IOSCO Consultation Report on Good Practices for Audit Committees in Supporting Audit Quality

The Board
OF THE
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

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Foreword

The Board of the International Organization of Securities Commissions (IOSCO) has published this Consultation Report with the aim of seeking input to a possible Good Practices Report on how issuer audit committees can support external audit quality.

How to Submit Comments

Comments may be submitted by one of the three following methods **on or before 24 July 2018**. To help us process and review your comments more efficiently, please use only one method.

Important: All comments will be made available publicly, unless anonymity is specifically requested. Comments will be converted to PDF format and posted on the IOSCO website. Personal identifying information will not be edited from submissions.

1. Email

- Send comments to consultation-04-2018@iosco.org
- The subject line of your message must indicate '***IOSCO Consultation Report on Good Practices for Audit Committees in Supporting Audit Quality***'
- If you attach a document, indicate the software used (e.g., WordPerfect, Microsoft WORD, ASCII text, etc) to create the attachment.
- Do not submit attachments as HTML, PDF, GIFG, TIFF, PIF, ZIP or EXE files.

2. Facsimile Transmission

Send by facsimile transmission using the following fax number: + 34 (91) 555 93 68.

3. Paper

Send 3 copies of your paper comment letter to:

Mr. Jonathan Bravo
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

Your comment letter should indicate prominently that it is a ***"Public Comment on IOSCO Consultation Report on Good Practices for Audit Committees in Supporting Audit Quality".***

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Chapter 1 – Executive Summary

This Consultation Report invites stakeholder feedback on IOSCO proposals for good practices for audit committees of issuers of listed securities in supporting external audit quality.

The quality of a company's financial report, supported by an independent external audit, is key to market confidence and informed investors. The audit committee has an important role in the quality of the financial report, since audit quality relates to an effective and independent audit function that is appropriately supported by the company.

While the auditor has primary responsibility for audit quality, the audit committee can promote and support audit quality and thereby contribute to greater confidence in the quality of information in the issuers' financial reports. The good practices report can therefore assist audit committees in considering ways in which they may be able to promote and support audit quality.

Findings by audit regulators indicate a need to improve audit quality and the consistency of audit execution. For example, the International Forum of Independent Audit Regulators (IFIAR) has reported that, according to audit regulators, auditors did not obtain reasonable assurance that financial reports were free of material misstatement in 40% of audits reviewed by audit regulators.[1]. These findings do not necessarily mean that the financial report was materially misstated.

Further, the practices of audit committees within the same jurisdiction, and across jurisdictions, can vary from one listed entity to the next, leading to a lack of consistency in the way audit committees carry out their responsibilities.

1.1 The Role of Audit Committees and Audit Quality

Chapter 2 of this Consultation Report gives proposed details about the role of audit committees and audit quality.

1.2 Proposed Good Practices

Chapter 3 of this Consultation Report proposes good practices regarding the features an audit committee should have to be more effective in promoting and supporting audit quality. These features include the qualifications and experience of audit committee members, their level of knowledge in the field of financial reporting and audit, and whether they have questioning minds and appropriately challenge management and

1 IFIAR Report on 2017 Survey of Inspection Findings - https://www.ifiar.org/activities/annual-inspection-findings-survey/index.php?wpdmdl=7970&ind=vuu3iseEqGPWqF4ESx9PRoRYMllZRusAJw6NrCVKjf5dD1RFGE6lwm_zaDcHkZXtiUnynLr5F7TTIx6qpr7Qrct9KbzpS4I_0sTzZlxf1bnUVyEVKJJVI3hKa-C5CqQY_c_WGBM65So3IYeb5FFODw&#zoom=100

auditors. These features also include whether the audit committee has adequate capacity and resources.

Chapter 3 proposes the following good practices for audit committees in promoting and supporting audit quality:

- *Recommending the appointment of an auditor* (Section 3.3): it is proposed that audit committees should develop a recommendation on the selection of auditors independently of management with selection criteria set upfront and tenderers assessed against those criteria. The focus should be on audit quality and not fee reduction. Opinion shopping should be avoided and auditor independence should be a key consideration.

- *Assessing potential and continuing auditors* (Section 3.4): it is proposed to outline some considerations for audit committees in assessing the auditors, and the adequacy and appropriateness of audit resources. These considerations include the auditor's knowledge of the issuer´s business and industry, the extent of involvement of senior team members in the audit, use of other auditors, use of technical and specialist expertise, the capability accessible by the auditor in different geographical locations, coverage of internal systems and controls, and how the engagement partner and team are accountable within their firm for audit quality.

- *What matters should be considered in setting audit fees* (Section 3.5): it is proposed that audit committees consider the extent to which audit fees are consistent with the audit plan and a quality audit.

- *Facilitating the audit process* (Section 3.6): it is proposed to outline the audit committee's role with respect to promoting quality and timely reporting, seeking explanations and advice on the appropriateness of accounting treatments and estimates, proper books and records, and systems and controls, which can facilitate a quality audit and avoid issues being missed or not adequately addressed due to deadline pressures.

- *Assessing auditor independence* (Section 3.7): it is proposed that audit committees should review and challenge management's accounting treatments and estimates, and where appropriate seek independent third party advice and not seek advice from the auditor. The audit committee should oversee the development of policies on auditor independence, undertake procedures to satisfy itself on the independence of the auditor and require non-audit services to be subject to its prior approval, and consider other matters affecting auditor independence.

