Background to the Audit Quality Project

- For an external audit to fulfill its objective the users of audited financial statements must have confidence that the auditor has worked to a suitable standard and that “a quality audit” has been performed.
- But what is audit quality?
- Audit quality is a complex subject and there is no analysis of it that has achieved universal recognition.
- The IAASB Framework, which was finalized in December 2013, provides an insight in the key Elements that Create an Environment for Audit Quality.
Framework for Audit Quality

Objectives:
• Raise awareness of the key elements of Audit Quality
• Encourage key stakeholders to explore ways to improve Audit Quality
• Facilitate greater dialogue between stakeholders on Audit Quality

Continuous Improvement to Audit Quality

Audit Quality and A Quality Audit

• A quality audit is likely to have been achieved by an engagement team that:
  – Exhibited appropriate values, ethics and attitudes;
  – Was sufficiently knowledgeable, skilled, and experienced and had sufficient time allocated to perform the audit work;
  – Applied a rigorous audit process and quality control procedures that complied with law, regulation and applicable standards;
  – Provided useful and timely reports; and
  – Interacted appropriately with relevant stakeholders.

• Audit quality encompasses the key elements that create an environment which maximizes the likelihood that quality audits are performed on a consistent basis.

• The responsibility for performing quality audits of financial statements rests with auditors. However, audit quality is best achieved in an environment where there is support from and appropriate interactions among participants in the financial reporting supply chain.
Status

- Non-Authoritative Framework that applies to all audits of all entities regardless of their size, nature, and complexity

- Auditors are required to comply with relevant auditing standards and standards of quality control within audit firms, as well as ethics and other regulatory requirements

- The Framework is not a substitute for such standards, nor does it establish additional standards or provide requirements for the performance of audit engagements.

Key Elements Further Explained

The Framework for Audit Quality describes the following Key Elements:
- Inputs
- Process
- Outputs
- Interactions
- Contextual Factors

at the Engagement, Firm, and National Levels
Details of the Inputs, Process and Output Factors
**Inputs: Values, Ethics and Attitudes – Engagement Level**

Key Attributes:

- The engagement team recognizes: that the audit is performed in the wider public interest; and the importance of complying with ethical requirements
- The engagement team exhibits objectivity and integrity
- The engagement team is independent
- The engagement team exhibits professional competence and due care
- The engagement team exhibits professional skepticism

**Input Values, Ethics and Attitudes – Firm Level**

Key Attributes:

- Governance arrangements are in place that establish the appropriate “tone at the top”, and which aim to safeguard the firm’s independence
- Necessary personal characteristics are promoted through appraisal and reward systems supporting audit quality
- Financial considerations do not drive actions and decisions that impair audit quality
- The firm emphasizes the importance of providing partners and staff with continuing professional development opportunities and access to high-quality technical support
- The firm promotes a culture of consultation on difficult issues
- Robust systems exist for making client acceptance and continuance decisions
Inputs
Values, Ethics and Attitudes – National Level

Key Attributes:
• Ethics requirements are promulgated that make clear both the underlying ethics principles and the specific requirements that apply
• Regulators, national standards setters and professional accountancy organizations are active in ensuring that the ethics principles are understood and the requirements are consistently applied
• Information relevant to client acceptance decisions is shared between audit firms

Inputs
Knowledge, Skills, Experience and Time – Engagement level

Key Attributes:
• Partners and staff have the necessary competences
• Partners and staff understand the entity’s business
• Partners and staff make reasonable judgments
• The audit engagement partner is actively involved in risk assessment, planning, supervising, and reviewing the work performed
• Staff performing detailed “on-site” audit work have sufficient experience, their work is appropriately directed, supervised and reviewed, and there is a reasonable degree of staff continuity
• Partners and staff have sufficient time to undertake the audit in an effective manner
• The audit engagement partner and other experienced members of the engagement team are accessible to management and those charged with governance
Inputs
Knowledge, Skills, Experience and Time – Firm Level

Key Attributes:
• Engagement teams are properly structured
• Partners and more senior staff provide less experienced staff with timely appraisals and appropriate coaching or “on-the-job” training
• Sufficient training is given to audit partners and staff on audit, accounting and, where appropriate, specialized industry issues

Inputs
Knowledge, Skills, Experience and Time – National Level

Key Attributes:
• Robust arrangements exist for licensing audit firms/individual auditors
• Education requirements are clearly defined and training is adequately resourced and effective
• Arrangements exist for updating auditors on current issues and for providing training to them in new accounting, auditing or regulatory requirements
• The auditing profession is well-positioned to attract and retain individuals with appropriate qualities
Process
Audit Process and Quality Control Procedures – Engagement Level

