ecoDa's Response to
IOSCO Consultation Report on Good Practices for Audit Committees in Supporting Audit Quality

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ecoDa strongly supports initiatives regarding audit committee practices with respect to audit quality. However, we believe that the IOSCO Good Practices for Audit Committees in Supporting Audit Quality are getting a step further than the EU Audit Reform by imposing an obligation of results on Audit Committees through prescriptive requirements to ensure an effective audit. The fact that the practices are considered as "good" and not "best" practices imply a level of practice deemed as "normal" for all proposed practices, in a context where some of the practices are beyond what is currently considered as best practices even for matured countries and audit committees.

Our additional general comments are as follows:

- Audit committee works must be manageable in the (relatively) short timeframe allocated to these matters, considering the overall mandate of board of directors and the fact that their key responsibility is strategy, reporting and senior management compensation and nomination. Regulation puts people on boards able to control but not able to respond to new challenges. Regulators have forgotten the competitiveness' aim of Corporate Governance.

  The agenda overload, including and beyond the strict topic of overseeing external auditors, is a serious concern for audit committees to be able to meet their mandate as delegated by the board. Audit committee members are board members who could (and should) be allowed to perform other duties to support overall board objectives.

- Audit committees must exercise <u>oversight</u> on the relationships with external auditors, but this must not come at the price of becoming a shadow finance department with respect to managing the auditors' relationship at large. In that respect, the depth of review and questioning, although probably in need of improvement and better calibration, must not be overestimated as to what audit committee can actually do (in terms of extent and impact), or this will create a new expectation gap.
- Audit committees must actively support audit quality, set the tone at the top and act as pressure points for audit firms to actively rank audit quality (in all its components and underlying factors) as a priority. However audit committees must not be seen as a substitute to audit regulators primary responsibilities of actually assessing the performance of audit firms.
- Audit committee performance will be improved with the proposed practices, but this should not be construed as an additional direct responsibility to board members in case of audit failures, as audit quality rests first and foremost with audit firms.
- It is also important to acknowledge that management is the primary party in communicating on a regular basis with the auditors. Clear cut of responsibilities is necessary for an efficient governance framework.

A summary of the proposed changes to the text is proposed in Appendix to our response document.

ecoDa will address all those issues and the below developments at a workshop with AC members/chairs in Brussels on September 19. IOSCO is more than welcome to join the debate.

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)?**

We agree that audit committees have a role in supporting audit quality, however we believe that this role should not be overestimated at the risk of creating unrealistic expectations and a new expectation gap.
There are many limitations to what audit committees can do with respect to audit quality, which are more fully developed under section 3.9 and Question 4 below.

As a consequence, we believe that audit committees will be most effective in applying pressure points on the auditors to establish a proper tone-at-the-top regarding audit quality, but should not be held as the ultimate safeguard against non-quality in the audit process. We would like to emphasize that the monitoring of audit quality is the role of the audit regulators. Practically, it means that how the Report defines this role should reflect a sound understanding of the level of inquiries that audit committee can conduct to carry out this objective (which it does), but also a practical realization that most of the answers received can be largely promotional.

[As a side comment but nevertheless connected audit firms are selected on the basis of the anticipated quality of their audits, and embedded in the audit fees is an intangible portion related to a high standard of quality and reputation of the selected audit firm. Current perception of audit committees for listed companies, which pay serious attention to audit quality, is that most audit firms are doing good audits, and the very high percentage mentioned in Chapter 1 ("auditors did not obtain reasonable assurance that financial reports were free of material misstatement in 40% of audits reviewed by audit regulators", which practically means that audit services are materially deficient in a proportion of 4 out of 10 issuers) would point to several underlying questions :

- How really close are these inspection-related deficiencies to near-misses and material weaknesses (ie. could they, alone or in aggregate, have caused a significant restatement or fraud to go undetected). Experience of audit committee members show that in certain cases, there is a lack of consensus regarding the potential impact (as is implicitly pointed in Practice #79). On another hand, where issues with quality are clearly demonstrated as to the magnitude of the potential impact, there is no doubt that swift and speedy action is taken for remediation.

- Is there a shared notion of materiality (like, some twenty years ago, it was demonstrated that there was no shared definition of internal control, which led to the report from the COSO of the Treadway Commission on the first internal control framework).
- Has the audit work become too complicated for the way audit firms are structured
- Has there been a serious look at the overall built up of audit procedures and whether they provide for effective audits, considering the maturity and complexity of the issuers]

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

Section 2.3: We agree with section 2.3, noting that this is restricted to an audit of financial statements and would *de facto* eliminate audits of internal control which have become a substantial portion of the auditors' assignment is certain countries.

We agree with the mentions of "financial report <u>as a whole</u>", and <u>material</u> misstatements, and believe that this would warrant a shared definition of materiality. Some auditors have taken the stance, based on their interpretation of inspections results, that all line items of the financial statements and disclosures, because they are required by GAAP, are equally important. This interpretation seems to by-pass the notion of materiality in the context of an audit. A shared definition of materiality would also help in clearly calibrating the severity of each inspection findings (individually and in aggregate for a specific inspection).

However, the way audit quality is defined, as "**matters that affect the auditor's ability to**", is very broad and mostly relates to the audit process as a proxy for audit quality. As mentioned below in Question 4 (Section 3.2 Practice #9), a logical assumption is that there should be a clear link between the quality of execution of the audit process and audit quality, but quality of the audit process and audit quality is not the same. This section should more clearly acknowledge the difference (and expectation) and provides for a definition of audit quality and its attributes.
Our views are that audit quality refers to well-designed, cost-efficient, audit procedures that achieve an audit's fundamental objectives [etc].
For investors and audit committees, a quality audit is one that provides for the reliability and credibility of the audit of a company (and underlying matters on which the auditors opine), at a fair cost and within a jointly agreed deadline (for these last two criteria, absent any unexpected material issue).
From an issuer standpoint, a quality audit is one that will allow the auditor to identify and assess deficiencies (internal control or financial) in time for these to be remediated, in the most cost-efficient and less disruptive way. Cost (ie. external auditors' time), internal time dedicated to

the auditors and deadline cannot be entirely removed from the equation. We believe that cost efficiency in the audit is a criteria that should be taken into consideration (which does not mean that audit budgets should be unduly reduced), otherwise the auditors might spend too much time on low risk areas 1) at the expense of the efficiency and other priorities of finance departments, 2) with a loss of opportunity for these costs (ie. those costs above normal and fair) to be expensed elsewhere, and 3) at the risk of unduly complexifying the audit and the auditors paying less attention to the high risk areas. The same for time constraints (which does not mean that the financial calendar should put the auditors under an unreasonable time pressure), otherwise in the absence of a clear deadline audit procedures can take much longer for no valid reasons (as could be observed with the difficulties surrounding the completion date for audit documentation some years ago).
In case material issues are encountered, time and costs become secondary to making sure that they are resolved in a satisfactorily manner (ie. one that a reasonable investor would expect and, as a substitute to the reasonable investor, the audit oversight regulator). In other words, ECODA strongly supports audit quality, but in the absence of material issues, "audit quality" should not be construed as "audit quality at any cost".