- *Communicating with the auditor* (Section 3.8): it is proposed to suggest good practices for open, timely and meaningful communication with auditors about risks, issues and other matters to assist each of them in performing their respective roles in overseeing the financial reporting process and conducting a quality audit.

- *Assessing audit quality* (Section 3.9): it is proposed to outline practices that enable audit committees to assess audit quality with regard to enquiry, observation and how the auditor addresses findings by audit regulators.

It is also proposed to mention the possibility of voluntary public reporting by audit committees on their support for audit quality (Section 4.1).

Chapter 2 – The Role of Audit Committees and Audit Quality

2.1 Introduction

The IOSCO objectives of securities regulation are protecting investors, ensuring that markets are fair, efficient, and transparent, and reducing systemic risk. IOSCO considers the accuracy, integrity, and comparability of issuer disclosure to be essential for maintaining investor confidence and therefore facilitating a stable international financial system. One of the IOSCO principles for issuers is that there should be full, accurate, and timely disclosure of financial results, risk, and other information that is material to investors' decisions.

Given the remit of securities regulators focuses on confident and informed markets and investors, IOSCO has an interest in both the quality of financial reports, which is supported by quality audits, and good corporate governance, which includes the role of the audit committee.

The quality of financial reports is key to confident and informed markets and investors. The objective of the independent audit is to provide confidence in the quality of financial reports. Improving audit quality and the consistency of audit execution is essential to continued confidence in the independent opinion expressed by auditors.

While the auditor has the primary responsibility for the quality of the audit, IOSCO has produced this consultation report because it considers that effective audit committees in all jurisdictions can support audit quality in the interests of market confidence in the quality of information in the financial reports of issuers. Our proposed good practices report would be intended to assist audit committees in considering ways in which they may be able to promote and support audit quality.

In preparing this consultation report, IOSCO has considered the experiences of its member organisations and aspects of audit committee practices in IOSCO Report FR04/2016 *Survey Report on Audit Committee Oversight of Auditors* dated May 2016 (the report can be found at: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD531.pdf).

Issuers have primary responsibility for the quality of the financial report. It is not the purpose of this consultation report to outline the roles and responsibilities of parties such as a governing board, audit committee and management which may differ between jurisdictions.

Irrespective of the good practices outlined in this consultation report, audit committees should follow any laws and regulations of national or other jurisdictions that apply to the issuer.

2.2 About Governance Structures and Audit Committees

The exact form of an entity's governance structure and the roles that any individual governance bodies perform in relation to the external auditor may vary depending on the requirements of national laws. In some jurisdictions, a single body commonly known as an "audit committee" oversees all matters relating to the external auditor. In other jurisdictions, more than one body within the governance structure of a listed entity may assume this responsibility.

For ease of reference, this paper uses the term "audit committee" to refer to any governance body or bodies that promote and support audit quality, regardless of whether they have that title.

Not all measures described in this paper may be able to be applied under the legal framework and governance structures in some jurisdictions. For example, in some jurisdictions there may be a supervisory board of non-executive members who choose executive directors to form an executive board. Some aspects of the role of the audit committee may be performed by the supervisory board or a subset of that board, but not other aspects.

2.3 Why is Audit Quality Important?

Auditors play a critical role in ensuring that investors can be confident and informed when making investment decisions. High-quality audits support the quality of financial reports and enable investors to rely on the auditor's independent assessment of those reports.

In IOSCO's view, audit quality relates to matters that affect the auditor's ability to:

(a) achieve an audit's fundamental objective: to obtain reasonable assurance that the financial report as a whole is free of material misstatement; and

(b) ensure that any material misstatements detected are addressed or communicated through the audit report.

2.4 What Factors Influence Audit Quality?

Audit firms can influence audit quality through a range of factors including:

- an audit firm's culture and focus on audit quality and professional skepticism, including how and to what extent the firm holds engagement partners and others in the firm accountable for audit quality (e.g. impact on remuneration for poor internal and external quality review findings);
- the auditor's understanding of the business and the risks affecting the financial report;
- the internal and external experience and expertise applied in audits (including recruitment and training, the use of experts, specialist industry knowledge, time allocated to an audit, and seniority of audit team members); and

- how effectively audit engagements are supervised and reviewed within the engagement team and firm (both during the audit and post-audit quality reviews of the firm).

While the auditor has primary responsibility for audit quality, this report suggests that audit committees should consider these and other factors in supporting audit quality. Audit committees may also consider how the auditor addresses the results of inspections by independent audit regulators.

2.5 What are the Auditor's Responsibilities?

Generally, the auditor of an issuer is required by national laws and, where applicable, auditing standards to:

- form an opinion about whether the financial report complies with relevant accounting standards and gives a true and fair view of [or presents fairly] the financial position, financial performance and cash flows of the entity [in all material respects][2]; and
- conduct their audit in accordance with the relevant auditing standards.

An auditor is also required to:

- meet independence requirements in rules, regulations or standards;
- read information accompanying the audited financial report for material inconsistency with the audited financial report, and for material misstatements of fact; and
- report in certain circumstances on suspected contraventions of particular rules and regulations to a securities or other regulator.

