

Feedback Statement
Prepared by the Staff of the IAASB
February 2014

A Framework for Audit Quality
*Key Elements That Create an
Environment for Audit Quality*

IAASB

**International Auditing
and Assurance
Standards Board™**

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FEEDBACK STATEMENT

A FRAMEWORK FOR AUDIT QUALITY KEY ELEMENTS THAT CREATE AN ENVIRONMENT FOR AUDIT QUALITY

This Feedback Statement has been prepared by staff of the International Auditing and Assurance Standards Board (IAASB). It relates to, but does not form part of the IAASB publication, [A Framework for Audit Quality: Key Elements That Create an Environment for Audit Quality](#) (“the Framework”), which was unanimously approved by the IAASB in December 2013. The IAASB’s website includes a separate [page](#) on the topic of audit quality.

Background

1. Audit quality is a matter of high importance for the IAASB and others. The turbulent events of the recent global financial crisis have highlighted the critical importance of credible, high-quality financial reporting and the relevance of quality audits to support this.
2. In January 2011, the IAASB published a thought-piece titled, *Audit Quality: An IAASB Perspective*. The publication described perceptions on audit quality, some relevant elements of audit quality, the improvement of IAASB’s International Standards on Auditing that contribute to audit quality, and the road ahead.
3. In March 2011, the IAASB commenced work in identifying factors that underlie audit quality with the objectives of:
 - Raising awareness of the key elements of audit quality;
 - Encouraging key stakeholders to explore ways to improve audit quality; and
 - Facilitating greater dialogue between key stakeholders on the topic.
4. In January 2013, the IAASB issued a Consultation Paper titled, *A Framework for Audit Quality* (the “draft Framework”). The draft Framework described input- and output factors that contribute to audit quality at the engagement, audit firm, and national levels and demonstrated the importance of appropriate interactions among stakeholders and of various contextual factors.
5. The IAASB invited comments on the draft Framework Consultation Paper by May 15, 2013, and sought views on:
 - Whether the draft Framework covered all of the areas of audit quality that one would expect;
 - Whether the draft Framework reflected an appropriate balance in the responsibility for audit quality among the auditor (engagement team and firm), the entity (management and those charged with governance), and other stakeholders;
 - How respondents would intend to use the Framework, and whether there were changes needed to its form or content to maximize its value; and
 - The suggested ‘Areas to Explore’ – areas where the IAASB thought that further consideration, by both auditors and other participants in the financial reporting supply chain,

may benefit audit quality on a global basis. Views were sought on which, if any, of the Areas to Explore should be given priority and by whom, and whether there were additional areas.

6. In total, 76 responses were received on the draft Framework Consultation Paper. An overview of the respondents is shown below.



7. The IAASB also discussed its work on the Framework with the IAASB Consultative Advisory Group (CAG), and in its outreach to different stakeholders.
8. This Feedback Statement highlights the more significant issues raised by respondents to the January 2013 draft Framework Consultation Paper, and how the IAASB has addressed them in finalizing the Framework.

Completeness of the Framework

9. Respondents broadly welcomed the IAASB's work in the area of audit quality and supported the objectives of the project. These respondents thought that the Framework would provide a useful source of reference to raise awareness, to inform discussions, and to support education and training initiatives. As feedback on whether the draft Framework covered all areas of audit quality that one would expect, the majority of respondents indicated that they thought the draft Framework was comprehensive and they supported its structure and content. Nonetheless, in relation to the question on completeness respondents raised different issues and suggestions for further improving the Framework.

Objectives and Scope

10. Several respondents thought that the Framework should address not just audits, but also engagements to review financial statements and assurance engagements.
11. Several respondents also observed that the draft Framework did not seek to support the measurement of audit quality. They indicated that there would be value in the IAASB establishing weightings to reflect the importance of the various inputs and interactions, or at least highlighting those that are considered most important. Similarly, a few respondents thought that the objectives of the draft Framework were too limited and some were disappointed that the draft Framework sought to describe the current attributes of audit quality rather than focusing more specifically on the changes that need to be made to improve audit quality in the future.