Section 2.4: We agree with the range of factors included under Section 2.4, noting that the following factors are also important and should be mentioned:

- A factor regarding adaptation of the technical means of audit firm to the complexity of their audit clients should be added to the mix of factors, in particular regarding computer-assisted audit techniques and other data analytics capabilities.
- Training should receive a specific mention as it is mostly viewed as technical training (on GAAP, GAAS, industry specifics and internal control). We believe soft skills and behavioral trainings such as: strategic interviewing, listening skills, sensitivity to bias and communication skills (within the team and auditor to client) are equally important. Communication is particularly important to provide a clear articulation and rationale for the request (re. not "because the audit regulator requires it"), and because difficult, contentious matters require to be properly framed and explained to be effectively communicated to management and the audit committee for appropriate action. Project management is also an area which require attention, so that important matters are anticipated during the year and not postponed to the last minute (in particular regarding exercise of quality controls by the audit firms).
- Staff retention (which is of paramount importance concerning industry expertise and understanding of the business), as well as the ability to attract and retain a qualified workforce (the latter is implicit under recruitment but should not be understated).

- Audit firm’s process for proposing specific partners and other senior personnel for an audit, with respect to professional background, expertise, and actual availability (beyond just expected time commitment)

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)?**

Section 2.5: We agree with section 2.5, with the same comment as for section 2.3.

Section 2.6: We agree with section 2.6, noting that the mandate of audit committee is defined by law (usually) and by the board of directors (or equivalent governance body) and is much broader than oversight of the independent auditors. We would suggest the following revision “Audit committees promote and support the quality of the audit through their various responsibilities, as far as they relate to the external audit.”
Wording (promoting, supporting) is a higher requirement than monitoring and should be viewed as a best practice (more on that below). Promoting and supporting audit quality is not a responsibility of the audit committee, unless taken from a high level standpoint (see our response to Question 10). Audit committees have a responsibility for the appointment and oversight of the independent auditors, and activities suggested under “supporting the quality of the work of an auditor” are those which are generally performed under the requirement for oversight.
Creating an additional (implied) responsibility for promoting and supporting audit quality opens the door to sanctions and enforcement for failure to do so. This is also highly judgmental (where does promoting and supporting stops, how is it demonstrated in an objectifiable manner, especially when most of the activities of the audit committee are conducted verbally and not minuted down to each question asked and answers received ?).
Also, promoting and supporting audit quality should not be construed as promoting and supporting the auditors in each and every request, in particular when they reflect an excessive focus on low risk areas (and communicated and jointly agreed as such) at the detriment of higher risk areas.

Section 2.6 & 2.7: We believe section 2.6 and section 2.7 overlaps to a certain extent. **The mandate of the audit committee is set by the Board, with certain compulsory requirements which are defined by the law. The audit committee does not focus only on issues relevant to the integrity of the financial reporting.**

Section 2.7: We note on page 7 that audit committees "*may raise [any audit quality] concerns with the relevant regulator if needed".* This is in substance an appeal mechanism which could be very important for audit committees if it was an actionable process, and for audit regulators, to gain a larger and quicker access to "near-misses". However, there is very little information in practice on how this would work, which does not provide a proper environment for issuers and their audit committees to actually take advantage of this suggestion. When audit quality concerns are suspected (in the absence of a triggering event such as material fraud or restatement), possible actions by audit committees are restating the tone-at-the-top and commitment to quality, and ultimately ask that the partner or senior managers be changed (and as audit relationships are complex ones, it is often difficult to ask for such a change or to "prove" the audit quality issue as a single factor). We believe that most companies (and in particular smaller ones, which are more susceptible to possible audit quality concerns) would not elect to choose the option to raise their concerns with the audit regulator for several reasons:

- The issue would have to be arbitrated in a timeline compatible with company reporting deadlines, which would probably be deemed too much of a challenge, and
- fear that the audit regulator, whose perspective is (deemed as) mostly geared towards more procedures, might systematically take the views of the auditors.

For this process to be effective and to reach its objective, it would have to meet specific criteria, amongst them, an honest investigation with a no sanction principle for either party. This process should also allow for companies to directly request the arbitrage of audit regulators (and not through their auditors).

Additional comment on Section 2.1 & Section 3.6: Although we understand IOSCO's focus as stated in section 2.1, we disagree with the view that auditors' role is exclusively oriented toward investors and other users of the financial report, as the wording "*Directors must not rely on the auditor when forming their own opinion on the financial report as this would undermine the objective of an audit, which is to obtain reasonable assurance and provide an independent opinion on the financial report.*" seems to imply, which is reiterated in section 3.6 on page 19 : "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". The audit committee and the board of directors also rely on the audit report, and before that on the various communications with the auditors, to get the pulse and an independent view on how the company is performing in terms of internal control over financial reporting and the financial reporting itself. Although they do form an opinion through their interaction with management and internal audit, an independent external opinion also provides a lot of added value internally. The quality of that dialogue also serves as a basis for an iterative process for improvements at issuers' level and should not be understated.

We would suggest that this wording be modified as follows: "Directors must not solely rely on the auditors when forming their own opinion on the financial report, although they may consider the result of the audit without breaching the auditors' independence and undermining as this would undermine the objective of an audit, which is to obtain reasonable assurance and provide an independent opinion on the financial report."

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)?**

Although we agree with most practices proposed in this section, we have the following comments :

Section 3.2 - *Practice #1:* We note Practice #1 on page 8 which states that "*The audit committee should comprise only NEDs*". **Although it appears desirable, in certain circumstances and in particular in jurisdictions where employee representatives must be appointed to the board, we believe that prohibiting their participation to the audit committee may not be in the best interest of governance, as they often have deeper insights on business practices and major transactions, which can impact accounting principles and treatment of transactions**. We believe that this restriction should only apply to persons with a financial reporting oversight role. We suggest that this Practice be modified as such : "The audit committee should <u>be</u> comprise<u>d</u> <u>mostly of</u> ~~only~~ <u>independent (non executive) directors</u> ~~NEDs~~. Executive directors in a financial reporting oversight role should not participate to the audit committee."

Section 3.2 - Practice #5: We note Practice # 5 on page 9 : "*Audit committee members should maintain <u>professional scepticism</u> […] in considering the quality of the audit*". The terminology "professional skepticism" is directly derived from the auditing literature and is the subject of considerable developments. It has even been deemed a "noble and useful concept but often elusive in audits"[1]. We understand that professional skepticism has been introduced in this Consultation report as a way to convey that audit committee should not presume auditors' integrity with respect to audit quality and the statements they make in response to questions

[1] PCAOB Investor Advisory Group Meeting, October 24, 2017, Report from the Working Group on Audit Quality Initiatives, https://pcaobus.org/News/Events/Documents/10242017-IAG-meeting/WG-slides-AQI.pdf

thereto. Professional skepticism in the context of an audit covers a wide range of attitudes and procedures, which cannot compare to the limited scope of interactions of the audit committee with the auditors (time spent and nature of interactions, which is mostly through inquiries). In other words, there is a limited pool of interaction and knowledge from which the audit committee can draw to corroborate the auditors' statements, and these sources are primarily from self-promotional materials. **We believe that a questioning mind and the underlying concept of professional skepticism is a major feature of a robust governance, however including such a specific criteria in a context where most audit committee members are not audit professional (and not knowledgeable of the full extent of how professional skepticism has been defined in the audit literature) will set a benchmark by which, in case of any litigation, the bar is raised too high and could be used to unfairly assess the responsibility of an audit committee member or the audit committee as a whole**.