2.6 Audit Committees and Auditors

Audit committees promote and support the quality of the audit through their various responsibilities. Among other things, those responsibilities can include making recommendations on the selection and appointment of auditors and approving the overall audit fees. Audit committees are also generally tasked with supporting the quality of the work of the auditor, which can include matters such as: considering whether the audit strategy addresses key risks, making inquiries regarding whether the audit is resourced with appropriate experience and expertise, assessing the performance of the auditor in relation to audit quality, and understanding whether the auditor has exercised appropriate professional skepticism. In many jurisdictions, the audit committee is also responsible for the oversight of the independence of the auditor, which may include the review and approval of non-audit services provided by the auditor.

[2] The opinion may or may not include the words "in all material respects" depending upon the requirements of each jurisdiction.

Open, timely and meaningful communication between the audit committee and the auditor is important in fulfilling the responsibilities of both the auditor and audit committee. In addition, the audit committee in its oversight role is involved in the financial reporting process that ultimately impacts the annual financial report and year-end audit. These activities might also include reviewing and approving interim financial reports and other periodic disclosure documents.

2.7 What are the Roles of Directors and Audit Committees?

For this consultation, an audit committee is a subcommittee of the board of directors that focuses on issues relevant to the integrity of the issuer's financial reporting.

While the existence of an audit committee does not alter the need for all directors of the overall governing board to take responsibility for financial reports, audit committees can play an important role in the financial reporting process and in supporting and promoting audit quality.

The auditor gives an independent opinion that, in most jurisdictions, is given after the directors' give their opinion on a financial report. An issuer must have its own systems, processes and controls, as well as appropriate resources, to produce high-quality financial reports. Directors must not rely on the auditor when forming their own opinion on the financial report[3] as this would undermine the objective of an audit, which is to obtain reasonable assurance and provide an independent opinion on the financial report. However, in some jurisdictions, the auditor may be required to address their audit report to the board of directors and members/shareholders.

Audit committees should consider raising any audit quality concerns that are not satisfactorily resolved with the auditor with the board of directors as well as the auditor. Directors and audit committees may ask that the issuer's management seek external advice where appropriate, and may raise concerns with the relevant regulator if needed.

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[3] While the directors do not rely on the auditor, the auditor would still communicate any concerns with the financial report identified in their independent audit so as to give the directors an opportunity to amend the financial report so that the market is properly informed through the financial report itself, rather than receiving a modified audit opinion.

Chapter 3 – Possible Good practices for Audit Committees in Supporting Audit Quality

3.1 How can Audit Committees Support Audit Quality?

To support audit quality, audit committees may consider certain good practice matters when:

- recommending the appointment[4] of an auditor to members/shareholders;
- assessing potential and continuing auditors;
- assessing the audit fees;
- facilitating the audit process;
- communicating with the auditor;
- assessing auditor independence; and
- assessing audit quality.

The matters that may be considered are listed under each of the sections in this chapter of this report that follow. The matters may also be considered for inclusion in some form in the charter or similar document (if any) of an audit committee.

3.2 Features of Audit Committees that Support Audit Quality

Proposed good practices for the features of audit committees that may facilitate a committee in being more effective in promoting and supporting audit quality may include:

Matter	**Proposed good practices**
Features of audit committees	1. The audit committee should comprise only non-executive directors. 2. Consideration should be given to whether all or a majority of audit committee members and the chair should be independent[5] with respect to matters such as financial and business interests with the issuer and

4 Appointment includes reappointment of the existing auditor, where applicable. It is important that the audit committee regularly reassesses the auditor's performance and capabilities, and takes appropriate actions to promote audit quality. This could include replacing the auditor. Disagreements with management on accounting treatments or estimates should not be a basis for terminating the auditor's mandate, as opposed to matters such as the auditor's experience, expertise and capacity.

5 There may be different understandings of approaches regarding independence of board members in different jurisdictions (see also 2007 IOSCO report *Board Independence of Listed Companies*).

Matter	Proposed good practices
	length of tenure, acknowledging that different concepts of independence may apply in different jurisdictions. 3. The audit committee chair or another audit committee member should have a good knowledge of financial reporting or audit (including accounting, auditing and audit independence requirements). 4. Audit committee members as a whole should between them have an appropriate understanding of financial reporting and audit, and knowledge of the industry in which the issuer operates. Where necessary, there should be some introductory and periodic ongoing training for audit committee members to ensure their capabilities and skills are appropriate and up-to-date. 5. Audit committee members should maintain professional scepticism and a questioning attitude toward the information received from management and in considering the quality of the audit. 6. Consideration should be given to how often the audit committee should meet. The audit committee should meet sufficiently frequently to meet its responsibilities on a timely basis. Regard may be given to factors such as the annual and interim financial reporting processes, the audit committee's role in the entity meeting certain market disclosure obligations (e.g, any continuous disclosure obligations), the complexity of the business, and the need to approve non-audit services. In some cases, ad hoc meetings, teleconferences or email exchanges may also be considered.

Matter	**Proposed good practices**
	7. The audit committee should be established with a mandate that permits it to carry out its responsibilities free of any unreasonable restraints.[6] 8. The audit committee should have appropriate support of a secretary or other appropriate resources for its role. 9. The audit committee should have sufficient capacity for its roles, and be effective in its role in relation to financial reporting and audit quality. 10. There should be open internal dialogue within the audit committee. All audit committee members should be encouraged to ask questions, express their views, be heard and have their views considered. 11. The audit committee should be the key representative body with which the external auditor interacts.[7]

These good practices apply to all issuers, irrespective of their size. However, audit committee practices (e.g. the frequency of meetings) may vary depending upon the size and complexity of the issuer.