12. Some respondents thought that the draft Framework needed to be more clearly placed in the wider context of the quality of financial reporting. Linked to this view, some respondents thought that the Framework needed to explore the relationship between audit quality and the value of an audit, and make clear that the value of an audit is subservient to the value of the underlying financial statements.
13. Several recommended that the Framework should more clearly articulate the benefits of quality audits.

IAASB Decisions

14. In relation to application of the Framework to assurance engagements in general, the IAASB acknowledged that many elements of the Framework may also have relevance to a wide range of assurance engagements. Nevertheless, the IAASB reaffirmed its view that, as a priority, its efforts in developing the Framework should focus on the quality of audits of financial statements.
15. In relation to the measurement of audit quality, the IAASB acknowledged that it is an area of interest to others exploring the topic. However, given the broad support received for the objectives of the Framework, the IAASB remains focused on: raising awareness of key elements of audit quality; encouraging key stakeholders to explore ways to improve audit quality; and facilitating greater dialogue among key stakeholders.
16. The IAASB concluded that describing audit quality in a holistic way, including qualitative factors with respect to inputs, processes and outputs, as well as interactions and contextual factors, is in and of itself an important contribution to the debate on audit quality. Such an approach reflects that, while the primary responsibility for performing quality audits rests with auditors, audit quality is best achieved in an environment where there is support from other participants in the financial reporting supply chain. However, the holistic approach lends itself less to direct measurement.
17. Further the IAASB noted that measuring audit quality would require a precise definition of audit quality. Appendix 1 of the Framework explains why this is inherently complex. (See also the section *Definition of Audit Quality* in this Feedback Statement.)
18. In relation to the objectives of the Framework being seen as too limited, some responses included recommendations that were beyond the scope of the project but that have been taken into account by the IAASB in developing its proposed 2015-2019 Strategy and Work Plan, on which consultation commenced in December 2013. In relation to audit quality in the future, the IAASB addressed more explicitly the relevance of continuously improving audit quality. (See paragraphs 95 and 96 of Appendix 2 in the Framework. See also the section *Topics to Emphasize in the Framework* in this Feedback Statement.)
19. With regard to the relationship between the value of an audit and the value of the underlying financial statements, the IAASB did not disagree with the notion that financial reporting statements may provide more valuable information if the applicable financial reporting framework is designed rigorously, thereby contributing to the perception on the quality of the audit performed. However, provided that the financial reporting framework to be applied in the preparation of the financial statements is determined to be acceptable, the IAASB believes that a quality audit can be performed. The IAASB noted that the different perceptions on the relationship between the value of financial reporting and audit quality are described in the Framework and did not see benefit to adding further material.

20. With regard to the relationship between audit quality and the value of an audit, the IAASB noted that the topic is complex and may deserve further exploration beyond what is in the Framework.
21. The IAASB supported the view of describing the benefits of quality audits and, accordingly, introduced a new paragraph to that effect placed prominently in the Foreword.

Definition of Audit Quality

22. The draft Framework did not define either “audit quality” or “a quality audit.” Rather, it included text that went some way to explaining these terms. The draft Framework also explained the complexity of audit quality and why it is difficult to define the term.
23. Many respondents supported the approach taken in the draft Framework recognizing that it was impractical to provide simple definitions of these terms, not least given the differing stakeholder perspectives that exist. Several respondents thought that a succinct definition of “audit quality” was needed but very few suggestions were offered as to what such a definition could be.