Section 3.2 - Practice #9: We note Practice # 9 on page 10 where "*the audit committee should […] be <u>effective</u> in its role in relation to financial reporting and audit quality*". Effective is different from efficient (which has a cost/benefit analysis embedded). Whilst we agree that the audit committee should seek effectiveness in its role in relation to financial reporting, this is always taking into account a reasonable time commitment (in the absence of identified material issue). **The audit committee cannot be ascribed the same adjective regarding audit quality, as a there are some important limitations to what an audit committee can do to that respect:**

- Quality of the audit is largely in the control of the audit firms, and audit firms internal consultations or debates about a specific engagement audit quality issues are usually largely hidden from the audit committees (unless they refer to a former auditor). It can be expected that, should there be anything detrimental to the audit firm, questions that the audit committee would ask regarding audit quality would probably not be answered with the expected degree of honesty as the auditor will seek to maintain its reputation. In other words, the risk for boilerplate discussions is high, which is not value added. Audit committees have a role in the tone-at-the top regarding quality of the audit, but not to the extent that they are required to be effective thereon.
- **There is an implicit thinking which mixes audit quality and quality of the audit process**. Quality of the audit process does not necessarily mean audit quality (however, a logical assumption would be that the probability of a poorly executed audit process to also lack audit quality runs high). It is fairly difficult for external parties like management and audit committees to develop a view of the quality of the audit process, because it is largely occurring outside of management and the audit committee's views, and even more so regarding audit quality. What is mostly addressed in the proposed

Practices (as well as in many audit quality indicators, an on-going debate dating back to 2008) is quality of the audit process.

- **Audit committees have a fairly limited view on how the audit engagement is actually performing**. The inquiries and observations that the audit committee can undertake (either during audit committees and between meetings) are limited in nature. Management comments on the quality of the audit can be viewed both ways: positive comments might well imply that the auditors are not challenging enough, and negative comments might well imply that the auditor is going too far. For example, probable rotation (re. not being re-appointed) or probability of being inspected can induce a fear of retrospective insights by the coming auditor or the audit regulator, and the incumbent auditors can take harsher positions than what it would have taken absent these specific circumstances. Should it be considered that audit quality was higher because the auditors took a harsher view? [2] When more is deemed sufficient in what is and will remain fundamentally highly judgmental?
- Perception of the extent of procedures required is also largely framed by the evolving requests of audit regulators in reaction to audit failures and audit inspection. **Audit quality is seen as a moving target on which the audit committee is largely dependent on the level of communication it receives from the auditors**, which can be self serving to a certain extent (as more work will translate into more fees).
- The audit committee is tasked by the law with many responsibilities, to which the board can add other responsibilities, without prejudice to the responsibility of the board as a whole. Monitoring the external auditor is one among many tasks that the audit committee must perform. **Stating that the audit committee must be <u>effective</u> with respect to audit quality is putting an obligation of means with no time limit, in the absence of material issue**, which would require the audit committee to actually devote a lot of its time to monitor quality at a third party over which it has little control, at the expense of other tasks equally important to investors.
- When audit quality issues are suspected, there is little that the audit committee can do unless an effective appeal mechanism is implemented. See above with respect to Question 3.

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[2] In particular, consider PCAOB speech by Jay D Hanson, November 17, 2005, PCAOB Impact on Financial Executives: Standards and Inspections : "Nevertheless, we cannot rule out that firms' concerns about the frequency of our findings in this area and their efforts to remediate the related quality control deficiencies have not caused some audit teams to do more work, and possibly the wrong kind of work, resulting in unnecessary burdens on management. Ultimately, this is an area where the PCAOB, the SEC, audit firms, and financial reporting management need to continue to monitor events in order to achieve an appropriate balance between auditors' doing sufficient and meaningful audit work to gather the right amount and the right type of audit evidence, while not imposing unnecessary burdens on management or causing needless delays in the financial reporting process. In other words, we need to be mindful about whether the audit effort pendulum has swung too far." _ https://pcaobus.org/News/Speech/Pages/11172015-Hanson-FEI-speech-PCAOB-impact.aspx

In case of an audit failure, a requirement of effectiveness regarding audit quality would unfairly burden the audit committee with an additional responsibility over which it has little control, noting that a lot of the interactions between the auditor and the audit committees is not recorded or otherwise documented in detail by the audit committee.

Finally, the expectations on the role of the audit committee regarding audit quality should be based on a general attitude towards audit quality, rather than strict adherence to a standard prescribed set of practices. We would also like to point out that the primary responsibility regarding audit quality is with the audit regulators, who have a large access to audit files.

We believe that this point has the potential for a mis-allocation of responsibility, and we suggest that this paragraph be modified as such: "the audit committee should have sufficient capacity and time commitment for its roles~~, and be effective~~ in relation to financial reporting and audit quality".

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

We have set out our comment below, organized by section.

3.3 Recommending the Appointment of an Auditor

Section 3.3: We note the paragraph on page 11: "*While consideration should be given to any management concerns with audit quality, <u>non-executive directors – who focus on the need for audit quality and who have direct accountability and fiduciary responsibilities to the members/shareholders</u> – should ideally <u>manage the process of developing</u> a recommendation on selecting, appointing […]*" . **We believe that all directors have direct accountability and fiduciary responsibilities to the members/shareholders and that independent non-executive directors (NEDs) should not be distinguished to that respect**. The same goes for the focus on audit quality, which takes a restrictive view of the focus of NEDs. Also, the whole paragraph seems to dismiss management concerns with audit quality. However apart from a fairly limited scope of interaction with the auditors (compared to management scope of interactions), the audit committee's views on audit performance are largely informed by management (negative or positive comments).

We suggest to delete the reference to management comments with audit quality as these will be discussed later in the Consultation [See Comments under Section 3.6].

With respect to the wording "<u>manage the process of developing",</u> we understand that the Consultation report makes a distinction between the person in charge of developing the process, and the person in charge of managing the process. We fully agree that the audit committee should be responsible for the selection process, however the process will be carried out with the assistance of management and with direct participation from the audit committee. A sound and fair selection process is a time-consuming effort, which the audit committee cannot carry out alone and separate from management, as the Report seems to imply (and notably in Practice #12).

We suggest that the whole paragraph be modified as such : "~~While consideration should be given to any management concerns with audit quality,~~ Where the audit committee is not composed solely of independent non-executive directors, ~~– who focus on the need for audit quality and who have direct accountability and fiduciary responsibilities to the members/shareholders –~~ non-executive directors should ~~ideally~~ ~~manage~~ be responsible for the process of developing a recommendation on selecting, appointing and replacing auditors and the process of determining their remuneration" and Practice #12 : "The audit committee, using a panel of independent non-executive directors, shall be responsible for Any audit tender or other selection process, which shall be conducted following a selection procedure organized by the audited entity with the assistance of management ~~is conducted independently of issuer management (i.e. using a panel of non-executive directors)~~."

Section 3.3 – Practice # 16: We note Practice # 16 on page 12 and in particular: "*Auditors are assessed against the criteria and selected having regard to audit quality, including skills, expertise, technical competence, and resource capacity […]. 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)*". We believe that although size should not be a criteria for exclusion of smaller firms, size is indicative of the resource capacity and expertise, in particular in the consolidated audit of international (not necessarily large) companies with components in various countries. A network with a larger size (not limited to the big 4 audit firms) is more able to ensure a robust quality control and homogeneous culture over its affiliated firms, to invest and develop enablers and tools for the performance of audits (in particular with respect to computer-assisted audit techniques and data analytics), and to attract and retain various expertises that are needed in an audit (and for which the cost can be spread over several audit clients).

Second, the specific consideration ("except having regard etc") would fall under the preliminary independence considerations and the firm would have recused itself on that ground before going to the final steps of the selection process.

