal characteristics include integrity, objectivity, professional competence and due care. These characteristics need to be nurtured and developed by the firm. This involves embedding them in training programs and in promotion and reward systems. It also involves ensuring that audit partners and staff are not penalized for jeopardizing a client relationship by taking a robust position on audit issues.

Financial Considerations do not Drive Actions and Decisions that Have a Negative Effect on Audit Quality

56. Financial considerations both at the firm level (such as the financial target that a firm sets for the margin to be achieved on audit work and the willingness to invest in training and support systems for audit) and at the engagement level (such as the audit fee and the recovery rate) should not be allowed to prevent the performance of a robust audit that meets the public interest.
57. Firm can achieve quality-oriented cultures by ensuring that:
 - The leadership of the audit function has sufficient input into overall firm management decisions.

- Over-emphasis is not given to winning audit appointments and on the retention of audit clients at the expense of the quality of audit judgments.
- Over-emphasis is not given to marketing non-audit services.
- There is not excessive cost cutting (including by reducing partners and staff) in the audit practice during times of economic downturn that damage the provision of audit quality.
- Internal training is not overly focused on improving client service at the expense of necessary training in technical competence and appreciation of the public interest aspect of auditing.

Partners and Staff Have Sufficient Time and Resources to Deal with Difficult Issues as They Arise

58. Partners and staff usually work on a number of audits and undertake other activities for clients or within the firm. Sometimes, this leads to concentrated periods of activity. The need to work intensively on one activity means that time available to allocate to another activity will be limited. It is important that firms anticipate, as best they can, and manage possible time conflicts when allocating responsibilities. Firm management need to proactively monitor work levels to ensure that an unacceptable burden is not put on individual partners or staff.
59. Resource allocation also needs to take account of audit risk. A danger exists that the most competent partners and staff will be allocated to the firm's largest, most prestigious, clients and as a result, will not be available to audit other less well-known clients where the risk that the financial statements are misstated may be greater.

The Firm Provides Partners and Staff with Access to High-Quality Technical Support

60. This indicator applies to firms except sole practitioners. Auditing requires knowledge of a considerable number of technical areas including company and tax law, and financial reporting, auditing and ethical standards. It is important that audit firms have technical support arrangements to help individual partners and staff keep up to date with developments in these areas and to provide assistance on complex areas. Audit quality can also be enhanced if an information infrastructure is developed that enables the firm to support audit judgments (for example, by assembling business and industry related databases), to track independence issues and ensure that they are properly addressed, and to plan and effectively manage the rotation of partners and managers on audit engagements.

The Firm Promotes the Merits of Consultation on Difficult Issues

61. Auditing often involves difficult decisions and judgments to be made. Staff will discuss these issues within the audit team and with the audit engagement partners. Audit engagements partners will often wish to discuss difficult decisions and judgments with other partners or with technical specialists. This process will be facilitated if there is a culture of consultation and where those involved have sufficient time available to deal properly with issues as they arise.

62. A culture of consultation is also important for sole practitioners, and they may leverage external technical resources available to them, whether through their professional bodies, their relationships with other firms, or suitably resourced third-party organizations.

Robust Systems Exist for Making Client Acceptance and Continuance Decisions

63. Prior to accepting an audit engagement, and annually thereafter, it is important that audit firms consider whether they are competent to perform the engagement and have the capabilities and resources to do so. This includes whether the firm can comply with relevant ethical requirements. At the same time, the audit firm considers whether there is information to suggest that client management lack integrity to the extent that it will not be possible to perform a quality audit.

Audit Quality is Monitored within Firms and across National and International Networks and Appropriate Consequential Action is Taken

64. Auditing involves compliance with standards, internal firm policies and procedures. It also involves difficult decisions and judgments made by staff at different levels of experience and sometimes under time pressure. Monitoring of audit quality is an important aspect of ensuring that standards are being adhered to and that the partners and staff are performing appropriately. It is important that this is done on an international basis where network firms perform the audits of important components of a group audit. It is also important that the firm takes appropriate steps to address any shortcomings revealed by these monitoring activities.

4.2 The Knowledge, Skills and Personal Qualities of Audit Partners and Staff

Input	Indicators
The knowledge, skills and personal qualities of audit partners and staff	The knowledge, skills and personal qualities of audit partners and staff are likely to make a positive contribution to audit quality where: <ul style="list-style-type: none"> • Partners and staff understand their clients’ business. • Staff performing detailed “on-site” audit work have sufficient experience and are appropriately supervised by partners and managers. • Partners and managers provide junior staff with timely appraisals and appropriate coaching and “on-the-job” training. • Partners and staff comply with the IESBA Code, including having integrity and acting objectively. • Partners and staff demonstrate professional competence, including skepticism. • Sufficient training is given to audit partners and staff

Input	Indicators
	on audit, accounting and, where appropriate, specialized issues.

The Importance of the Knowledge, Skills and Personal Qualities of Audit Partners and Staff

65. Audit is a discipline that relies on competent individuals demonstrating integrity, objectivity, rigor and skepticism to enable them to make reliable judgments on issues such as:
- Assessing the risks of material misstatement due to fraud or error;
 - Evaluating the reasonableness of accounting estimates;
 - Evaluating the adequacy of audit evidence; and
 - Concluding whether the financial statements are fairly presented.
66. The qualities of perseverance and robustness are also important in ensuring that necessary changes are made to the financial statements in the face of persuasive and, possibly, intimidating client management, or that the auditor’s report is appropriately qualified.
67. The auditor’s capabilities and competence⁹ are a vital input to audit quality because the majority of the requirements in ISAs either provide a framework for the judgments made in an audit or need judgment to be properly applied. The auditor’s capabilities and competence help ensure that those judgments are of a high quality.
68. Audit quality therefore necessitates that partners and staff, working as a team, have appropriate innate judgment skills and experience as well as technical skills and business knowledge. Experience, capabilities and training are closely linked. Relatively inexperienced staff can be effective in some audit roles – but only if they are properly trained, directed and supervised.
69. Some of the principal indicators of where the knowledge, skills and personal qualities of audit partners and staff are likely to make a positive contribution to audit quality are described below.

Partners and Staff Understand Their Clients’ Business

70. Business knowledge, both general and specific to the client and its industry, is of critical importance. Industry knowledge can be especially important for clients in, for example, the extractive, financial services and retailing industries. However, it is important that knowledge areas are not too limited.

⁹ International Education Standard (IES) 8 defines capabilities as “the professional knowledge; professional skills; and professional values, ethics, and attitudes required to demonstrate competence;” and competence as “being able to perform a work role to a defined standard, with reference to working environments.”