There may be additional considerations having regard to the circumstances of the entity such as the existence of a dominant chief executive officer or the protecting the interests of minority shareholders. For example, it may be necessary to consider any additional capabilities of, or other requirements for, those selected to be members of the audit committee or defining the role of the audit committee.

IOSCO Report FR04/2016 *Survey Report on Audit Committee Oversight of Auditors* dated May 2016 provides survey results across 47 jurisdictions on matters such as audit committee composition, audit committee independence, audit committee skills and

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6 This good practice matter was derived from the principles outlined in the IOSCO Statement *Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence* issued in October 2002. As such the principle has already been settled by IOSCO.

7 As per footnote 6.

expertise, and the source of requirements for audit committees. The survey report also includes survey results on requirements relating to auditors, such as selection of auditors, auditor independence and communications with auditors.

3.3 Recommending the Appointment[8] of an Auditor

In some jurisdictions, the audit committee is responsible for appointing the auditors and sets their remuneration. In other jurisdictions, the members/shareholders of an issuer appoint the auditor at an annual general meeting (AGM). Even in the latter jurisdictions, because it is generally not practical for members/shareholders of larger issuers to be involved in a detailed assessment of auditors and the determination of audit fees, the audit committee and directors can play an important role in recommending the appointment of an auditor.

In this context, management should not have sole responsibility for setting audit fees. It is possible that issuer management may have interests that are not fully aligned with the conduct of quality audits, and so may not be best placed to assess auditors and set audit fees. For example, incentives for management to achieve certain levels of financial performance may lead to setting low audit fees that could adversely affect audit quality.

While consideration should be given to any management concerns with audit quality, non-executive directors – who focus on the need for audit quality and who have direct accountability and fiduciary responsibilities to the members/shareholders – should ideally manage the process of developing a recommendation on selecting, appointing and replacing auditors and the process of determining their remuneration.

Proposed good practices for audit committees when recommending the appointment of an auditor may include:

Matter	**Proposed good practices**
Any audit tender or other selection process	The audit committee should take reasonable steps to ensure that: 12. Any audit tender or other selection process is conducted independently of issuer management (i.e. using a panel of non-executive directors).

8 Appointment includes reappointment of the existing auditor, where applicable. It is important that the audit committee regularly reassesses the auditor's performance and capabilities, and takes appropriate actions to promote audit quality. This could include replacing the auditor. Disagreements with management on accounting treatments or estimates should not be a basis for terminating the auditor's mandate, as opposed to matters such as the auditor's experience, expertise and capacity.

Matter	Proposed good practices
	13. Audit tender or selection criteria, which should generally be set at the start of the tender/selection process, are focused on audit quality. 14. Audit fees are not reduced where this may compromise audit quality (e.g. by inadequate resourcing or insufficient work being performed). 15. Requests for tenders include objective criteria relating to both audit quality and fees with fees not being given undue weight in selecting an auditor. 16. Auditors are assessed against the criteria and selected having regard to audit quality, including skills, expertise, technical competence, and resource capacity. One way to achieve this might be for the part of any tender document relating to quality to be considered before reviewing the proposed fees. This may provide an effective safeguard that a decision is not unduly influenced by a low audit fee in circumstances where audit quality may be compromised. A smaller firm should not be excluded based only on size if it is the firm that best meets the selection criteria and any other audit quality considerations (except having regard to circumstances where the fee could be large for the partner or firm concerned and may impact on actual or perceived independence of the auditor, or any similar issue). 17. Potential auditors are not asked for their views on contentious judgements or accounting treatments affecting the issuer's financial reports before their selection (also known as 'opinion shopping'). It may be relevant to ask general questions to ascertain the technical competence or industry knowledge of an auditor, provided such questions could not be regarded as opinion shopping. 18. Potential auditors are asked to confirm that, after appropriate due diligence, they are not aware of any matters affecting their independence.

Matter	Proposed good practices
	19. Consideration is given to any over familiarity with management of the incumbent auditor, particularly if there haven't been sufficiently recent partner rotation or changes in management, and there are no unusual circumstances (beyond the need for an incoming auditor to invest to understand the business and risks) where a change in auditors has the potential to compromise audit quality. 20. When selecting an auditor to recommend for appointment, the audit committee should satisfy itself that the auditor is independent in accordance with applicable standards.[9] See also Section 3.7.
Commitment to audit quality	The audit committee should consider the extent to which: 21. The auditor (including any incumbent auditor) has demonstrated a commitment to audit quality and to consider whether the audit committee or management is aware of any indication that the firm may not have a culture that sufficiently promotes audit quality. 22. Any information relevant to audit quality in the audit firm's annual audit transparency report (if any) is reviewed by the audit committee. 23. The auditor adequately addresses any general findings reported publicly by an audit oversight regulator from audit firm inspections, as well as any firm and engagement specific findings from inspections of the firm and from the firm's own internal quality reviews.

See also '3.4 Assessing potential and continuing auditors' for other matters that may be relevant.