Also, **we wonder whether the consideration of the proportion of audit fees relative to a partner portfolio is a realistic criteria (for smaller and larger audit firms).** We believe that

audit quality usually requires a significant time commitment from the partner in charge. As such, for audits of very large companies where the fees are significant, the fees could be large for the individual partner. Indication that the fee is not large in proportion to the rest of the portfolio could be an indication that the audit partner is managing too many significant audit clients. This is in relation to our comments on audit quality factors regarding the appointment process of partners to a specific audit and related compensation, which should take into consideration personal criteria such as independence of mind and other factors which might bear on the decision process (eg. for large audit clients, if the audit partner fears that contentious matters will significantly impact his or her career path and compensation, he/she could refrain from candid discussions with the audit committee).
We suggest that the whole Practice be modified as such : "Auditors are assessed against the criteria and selected having regard to audit quality, including in particular skills, expertise, technical competence, audit methodology and resource capacity […]. 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 as well as independence 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)~~".

Section 3.3 – Practice # 17: We note Practice # 17 on page 12 where potential auditors are not asked for their views on contentious judgments or accounting treatments. Although we understand the need for independence and quality-based criteria, we note that in certain countries where joint audit is mandatory, and where the re- appointment process calls for at least 2 propositions with recommendation for one, this would unduly restrict the capabilities of the audit committees or management to access qualified expertise. Contentious judgments or accounting treatments are usually in highly specialized areas, where adequate competencies are not available in all audit firms. We suggest that Practice # 17 be modified to read "To the extent possible, potential auditors should ~~are~~ not be asked for their views etc.".

Section 3.3 – Practice # 21: We note Practice # 21 on page 13 "*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*". Whilst we agree that this should be a criteria for the incumbent auditor, we believe that "demonstrated" is too strong a word for potential auditors, unless the audit committee relies on a self-promoting statement by the potential auditor. However we agree that a statement should be made to that respect (see suggestion below).
Also, we believe that the wording "is aware of any indication" is too broad and not clear as to what specific consideration is expected, unless a general statement is made regarding

application of these Practices. “Any indication” would refer to publicly available information on audit failures in addition to publicly available audit regulator reports (general sections), in addition to interactions with the audit team (but for incumbent auditors only). Should this be considered on a country or worldwide basis, for all sectors or only the sectors relevant to the company? Should there be a limitation in time? As all large networks (not limited to the big 4) are periodically called for in the case of large bankruptcies or fraud cases, and generally the outcome of the investigation is usually deemed less worthy of media attention, it is not possible for each individual audit committees to perform an unbiased assessment of these matters, which would be outside of their mandates. Whilst we agree with the general idea, we believe it should be toned down so that it does not receive undue preeminence as to what should be done practically by audit committees to that respect.

Otherwise, this would imply that audit committees should ask for specific reports from a service provider monitoring the audit sector, which would entail additional fees for which the added value to the final decision is not always obvious. This should also be tailored depending on the size and complexity of the company.

Finally, we believe that the primary indication to that respect is the individual audit firm inspection reports which should be made publicly available (see next point).

We suggest that the sentence be changed to read “The audit committee should consider the extent to which: 21. The auditor <u>has conveyed</u> [(<u>demonstrated, in the case of an</u> ~~including any~~ incumbent auditor)] ~~has demonstrated~~ a commitment to audit quality, and [22.] ~~to consider whether~~ the audit committee or management is aware of <u>material public allegation, in particular taking into account any general findings and conclusions by the audit oversight regulator</u> ~~any indication~~ that the firm may not have a culture that sufficiently promotes audit quality, which the potential auditors would not have adequately addressed as part of their response to the tender offer”.

Section 3.3 – Practice # 22: We note Practice # 22 on page 13, which reads: “*The audit committee should <u>consider the extent</u> to which : 22. <u>Any</u> information relevant to audit quality in the audit firm’s annual audit transparency report (if any) <u>is reviewed</u> by the audit committee*”. We would delete “any” as we believe that this is over prescriptive, and change the sentence to read so that it does not imply that the audit committee is considering the extent of its review but the information from the transparency report: “The audit committee should consider the extent to which : “ 22. ~~Any~~ information relevant to audit quality in the audit firm’s annual audit transparency report (if any) ~~is reviewed by the audit committee~~ **appropriately discusses the audit firm’s commitment to audit quality. ”**

Section 3.3 – Practice # 23: We note Practice # 23 on page 13: “*The audit committee should consider the extent to which: 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".*

We believe that the audit oversight regulator should be specified as being the local audit oversight regulator of the issuer and the one of the audit affiliates with substantial participation to the consolidated audit. As more audit regulators worldwide will make this information publicly available, audit committees cannot be expected to monitor and review all public reports regarding an audit firm and its network affiliates, and should focus on public inspection reports of the audit firm's and its network affiliates with substantial participation to the audit.

We note that this point stops short of the proposed (or incumbent) signatory partner and senior managers personal ratings from internal quality reviews that would be conducted on other audit assignments (with names of such audit assignments withheld). This information would help challenge the decision made by the audit firm to propose a specific partner for the audit engagement.

We understand that the purpose of Practice # 23 is to provide a supplemental criteria to the selection process through the voluntary disclosure by the auditors, as part of the response to the tender offer, that would demonstrate commitment to audit quality, rather than a formal prescriptive procedure. We understand that "adequately" refers to a level of precision rather than an assessment made by the audit committee as to the sufficiency of the remediation plan, which the audit committee will not be able to make absent a detailed knowledge of the specifics, and would delete that reference.

To that respect, we suggest that this point be revised as such: "The audit committee should consider the extent to which : 23. The auditor ~~adequately~~ addresses ~~any~~ <u>the</u> general findings reported publicly by ~~an~~ <u>the</u> audit oversight regulator<u>s of the audit firms with substantial participation to the audit</u> 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".

3.4 Assessing Potential and Continuing Auditors

Section 3.4 – Practice # 26: We note Practice # 26 on page 14, "Senior audit team members (particularly the engagement partner) are sufficiently involved in the audit", and suggest that the notion of sufficient time commitment be included as well as sufficient "bandwidth capacity" to accommodate unpredictable changes in the planning and approach. A proposed revision could be "Senior audit team members (particularly the engagement partner) are sufficiently involved ~~in~~ <u>throughout</u> the audit, <u>including at critical times</u>"

Section 3.4 – Practice # 31: We note Practice # 31 on page 15, "The auditor will not inappropriately use or rely on <u>internal auditors</u> to perform external audit work". We agree with

the principle however we believe that the wording and associated note would discourage the use of internal audit (when objective and qualified), for lower risk areas [3].
We suggest that this point be revised as such: "~~The auditor will not inappropriately use or rely on internal auditors to perform external audit work~~ If and when allowed by local jurisdiction, internal audit is used for audit work in lower risk areas, the auditor has processes to determine that use or reliance is appropriate and does not lead to a loss of audit quality and/or independence".

Section 3.4 – Practice # 33: We note Practice # 33 on page 16, "*The audit committee should take reasonable steps to ensure that: […] 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, 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*".
Whilst we agree with the principle that the audit committee must understand and challenge, to a reasonable extent, the audit approach in all three areas mentioned (but certainly not limited to these three areas), we believe that this Practice is over-prescriptive and that it could ultimately be viewed as transferring part of the responsibility in the audit approach from the external auditors to the audit committee, in a context where the audit committee does not have the same insights, time commitment and detailed understanding of the fact and circumstances to the level that is required from external auditors. We note ISA 260 (revised) Communication with those charged with governance which states that: "A11. Communication regarding the planned scope and timing of the audit may : (a) Assist those charged with governance to understand better the consequences of the auditor's work, to discuss issues of risk and the concept of materiality with the auditor, and to identify any areas in which they may request the auditor to undertake additional procedures", and favor aligning the current wording to the one in ISA 260.