71. ISA 315 requires the auditor to obtain an understanding of the entity and its environment in order to identify and assess the risks of material misstatement in the financial statements. This understanding extends to:¹⁰
- Relevant industry, regulatory, and other external factors including the applicable financial reporting framework;
 - The nature of the entity;
 - The entity’s selection and application of accounting policies;
 - The entity’s objectives and strategies and those business risks that may result in risks of material misstatement; and
 - The measurement and review of the entity’s financial performance.
72. ISA 315 also requires the auditor to obtain an understanding of internal control relevant to the audit.¹¹
73. The detailed understanding of the entity, its business and the industry in which it operates is key to the auditor both being appropriately skeptical and making appropriate judgments.

Staff Performing Detailed “On-Site” Audit Work Have Sufficient Experience and Are Appropriately Supervised by Partners and Managers

74. This indicator applies to firms except sole practitioners. The structure of an accountancy firm is generally hierarchical – often described as a “pyramid structure” – and the make-up of audit teams for individual engagements generally reflects this structure. As a result, much of the detailed “on-site” audit work is likely to be performed by staff who are relatively inexperienced; indeed, many may still be in training contracts. Because of this, it is important that experienced managers and partners are readily available to supervise their teams, deal with significant technical and judgmental issues, and communicate effectively with senior client management.

Partners and Managers Provide Junior Staff with Timely Appraisals and Appropriate Coaching and “On-the-Job” Training

75. This indicator applies to firms except sole practitioners. A firm’s appraisal process is an important aspect of developing an individual’s capabilities. Although it is difficult to measure, audit quality is likely to be improved if it is addressed in partners’ and staff’s appraisals. In the case of partners, this can be used to promote the exercise of good audit judgment, including consultation on difficult issues.
76. A distinction can usefully be made between appraisals and coaching/on-the-job training. While appraisals can be used to help identify the absence of an important skill or competence, coaching/on-the-job training can be used to help an individual develop that skill or competency. Coaching/on-the-job training are likely to be especially important in relation to developing key personal characteristics such as integrity, objectivity, rigor, skepticism, and perseverance.

¹⁰ ISA 315, paragraphs 3 and 11

¹¹ ISA 315, paragraph 12

77. However, the number of people capable of providing coaching is limited. Such people may have other demands on their time, including “special” or non-audit work, or involvement in the internal management of the firm. It is important that firms incentivize their more experienced staff to allocate the necessary time to undertake this important staff development role effectively.

Partners and Staff Comply with the IESBA Code, Including Having Integrity and Acting Objectively

78. The International Ethics Standard Board for Accountants’ (IESBA) Code of Ethics for Professional Accountants (IESBA Code)¹² establishes, and requires professional accountants to comply with, the following fundamental principles of professional ethics:¹³
- a) Integrity – to be straightforward and honest in all professional and business relationships. Integrity also implies fair dealing and truthfulness.¹⁴
 - b) Objectivity – to not allow bias, conflict of interest or undue influence of others to override professional or business judgments.
 - c) Professional competence and due care – to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional services based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable technical and professional standards.
 - d) Confidentiality – to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the professional accountant or third parties.
 - e) Professional behavior – to comply with relevant laws and regulations and avoid any action that discredits the profession.
79. In addition, ISAs require auditors to comply with relevant ethical requirements relating to auditor independence. Section 290 of the IESBA Code describes the approach auditors should take, including:
- Identifying threats to independence;
 - Evaluating the significance of the threats identified, and
 - Applying safeguards, when necessary, to eliminate the threats or reduce them to an acceptable level.
80. Section 290 of the IESBA Code states that when the professional accountant determines that appropriate safeguards are not available or cannot be applied to eliminate the threats or reduce them to an acceptable level, the professional accountant shall eliminate the

¹² In the public sector environment, the relevant ethical requirements may include the International Organization of Supreme Audit Institutions’ (INTOSAI) Code of Ethics or national ethical requirements applicable to public sector auditors that are at least as restrictive as the IESBA Code.

¹³ IESBA Code, paragraph 100.5

¹⁴ IESBA Code, Section 110

circumstance or relationship creating the threats or decline or terminate the audit engagement.¹⁵

Partners and Staff Demonstrate Skepticism and Professional Competence

81. International Education Standard (IES) 8 requires that the skills requirement within the education and development program for audit professionals should include developing the following professional skills at an advanced level in an audit environment:¹⁶

- a) Applying relevant audit standards and guidance;
- b) Evaluating applications of relevant financial reporting standards;
- c) Demonstrating capacity for inquiry, abstract logical thought, and critical analysis;
- d) Demonstrating professional skepticism;
- e) Applying professional judgment; and
- f) Withstanding and resolving conflicts.

82. Two issues of particular note are:

- Evaluating applications of relevant financial reporting standards.

In addition to the requirement in ISA 315 for the auditor to obtain an understanding of the applicable financial reporting framework, other ISAs may establish specific requirements or provide guidance regarding understanding aspects of the applicable financial reporting framework relevant to particular audit areas. For example, ISA 540¹⁷ requires the auditor to obtain an understanding of the requirements of the applicable financial reporting framework relevant to accounting estimates, including related disclosures. The related application material notes that this assists the auditor in determining whether the applicable financial reporting framework, for example:

- Prescribes certain conditions for the recognition, or methods for the measurement, of accounting estimates.
- Specifies certain conditions that permit or require measurement at a fair value.
- Specifies required or permitted disclosures.

- Demonstrating professional skepticism.

The application of an appropriate degree of professional skepticism¹⁸ is a crucial mindset for auditors. Unless auditors are prepared to challenge management's assertions, they will not act as deterrent to fraud nor be able to confirm, with

¹⁵ IESBA Code paragraph 290.7

¹⁶ IES 8, *Competence Requirements for Audit Professionals*, paragraph 42

¹⁷ ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, paragraph 8

¹⁸ Auditing Standards define professional skepticism as “an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.” This definition suggests that professional skepticism influences the scope of the work, helps the auditor evaluate audit findings and ultimately conclude whether sufficient appropriate audit evidence has been obtained to enable an opinion to be expressed on whether an entity's financial statements are fairly presented.

confidence, that a company’s financial statements are fairly presented. However, skepticism can be taken too far – challenging everything in a well run company will slow down the publication of its financial statements and risks unnecessary costs.

Sufficient Training is Given to Audit Partners and Staff on Audit, Accounting and, Where Appropriate, Specialized Issues

83. In many countries, auditors are graduates and have excellent academic qualifications but not necessarily in accountancy. The profession endeavors to ensure that auditors have the necessary technical skills through admission examinations and practical training. However, those professional exams are designed for qualification as an “accountant,” not just as an “auditor.”
84. Against this background, the training in auditing that is provided by the audit firms has acquired increased importance. Firms generally provide training in the technical aspects of audit and in the requirements of their audit methodologies. Firms also provide essential practical experience by including trainees in audit teams undertaking audit work.¹⁹ Merging learning the technical aspects of auditing with gaining practical experience is important because classroom training is only part, and perhaps only a small part, of the process by which auditors develop skills and experience.
85. Professional accountancy institutes have requirements relating to CPD and the post-qualification development programs developed by the firms have the potential to be an important contributor to an auditor’s competence. Generally, however, such programs address a wide range of areas relevant to the firm’s business as a whole and are not necessarily concerned with the technical skills needed to support audit quality.