Key Attributes:
• The engagement team complies with auditing standards, relevant laws and regulations, and the audit firm’s quality control procedures
• The engagement team makes appropriate use of information technology
• There is effective interaction with others involved in the audit
• There are appropriate arrangements with management so as to achieve an effective and efficient audit process

Process
Audit Process and Quality Control Procedures – Firm Level

Key Attributes:
• The audit methodology is adapted to developments in professional standards and to findings from internal quality control reviews and external inspections
• The audit methodology encourages individual team members to apply professional skepticism and exercise appropriate professional judgment
• The methodology requires effective supervision and review of audit work
• The methodology requires appropriate audit documentation
• Rigorous quality control procedures are established and audit quality is monitored and appropriate consequential action is taken
• Where required, effective engagement quality control reviews (EQCRs) are undertaken
Process
Audit Process and Quality Control Procedures – National Level

Key Attributes:
• Auditing and other standards are promulgated that make clear the underlying objectives as well as the specific requirements that apply
• Bodies responsible for external audit inspections consider relevant attributes of audit quality, both within audit firms and on individual audit engagements
• Effective systems exist for investigating allegations of audit failure and taking disciplinary action when appropriate

Outputs – Engagement Level

From the Auditor
• Auditor’s reports to users of audited financial statements
• Auditor’s reports to those charged with governance
• Auditor’s reports to regulators

From the Entity
• Reports from those charged with governance, including audit committees

From Audit Regulators
• Sometimes information on individual audits for audit committees
Outputs – Firm and National Level

From the Audit Firm
- Transparency reports
- Annual and other reports

From Audit Regulators
- Aggregate views on national results
- Sometimes results of audit firm inspections

Interactions
Each stakeholder plays an important role supporting high-quality financial reporting and the way in which they interact impacts audit quality.

Is there more that can be done to improve the interactions between the stakeholders?
Collectively, the contextual factors can impact the nature and quality of financial reporting and, directly or indirectly, audit quality.

Is action needed on any of the contextual factors to improve financial reporting and/or audit quality?

**Values, Ethics and Attitudes – Current Initiatives**

- IESBA plan to ‘clarify’ Code of Ethics
- New European Law mandates tendering / rotation for PIE audits and prohibits many non-audit services
- Audit firms working to ensure increased Professional Skepticism demonstrated in practice
- IAASB exploring treatment of Professional Skepticism in the ISAs
- Debates about audit firm governance
Knowledge, Skills, Experience and Time – Current Initiatives

- IAASB exploring revisions to Quality Control standards (ISQC 1 and ISA 220)
- Various groups (including the PCAOB) exploring metrics to ‘measure’ audit quality at engagement and firm level
- Improved disclosures in Transparency Reports
- IAESB Revision of IES 8, Competence Requirements for Audit Professionals
- Various national training initiatives
  - Distance learning
  - On-line testing

Audit Process and Quality Control Procedures – Current Initiatives

Current IAASB Projects
- Revisions to ISAs for auditing financial statements Disclosures
- Revision to ISA 720 – Other Information

New IAASB Projects
- Revisions to ISA 600 on group audits
- Special Audit Considerations Relevant to Financial Institutions
Outputs – Current Initiatives

• Expanded Audit Committee reporting in some countries
• Expanding reports from independent audit inspection activities:
  – themes
  – IFIAR aggregate
• Expanded Auditor Reporting – PCAOB, UK and EU
• IAASB has just finalized a new ISA 701 requiring Key Audit Matters to be described in Listed company auditor reports

Key Audit Matters (“KAM”)

New Key Audit Matters section to be required in the auditor’s report for listed entities in accordance with new ISA 701; may be required by law or regulation, or auditor may provide voluntarily, for other entities

Definition:
• Those matters that, in the auditor’s professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.
Interactions – current initiatives

- Auditor » Audit Committees
  - BCBS guidance issued in March 2014.
  - ISA 260 revised to link to new ISA 701 and new EU Legislation
- Auditor » Regulator
  - BCBS guidance
  - EBA to develop guidance to support EU legislation
- Regulator » Regulator
  - Improved dialogue between IFIAR and IAASB

Context: Current Initiatives

- Financial reporting framework
  - Relevance v reliability
  - Extent of ‘Other information’. UK’s ‘Fair, balanced and reasonable’
- Corporate Governance initiatives in a number of countries
  - Membership
  - Activities
  - Transparency
- Improvements in independent Audit Regulation in smaller countries.
Personal conclusions

- Many worthwhile initiatives - especially on audit committees and auditor regulator dialogue.
- However, challenges remain in relation to:
  - Subjectivity of the financial reporting framework
  - Skills and experience of audit teams (linked to business models of audit firms)
  - Skills and experience of audit inspectors
  - Technology and the pace of change