IAASB Decisions

24. After exploring different possibilities, the IAASB reaffirmed its view that it is not possible to develop a simple definition of audit quality. Challenges in developing a simple definition are described in Appendix 1 of the Framework. They include the judgmental nature of aspects of the underlying financial statements; what is sufficient, appropriate audit evidence; the inherent limitations of an audit designed to obtain reasonable rather than absolute assurance; the limited transparency on audit work performed; and audit findings and the different perspectives on what constitutes audit quality among stakeholders. The IAASB confirmed the appropriateness of its decision to issue a Framework that describes the input-, process- and output factors that contribute to audit quality as well as the appropriate interactions among stakeholders and the importance of various contextual factors.
25. Nevertheless, to respond to concerns raised, the IAASB further elaborated on the terms “audit quality” and “quality audit” to assist users of the Framework in understanding the IAASB’s thinking. (See paragraphs 1 and 2 of the Overview of the Framework.)

Clarification of the Status of the Framework

26. Many respondents considered that the status of the draft Framework was unclear and that its relationship with the International Standards on Auditing (ISAs) and International Standard on Quality Control (ISQC 1)¹ needed to be clarified. Some were concerned that the Framework might be thought of as a “super standard”, while others were concerned that the Framework might raise questions about the robustness of the ISAs.
27. In addition, some questioned calling the document “A Framework” as they thought this implied a role that was inconsistent with the IAASB’s *International Framework for Assurance Engagements* (Assurance Framework) and the International Accounting Standards Board’s Conceptual Framework.

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

IAASB Decisions

28. The IAASB discussed, at length, the use of the term “Framework” before issuing the Consultation Paper and decided that this title should be retained as the document provides an overview of the different dimensions of audit quality. To better distinguish the Framework from the Assurance Framework and to help better describe the nature of the document the sub-title “*Key Elements That Create an Environment for Audit Quality*” was added.
29. The IAASB does not intend the Framework to be authoritative. Accordingly, the Framework includes a clear statement to that effect, as follows: “*Auditors are required to comply with relevant auditing standards and standards of quality control for audit firms, as well as ethics and other regulatory requirements. In particular, ISQC1 addresses a firm’s responsibilities for its system of quality control for audits. The Framework is not a substitute for such standards, nor does it establish additional standards or provide procedural requirements for the performance of audit engagements.*” (See paragraph 6 of the Framework.)
30. In addition, the IAASB made a number of detailed drafting changes to reduce the possibility that terminology or statements in the Framework might be misinterpreted as new auditing requirements.

Length of the Framework

31. The majority of respondents thought that the draft Framework was too long and that its length would limit the extent to which it was used, especially by non-auditors.

IAASB Decision

32. The IAASB explored a number of options for shortening the document, including consideration of moving some of the material to other supporting documents (which some stakeholders, including some Representatives of the CAG, felt would be less helpful). The IAASB concluded that the best approach would be to move the detailed descriptions of the input- and process factors to an appendix (see Appendix 2 of the Framework). This change, together with further editorial changes to simplify some text, had the positive effect of substantively reducing the main body of the Framework, while retaining important content within one document. The IAASB also noted that the use and promotion of different vehicles on the IAASB website to communicate the main elements of the Framework to different stakeholders can be pursued.

Topics to Emphasize in the Framework

33. Respondents suggested a small number of additional factors to consider in the Framework, as well as suggestions on topics where they thought greater emphasis should be given.
 - In relation to input- and process factors, the main suggestions included:
 - (i) Additional emphasis on ensuring staff is sufficiently skeptical in practice.
 - (ii) Additional discussion about the relationship between quality and the remuneration of the audit partner.
 - (iii) Consideration of the impact that audit firms’ business model with regard to experience of employees, often described as a pyramid structure, could have on audit quality.
 - (iv) Additional discussion about specialist skills.