4.3 The Effectiveness of the Audit Process

Input	Indicators
The effectiveness of the audit process	The audit process is likely to make a positive contribution to audit quality where: <ul style="list-style-type: none"> • The engagement team is properly structured. • The audit methodology encourages partners and managers to be actively involved in audit planning. • The audit methodology provides for compliance with law and regulations and auditing standards without discouraging individual team members to think creatively and exercise judgment. • The audit methodology ensures there is effective review of audit work. • The audit methodology requires appropriate audit

¹⁹ IES 8, paragraphs 54 and 59, establishes requirements for practical experience for audit professionals.

Input	Indicators
	documentation. <ul style="list-style-type: none"> • There is effective engagement with the auditors of other components in the group. • There is effective engagement with the client’s internal auditors. • The audit process is adapted to developments in professional standards and is responsive to regulatory inspection findings.

The Importance of a High Quality Audit Process

86. It is well recognized that the audits of most large companies, especially multi-national companies, have tight reporting deadlines and are increasingly complex. There is an ever-increasing need for auditors to have an effective process to ensure that quality audits are performed.
87. Some of the principal indicators of a high quality audit process are described below.

The Engagement Team is Properly Structured

88. An audit firm needs to allocate its resources such that audit teams have the expertise and experience to undertake particular audits, whilst at the same time complying with relevant ethical requirements (such as rotation of audit and other key partners). This involves structuring an audit team so that:
- It has individuals with appropriate knowledge of the industry in which the client operates and its applicable financial reporting framework;
 - Partners and staff act objectively and are seen as being independent. There can be a challenge in balancing knowledge of the client and objectivity. There is a risk of “client capture” where the relationship between the audit engagement partner and the client is so close that the partner’s objectivity is impaired. This may be caused by the partner working so closely with management over a period of time that sentiments of familiarity and confidence displace the skepticism and objectivity that are so fundamental to an effective audit. Client capture may also arise if partners believe that their remuneration and, indeed, their ongoing careers with the firm are dependent on maintaining “happy client management.”
 - It has sufficient resources to enable:
 - Partners to be adequately involved in establishing the overall audit strategy, assessing risks and developing appropriate responses to audit issues, and evaluating audit evidence in important areas;
 - Staff to carry out the audit work required in a considered way having regard to their level of experience and the timetable for completion of the audit work involved; and

- Partners and experienced managers to have the time necessary to review the staff's work and respond in a considered way to issues identified.

The Audit Methodology Encourages Partners and Managers to be Actively Involved in Planning

89. Auditing standards place an emphasis on risk assessment to drive the extent and nature of the work to be performed. It is essential that the person who is to take responsibility for the audit opinion to be issued is actively involved in risk assessment and planning processes. Otherwise, the audit is likely to be ineffective, inefficient or possibly both.

The Audit Methodology Provides for Compliance with Law and Regulation and Auditing Standards without Discouraging Individual Team Members to Think Creatively and Exercise Appropriate Judgment

90. Most audit firms use methodologies to assist staff in achieving an efficient and effective audit and for quality control processes. These methodologies are often in the form of software that sometimes supports decisions and generates electronic working papers that can be viewed at remote locations.
91. Such methodologies can be an effective mechanism for achieving compliance with law and regulation and auditing standards. However, in some circumstances, they may reduce freedom of action. There is a risk that increasing too far the level of prescription in audit methodologies will have negative implications for other elements of audit quality. For example:
- If compliance with a very prescriptive methodology is over-emphasized, there is a risk that insufficient emphasis is given to experienced staff tailoring the specified audit procedures to the circumstances and considering whether further procedures need to be performed.
 - Over-emphasizing the process by which an audit is performed may detract from experienced audit partners and staff making important judgments.
 - Reducing too far the freedom of action of partners and staff may undermine the motivation of these individuals and cause them not to pursue a career in auditing.
92. The trend to use computerized methodologies also has the potential to distance both partners and staff from the company being audited. In part, this trend increases the risk that the information and audit evidence that have historically been obtained by spending time with company personnel, “walking the floor” and observing and inspecting the company's operations may not be obtained.
93. The challenges posed by increased use of computerized audit methodologies also include:
- Excessive use of computerized programs that reduce flexibility and leads to auditing being seen as a “box-ticking” exercise;
 - New staff spending their time learning how to use the technology (because the methodologies require extensive training), rather than how to audit; and
 - Partners and managers reviewing audit work from remote locations with the consequence that, while this approach may be “efficient” (in a narrow sense), it

significantly reduces the opportunity for experienced staff to provide coaching and “on-the-job” training. It also may limit the active involvement of the partner in decision making.

The Audit Methodology Ensures There is Effective Supervision and Review of Audit Work

94. As noted paragraph 74 above, much of the detailed “on-site” audit work may be performed by staff who are relatively inexperienced. In such circumstances, it is vital that their work is supervised and reviewed by experienced staff. Furthermore, as noted in paragraph 76 above, the process of supervision and review, if properly performed, can also have a very positive effect on staff development.

The Audit Methodology Requires Appropriate Audit Documentation

95. Audit documentation performs a number of roles including:

- Assisting the engagement team to plan and perform the audit.
- Assisting members of the engagement team responsible for supervision to direct and supervise the audit work.
- Enabling the engagement team to be accountable for its work.
- Retaining a record of matters of continuing significance to future audits.
- Enabling the conduct of intra-firm quality control reviews and inspections, and external inspections in accordance with applicable legal, regulatory or other requirements.

96. Documentation of the rationale for an audit judgment is likely to increase the rigor, and therefore the quality, of that judgment. The process of committing to writing the issues and how they have been resolved is likely to improve the rigor of the auditor’s thought process and the validity of the conclusions reached.

There is Effective Engagement with the Auditors of Other Components in a Group Audit

97. Most large entities will have divisions, subsidiaries, joint ventures or investees accounted for by the equity method (components). One or more components are frequently audited by audit teams other than the group audit team. Component auditors may be from within the group auditor’s firm, from one of its network firms, or from a different firm of auditors.

98. The group auditor will often wish to use the work of the component auditors when obtaining evidence to support the group auditor’s opinion on the group financial statements. It is likely to be important for the group auditor to engage effectively with component auditors.

99. Whilst an international firm’s audit methodology may be applicable across all the firms within the network, the importance of ensuring that the firms within the network observe consistent high standards of professional skill, integrity and conduct cannot be overstated. Firms therefore need to give priority to having effective quality control systems across the whole network.

