



**The Institute of
Chartered Accountants
of Pakistan**

**CA
PAKISTAN**

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Invitation to Comment, Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits

Dear Sir/Madam,

The Institute of Chartered Accountants of Pakistan welcomes the opportunity to offer comments on the above ITC.

Please find enclosed the comments of the relevant Committee of the Institute for your perusal.

If you require any further clarification, please do not hesitate to contact us.

Yours faithfully,

Farheen Mirza
Senior Manager Technical Services
The Institute of Chartered Accountants of Pakistan

ICAP comments on "Invitation to Comment, Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits"

Introduction

This consultation paper was issued by IAASB (the Board) with the objective of enhancing audit quality worldwide. The paper focuses its attention on three areas which IAASB believes are critical to improving audit quality. In particular, it discusses potential standard-setting activities the Board could undertake in these areas to achieve this objective. It is accompanied by an "Overview" document which summarizes the key areas the IAASB is exploring and the direction it may take. This document is particularly aimed at encouraging feedback from investors, audit committees, and preparers on these important issues because these stakeholders may not usually engage with the Board on audit technical matters but their input will be important in setting the Board's direction on these topics.

Professional Skepticism

Auditing is fundamentally behavioral in nature and, therefore, standards should address requirements and application material need to be designed in a way that will promote the mind-set necessary for appropriate application of professional skepticism and professional judgment.

This is fundamentally important to apply professional skepticism in the audit procedure. ICAP supports measures that can help auditors in the practical application of professional skepticism. Exploring how individual auditor behaviors, and inherent conscious and unconscious biases, impact the application of professional skepticism is critical to understanding how to better promote its consistent application. Changes to auditing standards cannot address all of the issues being raised about skepticism as it is only the mindset / behavioral aspects which impact professional skepticism.

Quality Control

Quality control standards should be designed to embed and reinforce audit quality throughout the audit process, by focusing on:

- the key inputs and drivers of audit quality, rather than primarily relying on detective measures;
- identifying and assessing the risks to achieving audit quality as a basis for designing and implementing quality processes and controls that are commensurate with identified risks; and
- Promoting continuous improvement.

A culture of, commitment to quality is fundamental need for the audit firms, audit engagements and auditors. There has to be an unwavering focus on delivering the high quality audits expected by stakeholders, including investors, those charged with governance, regulators and the public. The concept of a Quality Management Approach (QMA) is entirely consistent with this goal and ICAP supports the Board in exploring how a QMA can be incorporated effectively into ISQC1.

ISQC 1 has moved the audit profession's thinking forward about the role each firm plays in promoting, supporting and managing quality in the audits, reviews, and other assurance and related services. Focus of ISQC 1 on the recognised drivers on audit quality (quality elements) has provided a structure for firms to develop their quality controls and systems. The requirements in ISQC 1 quality management systems and review should be an integral part of Quality Review programme.

The term audit quality encompasses the key elements that create an environment which maximizes the likelihood that quality audits are performed on a consistent basis. A quality audit is likely to have been achieved by an engagement team that:

- Exhibited appropriate values, ethics and attitudes;
- Was sufficiently knowledgeable, skilled, and experienced and had sufficient time allocated to perform the audit work;
- Applied a rigorous audit process and quality control procedures that complied with law, regulation and applicable standards;
- Provided useful and timely reports; and
- Interacted appropriately with relevant stakeholders.

Group Audit

Standards should address the conditions under which audit evidence can be shared. Changes to the standards should:

- avoid unnecessary duplication of effort by allowing for the sharing of audit evidence and using the work of others, when permitted and justifiable in the circumstances; and
- recognise the value that firm and network processes and controls contribute to audit quality, when appropriate in the circumstances.

There are many circumstances in which audit evidence obtained at the group level or other centralised location, such as a shared service centre (SSC), is relevant to both the group and multiple auditors of different components. The ISA requirements today can result in duplication in work effort by the group auditor and auditors of components who each need audit evidence from that work as the basis for their own audit opinions. There are circumstances when audit evidence should be able to be appropriately 'shared' if certain conditions are met. There is scope for exploring which conditions would support use by different auditors of the same audit evidence.