9 As per footnote 6.

3.4 Assessing Potential and Continuing Auditors

Audit committees should understand the audit process, risks identified by the auditor, the auditors planned responses to the identified risks, etc. It is important that the auditor is committed to devoting an appropriate level of resources with appropriate skills and expertise for the audit

Matter	**Proposed good practices**
Resources devoted to the audit	The audit committee should consider the extent to which: 24. The auditor demonstrates a sufficient understanding of the business, operations and risk areas relevant to the financial report, and plans to respond appropriately to assessed risks. In a tender process, sufficient access would normally be provided to management for a prospective auditor to obtain an understanding of the business, operations and risk areas. 25. The auditor's engagement partner, engagement quality control review partner and audit team members have sufficient experience and expertise, given the size and complexity of the issuer and its operations. This includes relevant industry expertise, and valuation expertise (including expertise engaged directly by the auditor from a third party) appropriate for the types of assets, liabilities and exposures of the issuer. The audit committee may also wish to consider encouraging the audit firm to consult with the audit committee on any change in partners or key audit team members to ensure that audit quality is maintained. 26. Senior audit team members (particularly the engagement partner) are sufficiently involved in the audit. 27. The audit firm has adequate arrangements for supervising and reviewing the audit, and adequate internal firm quality reviews and controls. 28. The auditor demonstrated their ability and capacity to adequately cover audit work in geographical locations in which components of the issuer operate.

Matter	Proposed good practices
Reliance on experts and other auditors	The audit committee should consider the extent to which: 29. The auditor directly uses their own firm's specialized resources or engages external experts to supplement the audit team's experience and expertise in specialist areas by obtaining an independent view on the work of issuer management and any external specialists engaged by the issuer. For example, for complex asset and financial instrument valuations, the auditor could engage their own specialists such as geologists, chemists, actuaries, corporate valuers or treasury experts. For revenue recognition, the auditor might engage their own industry expert to assess the stage of completion of a project. 30. Where the auditor uses the work of other auditors for audit work on components within a group (e.g. local or foreign branches, and subsidiaries), the auditor has processes to determine that their participation in the audit is sufficient and to satisfy the auditor regarding the qualifications and the work of other auditors. 31. The auditor will not inappropriately use or rely on internal auditors to perform external audit work.[10]
Audit strategy and scope	The audit committee should take reasonable steps to ensure that: 32. A continuing auditor has prepared a plan for the audit for discussion with the audit committee that includes the audit strategy and scope. The audit committee should review any such plan with regard to whether

10 In some jurisdictions, external auditors may not use internal auditors to perform external audit work and are only allowed to rely on the work of internal auditors as a part of the company's own internal control processes and when identifying risks of material misstatement. In other jurisdictions, the external auditor may be able to substitute internal audit work (e.g. tests of detail) for their own work, subject to appropriate review and reperformance. In these latter jurisdictions, the audit committee may wish to consider whether the extent of reliance on internal audit as a substitute for external audit work is appropriate.

Matter	Proposed good practices
	the auditor plans to address risks known to audit committee members (see also Section 3.8). 33. The auditor's decision not to review or test one of the significant systems supporting information in the financial report in a particular year but still rely on relevant key controls is appropriate[11], particularly where the audit committee is aware of risks that controls may be intended to address or has other relevant concerns. The audit committee may also consider whether the auditor should review and test IT general and application controls if they do not intend to do so. Similarly, the audit committee may consider whether the auditor's decision not to ask component auditors to perform work at particular operations or locations is appropriate.
Accountability	34. The audit committee should discuss with the audit engagement partner how the audit firm and its affiliate firms, engagement partner, review partner, specialists and audit team members are appropriately held accountable for audit quality within their firm or network. For example, audit quality is a key consideration in performance assessments and setting remuneration.

See '3.9 Assessing audit quality' for other matters that may be relevant.

3.5 Setting Audit Fees

An issuer should pay the auditor's reasonable fees and expenses. The setting of audit fees is a commercial decision by issuers and their auditors. The process should be managed by the directors (who should be responsible for setting the overall fee[12]) and the audit committee. Directors and audit committees should consider whether audit fees are reasonable for the work required to conduct a quality audit in the interests of investors

11 Further, this approach may not be permitted under auditing standards in some jurisdictions.

12 In some jurisdictions, the audit fees are set by a supervisory board.

and other users of the financial report, and not set at a level that could lead to audit quality being compromised.

Auditors may be faced with challenging judgements in areas such as assessing whether an issuer is a going concern, impairments of assets and fair values. This increases the time spent on an audit and might be expected to increase audit fees. Changes in the issuer's business, reporting requirements, internal control environment or the risks affecting financial reports may also warrant increases in fees.

There may be a temptation to reduce audit fees in the pursuit of general cost reductions. Cost should not be a consideration if that may adversely affect audit quality, particularly where an issuer may be under financial pressure and more audit effort may be required. In any event, audit fees are usually a small proportion of costs, and reducing them does not generally have a significant impact on an issuer's profit.

If an issuer decides to seek tenders for audit services, the primary focus should be on audit quality rather than on reducing costs. A quality audit enhances the credibility of the issuer's financial report.

Some audit firms may offer discounted fees to maintain or increase revenues, contribute to fixed costs, occupy staff during downturns, maintain or build market share, or build a presence in a particular industry. In some cases, an auditor may not have understood the issuer's business, reporting requirements and the extent of audit work required.

While there may be instances where an effective but more efficient audit can be obtained for a lower fee, audit committees and directors should be aware of pressures in some audit firms to limit the impacts of low or reduced fees on margins. Inadequate fees can create a risk that audit quality is compromised and that auditors do not obtain sufficient and appropriate audit evidence to support their opinion.

