



CANADIAN PUBLIC ACCOUNTABILITY BOARD
CONSEIL CANADIEN SUR LA REDDITION DE COMPTES

150 York Street, Suite 900, Toronto, Ontario M5H 3S5
Tel 416.913.8260 Fax 416.850.9235 www.cpab-ccrc.ca

May 15, 2016

Kathleen Healy, Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, NY 10017
USA

Dear Ms. Healy:

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

The Canadian Public Accountability Board (CPAB) is pleased to respond to the *Invitation to Comment – Enhancing Audit Quality (ITC) in the Public Interest* as issued by the IAASB.

CPAB is Canada's independent audit regulator responsible for overseeing firms that audit Canadian reporting issuers. Our mandate is to promote high quality independent auditing that contributes to public confidence in the integrity of reporting issuers' financial reporting. We accomplish our mandate by inspecting audit firms and audit working paper files which provides us with insights into the application of auditing standards and how they might be improved.

General Comments

Overall strategy for the IAASB's approach to standards

We appreciate the IAASB's effort to develop a comprehensive document to address a number of the current issues that have been raised by CPAB and other audit regulators in recent years. Upon completion of the consultation process on the ITC, we believe it is essential that the IAASB act quickly to move these projects ahead.

To do this, we believe it is important that the IAASB have a flexible approach in addressing areas of significance and to deal with emerging issues in a manner that is proactive and responsive to the changing business and audit environment.

We encourage the IAASB to continue to develop a flexible approach to its standard setting. We believe this approach should include the following:

- Accelerated approach to amendments to standards where the required changes are clearly defined.
 - the discussions on certain issues in the ITC are sufficiently well developed to allow the IAASB to move quickly to issuance of an exposure draft and final standard on an accelerated basis. In our view a specific focus should be placed on Group Audits which has been highlighted as a priority issue for several years. We note that the IAASB has already commenced a project to take an accelerated approach to its current project on accounting estimates (ISA 540).

- Continued progress on longer term projects where additional research and consultation is required to determine the appropriate standard setting approach.
- Research and data gathering on emerging issues to ensure the auditing standards remain relevant and consistent with changes in the business environment and auditing practice.
 - We believe the Board's efforts to explore the use of data analytics and the work of the Innovation Working Group to be important areas of focus in this area.

Supervision, review and involvement in work performed by others

In our view, there is an important theme from a number of the areas discussed in the ITC of the need for the auditing standards to clarify and highlight, throughout the standards, the fundamental principle of the need for an appropriate level of direction, supervision and review at all stages of the audit. This is important when others are involved in the audit whether they are members of the audit engagement team, specialists, employees or staff at an ADM or other auditors.

Focus on changes to requirements

We observe that many of the proposals outlined in the ITC are focused primarily on the development of guidance and application material, as opposed to adding or enhancing some aspects of the requirements included in the standards. We are concerned that changes to application material, on their own, are unlikely to have a significant impact on changing behavior. Accordingly, we encourage the IAASB to direct its focus at enhancing the requirements within the relevant standards.

Group audits

In our audit inspections, group audits, specifically the audit of reporting issuers with operations in foreign jurisdictions, remains an area of concern and focus.

Fundamental principle of responsibility of the group engagement partner and group engagement team

There is a need for the group engagement partner to have a high level of involvement in the work performed by others. Accordingly, it is important to establish a strong linkage between the role of the engagement partner and group audit responsibilities in all other standards (including ISA 220) in addition to ISA 600.

Involvement of the group auditor through review and retention of working papers

We have concerns that we continue to see significant variation in practice with respect to the extent of involvement of the group auditor in the work of the component auditor. This includes a variety of practices in group auditor visits of component auditors, group auditor review of

component auditor working papers and retention of component auditor working papers in the audit files of the group auditor.

Further, we are concerned that the group engagement team may not have a sufficient understanding of the impact that local customs and business practices may have on the effectiveness of the planned audit approach. In addition, we have some concerns that language limitations may discourage the review of a component auditor's work or result in the review being performed by a less experienced member of the group engagement team because they have the necessary linguistic skill.

In determining the next steps in this area, we believe the IAASB should provide additional clarity in the requirements on the work effort required by the group auditor in understanding the work performed by the component auditor (including providing evidence of that understanding), including:

1. Obtaining an understanding of the local customs and business practices and consideration of the impact on the planned audit procedures.
2. Regularly planned and scheduled visits to component auditors for the purpose of meeting with local management and the component auditor and to review the work performed by the component auditor.
3. Retention of copies of the component auditor's working papers, especially on areas of significant risk.

Component materiality

In our inspections, we find inconsistency among audit firms in the approach to determining component materiality. Many firms have adopted quantitative guidance for component materiality based on the number of identified components to reduce to an appropriately low level the aggregation risk of uncorrected and undetected misstatements to the group financial statements. However, in the absence of quantitative guidance it is not uncommon to find component materiality that is equal to or just marginally less than group materiality. This inconsistency indicates that the concept of aggregation risk is not clearly defined in the standards and is not well understood by some group auditors. We believe it is important for improvements in practice in addressing aggregation risk and establishing component materiality to be made as part of the revisions to ISA 600. Due to the prevalence of this topic, we do not support waiting for a separate project on materiality to address this issue.

Professional Skepticism

Lack of professional skepticism is a common CPAB inspection finding. Professional skepticism would be more consistently applied if guidance is embedded into those ISAs that address the auditor's response to risk, including the audit of transactions and balances subject to significant judgment on the part of management. Accordingly, we support the proposals in the ITC to incorporate professional skepticism in all of the Board's projects to amend the ISAs.