There is Effective Engagement with the Client’s Internal Auditors

100. Many large entities will have internal auditors. It is likely to be important for both efficiency and effectiveness for there to be effective engagement between the external and internal auditors.

The Audit Process is Adapted to Developments in Professional Standards and is Responsive to Regulatory Inspection Findings

101. The audit firm’s audit process should not remain static but should evolve with changes in professional standards. Importantly, continual improvements to the firm’s audit methodology and tools should be made to respond to findings from regulatory inspections.

5. Output Factors

102. In this Section, the main outputs are described within the categories of:

- The reliability of audit reporting to users of audited financial statements;
- The usefulness of audit reporting to such users; and
- The quality and usefulness of audit communications to those charged with governance and management.

103. Appendix 2 lists possible threats to audit quality relative to the output factors and possible actions in response to such threats.

5.1 The Reliability of Audit Reporting to Users of Audited Financial Statements

Output	Indicator
The reliability of audit reporting to users of audited financial statements	Audit reporting is likely to provide a positive contribution to audit quality where audit reports are written in a manner that conveys the auditor’s opinion on the financial statements.

The Importance of an Audit Opinion that Commands Confidence

104. The ultimate objective of an audit is the provision of an audit opinion that provides users confidence as to the reliability of the audited financial statements. For the majority of users, the absence of a qualified audit opinion is an important signal. However, the value of that signal is influenced by the reputation of the audit firm that has conducted the audit and an assumption about the effectiveness of the audit process employed. One of the difficulties associated with the audit process is that the work performed and the findings that arise from it are largely invisible to the main users of the audit – the shareholders.

105. A principal indicator of where audit reporting to users is likely to provide a positive contribution to audit quality is when audit reports are written in a manner that conveys clearly the auditor’s opinion on the financial statements. Audit reports have developed over the years, influenced by law and auditing standards, to a degree that they are largely standardized. An audit report can be unmodified. It can also be modified by:

- A qualification of the opinion
- The inclusion of an adverse opinion
- The disclaimer of an opinion.

106. An audit report also can contain an emphasis of matter paragraph to draw users’ attention to a matter disclosed in the financial statements that the auditor believes is fundamental to users’ understanding of the financial statements. Such a matter may concern, for example, uncertainty regarding the entity’s ability to continue as a going concern.

5.2 The Usefulness of Audit Reporting to Users of Audited Financial Statements

107. Information obtained by the IAASB signals that:

- a) The financial statement audit and the independent auditor’s opinion on an entity’s financial statements are valued. However, other than communicating the auditor’s overall conclusion, the content of the auditor’s report is not viewed as being as useful or informative as it could be.
- b) Users recognize there is richer information about the entity and about the audit itself than is currently being provided through the audited financial statements and other corporate disclosure mechanisms, and through the auditor’s report. Some of those users wish to obtain this richer information directly from the entity and/or through communications about the auditor’s insight into such matters. They believe such information would assist them in assessing the financial condition and performance of the entity, as well as the quality of its corporate reporting and the quality of the audit.
- c) Some users also believe that the communicative value of the auditor’s report could be improved if changes were made to the structure and wording of the auditor’s report.

108. As explained in paragraph 13, the IAASB is undertaking a separate initiative to explore how to enhance the quality, relevance and value of auditor reporting. There are many potential options for changes that might address these concerns, including some shorter-term options that fall under the IAASB’s mandate and some longer-term options that would require co-operation with organizations the mandates of which extend to legislative and other regulatory frameworks.

5.3 The Quality and Usefulness of Audit Communications to Those Charged with Governance and Management

Output	Indicators
The quality and usefulness of audit communications to those charged with governance and management	Audit reporting is likely to provide a positive contribution to audit quality where: <ul style="list-style-type: none"> • Communications with those charged with governance include information about: <ul style="list-style-type: none"> ○ The scope of the audit. ○ The threats to auditor objectivity. ○ The key risks identified. ○ Judgments made in reaching the audit opinion. ○ The qualitative aspects of the entity’s accounting and reporting and potential ways of improving financial reporting. • Communications with management include findings

Output	Indicators
	about: <ul style="list-style-type: none"> ○ Misstatements in the financial statements. ○ Deficiencies in internal control.

109. Some of the principal indicators of where audit communications to those charged with governance and management are likely to provide a positive contribution to audit quality are described below.

Communications with Those Charged with Governance

110. Effective two-way communication is important in assisting:

- The auditor and those charged with governance in understanding matters related to the audit in context, and in developing a constructive working relationship;
- The auditor in obtaining from those charged with governance information relevant to the audit. For example, those charged with governance may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events; and
- Those charged with governance in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the risks of material misstatement of the financial statements.

Communications with Management

111. While not a direct objective, an audit has the ability to make a valuable contribution to management to assist them in complying with relevant law, regulations and financial reporting standards. It can also provide useful information of weaknesses in controls and accounting systems that can lead to improved efficiency or effectiveness in management's processes.

6. Stakeholder Perceptions of Audit Quality



112. Audit quality cannot be measured, and, rather like beauty, it will be assessed “in the eye of the beholder.” While it is important to focus on the inputs to audit quality, this perspective alone is insufficient to address the question of whether audit quality has been achieved in the broader context.
113. Perceptions of audit quality vary amongst stakeholders depending on their level of direct involvement in audits and on the lens through which they assess audit quality. The table below lists a number of factors that the following key stakeholder groups are assumed to take into account in forming a view on the likely quality of an audit:²⁰
- Management (both large entities and owner-managed entities)
 - Audit committees (large entities)
 - Institutional investors
 - Primary public sector users (such as Public Accounts Committee secretariats)

²⁰ This will be updated in the light of the research findings from the current survey of stakeholders being undertaken by national auditing standard setters.

Stakeholder	Factors Influencing Perceptions of Audit Quality
Management (Large Entities and Owner-Managed Entities)	<ul style="list-style-type: none"> • Engagement effectiveness, including, where applicable, coverage of subsidiaries • Professional relationship with engagement partner • Accessibility of engagement partner and others within the engagement team • Knowledge of, and experience with, the entity and its industry • Efficient use of management’s time and resources • Quality, timeliness and usefulness of communications • Competence and continuity of the engagement team • Firm reputation
Audit Committees (Large Entities)	<ul style="list-style-type: none"> • Quality, timeliness and usefulness of communications • Professional relationship with engagement partner • Accessibility of engagement partner and others within the engagement team • Knowledge of, and experience with, the entity and its industry • Independence from management • Competence of senior engagement team members • Robustness of the audit, including auditor’s: <ul style="list-style-type: none"> ○ Risk assessment and responses to identified risks ○ Ability to stand firm against pressure from management ○ Appropriate leveraging of internal audit function where applicable • Efficient use of management’s time and resources • Firm reputation
Institutional Investors	<ul style="list-style-type: none"> • Firm reputation and industry expertise • Perception of independence • Strength of the regulatory framework surrounding audit • Quality of clients’ periodic financial reports, including disclosures • Regulatory inspection reports
Primary Public Sector Users (e.g. Public Accounts)	<ul style="list-style-type: none"> • Knowledge of, and experience with, the entity and its industry • Competence of senior engagement team members • Independence from management