- (v) Greater emphasis on innovation and continuous improvement to meet the needs of society, and the potential impact of litigation.
- (vi) Greater emphasis on the audit process.
- In relation to output factors and interactions the main suggestions included:
 - (i) Additional emphasis needed on the importance of effective engagement between auditors and users.
 - (ii) Further elaboration on what IAASB meant by the term “effective interaction”.
 - (iii) Further elaboration on interactions between the auditor and the audit committee.
 - (iv) Addition of a number of contextual matters specific to audit.
 - (v) Further emphasis that auditors have a responsibility to perform additional procedures when the entity being audited does not have robust corporate governance and strong information systems.

IAASB Decisions

34. In relation to the input- and process factors :

- (i) Although professional skepticism was already included in the draft Framework as a separate attribute, the IAASB enhanced the material describing how members of the engagement team can apply professional skepticism. (See paragraph 16 in Appendix 2 of the Framework.)
- (ii) The IAASB changed the firm level attribute 1.2.2 to ‘Necessary Personal Characteristics are Promoted through Appraisal and Reward Systems Supporting Audit Quality’. In addition, drafting changes were made to the text supporting this attribute. (See attribute 1.2.2 in Appendix 2 of the Framework.)
- (iii) The IAASB made drafting changes to reflect the relevance of experience in making reasonable professional judgments, including in public sector audit bodies as well as to align further with the developments of the International Accounting Education Standards Board. (See paragraph 53 of Appendix 2 of the Framework.)
- (iv) The IAASB added further examples of where specialist skills may be needed. (See paragraph 42 in Appendix 2 of the Framework.)
- (v) In relation to innovation and continuous improvement, the IAASB further explained that the methodology should also evolve with business processes and changes in the environment, elaborated on the relevance of monitoring audit quality by the firm in identifying emerging risks and opportunities and introduced a new paragraph emphasizing the importance of a commitment to continuous improvement, as well as on the usefulness of root cause analysis. (See paragraphs 95 and 96 and 106 of Appendix 2 of the Framework.)
- (vi) In addition, the IAASB added the litigation environment as a separate attribute of contextual factors, explaining the relationship between litigation risk and audit quality. (See Section 5.8 of the Framework.) In order to give greater emphasis to the audit process this section was separated from the input factors and the graphic that

summarizes the Framework was revised accordingly. (See paragraphs 8 and 13 of the Overview and Section 2 of the Framework.)

35. In relation to output factors, interactions and contextual factors:
- (i) The IAASB introduced examples in the Framework on how interactions between auditors and financial statement users may occur, in order to give further emphasis to these interactions. (See Section 4.3 of the Framework.)
 - (ii) In relation to what constitutes an “effective interaction”, the IAASB concluded that this is sufficiently covered in relevant ISAs (for example, ISA 260² dealing with those charged with corporate governance). Accordingly, no changes were made.
 - (iii) On the interactions between the auditor and the audit committee, the IAASB introduced a new paragraph in the Framework to reflect the topics to be discussed (as addressed in the ISAs), how effective communication can be facilitated, and how this interaction often takes place for smaller entities. (See Section 4.3 of the Framework.)
 - (iv) In relation to contextual factors that relate more directly to audit quality, the IAASB added information on the following factors: audit regulation, the litigation environment, attracting talent and the financial reporting timetable. Additional text was also added on corporate governance in the context of an audit. (See Sections 5.5, 5.7-5.9 and 5.10 of the Framework.)
 - (v) In relation to the lack of robust corporate governance and strong information systems, the IAASB added text to the paragraphs on contextual factors on information systems and corporate governance reflecting that environmental factors have the potential to impact the nature and quality of financial reporting and, directly or indirectly, audit quality. Where appropriate, auditors respond to these factors when determining how best to obtain sufficient appropriate audit evidence. (See paragraphs 81 and 95-97 of the Framework.)