This consultation paper desired to achieve a defined layout within auditing standards that can deal with the following public interest issues related to **Professional Skepticism, Quality Control and Group Audits**.

- i) How ISAs help in fostering an appropriately independent and challenging skeptical mindset of the auditor?
- ii) How might an audit file more appropriately demonstrate the auditor's decision-making processes, essential interactions and communications, in order to support the auditor's judgments and the audit opinion overall?
- iii) What changes in ISAs will result in robust, yet flexible requirements and guidance to drive appropriate engagement partner and engagement team performance, regardless of the circumstances?
- iv) How can important processes like engagement quality control (EQC) reviews and processes to respond to internal and external inspection findings be strengthened in our standards?
- v) Should our standards more explicitly address expected actions to remediate audit deficiencies or inspection findings?
- vi) Are there opportunities to strengthen our standards in relation to interactions and communication among those involved in a group audit?

Key Issues identified

ITC consisted of 305 paragraphs explaining the issues and potential actions followed by 35 questions around those 305 paragraphs. A comprehensive response would entail a long project involving larger number of resources and longer time frame. In this context, we have identified following fourteen key issues which can be commented upon by ICAP.

1. Relevancy of public interest issues identified in Table 1 of consultation paper with the topics under discussion
2. Drivers for , and impediments to, the appropriate application of professional skepticism
3. Actions required by others Regulatory bodies that inhibit the application of professional skepticism
4. Role of Quality Management Approach (QMA) for improvement of audit quality and restructuring of ISQC 1.
5. Roles and responsibilities in respect of quality control of;
 - 5.1. Engagement Leader
 - 5.2. Quality Control Reviewer
 - 5.3. Network Audit Firm
6. Governance of the Firm, Including leadership responsibilities for Quality
7. Monitoring and Remediation process for deficiencies identified in internal and external inspections.
8. Human resources and Engagement Partner Competency
9. Acceptance and Continuance of the Group Audit Engagement
10. Communication between the Group Engagement team and Component auditors
11. Using the work of Component auditors
12. Identifying and assessing the risk of material misstatement in a Group Audit
13. Issues relating to Component materiality

14. Review and Evaluation of the work of component auditor by Group engagement team

Comments on key issues Identified

1- *Relevancy of public interest issues identified in Table 1 of consultation paper with the topics under discussion*

Comments

ICAP broadly support the matters outlined in Table 1. The actions described on these topics are the right areas to explore. In exploring these matters it will be critical to seek consensus on

- 1) their underlying root causes;
- 2) the objectives to be achieved in addressing them; and
- 3) how best to achieve consistency in interpretation.

It is critical that changes to the standards:

- Are based on clear evidence of an underlying deficiency in a standard or requirement to avoid a proliferation of changes that may not prove relevant responses in enhancing audit quality.
- Seek to eliminate existing different interpretations of requirements through clarifying the intent of existing requirements thus helping to build consensus around what represents a quality audit.
- Be adaptable to developments in the global business and audit environments and the circumstances of particular audit engagements.
- Be worded having regard to developments in technology that are transforming auditing tools and methods that are helping contribute to enhanced audit quality.

Further, the increasing use of shared service centres (SSCs) is an important development that the IAASB needs to address. SSCs, often support multiple audit engagements concurrently. How such work is co-ordinated, the conditions under which audit evidence can be shared, and how audit quality is best brought to bear in such circumstances, including where, and with whom, that responsibility rests, are key questions that we consider should be addressed by the IAASB in its projects on Quality Control and Group Audits.

2- *Drivers for the appropriate application of professional skepticism and related impediments.*

Comments

Drivers for the appropriate application of professional skepticism includes designing and implementing policies, procedures and incentives that promote a culture that recognizes and reinforces professional skepticism as being essential and therefore expected as audits are conducted. A firm's approach to training, mentoring, and effective performance of EQC reviews may contribute to the appropriate application of professional skepticism.