Stakeholder	Factors Influencing Perceptions of Audit Quality
Committee Secretariats)	<ul style="list-style-type: none"> • Professional relationship with engagement partner • Accessibility of engagement partner and others within the engagement team • Robustness of the audit, including auditor’s: <ul style="list-style-type: none"> ○ Risk assessment and responses to identified risks ○ Ability to stand firm against pressure from management ○ Appropriate leveraging of internal audit function where applicable • Efficient use of management’s time and resources • Quality of clients’ periodic financial reports, including disclosures • Quality and transparency of auditor reporting • Quality, timeliness and usefulness of communications, including impact of recommendations in areas of performance and compliance with relevant mandates • Auditor reputation

6.1 Management

114. Management is likely to view an audit as a service. An important feature of services is that the perception of their quality is usually based on *how* they are provided as much as their outcome. Further, auditing is a *professional* service. Several characteristics of a professional service influence how its value is perceived by the recipient of the service:

- The output of a professional service is based on the professional’s expertise as opposed to a tangible deliverable such as a physical product.
- Its outcome is uncertain as opposed to determinable in terms of a specific result.
- It is idiosyncratic in nature as opposed to standardized.
- Its pricing is time-based as opposed to product- or service demand-based.²¹

115. Therefore, variability in how the audit is delivered as a service and how the auditor is seen as providing value affect management’s perceptions of audit quality for both large entities and owner-managed entities.

116. In the light of these general considerations, it is likely that management will pay particular attention to the following factors in its assessment of audit quality.

²¹ *Rethinking Audit Quality: Eight Propositions for Auditors to Think About*, Dr. Robert Knechel, Inaugural Lecture, Maastricht University, September 2009

Engagement Effectiveness, Including, Where Appropriate, Coverage of Subsidiaries

117. Overall engagement effectiveness seen from management’s perspective contributes to management’s perception of audit quality. In practical terms, this means the avoidance of surprises throughout the audit and after its completion. Engagement effectiveness may be signaled by the auditor in such ways as:
- 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.
 - Engagement partner “visibility” on the job, such as through on-site supervision of audit staff.
 - Meeting agreed timelines and reporting deadlines.
118. Management may also look for indications that the auditor has appropriately focused on key risk areas, shown a thoughtful approach to the audit, avoided over-auditing in lower risk areas, and delivered value for money.
119. In the context of group audits, the firm’s geographic reach and therefore its ability to provide audit coverage for subsidiaries and other components of the group likely also contribute to management’s perception of audit quality. The greater the international reach of the firm, the greater the likely impact on management’s perception of the firm’s strength, depth of resources, and breadth of capabilities, and therefore of the overall engagement effectiveness.

Professional Relationship with Engagement Partner

120. Given that the audit is a service, people relationships matter a great deal in how management perceives audit quality. In particular, the presence of chemistry and a strong cultural fit between management and the engagement partner are likely positive factors influencing management’s view of audit quality. The relationship may be forged over time through the development of mutual trust and respect.
121. There is little in the way of guidance on relationship building in auditing standards. Some auditors will be better at it than others, and management may only perceive a difference in chemistry in this regard when there is a change in engagement partner or firm for the audit.

Accessibility of Engagement Partner and Others within the Engagement Team

122. The accessibility of the engagement partner and others within the engagement team can have an important influence on management’s perception of audit quality. Face time with the engagement partner in particular helps to build rapport and mutual understanding. Importantly, however, it helps to demonstrate to management that the entity’s audit and its business are valued by the firm. Accessibility also may manifest itself through frank and open dialogue between the engagement partner and management on a regular basis.

123. Making the engagement partner and others within the team accessible may be particularly challenging during busy reporting times of the year or when they are spread unduly thin through an unbalanced work load.

Knowledge of, and Experience with, the Entity and its Industry

124. 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, notwithstanding requirements in the ISAs for the auditor to obtain an understanding of the entity and its environment. This aspect 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.
125. Nevertheless, regardless of the industry, the extent of prior knowledge of industry practices and regulation can strongly influence management's view of the competence and credibility of the auditor and, therefore, management's perception of audit quality. Equally, the extent to which the auditor understands the entity's business, including key operational drivers and specific financial reporting issues, can be a significant influence.

Efficient Use of Management's Time and Resources

126. Efficient performance of the audit has a significant bearing on how management perceives the overall quality of the audit. From management's viewpoint, this means making efficient use of management's time and resources. In practical terms, an efficient execution may be signaled by the auditor through such means as:
- Timely submission and clear articulation of information requests.
 - Avoidance of duplicate inquiries of management on the same matter from different engagement team members.
 - Provision of consistent audit personnel year on year.
 - Minimization of disruption to the entity's day-to-day business.
 - Avoidance of billing surprises for cost overruns.

Quality, Timeliness and Usefulness of Communications

127. The quality, timeliness and usefulness of communications from the engagement team, whether through informal discussions with management or a formal management letter, all add to the value of the service that management perceives it receives on the audit. 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.
 - Constructive advice on regulatory matters.
 - Global perspectives on significant industry issues or trends.

Competence and Continuity of the Engagement Team

128. In interacting with the engagement team, management will form views as to the caliber of the people staffing the audit, and these in turn will likely color management's overall view of audit quality. Confident and articulate engagement team members are a signal to management that the engagement team is capable of undertaking a high-quality audit. Importantly, the professional competence, including technical skills and experience, of senior engagement team members contributes to management's forming a view as to the credibility of the engagement team and, therefore, the quality of the audit work.
129. 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 drawn on technical expertise in resolving highly complex financial reporting issues.
 - The quality of the advice management has received through a management letter from the auditor.
130. In addition, continuity in the engagement team from year to year can often influence 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 as this contributes to the conduct of an effective and efficient audit.

Firm Reputation

131. The reputation of the firm and its brand recognition likely also help to color the lens through which management perceives audit quality. The firm's brand may be visible to management through the media, sponsorship events, firm leadership presentations, and other public avenues. By building public recognition and acceptance of the firm, these exposures may indirectly support a perception by management of quality in the firm's work.
132. Quite apart from its brand, a firm may have built a solid reputation with management over a long period of time through delivering robust, high-quality audit work to the entity time and again. Such prior expectations may lead management to form judgments about the quality of the current audit engagement. However, as in the case of any other service provider, the firm's reputation lives by the quality of its last completed engagement. Therefore, adverse impacts on the firm's reputation, such as through disciplinary proceedings or regulatory sanctions, may alter management's perception of audit quality.