3.5 Setting Audit Fees

Section 3.5: We note the comments on page 16 and 17 regarding the setting of audit fees :

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[3] ISA 610 (Revised 2013), Using the Work of Internal Auditors; A14. Other planning matters that it may be appropriate to discuss with those charged with governance include: […] Where the entity has an internal audit function, how the external auditor and internal auditors can work together in a constructive and complementary manner, including any planned use of the work of the internal audit function, and the nature and extent of any planned use of internal auditors to provide direct assistance.

“The setting of audit fees is a commercial decision by issuers and their auditors », « 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 », and « audit committees and directors should be aware of pressures in some audit firms to limit the impacts of low or reduced fees on margins ».

Whilst we agree that audit fees should be set at a fair amount commensurate with a quality audit, we note that the practice which consists of accepting lower fees to gain the audit of an issuer is a decision that is made by the audit firm, which by the number of employees and the global revenue are often larger firms than the issuer. When that decision is made, the audit commitment should be met by the audit firm, at the same level of quality had that discount not been provided (providing an audit report in accordance with GAAS, without compromising audit quality). We believe that the practice which consists of winning a tender offer at a reduced fee, and then gradually (or not gradually) increasing the fee to the level at which it should have been set initially (all things equal), is an unfair commercial practice which is particularly detrimental to smaller audit firms as well as to smaller issuers.

We also note a particular focus on the risk of lower audit fees compromising audit quality. We would welcome a more nuanced view regarding the setting of audit fees. Audit fees are usually higher in proportion to total expenses for smaller issuers compared to larger issuers, and the bargaining power of large issuers is, overall, usually greater than that of smaller ones. Alongside the debate in the US regarding the middle-market IPO tax [4], there is to a certain extent a middle-market audit tax. **Whilst we agree that audit quality is of paramount importance, we also would welcome a debate of why audit fees should only, systematically, be considered on the safe side when they increase, and all reductions suspect of a potential compromise to audit quality. We would like to emphasize the top-down risk-based approach as being equally important, the discussion on materiality, as well as productivity gains in the audit sector. We also note that auditing standards have piled up layers of mandatory procedures at the detriment of professional judgment, and question whether certain aspects of auditing standards are still addressing at the right level the complexity and structure of companies**, in particular in the area regarding the understanding of internal control required for an audit. We believe that this debate is of particular importance to keep capital markets an attractive option for smaller issuers.

Section 3.5 - Practice # 36: We note Practice # 36 on page 18: “*The audit committee should consider the extent to which: […] Audit committees may wish to consider the level of audit fees is adequate with regard to matters such as: […] (iii) appropriate benchmarking against similar businesses*”. Whilst we appreciate that this practice (like all others considered in the Consultation report) is optional, we nevertheless draw the attention of the IOSCO committee

[4] https://www.sec.gov/news/speech/jackson-middle-market-ipo-tax

to the fact that the use of benchmarks usually results in driving fees upward, and that, unless a specific service provider is used (with range of fees around 20-30K€ for a full benchmark report), audit committees generally would not have the time for the full analysis of a benchmark, which should take into consideration specific circumstances occurring at other companies and would require a detailed look at many companies' filings. For that reason, we would not put the use of benchmarks at the same level for consideration than (i) any risks, judgements and estimates to be addressed by the auditor and (ii) changes in the business or financial reporting requirements.

3.6 Facilitating the Audit Process

Section 3.6: We note the following comment on page 18: "*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".*

Whilst we agree with the general idea of this section, and with the principle that management must produce high-quality information, we believe that the section could be viewed as a change of paradigm. **Auditors must adapt to the information produced by management, not the other way around.** Auditors may request additional analysis and may suggest improvements in the way the information is structured to facilitate their audit, however this should not be construed as a specific request for management to structure or change the information produced with a particular focus which would be to accommodate the auditors and the audit process. Examples would include: requesting that management develops country-based business plans rather than using the business plans prepared for internal purposes, when this information is not readily available internally and would not make sense in the context of the company. In the same order of consideration, requiring that management develop a specific tax planning strategy for deferred tax audit purposes.

Also, accounting standards, auditing standards and the inspection process have been driving a trend towards a greater sophistication within finance departments, and to a much more detailed documentation of the financial statements closing process. Finance departments in all companies, in particular the smaller issuers, usually apply a cost/benefit analysis which takes into account the materiality of the related financial information. A robust materiality assessment should be undertaken to that respect, so that the effort of finance departments be also focused on the at-risk areas, and priorities are not lost in the pursuit of perfection at all costs.

We believe that this whole section should be clarified so that the reader does not infer that management should prepare information specifically structured for the auditors.

Section 3.6: We note the following comment on page 19 "*They [directors] 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*", and **question whether this could be regarded, in certain circumstances, as opinion shopping, in particular when the conclusion is different, ultimately, from that of the auditors (with a potential consequence of a disagreement with the auditors should it be maintained, or worse, suspicion of improper influence if the auditors change their views).**

In certain situations, management or both management and the audit committee, might decide to seek the assistance of an external independent expert to determine the appropriate accounting in advance of the auditors' review rather than rely only on internal technical resources. Typically, the audit committee listens to both management (who should be responsible for the development of their own views and interpretations, possibly with the help of outside experts) and the auditors' views to form their own views. Listening to the auditors' views during an iterative discussion to ascertain the fact pattern and accounting literature interpretation is not the same as seeking advice from the auditors on an accounting treatment, and is usually required as a best practice to ensure that all facts and circumstances have been considered (a bias reduction technique, in areas which are often structurally high in judgment and possible interpretations considering the complexity of both accounting standards and transactions).

Pragmatically, these discussions are often highly technical and occur between management (the outside expert as the case maybe) and the auditors, and the audit committee is involved at a later stage or earlier in case of a continued disagreement, which should be the case for very limited circumstances. Where a treatment still does not reflect their understanding of the substance of an arrangement after consideration of both views, the audit committee would ask that its understanding (and underlying facts and circumstances) be taken into consideration in the fact pattern. Only in a highly contentious relationships would they seek external assistance. We believe that the emphasis on the independent external expert should be amended as it could be misinterpreted, and suggest that Practice #40 be modified as follows: "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~~ In the unusual circumstances where a treatment still does not reflect their understanding of the substance of an arrangement after due consideration of all views, the audit committee should consider seeking external professional advice. "

Section 3.6 – Practices: We note the title "*Supporting the audit*" in the proposed Practices table on page 19. **We believe that audit committees must support audit quality, which might not necessarily translate into supporting the auditors**. Audit committees are required to have a balanced view and to keep a questioning mind, to assess whether all facts and circumstances have been appropriately taken into account by the auditors, and whether management has appropriately considered all of the auditors' comments. We suggest that the wording be changed to "Supporting audit quality".

Section 3.6 – Practices # 42 and # 43: We note Practices # 42 and # 43 on page 20 regarding: *"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*". We believe that the request for "take reasonable steps to ensure" is vague and potentially charged with the potential for possible interference with management prerogatives. We also note that this Practice is a standard feature of engagement letters (audit fees are usually established in consideration of these factors, including cooperation). We suggest that "take reasonable steps" be changed to "enquire with management as to whether".

3.7 Assessing Auditor Independence

Section 3.7: We note Practice # 45 on page 21 and refer to our developments under 3.6 above.