Matter	**Proposed good practices**
Setting audit fees	The audit committee should: 35. Evaluate whether the audit fees charged by the auditor appear adequate in relation to the work required to support an audit opinion without regard to fees that might be paid to the auditor for other services.[13] The audit committee should consider the extent to which:

[13] As per footnote 6.

Matter	Proposed good practices
	36. Audit fees are consistent with the auditor's overall plan, and are sufficient to support the execution of an appropriately resourced and effective audit. Audit committees may wish to consider the level of audit fees is adequate with regard to matters such as: (i) any risks, judgements and estimates to be addressed by the auditor; (ii) changes in the business or financial reporting requirements; and (iii) appropriate benchmarking against similar businesses. Audit committees may also wish to challenge the reasons for any reduction in audit fees. 37. There is any indication that audit quality may be compromised by reduced audit fees causing the audit to be inadequately resourced or insufficient work performed. 38. Audit fees reflect changes in risks, new businesses, new complex transactions, etc.

3.6 Facilitating the Audit Process

Not all measures described in this section of the report may be able to be applied under the legal framework and governance structures in some jurisdictions.

The audit committee can have a key role in ensuring the quality of financial information produced by management, and the quality of records and analyses supporting the financial report. High quality information produced by management will enable auditors to conduct a more efficient and effective audit that focuses on their role of providing an independent opinion on the financial report.

The audit committee should assist the board by reviewing significant financial reporting issues and judgements made in connection with the preparation of the company's financial statements (having regard to matters communicated to it by the auditor), interim reports, preliminary announcements, and related formal statements. This includes considering whether management has adopted appropriate accounting policies, made appropriate estimates and judgements, and made appropriate disclosures.

In many jurisdictions directors are responsible for the quality of the financial report.[14] Issuers must also have appropriate systems, processes, controls and records to support information in the financial report and must not rely on the auditor, whose role is to provide an independent opinion to investors and other users of the financial report. While the direct responsibility for preparing the financial report and for related systems, process and controls may be delegated to management, the audit committee should oversee these aspects and question management about the production of quality financial information.

Issuers should apply appropriate experience and expertise, particularly in more difficult and complex areas such as accounting estimates (including impairment of non-financial assets), accounting policies (such as revenue recognition) and taxation.

While directors are not expected to be accounting experts, they should seek explanation and advice supporting the accounting treatments chosen and, where appropriate, challenge the accounting estimates and treatments applied in the financial report. They should particularly consider seeking advice from an external expert (independent of the external auditor) where a treatment does not reflect their understanding of the substance of an arrangement, rather than seeking the advice of the auditor.

Matter	**Proposed good practices**
Supporting the audit	The audit committee should consider the extent to which: 39. Financial reporting processes and audit processes are planned so that an effective quality audit can be conducted within the financial reporting deadlines. 40. The audit committee seeks explanations and advice supporting the accounting treatments chosen and, where appropriate, challenge the accounting estimates and treatments applied in the financial report. The audit committee should particularly seek external professional advice where a treatment does not reflect their understanding of the substance of an arrangement. 41. Any concerns or risks highlighted by the auditor (for example, in comment letters from the auditor to the governing board), including concerns about systems, processes or policies that could materially affect

14 In many jurisdictions, the directors have direct statutory responsibility for the financial report but delegate to management and oversee management. In other jurisdictions, management has direct primary responsibility for the financial report and the directors may oversee management.

Matter	Proposed good practices
	future financial reports, are considered and addressed.
Issuer management and staff	The audit committee should take reasonable steps to ensure that: 42. There are appropriate accountability and incentives for issuer management and staff to focus on the quality of financial reporting, timely reporting and facilitation of the audit process. 43. Management has produced all information, records, and explanations that may be relevant to the financial report and audit in a timely manner. Information should be supported by appropriate analysis and documentation, particularly for key accounting estimates and judgements. The audit committee should: 44. Encourage management and staff to have a positive and helpful approach to the audit process, and make enquiries of the auditor as to whether there has been a lack of cooperation. Appropriate action should be taken by the audit committee to ensure that any lack of cooperation is addressed.

3.7 Assessing Auditor Independence

The audit committee should assess auditor independence. The independence of the auditor (both in fact and appearance) is important for promoting market confidence in the auditor's report on the financial report. Actual and perceived independence from directors and issuer management, as well as the objectivity of the auditor, underpins audit quality.

It is important for directors and audit committees to evaluate the independence of the auditor – both when recommending the appointment of auditors and on an ongoing basis.

In many jurisdictions audit fees and fees for non-audit services are required to be disclosed in the financial report. There may also be a requirement to disclose whether fees for non-audit services were approved in advance by the audit committee. This information may be useful indicators for audit independence and also the adequacy of audit fees in the context of audit quality.

In considering auditor independence, the term "auditor" should be broadly construed to include not only an individual engagement partner but also, for example, members of the audit team, the firm itself, and related entities of the firm such as what is sometimes termed a "network firm".