Whereas impediments to appropriate application of professional skepticism include tight financial reporting deadlines, and heavy staff workloads, as well as time and resource constraints. Environmental and contextual factors can also affect the application of professional skepticism. These include the business environment, laws and regulations, as well as the local norms and culture in which an auditor operates.

We also believe it is of particular importance to recognize that effective application of professional skepticism is subject to behavioral factors and personal traits.

Consequently, we believe that coaching and mentoring by experienced team members, setting the tone within the team, supported by firms' training - based on a better understanding of the root causes of poor application of skepticism - is likely to be a compelling driver in influencing and reinforcing practice. Recognising these driving factors in application material may help raise awareness on professional skepticism.

3- *Actions required by others Regulatory bodies that inhibit the application of professional skepticism*

Comments

We believe that audit committees and others charged with governance have a key role to play in encouraging and reinforcing scepticism - providing robust oversight over the audit.

Audit inspection bodies also have a role to play in working with standard setters and practitioners to collectively agree on the underlying nature of issues raised with respect to professional scepticism. We believe the IAESB could facilitate a dialogue or outreach exploring education responses to professional scepticism and seeking to understand the evidence that such training has on its application in practice.

4- *Role of Quality Management Approach (QMA) for improvement of audit quality and restructuring of ISQC 1.*

Comments

The standard needs to evolve, to reflect developments in approaches for effective risk management, quality and compliance systems that exist in today's environment.

Incorporating into ISQC 1 greater focus on quality management would, have a positive impact on shifting the mindset to:

- a more proactive identification and assessment of risks to quality;
- think more broadly about how quality can be built into the design of processes, rather than focus primarily on detective controls;
- continuous improvement; and
- seeking clarity in responsibility and accountability.

The key elements currently described in ISQC1 are important drivers of audit quality (e.g., leadership, independence, human resources etc.).

Amendments will likely be needed to ISA 220 to accommodate potential engagement levels risks and responses that are identified by a firm through its application of the QMA.

We also suggest that paragraphs A32 to A34 of ISA 220 could be expanded to reference the importance of determining the root cause of any deficiencies noted during an inspection of engagement documentation both to develop an appropriate action plan for the engagement as well as for the broader system of quality control.

5- *Roles and responsibilities in respect of quality control Of;*

5.1 *Roles and responsibilities in respect of quality control - Engagement Leader*

Comments

The spectrum for the expected involvement of the engagement partner (i.e., direction, supervision and review), should be reflected through requirements that can be appropriately adapted to different engagement circumstances. The engagement leader has overall responsibility for the engagement. However, accountability for different aspects of audit quality can, in our view, be shared with others on the engagement team when all participants understand their role and how that interrelates with those of others. There is a distinction to be drawn between the engagement partner's overall responsibility for the engagement and how to best achieve execution of that responsibility, in a way that acknowledges how audit quality is best supported.

Audit quality will best be enhanced if responsibility for overall engagement quality, responsibility for quality on specific aspects of an engagement, and responsibility for signing the auditor's report are each individually addressed.

To achieve this, following actions would benefit most from clarification:

- Clarifying the meaning of proactive and appropriate direction, supervision and review, and

identifying factors that assist in considering who may be best placed to perform this in relation to different aspects of the audit based on the organisational structure and circumstances.

- As an extension of the above, providing clarity as to responsibilities of the engagement partner when that individual is not located where the majority of the audit work is performed.

5.2 Roles and responsibilities in respect of quality control – Quality Control Reviewer (where applicable)

Comments

We support bringing clarity to the objective and scope of the role of the engagement quality control (EQC) reviewer. Key to addressing this is to get consensus on what the roles and responsibilities of an EQC review is, and how it relates to other aspects of a QMA / quality management system in supporting quality on an engagement.

It is important that the respective roles and responsibilities between the engagement partner and EQC reviewer are clear. This includes addressing key questions of timing and extent of involvement in the audit by the EQC reviewer and recognising the behavioral implications changes in roles might inadvertently drive. Proposed changes to the EQC role should clearly identify the risk that is trying to be addressed, how that might best be addressed (and by whom) and what the relevant costs/benefits might be.