6.2 Audit Committees

133. Some of the factors that influence audit committees' perceptions of audit quality are likely to be similar to those of management. This will include:
- Professional relationship with engagement partner

- Accessibility of 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
134. However audit committees have a different perspective and are likely to be particularly focused on:
- Quality, timeliness and usefulness of communications;
 - Independence from management; and
 - The robustness of the audit.

Quality, Timeliness and Usefulness of Communications

135. In relation to the quality, timeliness and usefulness of communications, audit committees may look favorably upon auditor communications that provide:
- Unbiased insight 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 and practices.
 - Information that enable them to effectively fulfill their governance responsibilities, including, where applicable, their responsibility to evaluate the effectiveness of the audit.

Independence from Management

136. Audit committees are likely to especially value the objectivity of the auditors and their willingness, where necessary, to take differing views from management and perhaps the audit committee itself.

The Robustness of the Audit

137. The engagement team’s audit approach may factor into the audit committee’s overall evaluation of the effectiveness of the audit, and therefore audit quality. An audit that is appropriately focused on the higher risk areas and that incorporates robust responses to the identified risks will likely engender confidence amongst the audit committee that all significant issues will be addressed.
138. Equally, in forming a view on audit quality, the audit committee will likely consider 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. Such evidence may

suggest to the audit committee both auditor independence from management and the conduct of a robust audit.

139. A signal of a robust audit can also be conveyed by the engagement partner through demonstrating appropriate professional skepticism, such as through probing inquiries on significant matters, and exercising appropriate professional judgment on significant issues.
140. Where an internal audit function exists within the entity, appropriate consideration by the engagement team of whether to use the work of internal auditors can also be viewed favorably by the audit committee relative to audit quality.

6.3 Institutional Investors

141. Factors that may influence institutional investors' perceptions of audit quality are described below.

Firm Reputation and Industry Expertise

142. From institutional investors' perspective, a firm's reputation and industry expertise may be gauged in a number of ways, particularly through the firm's branding (as discussed in section 6.1 above), its client list, and whether it has clients in the same industry.
143. 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 service.
144. Investors may also view a firm that has clients in the same industry as strongly 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. In making this judgment, however, investors may not necessarily be aware of the limited choice amongst audit firms that may exist in some industries or market segments.
145. More generally, a track record of servicing "household name" entities in a particular industry can suggest to investors that the firm has in-depth industry expertise.

Perception of Independence

146. Evidence of independence by the firm also can steer investors' perceptions of audit quality. Independence may be demonstrated in a number of ways, such as:
 - Issuing modified reports as a result of disagreement with management on significant financial reporting issues.
 - Periodically rotating the engagement partner on the audit.
 - Resigning from the engagement or withdrawing from the client relationship if the firm deems it necessary to do so.

Strength of the Regulatory Framework Surrounding Audit

147. The strength of the regulatory framework that surrounds the audit also can be a significant influence on investor perceptions of audit quality. A robust regulatory regime will recognize and support the important role of the audit in ensuring high-quality financial reporting. At the same time, it will provide institutional mechanisms for ensuring adequate oversight of the firms, including provisions for adequate sanctions for poor quality or negligent audit work.
148. Equally, a regime that promotes best practices in corporate governance will facilitate the conduct of effective audits through emphasizing to audit committees the important role they play in overseeing the financial reporting process, including the audit. Also, a regime that requires the use of high-quality financial reporting standards will support perceptions of audit quality through mandating robust benchmarks against which the auditor should validate the entity's financial reporting practices.
149. Conversely, a weak regulatory framework will likely not engender confidence amongst investors regarding audit quality, especially in this age of globalization when capital can be diverted at a moment's notice.

Quality of Clients' Periodic Financial Reports, Including Disclosures

150. The overall quality of the entity's financial report, including disclosures, can lead to a favorable impression by investors of audit quality, especially if the entity's business involves complex transactions that give rise to difficult financial reporting issues. In this regard, compliance with the requirements of the applicable financial reporting framework and whether a fair presentation is achieved are implicit criteria in investors' evaluation of the quality of the financial reporting. These considerations, in turn, include such matters as:
 - 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

151. Findings from published regulatory inspection reports regarding a particular firm may color investors' perceptions of audit quality relative to that firm. Such findings may reveal information concerning such matters as:
 - The robustness of the firm's quality control system.
 - The rigor of the firm's audit approach, including compliance with auditing and other professional standards.
 - The quality of professional judgments on significant issues, and the process applied in making those judgments.
 - The effectiveness of the firm's engagement teams' communications with audit committees.

152. Adverse findings resulting in significant disciplinary action against the firm can undermine investors' confidence of audit quality with respect to the firm.

6.4 Primary Public Sector Users

153. Many of the factors affecting perceptions of audit quality for 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.

154. In addition to the factors applicable to audit committees as described above, the following aspects of reporting and communication by NAOs 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 and compliance with relevant mandates, particularly value-for-money advice relative to budgets.
- Fair, unbiased and politically neutral reporting.
- Well-balanced and educational reports in the appropriate contexts.

Threats to Audit Quality Input Factors and Possible Actions to Address Such Threats

The following tables list possible threats to audit quality and possible actions in response relative to the input factors. These lists are illustrative only and are not intended to be comprehensive.

1. A Culture Within the Audit Firm that Promotes the Appropriate Values

#	Indicators	Threats to Audit Quality	Possible Actions
1.	The firm has recruitment, promotion and reward systems for partners and staff that promote the personal characteristics essential to audit quality.	<ul style="list-style-type: none"> Recruitment, promotion and reward systems that give little or no recognition to the personal characteristics essential to audit quality. 	<ul style="list-style-type: none"> Promote a culture that recognizes and rewards high quality work. Recruit individuals of integrity who have the capacity to develop the competence and capabilities necessary to perform the firm’s work and possess the appropriate characteristics to enable them to perform competently. Recognize and reward the development and maintenance of competence and commitment to ethical principles. Emphasize the need for continuing training for all levels of firm personnel, and provide the necessary training resources and assistance to enable personnel to develop and maintain the required competence and capabilities.
2.	Financial considerations do not drive	<ul style="list-style-type: none"> Business strategy of the firm that is 	<ul style="list-style-type: none"> Promote an internal culture