Matter	**Proposed good practices**
Independence and objectivity	The audit committee should take reasonable steps to ensure that: 45. When audit committee members challenge complex accounting policy choices and estimates, they should have regard to their knowledge of the business and the substance of any arrangements. This may include seeking independent third-party advice where necessary, rather than relying on the views of the auditor. The directors remain responsible for the accounting treatments applied and estimates made in the issuer's financial report and the auditor remain responsible for the independent audit. 46. The audit committee has a policy regarding how to evaluate the auditor's independence. The audit committee should: 47. Oversee establishment of the issuer's policies governing the circumstances in which contracts for the provision of permitted non-audit services can be entered into with the auditor and the procedures that must be followed before doing so.[15] 48. Consider implementing a policy that all non-audit services to be provided by the auditor must be approved in advance by the audit committee.[16]

15 This good practice matter was derived from the principles outlined in the IOSCO Statement *Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence* issued in October 2002. As such the principle has already been settled by IOSCO. Please refer to the October 2002 IOSCO Statement for further guidance in relation to this principle.

16 As per footnote 6.

Matter	**Proposed good practices**
	49. Establish policies relating to the hiring from an entity's audit firm of senior officers for the entity, including the Chief Executive Officer and the Chief Financial Officer.[17] 50. Undertake procedures to satisfy itself, both initially and on an ongoing basis, as to the auditor's independence.[18] 52. Consider any other matters that may affect the independence and objectivity of the auditor, including independence of auditors of domestic and foreign components (e.g. controlled entities, associates, joint arrangements and structured entities). 53. Discuss with the auditors, at least annually, matters relating to their independence, including all significant threats to independence identified by the auditors and the safeguards implemented.[19]
Reporting to members/investors/ shareholders	The audit committee should: 54. Report to the shareholders on the actions it has taken to safeguard the independence of the auditor, including satisfying itself that the auditor is independent in accordance with applicable standards.[20]

3.8 Communicating with the Auditor

An audit committee should establish a direct line of communication between the audit committee and the auditor. The quality of communications between directors and audit committees and the auditor is important in supporting audit quality. This communication should include concerns and risks affecting the processes which support the information

17 As per footnote 6.

18 As per footnote 6.

19 As per footnote 6.

20 As per footnote 6.

in the financial report, and how these concerns and risks are being addressed by directors and management and responded to in the audit.

Open, timely and meaningful communication between the auditor and the audit committee is important in fulfilling the responsibilities of both the auditor and audit committee. Two-way communication between the auditor and the audit committee members helps the auditor to obtain information that is relevant to the audit and assists the audit committee and directors in overseeing the financial reporting process.

There may also be instances where the audit committee's communications with the auditor include the auditor's experts or members of the audit team who have detailed knowledge of particular matters.

Communications between the auditor and the audit committee must not undermine the auditor's independence or the effectiveness of performance of the audit or auditing procedures.

Matter	**Proposed good practices**
Addressing any relevant risk areas or areas of concern	The audit committee should take reasonable steps to focus on the following: 55. The audit committee discusses the overall audit strategy developed by the auditor and how it responds to risks known to the audit committee. 56. The audit committee and management inform the auditor in a timely manner about any relevant risks, judgements or significant concerns with accounting treatments, accounting estimates, accounting records, financial reporting systems and processes (e.g. internal control deficiencies) and fraud risks so that any matters may be properly considered and addressed by the auditor in assessing risk and the auditor's response as part of the independent audit. 57. The audit committee and management inform the auditor of the understanding of the business purpose of complex new transactions which may affect the accounting treatment, or uncertain accounting estimates. 58. The audit committee and management promptly inform the auditor of relevant correspondence or other communications from regulators or market

Matter	Proposed good practices
	operators (e.g. inquiries made, or concerns raised about, accounting policies, accounting estimates or material disclosures, or any matter that could have an impact on financial information reported to the market). The audit committee should also consider whether there are appropriate processes for its members to be promptly informed of any such communications. 59. The auditor provides written reports on key issues and concerns, and these reports are considered and acted upon appropriately. These reports may include matters such as deficiencies in controls and errors identified by the auditor, and any significant concerns with accounting treatments and estimates. They may also include suspected non-compliances with laws and regulations. 60. The auditor demonstrates professional skepticism in considering judgement areas such as accounting estimates and accounting policies. 61. If Key Audit Matters or Critical Audit Matters (KAMs) are required to be disclosed in the audit report, the audit committee discusses proposed KAMs with the auditor and how these affect disclosures in the financial report of accounting policies and sources of estimation uncertainty or risks in the management discussion and analysis. The audit committee should consider the need for any issues to be addressed by management or the directors (e.g. addressed in the finalisation of the financial report or by improving systems and controls).
Ensuring access to directors and audit committee	The audit committee should ensure that: 62. There are established protocols for communications between the audit committee and the auditor,

Matter	Proposed good practices
	including setting clear expectations regarding the nature and method of communication. 63. The auditor is allowed unfettered access to the audit committee or audit committee chair. 64. The auditor is regularly invited to attend audit committee meetings, particularly where material issues concerning financial reporting are discussed. 65. There is an open dialogue between the auditor and the audit committee on matters affecting the financial report, the audit and audit quality. 66. The audit committee meets with the auditor without management present on a regular and frequent basis and discusses with the auditor any contentious issues that have arisen with management during the course of the audit and whether they have been resolved to the auditor's satisfaction. Minutes of these discussions should not be provided to management. 67. Communications with the auditor are regularly reviewed and are effective in supporting audit quality.

3.9 Assessing Audit Quality

Audit committees are well-placed to evaluate an auditor's performance, and can help to ensure that members receive a valuable independent audit opinion on the financial reports. This promotes market confidence in the issuer's financial reports.