3.8 Communicating with the Auditor

Section 3.8: We note the following comment on page 23 regarding: "*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*". We understand that this paragraph refers to what is otherwise known as improper influence in the conduct of an audit. We suggest that the wording be amended as follows: "Communications between the auditor and the audit committee must not, <u>in the way they are conducted</u>, undermine the auditor's independence or the effectiveness of performance of the audit or auditing procedures", so that it cannot be interpreted as a measured communication. We believe honest and transparent (candid) discussions between the auditors and the audit committee are a key factor for audit quality.

Section 3.8 - Practices # 56, # 57 and # 58: We note Practices # 56, # 57 and # 58 the wording "*the audit committee and management*". **We believe that management being (and should remain) the primary party in communicating on a regular basis with the auditors**, the Practices should rather read "management informs etc. [59] The audit committee may wish to enquire with the auditors whether they have been informed on a timely basis for the matters referred to above", so that not to create unrealistic expectations regarding the extent and frequency of the participation of the audit committee to the day-to-day monitoring audit process.

Section 3.8 - Practice # 67: We note Practice # 67 on page 25 "*The audit committee should ensure that: […] 67. Communications with the auditor are regularly reviewed and are effective in supporting audit quality*". We believe that, as currently written, it is not clear whether "communications with the auditor" refer to the auditors' slides and reports to the audit committee, or written communication from the audit committee to the auditors (noting that verbal communication cannot be "reviewed" and are usually not minuted to the level of detail where they can be reviewed, except for material communication), and the statement "are effective in supporting audit quality" is vague, ambiguous and not precise enough as to what is expected. We also consider that it is the responsibility of the auditors to gather the communication and ensure that these are appropriately considered in their audit. As such, we believe that this Practice doubles with other Practices regarding open dialogue and unfettered access, and should be deleted.

3.9 Assessing Audit Quality

Section 3.9: We strongly disagree that "*Audit committees are well-placed to evaluate an auditor's performance*". Audit committees may be better placed than others to form a contemporaneous view of an auditor's performance <u>up to certain extent</u>, but the on-going debate on audit quality indicators (dating back to 2008 in the US) clearly shows that the topic is much more complex and that audit committees' focus on audit quality will not, by itself, solve the issue. Audit regulators are better placed to gain a more thorough view, although within a delayed timeframe, of an auditor's performance. As mentioned in the July 1, 2015 PCAOB Concept Release on Audit Quality, page 5 :

> The lack of information [*regarding indicators of audit quality at individual accounting firms]* identified by the Treasury Advisory Committee arises from the inherent circumstances of auditing. Although a public company's audited financial statements and related auditor's report are themselves made public, and certain disclosures are now required by law to be made to the company's audit committee, those items provide limited information on which to evaluate the quality of an audit and explain how auditing actually takes place. The manner in which the audit is conducted lies primarily under the surface, and the strengths and weaknesses of the process are opaque. The sole observable output of the audit is a standardized report that cannot be used to distinguish auditors from one another. Since this is so, it is difficult to evaluate the elements of audit quality (although [PCAOB] Board members have learned that some audit committees are experimenting with various kinds of AQIs [*Audit Quality Indicators*] to inform discussions with their companies' auditors), or to understand how it might be strengthened; it is also hard to recognize and reward audit quality when it is present.
>
> For these reasons, audits currently may fall within the class of what economists call

"credence goods." That is, the quality and impact of the auditor's services may be difficult or in some cases impossible to ascertain accurately. The auditor is usually in the best position to determine the scope of the service required; the client has limited ability to make a similar judgment, and the outcome of the service – the quality of the audit – is either unobservable or can only be observed at significant cost to the audited company or others."

We suggest that the sentence be amended as such : "Audit committees ~~are well-placed to~~ can play a role in the ~~evaluate~~ evaluation of an auditor's performance".

Section 3.9 - Practices # 68: We note Practices # 68 on page 25, "*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 standard*s." As mentioned earlier, we believe that the wording "any" is over-prescriptive and would open the door to retrospective hindsight. We also consider that it is not the purpose of management and/or the audit committee to suspect non-quality and "audit the auditor" to the detail level that "any" would seem to imply. We suggest that the Practice be amended as such "The audit committee should consider whether there is ~~any~~ material indication that the auditor is not committed to audit quality and the application of high ethical standards".

4.1 Audit Committee Reporting

Section 4.1: See our response under question 12 below.

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

Sections 3.3 to 3.9: We believe the proposed practices are comprehensive and have no further suggestions.

Considerations under Question 11 below are for IOSCO's information on audit committee practices deemed relevant with regards to the topic, and are not an indication that ecoDa would welcome more prescriptive guidance to that respect.

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)?**

Sections 3.3 to 3.9: We have included our comments on section 3.3 and 3.9 in the question above and have no further comments.

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)?**

We believe that the wording "*The audit committee should take reasonable steps to ensure that"* is too process-driven, and that the introduction of a reasonable criteria will cause variance in the interpretation, especially considering the various levels of maturity in governance practices around the world. Some might consider this wording as intending for some extent of proportionality (less work if less complex), whereas other might read it as requiring more than current practice (if already implemented). We also believe it is fairly difficult to see how this would be applied in practice, in particular if the final report was used as a benchmark of audit committees' performance.
We consider that the wording "should consider the extent to which […]" is better suited to how governance works, and nevertheless provides for the intended behavior.

We have reviewed the various instances where this wording appears, and we believe that, where they appear, all these wordings should be aligned to "the audit committee should consider the extent to which".

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)?**

We believe that the approach currently taken is already fairly detailed and prescriptive in terms of what audit committees should do (see also Question 8 above regarding the wording "reasonable steps" versus "should consider").

ecoDa is a strong advocate for excellence in governance, with a view that good governance enhances competitiveness and should be adapted to each specific company and circumstances.

Including detailed procedures would be a departure from our principle as it would make the audit committee a compliance committee of the board of directors, without necessarily reaching the initial objective of better audit quality.

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)?**

We agree with the stated intention on page 4: "*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*." Even when considering a limited geographic area such as the European Union, there are many different structures and roles in relation to financial reporting, systems and processes.

This being said, we believe that section 3.6 has properly outlined the key features of issuers' and auditors' respective roles. and we agree with the proposed wording subject to our comments provided under Question 3 (3.3) and Question 5 (5.12) and the following additional comment.

We suggest that the title of section 3.6 be replaced by "Supporting" rather than "Facilitating" the audit process, which better corresponds to audit committees' role to that respect. **Management is responsible with the day-to-day dealings and interactions with the external auditors, and the audit committee can help promote and support, in line with Practice #44, but this is not the same as "facilitating the audit process" which requires a much more active and continuous involvement.** We acknowledge however that in certain situations of disagreement or tension between the finance department and the auditors, the audit committee role can extend to that of an objective third party, and in that role it can facilitate the resolution of contentious issues, but this is limited to very specific circumstances.

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

a) Professional skepticism of auditors;

Professional skepticism of auditors is usually assessed by audit committees through comments made verbally or in writing during presentations, as a generic (disclaimer) statement or more specifically regarding unusual or significant transactions.

Whilst easier to discuss in the context of specific transactions, appropriate professional skepticism is more difficult to monitor in the context of the regular audit execution.