Balance of the Framework

36. The draft Framework reflected that auditors are responsible for the quality of individual audits. Thus the draft Framework has a structure with inputs and processes being the first section as inputs and processes are largely auditor driven, followed by outputs and interactions, that involves both auditors and other stakeholders, and as last section contextual factors. The IAASB invited feedback on whether the draft Framework reflected an appropriate balance in responsibility for audit quality between the auditor (engagement team and firm), the entity (management and those charged with governance) and other stakeholders.
37. Responses to this question varied significantly. An almost equal number of respondents thought the draft Framework:
- Was suitably balanced;
 - Gave insufficient emphasis to non-auditor stakeholders, in particular the importance of management providing timely and relevant information to auditors; and

² ISA 260, *Communication with Those Charged with Governance*

- Gave insufficient emphasis to the interactions and contextual factors.
38. Some thought that the responsibilities of the various stakeholders should be defined within the Framework. Others were of the view that more emphasis needed to be placed on oversight and regulation, including exploring how regulatory activities influence audit quality both positively and negatively.
39. It was also observed that the contextual factors described in the draft Framework were those considered likely to impact the nature and *quality of financial reporting*. A number of respondents thought that there was a need to also describe contextual factors that specifically impact *audit quality*. These include matters such as the attitude of those charged with corporate governance towards audit, litigation risk, audit regulation, education, and competitive pressures impacting audit fees.

IAASB Decisions

40. The IAASB discussed, at length, the appropriate balance for the draft Framework before issuing the Consultation Paper and this has also been a topic on which the IAASB CAG had, in particular, contributed views. Given that many respondents agreed with the proposed structure of the Framework, the IAASB decided not to change it, but noted that the relocation of the descriptions of the various input factors and process factors to an appendix should assist those respondents who thought there was too much emphasis on the auditor and not enough on other stakeholders, and that there was an understatement of the role of interactions and contextual factors on audit quality.
41. Changes were also made to the audit quality diagram in the Framework to give more emphasis to non-auditor stakeholders (See paragraph 8 of the Overview in the Framework.)
42. In relation to contextual factors, the IAASB agreed with respondents' recommendations. Accordingly, the IAASB introduced additional material on corporate governance, audit regulation, the litigation environment and attracting talent in the Framework (See Section 5 of the Framework.)

Treatment of Audits of Smaller Entities and Public Sector Audits

43. The IAASB's intention is that the entire suite of input and output factors in the draft Framework, as well as the appropriate interactions among stakeholders and the various contextual factors, applies to all audits. It is possible that the draft Framework did not effectively convey its applicability to all audits because respondents called for changes to be made so that the Framework would cover all audits.
44. In addition, concerns were expressed by some respondents who thought that the Framework was biased toward audits of larger entities and over-simplified aspects of audits of smaller entities.

IAASB Decisions

45. The IAASB noted that the inclusion of a separate section titled "Considerations Relating to Specific Audits" may have caused some respondents to believe the IAASB was intending audits of smaller entities and public sector audits be treated differently under the Framework. In light of this potential confusion, the IAASB decided to remove this section from the Framework. Instead, the material that had been included in this section has now been integrated into the other sections of the Framework, including in the new appendix (Appendix 2) describing the input- and process factors.

46. The IAASB noted that many of the concerns about bias of the Framework towards audits of larger entities related to the discussion of corporate governance. Accordingly, the IAASB simplified and redrafted this section of the Framework. (See paragraphs 101-110 of the Framework.)
47. The IAASB was pleased that, in general, respondents did not challenge the relevance of the input, output, and interactions sections of the draft Framework for audits of smaller entities or public sector entities. The IAASB observes that there is a limit to how far it can explore detailed aspects about audits of smaller or public sector entities in a generic framework, especially when there are concerns about the length of the document. In the longer term it may be appropriate for the IAASB, or others, to develop specific user guides for audits of smaller entities and public sector audits.