Matter	Proposed good practices
Quality and standards	68. The audit committee should consider whether there is any indication that the auditor is not committed to audit quality and the application of high ethical standards.

Matter	Proposed good practices
The audit process	The audit committee should consider the extent to which: 69. The auditor demonstrates a sufficient understanding of the business, operations and risk areas relevant to the financial report, and has responded appropriately to assessed risks. 70. The auditor appears to exhibit sufficient professional scepticism in challenging, rather than rationalising, estimates and accounting policy choices (e.g. complex or subjective asset valuations, including cases where the reported net assets exceed the market capitalisation of the issuer). 71. The auditor appears to address risks or concerns identified by the audit committee.
Communication of issues	The audit committee should consider the extent to which: 72. The auditor raises key issues affecting the financial report in a timely manner. 73. The auditor raises relevant and useful comments in their management letters.
Other information	The audit committee should consider the extent to which: 74. Information relevant to audit quality in an audit firm's annual audit transparency report is reviewed. 75. Any other information on audit quality is reviewed (e.g. internal issuer staff observations or assessments of audit quality). 76. The auditor takes actions to improve audit quality, and that there are measures and timetables in place to track progress of these actions.
Findings from regulatory audit	The audit committee should consider the extent to which:

Matter	Proposed good practices
inspections and surveillances	77. If a regulator selected the issuer's audit for review, the audit committee has considered the review's scope and results when evaluating the auditor's performance and the quality of the audit. 78. Any overall public aggregate thematic findings from a regulator's inspections or surveillances that are common across many audit engagements are addressed. 79. If the auditor indicated that findings of an audit oversight regulator from the review of the audit files for the specific issuer were not significant (e.g. mere documentation matters or matters where judgements reasonably differ), the audit committee challenges this, as regulators do not generally report insignificant findings.

Chapter 4 – Other Matters

4.1 Audit Committee Reporting

While some jurisdictions require the audit committee to publicly report on how their oversight of the auditor and/or other actions support the quality of the audit,[21] there is currently no such requirement in most jurisdictions other than reporting on the role of the audit committee in relation to auditor independence.

To the extent not already required by law or regulation, audit committees might wish to consider whether to publicly voluntarily comment on the role of the audit committee in supporting audit quality, either in documents accompanying the financial report or another document (e.g. a statement on the issuer's website).[22] For example, consideration might be given to providing a discussion of the involvement of, and process undertaken by, the audit committee to support audit quality in recommending the appointment of auditors, assessing the auditor's ongoing performance, reviewing audit fees, or other areas.

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21 Reporting on the role of the audit committee in relation to auditor independence is required in a number of jurisdictions and is covered separately in Section 3.7.

22 Except that the audit committee's role in relation to auditor independence is covered separately in Section 3.7.

Chapter 5 – Questions for Respondents

To assist in developing a final good practices report, respondents are encouraged to answer the following questions in their responses:

Questions relating to the role of audit committees and audit quality (Chapter 2)

1. Do you agree that audit committees can have an important role in supporting audit quality in the interests of market confidence in the quality of information in the financial reports of issuers (see Section 2.1)?

2. Do you have any comments on the background material on audit quality (see Sections 2.3 and 2.4)?

3. Do you have any comments on the proposed description of the roles and responsibilities of audit committees and auditors (see Sections 2.5 to 2.7)?

Questions relating to proposed good practices (Chapter 3)

4. Do you have any comments on the proposed good practices for the features of audit committees that may facilitate a committee in being more effective in promoting and supporting audit quality (see Section 3.2)?

5. Do you agree with the good practices for audit committees outlined in Sections 3.3 to 3.9?

6. Do you have any additional suggestions on good practices to be adopted by audit committees (see Sections 3.3 to 3.9)?

7. Would you suggest any other changes to the proposed good practices outlined in this report? If so, in what manner (see Sections 3.3 to 3.9)?

8. In some cases a good practice is introduced with the words "The audit committee should take reasonable steps to ensure that" and in other case the words "The audit committee should consider the extent to which". Is the wording used for each good practice appropriate (see Sections 3.3 to 3.9)?

9. It is proposed to provide good practices at principles level and not to include detailed procedures to support those principles. Do you agree with this approach (see Sections 3.3 to 3.9)?

10. Given the differing governance structures for issuers in different jurisdictions, to what extent should any final good practices report deal with the roles of the governing board, audit committee and management in relation to financial reporting, systems and processes (see Section 3.6)?

11. What frameworks, practices, methodologies, or tools have audit committees found to be helpful in evaluating the following:

a) Professional skepticism of auditors;

b) An auditor's commitment to audit quality;

c) Whether an audit firm's culture supports audit quality;

d) Whether an audit firm has or makes available during an audit an appropriate level of resources with appropriate skills and expertise; and

e) Whether audit quality has been compromised by reduced audit fees?

Questions relating to other matters (Chapter 4)

12. Should the proposed report include a section mentioning the possibility of public reporting by audit committees on how they support audit quality? If so, should such reporting be described as "voluntary" or as a "good practice" for the majority of jurisdictions where there is no mandatory requirement? Should more detailed reporting criteria be provided in any final report (see Section 4.1)?

Other comments

13. Are there any other comments that you have on the proposed good practices report and the material that may be included in any final report?