#	Indicators	Threats to Audit Quality	Possible Actions
	actions and decisions that have a negative effect on audit quality.	<p>geared more towards promoting its commercial interests than achieving quality on its engagements.</p> <ul style="list-style-type: none"> • Firm rapidly expanding / contracting. • Firm leadership unwilling to invest in audit quality. • Internal training overly focused on improving client service at the expense of necessary training in technical competence and appreciation of the public interest aspect of auditing. • Client pressure or intimidation (e.g., threat of dismissal or litigation, or pressure to reduce inappropriately the extent of work performed in order to reduce fees.). • Quoting fees that are so low that it may be difficult to perform the engagement in accordance with applicable technical and professional standards for that price. 	<p>recognizing that quality is essential in performing engagements; in particular, recognizing that the firm’s business strategy is subject to the overriding requirement for the firm to achieve quality in all the engagements that the firm performs.</p>
3.	Partners and staff have sufficient time and resources to deal with difficult issues as they arise.	<ul style="list-style-type: none"> • Business strategy places undue emphasis on engagement profitability at the expense of quality. • Client pressure to complete engagements within tight deadlines. • Excessive workloads placed on 	<ul style="list-style-type: none"> • Promote an internal culture recognizing that quality is essential in performing engagements. • Assign appropriate engagement teams. • Monitor the workload and

#	Indicators	Threats to Audit Quality	Possible Actions
		individual partners and staff. <ul style="list-style-type: none"> • Assigning the most competent partners and staff to the firm’s largest and most prestigious clients at the expense of the firm’s riskier clients. 	availability of engagement partners and staff so as to enable these individuals to have sufficient time to adequately discharge their responsibilities. <ul style="list-style-type: none"> • Agree on realistic time frames with clients.
4.	The firm provides partners and staff with high-quality technical support.	<ul style="list-style-type: none"> • Inadequate resources invested in high quality technical support. 	<ul style="list-style-type: none"> • Provide sufficient resources to enable appropriate consultation to take place.
5.	The firm promotes the merits of consultation on difficult issues.	<ul style="list-style-type: none"> • The firm culture does not encourage consultation on difficult issues. • Lack of investment in experienced resources to provide support to engagement teams. 	<ul style="list-style-type: none"> • Possible actions include the following: <ul style="list-style-type: none"> ○ Consult appropriately on difficult or contentious issues. ○ Provide for sufficient resources to enable appropriate consultation. ○ Document consultations. ○ Implement the outcome of consultations. • Require, for appropriate engagements, an engagement quality control review. • Deal with and resolve differences of opinion within the engagement team, with those consulted and, where

#	Indicators	Threats to Audit Quality	Possible Actions
			applicable, between the engagement partner and the engagement quality control reviewer.
6.	Robust systems exist for making client acceptance and continuance decisions.	<ul style="list-style-type: none"> • Weak or non-existent policies and procedures addressing acceptance and continuance of client relationships and specific engagements. 	<ul style="list-style-type: none"> • Accept and continue client relationships and specific engagements only when appropriate.
7.	Audit quality is monitored within firms and across international networks and appropriate consequential action is taken.	<ul style="list-style-type: none"> • Inadequate resources (quantity and quality) for monitoring of audit quality. • Inadequate responses to weaknesses identified. • Weak or non-existent monitoring process for network firms. 	<ul style="list-style-type: none"> • Monitor the firm’s system of quality control to ensure that it is relevant, adequate, and operating effectively.

2. The Knowledge, Skills and Personal Qualities of Audit Partners and Staff

#	Indicators	Threats to Audit Quality	Possible Actions
1.	Partners and staff understand their clients' business.	<ul style="list-style-type: none"> Understanding the business insufficiently emphasized in the firm's culture and methodology. The engagement team does not possess the expertise in the client's business. Lack of support for specialist industries within the firm. 	<ul style="list-style-type: none"> Provide for sufficient personnel with the necessary competence and capabilities, including calling upon experts where necessary.
2.	Staff performing detailed "on-site" audit work have sufficient experience and are appropriately supervised by partners and managers.	<ul style="list-style-type: none"> Lack of partner involvement in the audit process. Weak arrangements for review and supervision. Lack of experienced engagement team members on site to direct and supervise the audit work. 	<ul style="list-style-type: none"> Ensure that methodology has clear requirements relating to review and that these are implemented in practice. Provide for sufficient personnel with the necessary competence and capabilities. Provide for the assignment of appropriate engagement teams. Comply effectively with ISA 220.22
3.	Partners and managers provide junior staff with timely appraisals and appropriate coaching and "on-the-job" training.	<ul style="list-style-type: none"> Senior engagement team members disregarding personal development needs of less experienced staff. Lack of time for coaching or providing "on-the-job" training. 	<ul style="list-style-type: none"> Provide timely appraisals, appropriate coaching and "on-the-job" training, all focused on enhancing audit quality.

²² ISA 220, *Quality Control for an Audit of Financial Statements*

#	Indicators	Threats to Audit Quality	Possible Actions
		<ul style="list-style-type: none"> • Undertaking performance appraisals long after engagement completion. 	
4.	Partners and staff comply with the IESBA Code, including having integrity and acting objectively.	<ul style="list-style-type: none"> • Partners and staff motivated to achieve commercial goals rather than audit quality. • Partners and staff have been associated with the client for many years. 	<ul style="list-style-type: none"> • Comply with the IESBA Code. • Address the familiarity threat caused by long association.
5.	Partners and staff demonstrate professional competence, including: <ul style="list-style-type: none"> • Skepticism. 	<ul style="list-style-type: none"> • The importance of skepticism not emphasized at the firm level. • Lack of leadership from the engagement partner, e.g., from active involvement in audit planning meetings. • Inadequate “on-the job” training and coaching for engagement team members. • Senior personnel having a long association with the client. • Client influence (e.g. through non-trivial gifts), pressure or intimidation. 	<ul style="list-style-type: none"> • Partners and staff to demonstrate a capacity for inquiry and critical analysis. • Require firm personnel to comply with relevant ethical requirements, including independence. • Perform engagements in accordance with professional standards and applicable legal and regulatory requirements.
6.	Partners and staff demonstrate professional competence: <ul style="list-style-type: none"> • They have an appropriate understanding of the client’s 	<ul style="list-style-type: none"> • Complex applicable financial reporting framework. • Lack of consultation with technical experts. 	<ul style="list-style-type: none"> • Provide training / technical support to allow partners and staff to understand applicable financial reporting framework.