Areas to Explore

48. In the January 2013 Consultation Paper, the IAASB explained that while developing the draft Framework it had identified a number of areas where it thought that further consideration, by both auditors and other participants in the financial reporting supply chain, may benefit audit quality on a global basis. The IAASB listed the following ten 'Areas to Explore' and invited views on which, if any, should be given priority and whether there were additional Areas to Explore:
- Area 1: Establishing global guidance against which audit firms can assess their governance arrangements.
 - Area 2: Establishing a common understanding of capabilities, and how they are demonstrated and assessed, as they relate to audit quality for use by audit firms when recruiting, evaluating, promoting, and remunerating partners and staff.
 - Area 3: Improving information sharing between audit firms when one firm decides to resign from, or is not reappointed to, an audit engagement.
 - Area 4: Considering whether audit inspection activities can do more to improve audit quality and to make audit quality more transparent to users.
 - Area 5: Exploring whether there would be value in national authorities responsible for determining sanctions on auditors exchanging information with a view to evaluating the relative effectiveness of their different arrangements.
 - Area 6: Considering "root causes" and best practices by regulators, audit firms, and the wider audit profession in order to learn from past audit deficiencies and to identify and address systemic issues.
 - Area 7: Increasing the informational value of auditor's reports and improving perceptions of the value of the audit.³
 - Area 8: Achieving improved two-way communication between auditors and financial and prudential regulators, particularly in the financial services sector.

³ The IAASB notes that Area 7 to Explore ("Increasing the informational value of auditor's reports...") is directly related to IAASB's remit. In July 2013, the IAASB published an Exposure Draft "Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing" to achieve this aim.

- Area 9: Striving for greater international harmonization in the role of audit committees with regard to the evaluation of the quality of the external audit.
 - Area 10: Encouraging audit committees to provide more information to users of the financial statements on the work they have undertaken, the main issues they have addressed, and the reasons for their conclusions.
49. Several respondents supported further work being undertaken on an international basis on each of the Areas to Explore. Other respondents were of the view that, as each of the areas would take resources to develop, there was a need to prioritize the areas. It was also observed that some Areas to Explore are beyond the scope of the IAASB and that addressing them would require coordinated efforts by a number of stakeholders.
50. Using a simple weighting system⁴, the areas of primary interest were:
- Area 6: Considering ‘root causes’ and best practice by regulators, audit firms, and the wider audit profession in order to learn from past audit deficiencies and to identify and address systemic issues;
 - Area 9: Striving for greater harmonization in the role of audit committees with regard to the evaluation of the quality of the external audit; and
 - Area 4: Considering whether audit inspection activities can do more to improve audit quality and to make audit quality more transparent to users.

Prioritization of Areas to Explore



51. A number of the Areas to Explore do not fall directly under the IAASB's remit. The IAASB hopes that other bodies will commence work on these areas and seek to build an international consensus on them.

⁴ A simple scoring system was used based on assigning scores of:

- (a) "2" where respondents indicated "Strong Support" (SS);
- (b) "1" where respondents indicated "Support" (S); and
- (c) "-1" where respondents indicated "Little or Less Support" (LS).

Next Steps

52. In finalizing the Framework, the IAASB acknowledged that audit quality is continuously evolving and different elements and stakeholders play a role. The context in which an audit is undertaken is also evolving and to keep pace with changes in the business environment, financial reporting standards, regulation and technology, intrinsically an audit is an activity that evolves over time. The pursuit of audit quality, therefore, is not a fixed program with a definitive outcome. Rather, it is a process that ensures that, through continual improvements in its elements, audit quality evolves with the environment in which audits are performed.
53. The IAASB will therefore seek to continuously contribute to the performance of quality audits through dialogue, raising awareness, improving standards, setting new standards, involvement in research and education and stimulating other stakeholders in the financial reporting supply chain to take action to further improve the full context of audit quality.
54. The IAASB also recognizes that discussions and dialogue about audit quality are essential in the public interest. Accordingly, it has identified collaboration and cooperation with contributors to the financial reporting supply chain to foster audit quality and stay informed as one of its proposed strategic objectives for 2015 – 2019, subject to feedback on its current consultation.

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