The EQC reviewer brings a critical challenge to areas of significant management judgement and provides a check on the quality of the audit work done in response to those areas, including key judgements made by the engagement team. It is impracticable to expect the EQC reviewer to check and be responsible for all aspects of audit quality – they are not the engagement partner. Such an extension of scope would be unworkable in practice.

6- Governance of the Firm, Including leadership responsibilities for Quality

Comments

We agree that leadership and tone-at-the-top are important to setting a culture of quality, and that having an effective structure and mechanisms for governance can play a role. We therefore support the need to address the matters described in paragraph 127 within ISQC1 and, consistent with our principle, we believe assigning responsibility and accountability for audit quality to those best placed to influence it is important.

7- Monitoring and Remediation process for deficiencies identified in internal and external inspections.

Comments

We believe it is important that findings identified from all relevant sources are considered, thematic findings analysed from a root cause perspective to allow for meaningful action to be taken, and that the link between the inspection/review program and QMA is strengthened. We believe this is best addressed at the firm level as it is impracticable to require individual engagement partners to perform such analysis. The firm will have access to the relevant information to be able to analyse and cascade key messages to engagement partners and other team members.

There can be various formal and informal processes that contribute to the evidence a firm obtains of effective monitoring of ISQC 1 policies, procedures and controls. We believe it would be helpful to clarify in ISQC1 what is needed to evidence the effectiveness of relevant monitoring controls.

8- Human resources and Engagement Partner Competency

Comments

We agree that emphasising the role and responsibility of experienced team members in setting the tone within the team and in coaching and mentoring junior team members is important as this underpins behaviors that support professional skepticism.

Commitment to developing experienced staff, supported through appropriate training, is a vital component in a firm's ability to deliver a high quality audit.

Coupled with mentoring and training, we agree that timely and informative performance appraisals support building experienced and competent individuals. Performance evaluations and “continuous development” are already required under many professional bodies. As such, reinforcing these concepts in ISQC 1 and ISA 220 would be consistent with practice.

We consider it appropriate for Engagement partner to set quality objectives, undertake performance reviews, be subject to internal inspection reviews on their engagements, and be subject to an accountability framework.

9- *Acceptance and Continuance of the Group Audit Engagement*

Comments

We recognise and broadly agree with the analysis of the issues set out in paragraphs 204-217.

The actions identified in paragraph 215(e) – providing more clarity over the circumstances that may lead to access issues and examples of how they might be addressed - are those which in our view are of greater importance, given the increasing complexity of organisations and cross-border implications. However, many of the issues stem from legal or regulatory requirements in a jurisdiction. Therefore, the extent of the IAASB’s ability to take action in this areas is likely limited to providing guidance on alternative actions that auditors may take in addressing the requirements of the ISA. Accordingly, and acknowledging that it is often not practicable for an engagement to be declined, we strongly encourage the IAASB to include guidance in ISA 600 in on how to deal with requirements when access might be an issue. In the absence of division of responsibility, which as we have explained we do not support, how an auditor addresses the challenges of access, in particular for equity accounted entities, is a very significant current problem.

We agree that there are challenges with respect to obtaining sufficient appropriate audit evidence for certain components, such as significant equity associates not controlled by the entity, or other issues relating to access by the group engagement team to the work of component auditors. We support clarifying guidance related to acceptance and continuance considerations in such circumstances, however caution against setting requirements that could have the inadvertent effect of precluding the appointment of any auditor. The key issue is how the group engagement team can be satisfied that they have obtained sufficient appropriate audit evidence.

Access issues are somewhat still common, particularly in situations when the group has limited control of the component (equity associate). Such investments might be significant due to size, but the group auditor’s ability to have the level of involvement described in the ISAs for significant components due to size can be constrained because the group does not exercise control over that entity.