#	Indicators	Threats to Audit Quality	Possible Actions
	<p>applicable financial reporting framework</p>	<ul style="list-style-type: none"> • Lack of training / technical support to allow partners and staff to understand applicable financial reporting framework. 	<ul style="list-style-type: none"> • Comply with relevant ISAs, including 315.
7.	<p>Partners and staff demonstrate professional competence:</p> <ul style="list-style-type: none"> • They demonstrate a capacity for inquiry, abstract logical thought and critical analysis, and are able to withstand and resolve conflicts. 	<ul style="list-style-type: none"> • Recruitment processes that do not focus on identifying individuals possessing these capabilities. • Inadequate “on-the-job” training. 	<ul style="list-style-type: none"> • Recruit individuals with these capabilities, and providing them with appropriate training.
8.	<p>Partners and staff demonstrate professional competence:</p> <ul style="list-style-type: none"> • They are robust in dealing with issues identified during the audit. 	<ul style="list-style-type: none"> • Partners and staff too closely aligned with helping the client achieve its commercial goals. • A culture exists of bowing to client pressure or intimidation (e.g. threat of dismissal or litigation). • Undue time pressures to complete engagements. 	<ul style="list-style-type: none"> • Emphasize audit quality in the firm’s culture. • Encourage consultation within the firm
9.	<p>Sufficient training is given to audit personnel on audit, accounting and, where appropriate, specialized issues.</p>	<ul style="list-style-type: none"> • Insufficient investment by the firm in specialized industries. • Inadequate time and resources devoted to training. • Lack of on-site involvement of senior engagement team members in directing, supervising and reviewing the audit work. 	<ul style="list-style-type: none"> • Emphasize the need for continuing training for all levels of firm personnel, and provide the necessary training resources and assistance to enable personnel to develop and maintain the required competence and capabilities. • Provide on-site direction and supervision of less experienced engagement team members by

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#	Indicators	Threats to Audit Quality	Possible Actions
			more experienced team members, thus providing appropriate “on- the-job” training.

3. The Effectiveness of the Audit Process

#	Indicators	Threats to Audit Quality	Possible Actions
1.	The engagement team is properly structured.	<ul style="list-style-type: none"> The engagement team does not possess the capabilities necessary to properly carry out the engagement. Senior personnel having a long association with the client. Firm pressure on senior engagement team members to keep the client “happy.” Inadequate resources for the engagement team. 	<ul style="list-style-type: none"> Assign appropriate and adequately resourced engagement teams. Comply effectively with ISA 300.²³ Perform engagements in accordance with professional standards and applicable legal and regulatory requirements.
2.	<p>The audit methodology:</p> <ul style="list-style-type: none"> Encourages partners and managers to be actively involved in audit planning. Provides for compliance with law and regulations and auditing standards without discouraging individual team members to think creatively and exercise judgment. Ensures there is effective review of audit work. Requires appropriate audit documentation. 	<ul style="list-style-type: none"> Ineffective engagement planning. Over-emphasis on compliance with firm’s methodology at the expense of appropriate professional judgment. Lack of involvement of the engagement partner in risk assessment and planning processes, and in directing, supervising and reviewing the audit work. Prescriptive audit methodology. Challenges arising from increased use of computerized audit 	<ul style="list-style-type: none"> Perform engagements in accordance with professional standards and applicable legal and regulatory requirements, including in relation to: <ul style="list-style-type: none"> Promoting consistency in the quality of engagement performance; Supervision; and Review. Comply effectively with ISAs 200,²⁴ 220, 230,²⁵ 240,²⁶ 300, and 315.

²³ ISA 300, *Planning an Audit of Financial Statements*

²⁴ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

#	Indicators	Threats to Audit Quality	Possible Actions
		<p>methodologies, such as excessive use of computerized programs that reduce flexibility.</p> <ul style="list-style-type: none"> • Insufficient emphasis on importance of documenting significant professional judgments. 	<ul style="list-style-type: none"> • Ensure appropriate assembly, safe custody and retention of engagement documentation.
3.	There is effective engagement with the auditors of other components in the group.	<ul style="list-style-type: none"> • Ineffective engagement planning. • Poor communications with component auditors. • Limitations on access to component auditors, whether imposed by management or by circumstances. 	<ul style="list-style-type: none"> • Comply effectively with ISAs 300 and 600.27 • Discuss issues regarding access to component auditors with management or those charged with governance of the entity.
4.	There is effective engagement with the client’s internal auditors.	<ul style="list-style-type: none"> • Ineffective engagement planning. • Poor communications with internal auditors. • Undue reliance on internal auditors. • Ineffective use of the work of internal auditors. 	<ul style="list-style-type: none"> • Comply effectively with ISAs 315 and 610.28
5.	The audit process is adapted to developments in professional standards and is responsive to regulatory inspection findings.	<ul style="list-style-type: none"> • Lack of resources to support the audit methodology function. • Lack of timely updates to the audit methodology in response to developments in professional 	<ul style="list-style-type: none"> • Provide adequate resources to support the audit methodology function. • Respond on a timely basis to developments in professional

²⁵ ISA 230, *Audit Documentation*

²⁶ ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*

²⁷ ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

²⁸ ISA 610, *Using the Work of Internal Auditors*

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#	Indicators	Threats to Audit Quality	Possible Actions
		standards. <ul style="list-style-type: none"> • Disregard for regulatory inspection findings. 	standards. <ul style="list-style-type: none"> • Firm leadership to give due recognition to the importance of responding constructively to regulatory inspection findings, including taking steps where necessary to improve the audit process.

APPENDIX 2

Threats to Audit Quality Output Factors and Possible Actions to Address Such Threats

The following tables list possible threats to audit quality and possible actions in response relative to the output factors. These lists are illustrative only and are not intended to be comprehensive.

1. The Reliability of Audit Reporting to Users of Audited Financial Statements

#	Indicator	Threats to Audit Quality	Possible Actions
1.	Audit reports are written in a manner that conveys the auditor’s opinion on the financial statements.	<ul style="list-style-type: none"> Audit reports that are not appropriate in the circumstances, e.g., if they are not supported by sufficient appropriate audit evidence. 	<ul style="list-style-type: none"> Comply effectively with ISAs 700,29 705,30 and 706.31

2. The Quality and Usefulness of Audit Communications to Those Charged with Governance and Management

#	Indicators	Threats to Audit Quality	Possible Actions
1.	Communications with those charged with governance include information about: <ul style="list-style-type: none"> The scope of the audit. The threats to auditor objectivity. The key risks identified. 	<ul style="list-style-type: none"> Inadequate engagement with TCWG during the audit. Lack of an effective two-way dialogue between the auditor and TWCG. Inadequate discussion of key risk 	<ul style="list-style-type: none"> Comply effectively with ISA 260.32

²⁹ ISA 700, *Forming an Opinion and Reporting on Financial Statements*

³⁰ ISA 705, *Modifications to the Opinion in the Independent Auditor’s Report*

³¹ ISA 706, *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report*

³² ISA 260, *Communication with Those Charged with Governance*

#	Indicators	Threats to Audit Quality	Possible Actions
	<ul style="list-style-type: none"> • Judgments made in reaching the audit opinion. • The qualitative aspects of the entity’s accounting and reporting and potential ways of improving financial reporting. 	<p>areas and significant audit findings.</p>	
2.	<p>Communications with management include findings about:</p> <ul style="list-style-type: none"> • Misstatements in the financial statements. • Deficiencies in internal control. 	<ul style="list-style-type: none"> • Non-communication or ineffective communication to management regarding identified misstatements and deficiencies in internal control. 	<ul style="list-style-type: none"> • Comply effectively with ISAs 265.33 and 450.34

³³ ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

³⁴ ISA 450, *Evaluation of Misstatements Identified during the Audit*