To do this effectively we encourage the IAASB to accelerate the timeline for its work on the topic of professional skepticism. The ITC indicates that the way forward for both quality control and group audits will result in the tabling and approval of project proposals between September and December 2016. However, for professional skepticism, the joint working group only expects to decide on a way forward by late 2016. This timeline will make it difficult to take an integrated approach in addressing professional skepticism within these current projects.

Specific comments in this area also include:

- Paragraph 38 of the ITC sets out how the IAASB's current efforts on quality control and group audits, as well as its project on accounting estimates, provide opportunities to reinforce the concept of professional skepticism. However, the quality control section of the ITC does not directly deal with how firm leadership responsibility and accountability, firm culture and strategy, as well as actions by the engagement partner and the EQCR, can better promote the application of professional skepticism in audits.
- Accounting estimates generally involve significant management judgment and therefore there is an increased risk of unintentional or intentional management bias. We support the IAASB in investigating further how ISA 540 can be strengthened to improve the focus on auditors approaching accounting estimates with a more questioning mindset and in highlighting the need to consider the effect of contradictory audit evidence that comes to the auditor's attention.

Quality Control

QMA

The ITC outlines a proposal to adopt a quality management approach (QMA). However, the ITC does not provide sufficient detail to obtain an understanding how the QMA would be operationalized. We encourage the IAASB to engage in further outreach in gathering input into how a QMA could be adopted and how this would interact with the existing ISAs and ISQC 1.

Leadership responsibilities to encourage professional skepticism

We note that specific reference is made to governance of the firm, including leadership responsibilities for quality (paragraphs 125-135). However there is no clear statement that the concept of professional skepticism will be reinforced in this element of the quality control standards. We recommend that the IAASB include this in their review of the responsibilities of firm leadership given it is a key component of audit quality. In particular, the importance of applying professional skepticism and being seen to apply professional skepticism needs to be emphasized.

Engagement Quality control reviews

We support the IAASB's proposal to review the standards in respect of the engagement quality control review (EQCR). We believe that a clearly defined objective needs to be articulated for the EQCR to drive improved behavior by engagement quality control reviewers and audit firms in performing reviews and establishing policies and procedures for EQCRs respectively. We believe this objective should address the extent and timing of the EQCR including the depth of review required by an EQCR.

Further, we encourage the IAASB, in making changes to the standards, to clarify and highlight throughout the standards the need for professional skepticism in the performance of an EQCR. This can be reflected in changes that require the engagement quality control reviewer to review and challenge the audit work performed in respect of the more judgmental and higher risk areas, thereby clearly addressing the significant decisions made by the engagement partner.

Reference to other auditors in the audit report

We note the discussion in paragraph 79 of the ITC addressing the inclusion of references to another auditor within the auditor's report. We support providing investors and other users with increased transparency, specifically where other auditors were involved in performing the audit. However, we would not support any action which contradicts the overall responsibility of the group auditor or creates an element of doubt as to who is responsible for the audit opinion. An option may be to include an enhanced scope section where the auditor is able to describe how they planned and performed the group audit. Further material on this topic is available from other jurisdictions where additional requirements supplement the ISAs; for example disclosure of the scope of the audit within the auditor's report in the UK and the PCAOB's requirements to disclose the names of other auditors that are involved in the audit.

Link between audit quality and audit firm compensation

It is imperative that the quality control standards of audit firms address the link between compensation and audit quality. The IAASB should seek to develop requirements which positively influence the extent to which those policies take into account audit quality.

Transparency reporting

We support the IAASB's consideration of exploring the role that transparency reporting can play in increasing the dialogue and discussion of audit quality with external stakeholders. Although we support this initiative, more work is needed to confirm this reporting is useful to investors and other users and enhances audit quality.

Reliance on global controls within audit firms

Paragraphs 114 – 116 of the ITC discuss the issue of controls within network firms and whether it would be possible to place reliance on these controls. This may be difficult to achieve given the current governance arrangements of each firm and limitations of information on global monitoring efforts at the local firm level.

IAASB future work plan

In reference to question G2 of the ITC, we perform a periodic review of the results of our audit inspections to consider whether the results highlight any areas of future focus for standard setting activities. In considering the results of our inspections we support the IAASB's current planned projects regarding the audit of accounting estimates (ISA 540) and risk assessment (ISA 315). We also support the IAASB's ongoing evaluation of the impact of the evolving use of technology to perform audits, including the use of data analytics and artificial intelligence.

Through our inspections we have identified a number of additional areas which we believe require attention from a standard setting perspective. These include:

- Responses to assessed risks – specifically in conjunction with the planned project to review ISA 315. We believe it would be difficult to consider ISA 315 without a corresponding review of ISA 330.
- Use of experts – specifically the use of management's expert (addressed in ISA 500) and use of the auditor's expert (addressed in ISA 620). We believe the use of experts should be considered together with the Board's planned project on the audit of accounting estimates (ISA 540).
- Materiality – we also encourage the IAASB to consider a project on materiality (ISA 320).

We would be pleased to discuss further any of the above comments.

Yours very truly,



Brian Hunt, FCPA, FCA, ICD.D
Chief Executive Officer

cc. Darrell Jensen, CPA, CA
Chair, Auditing and Assurance Standards Board (Canada)