There are a few ways the IAASB could address these practical issues. Perhaps a different audit approach may be appropriate to that expected in relation to other components that are significant due to size and fully consolidated in the group’s financial statements. It may also be a limited circumstance when reference to the other auditor would be appropriate.

10- *Communication between the Group Engagement team and Component auditors*

Comments

Effective mutual communications between a group engagement team and component auditors is critical to an effective and high quality audit. We are therefore supportive of proposals to reinforce aspects (timing and extent) of such communications.

We support the principle that the ISA can specify matters to be communicated, but not the mechanism of how that is to be achieved. That being said, we believe that the principle of a component auditor taking responsibility for issuing an opinion to the group engagement team on the financial information of a component (in circumstances other than specified procedures, when no opinion is expressed) builds in an important discipline of accountability that reinforces audit quality.

11- *Using the work of Component auditors*

Comments

The ISA should reflect the spectrum of involvement of the group engagement team that may be necessary in the circumstances, based on professional judgement. We believe that enhancing the application material to more clearly address how firms and, through the guidance issued internally within a firm, group engagement teams can evidence how common network policies and procedures impact their levels of involvement in the work of component auditors is most beneficial. This may help clarify how a group engagement team's procedures, including the nature and extent of those procedures, may differ between component auditors from within the same network and those from other networks.

There are a broad range of circumstances that may be encountered, reflecting the evolving corporate structures of large groups. We believe that in acknowledging the spectrum of engagements that exist, the ISA (or separate standard) needs to address how evidence can be effectively shared across a group engagement, and also across other audit engagements that may be required within that group corporate structure. It is, however, not possible for the ISA to address all potential circumstances. As such, requirements need to set out broad principles that are capable of being applied to those varying situations.

The nature, timing and extent of involvement of the group engagement team in the work of the component auditor should vary, depending on the circumstances. The level of involvement needs to be commensurate with the group engagement team's evaluation of the significance of the component, the identified risks of material misstatement, evaluation of the component auditor's competence, including use of common network methodology and quality review processes. The ISA needs to reflect the need for a group engagement team to apply professional judgement.

The extent of involvement will therefore vary based on whether a component auditor is from the same network or a different network, whether there are any access, or other barriers, to involvement.

We believe relevant considerations related to each of these factors could be included within application material in support of existing requirements on the group engagement team's understanding of component auditors.

12- Identifying and assessing the risk of material misstatement in a Group Audit

Comments

We agree that ISA 315 provides an appropriate framework for the group engagement team's understanding of the group and identification of risks.

In principle, emphasising key points from ISA 315 or ISA 330 (that are not already reflected in ISA 600 – either in the application material or appendices) appears reasonable if that will facilitate better understanding of the group and risk assessment at the group financial statement level. Such clarifications can address issues such as complex structures and use of SSC's by the group.

Communication, and sharing of information, between component auditors and the group engagement team, both in respect of risk identification and other information, and as appropriate, across the population of component auditors would seem to be best practice. A group engagement team should make an assessment of whether risks identified by components impact the group financial statements and may also be relevant to other components. Building such consideration into the requirements would appear reasonable.

13- Issues relating to Component materiality

Comments

We agree that component materiality needs to be set at a level that is lower than overall group materiality, and that the concept of 'below' means more than simply one unit below e.g., \$1. We believe there is merit in clarifying how component *performance* materiality is evaluated by group engagement teams taking into consideration the risks associated with individual components and other circumstances of the organisational structure.

14- Review and Evaluation of the work of component auditor by Group engagement team

Comments

We do not believe the ISA should be unduly prescriptive in this area. Engagements and components vary in their size and nature. In addition, component auditors may come from within or outside a firm's network.

We believe application material can address the relevant considerations to be taken into account by a group engagement team in determining the nature and extent of review that is appropriate in the circumstances. This necessarily builds on the group engagement team's evaluation of the component auditor, including their competence and adoption of common network policies and procedures designed to support audit quality.

Timely and detailed two-way communications also play a key role in evidencing appropriate evaluation of the work of component auditors.