Tools which were found useful by audit committee members to that effect are:

- talking points with examples of specific questions regarding actual practices implemented within the audit team (including component teams and experts), so that these discussions go beyond statements that would already be contained in the annual transparency report or other documents (such as the generic disclaimer mentioned above).
- Direct discussion with the engagement quality reviewer on these matters

b) An auditor's commitment to audit quality;

Apart from what can be read in the various documentation available on the initial request for proposal, audit firms websites and publications, and annual transparency reports (when they exist), practices which have been found as helpful in evaluating an auditor's commitment to audit quality have been found as such:

- Visible involvement (and stability) of experienced and skilled senior personnel, whilst respecting and anticipating rotation, which should lead to a better understanding of the business, of the risks, and to an effective supervision of the whole team (in particular, regarding more junior employees, experts and component teams). This should be visible by management and company employees interacting with audit personnel in a direct or indirect manner (for example, how far are more junior personnel specifically prepared for interviews and inquiries of company personnel).
- An informal assessment of the general quality of all communications (formal and informal), and in particular: informed views on risk areas/audit approach thereof and difficult matters (especially when a high level of interpretation or judgment is applied), informed views on materiality applied to the company (which should enable a better focus), and clarity of explanations provided to inquiries on difficult matters. A willingness to explain in concise and clear terms and to speak one's mind (on difficult accounting treatment but also on difficulties arising in the audit, with management but

also internal to the audit team) is a clear indication of a commitment to transparency and quality.

- Ability to bring experts and senior managers in front of the audit committee (and not restricting interaction to the senior partners), for more detailed questions. These personnel usually have less curated views and can bring a different angle to the discussions.
- The sharing of information regarding senior audit personnel own internal inspection results (consistency of ratings across one's personal portfolio of engagement), and action plans.

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

Apart from the previously mentioned sources of information, practices which have been found as helpful in evaluating the audit firm's culture with respect to audit quality are:

- The sharing of the results of internal people surveys' results for questions regarding (or impacting) audit quality, and action plans
- Information on how technical groups (generally responsible for implementing and overseeing the quality control infrastructure) are considered within the audit firm (in terms of compensation; promotion; access to, and equal, partner status; rotation in and out of the technical groups to audit clients, etc)
- Information on how employees (including rank-and-file partners) are treated, and in particular the pay ratio between rank-and-file partners and audit firms senior management
- Information on training (attendance, but also nature of training including on bias and soft skills, and how does the audit firm monitors that training is effective ie. understood and applied).

However audit committee members generally agree that these practices should be more thoroughly assessed at the level of audit oversight regulators' inspections than at the level of individual audit committees, unless in an informal way (tone-at-the top and pressure point).

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

Practices which have been found helpful in evaluating whether an audit firm has or makes available during an audit an appropriate level of resources with appropriate skills and expertise are :

- How the audit firm reacts to unusual and (often) late minute circumstances (be it : a major transaction, a material adverse event, etc)
- the timely provision of budget and actual disaggregated audit <u>hours</u> (more than audit fees) by audit areas (including specific risk areas and supervision time), experience levels (including experts), and geographies (covering components).
- Formal and informal surveys of management and other company personnel who directly interact with audit personnel.

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

We refer to our comments on Question 5 (5.10) and disagree with the implied statement in the question that in circumstances where audit fees are decreased there should necessarily be a greater focus on audit quality (ie. greater than the normal focus that audit quality should request).

Audit quality is not the same as the audit process, and there are normal, structural limits to the extent of the audit process (provided by materiality, a top-down risk assessment and the auditing standards).

Increased audit fees can also be an indication of lesser <u>audit</u> quality, for example:

- communication between the audit team at large (including components and experts) being less than fluid for various reasons internal to the audit team
- audit approach being suboptimal and not focused on the risk areas
- lesser use of audit analytics (or using audit analytics whilst also performing extensive manual audit procedures).

Also, indicators such as the number of hours spent by technical groups can be subject to various interpretations and not necessarily indicate audit quality: does it reflect “close calls” or attempted rationalization of aggressive accounting practices, or disagreement between management and the auditors, or a lack of technical competence at the level of the audit team?

Practices which have been helpful consist mostly of an honest review of the disaggregated hourly budget and subsequent review of actual to budget on the same disaggregated basis, and the resulting discussions to understand the approach including where and why the audit effort has been allocated in the planning stage, and difference to actual. This is usually a complex exercise because the information is not readily available in the right format within audit firms (especially when they have not properly structured the detailed follow up of internal time spent), and furthermore audit firms are somewhat reluctant to go to that level of detail.

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)?**

We note the discussion on page 28 regarding audit committee reporting. We agree that a description as a [good] practice in the same format as for other sections will encourage more disclosure on this specific area of the audit committee work.

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?**

13.1. As a general comment, we note that the terminology "good practices" was retained, and not "best practices". We are concerned that this might imply a level of practice deemed as "normal" for all proposed practices, in a context where some of the practices are beyond what is currently considered as best practices even for matured countries and audit committees. Also, in certain countries where the assessment of audit committee performance with respect to the monitoring of the independent auditors is required from audit regulators (in particular in the EU), audit regulators might assess audit committee practices by the lens of what could be construed as a compliance checklist, which we believe has the potential to create an expectation gap. **We believe that the final report should make clear that the audit committee role with respect to audit quality is to establish the proper tone at the top and mindset. It should not be the meticulous application of the practices listed in the Consultation report, but an appreciation as a whole.**

13.2. We note that the Consultation report has stopped short of providing a list of Audit Quality Indicators (AQIs) although some might be inferred/derived from the Practices. We agree with that view as we support flexibility for audit committees to adapt to the specific circumstances of the entity, however we support an appendix with reference to some major initiatives regarding AQIs as a source of inspiration (for example the list provided by the PCAOB in July

2015, or the frameworks in Singapore and Canada). We believe that should such a list be implemented, disclosure of these AQIs should be both to auditors and the audit oversight regulator for consistency review during their inspections. We also believe that enhanced disclosures by audit committees will not dramatically enhance the transparency of the audit market and the perception of audit quality (or quality of the audit process), as they will probably be mostly qualitative and address the nature (and possibly extent) of work done. However the public release of certain selected audit quality indicators (which would be reviewed by audit oversight regulators), at firm level and company-specific (eg. in aggregate for all audited issuers of the audit firm), would certainly provide for greater transparency, information and incentive to the audit firms, on the basis that what matters gets to be measured.

13.3. We also believe that the debate on audit quality has reached, at least in mature countries, a level where it is biased in the sense that the only response to audit failures is to pile up more procedures and counterchecks (which is also true at the level of audit firms). The audit committee's role has received significant focus over the last 15 years under the Sarbanes-Oxley law in the US, however inspection in the US is still showing a large number of audit deficiencies. Whilst we concur with the US Investor Advisory Group of the PCAOB in its October 2017 report that Relationship between "user pays" audit model and audit quality deserves careful examination, we also suggest that research in these matters also covers the following:

- Are auditing standards still adapted and with the right focus considering the complexity of current organizations.
- How materiality is understood by the different stakeholders' groups (issuers and in particular preparers of financial statements, audit committees, investors, auditors, audit oversight regulators, exchange securities regulators).
- Is the organizational structure of audit engagements (highly hierarchical, and with the more junior members having the larger volume of interaction with the company under audit) still effective.

We believe that although governance, and in particular the audit committee, has a role to play in audit quality, that role should be in due proportion to the complexity of the entity. Governance at institutions such as banks and insurance has received a large focus and been considerably reinforced because these institutions have been identified as the source of potentially material systemic risks. We believe that extending this extensive view of governance indiscriminately to other entities with no such systemic risk runs the risk of misinterpreting effective governance into what would be in substance a compliance role.

APPENDIX: SUMMARY OF ECODA'S PROPOSED AMENDMENTS

Section	Current Text	Proposed ecoDa's amendments
Main Title	*Good Practices for Audit Committees in Supporting Audit Quality*	***Best** Practices for Audit Committees in Supporting Audit Quality*
Section 2.1	*Directors must not rely on the auditor when forming their own opinion on the financial report as this would undermine the objective of an audit, which is to obtain reasonable assurance and provide an independent opinion on the financial report.*	*Directors must not **solely** rely on the auditors when forming their own opinion on the financial report, **although they may consider the result of the audit without breaching the auditors' independence and undermining** the objective of an audit, which is to obtain reasonable assurance and provide an independent opinion on the financial report.*
Section 2.4		Additional factors should be added : • adaptation of the technical means of audit firm to the complexity of their audit clients, • Staff retention as well as the ability to attract and retain a qualified workforce, • soft skills and behavioral trainings such as strategic interviewing, listening skills, sensitivity to bias and communication skills, • Audit firm's process for proposing specific partners and other senior personnel for an audit, with respect to professional background, expertise, and actual availability.
Section 2.6	*Audit committees promote and support the quality of the audit through their various responsibilities.*	*Audit committees promote and support the quality of the audit through their various responsibilities, **as far as they relate to the external audit.***
Section 3.2 - Practice #1	*The audit committee should comprise only NEDs*	*The audit committee should **be** comprise**d mostly of** only NEDs. **Executive directors in a financial reporting oversight role should not participate to the audit committee.***
Section 3.2 - Practice #5	*Audit committee members should maintain professional scepticism […] in considering the quality of the audit.*	**TO BE DELETED**
Section 3.2 - Practice #9	*The audit committee should sufficient capacity for its roles, be effective in its role in relation to financial reporting and audit quality.*	*The audit committee should have sufficient capacity **and time commitment for its roles** in relation to financial reporting and audit quality.*
Section 3.3	*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 […]"*	***Where the audit committee is not composed solely of non-executive (independent) directors, non-executive (independent) directors should be responsible** for the process of developing a recommendation on selecting, appointing and replacing auditors and the process of determining their remuneration.*
Section 3.3 - Practice #12	*Any audit tender or other selection process is conducted independently of issuer management (i.e. using a panel of non-executive directors).*	***The audit committee, using a panel of independent non-executive directors, shall be responsible for** any audit tender or other selection process, **which shall be conducted following a selection procedure organized by the audited entity with the assistance of management.***
Section 3.3 - Practice #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*	*Auditors are assessed against the criteria and selected having regard to audit quality, including **in particular** skills, expertise, technical competence, audit methodology 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*

	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).	*influenced by a low audit fee in circumstances where audit quality may be compromised. A smaller firm should not be* ***excluded if it is*** *the firm that best meets the selection criteria and any other audit quality* ***as well as independence considerations***
Section 3.3 - Practice #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.*	***To the extent possible, p****otential auditors* ***should*** *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.*
Section 3.3 - Practice #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*	*The auditor has* ***conveyed*** *a commitment to audit quality* ***and the audit committee*** *or management is aware of* ***any material public allegation, in particular taking into account any general findings and conclusions by the audit oversight regulator****.*
Section 3.3 - Practice #22	*Any information relevant to audit quality in the audit firm's annual audit transparency report (if any) is reviewed by the audit committee.*	*Information relevant to audit quality in the audit firm's annual audit transparency report (if any) is* ***appropriately discussed regarding the audit firm's commitment to audit quality.***
Section 3.3 - Practice #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.*	*The auditor* ***addresses the*** *general findings reported publicly by* ***the*** *audit oversight regulator****s of the audit firms with substantial participation to the audit*** *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.*
Section 3.4 - Practice #26	*Senior audit team members (particularly the engagement partner) are sufficiently involved in the audit.*	*Senior audit team members (particularly the engagement partner) are sufficiently involved* ***throughout*** *the audit* ***including at critical times****.*
Section 3.4 - Practice #31	*The auditor will not inappropriately use or rely on internal auditors to perform external audit work*	***If and when allowed by local jurisdiction, internal audit is used for audit work in lower risk areas, the auditor has processes to determine that use or reliance is appropriate and does not lead to a loss of audit quality and/or independence***
Section 3.4 - Practice #33	*The audit committee should take reasonable steps to ensure that: […] 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, 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*	ALIGN TO ISA 260 A.11
Section 3.6	*The audit committee can have a <u>key</u> 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*	CLARIFICATIONS NEEDED

	effective audit that focuses on their role of providing an independent opinion on the financial report	
Section 3.9	*They [directors] 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*	*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.* ***In the unusual circumstances*** *where a treatment* ***still*** *does not reflect their understanding of the substance of an arrangement* ***after due consideration of all views, the audit committee should consider seeking external professional advice***
Section 3.6 – Title	*Facilitating the Audit Process*	***Supporting*** *the Audit Process*
Section 3.6 – Practices (title)	*Supporting the audit*	*Supporting* ***audit quality***
Section 3.6 – Practices # 42 and # 43	*The audit committee should take reasonable steps to ensure that: 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* ***enquire with management as to whether****: 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.*
Section 3.8	*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.*	*Communications between the auditor and the audit committee must not, in* ***the way they are conducted****, undermine the auditor's independence or the effectiveness of performance of the audit or auditing procedures.*
Section 3.8 - Practices # 56, # 57 and # 58	*The audit committee and management inform (..)*	***The management*** *informs (..)*
Section 3.8 - Practice # 67	*The audit committee should ensure that: […] 67. Communications with the auditor are regularly reviewed and are effective in supporting audit quality*	**TO BE DELETED**
Section 3.9	*Audit committees are well-placed to evaluate an auditor's performance*	***Audit committees can play a role in the evaluation*** *of an auditor's performance*
Section 3.9 - Practices # 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*	*The audit committee should consider whether there* ***is indication*** *that the auditor is not committed to audit quality and the application of high ethical standards*
Sections 3.3 to 3.9	*The audit committee should take reasonable steps to ensure that (..)*	*The audit committee should* ***consider the extent to which*** *(..)*

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About the European Confederation of Directors Associations (ecoDa)

The European Confederation of Directors Associations (ecoDa) is a not-for-profit association founded in December 2004 under the laws of Belgium. Through its national institutes of directors (the main national institutes existing in Europe), ecoDa represents approximately 55,000 board directors from across the EU. ecoDa’s member organisations represent board directors from the largest public companies to the smallest private firms, both listed and unlisted.

ecoDa full members:

- The British "Institute of Directors" (IoD)
- The Belgian “GUBERNA”
- The French “IFA”
- The Luxembourg “ILA”
- “Directors' Institute Finland”
- The Spanish institute "Instituto de Consejeros – Administradores"
- The “Slovenian Directors' Association”
- The Dutch “Nederlandse vereniging van Commissarissen en Directeuren”
- The Italian Directors’ Association, “Nedcommunity”
- The “Polish Institute of Directors”
- The “Norwegian Institute of Directors”
- The Swedish “StyrelseAkademien”
- “Vereinigung der Aufsichtsrate in Deutschland” e.V., VARD
- The Portuguese “Forum de Administratores Emprases »
- The Baltic Institute of Corporate Governance
- The Swiss Institute of Directors
- The Romanian Independent Directors Association

ecoDa affiliated members (national institutes of directors):

- The “Croatian Institute of Directors”
- The “Macedonian Institute of Directors”, MIoD
- “Corporate Governance Institute Albania” (CGIA)

Corporate Associates (national institutes of directors):

- The “Danish Board Network”

Correspondents:
- Cyprus IoD Branch
- Malta IoD Branch

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