

**International Forum of Independent Audit Regulators  
2012 Summary Report of Inspection Findings  
18 December 2012**

Key Messages

- This is the first International Forum of Independent Audit Regulators (IFIAR) global survey of inspection findings summarizing issues identified by:
  - Twenty-two IFIAR Members' inspections of audit engagements for 961 public companies at 98 audit firms;
  - Ten Members' inspections of audit engagements for 108 major financial institutions at 28 audit firms; and
  - Twenty-three Members' inspections of 109 audit firms' internal quality control systems.
- There are common audit findings among Members in a number of areas (inspection themes), including four that have been discussed by IFIAR with representatives from the six largest international audit firm networks since 2010: professional skepticism, group audits, revenue recognition, and the role of the engagement quality control reviewer.
- The survey results identify and rank the Members' most commonly identified audit findings by inspection theme.
- The survey results suggest that audit firms need to do more to improve the consistency of performance on individual audit engagements, including remediating the inspection findings and determining the possible root causes underlying these findings.
- The survey data indicates that the scale of Members' inspection activity at the largest international audit firms varies by jurisdiction.
- The information in this report may be of use to audit firms, audit regulators, other regulators, policy makers and standard-setters in their efforts to improve audit quality. It also may be of use to investors and audit committees as an indicator of the current status of inspections of auditors of public companies, including major financial institutions in jurisdictions around the world.

Executive Summary

This is the first global survey of audit inspection findings summarizing issues identified by IFIAR Members located around the world. The survey was designed to identify the level of inspection activity and common inspection findings related to the audits of public companies. The survey also responds to a request from the Financial Stability Board to provide information regarding findings from the inspections of audits of major financial institutions.

In the last several years, Member updates at the IFIAR plenary meetings on the results of their inspections of audit firms have included a number of common inspection findings across different jurisdictions. Certain inspection findings also have been identified by Members repeatedly from year to year. Findings in four areas – professional skepticism, group audits, revenue recognition, and the role of the engagement quality control reviewer – have been the subject of detailed discussion between IFIAR and the six largest international audit firms. The results of this survey show that these four areas remain sources of concern.

The survey asked Members to report findings from their inspections of audit engagements for specific areas; it did not seek information regarding instances where auditors had met the required professional standards. Therefore, this report is not a balanced scorecard.

This survey does, however, illustrate that more needs to be done to improve the consistency of performance by auditors. For example, the survey results confirm that Members are noting audit findings in numerous common areas (inspection themes) across the different jurisdictions. The survey results indicate that the largest number of inspection findings in audits of public companies occurred in the following areas:

- Fair value measurements;
- Internal control testing; and
- Engagement quality control reviews

Inspections of the audits of major financial institutions revealed that the largest number of common inspection findings occurred in the following areas:

- Internal control testing;
- Valuation of investments and securities; and
- Audit of allowance for loan losses and loan impairments

Many Members who responded to the survey also noted that a lack of auditors' professional skepticism on audit engagements was a significant performance issue as well as a possible cause underlying many inspection findings.

With regard to Members' inspections of the audit firms' own firm-wide quality control systems, the survey results highlighted concerns with policies and procedures in place to provide the firms' with reasonable assurance that:

- Audit engagements are performed in accordance with professional standards and legal requirements;
- The firms have sufficient personnel with the technical competence, capabilities, and commitment to ethical principles necessary to perform audits; and
- The firms and its personnel are in compliance with independence and ethical requirements.

Members also provided responses to five questions designed to solicit open-ended, unrestricted feedback. These questions related to: significant challenges and audit quality issues faced by audit firms; measures the firms have taken to address those challenges and audit quality issues; specific quality control measures the firms have taken in relation to audits of public companies, including financial institutions; changes Members consider most necessary to achieve the required improvements in audit quality; and measures that Members have adopted to achieve improvements in audit quality that they would recommend to others.

Although Members who responded to the survey noted that audit firms have taken remedial actions in response to the Members' inspection findings, the frequency of findings across

jurisdictions in the various audit areas demonstrates that auditors still need to improve the consistency of their performance. That so many findings recur year after year suggests that audit firms should continue to improve their auditing techniques and their oversight policies and procedures. Audit firms also should take steps to develop a robust root cause analysis to gain a clearer understanding of the factors that underlie the inspection findings and take appropriate actions to remediate those findings.

The results of this survey will contribute to Members' ongoing work in promoting audit quality through their regulation and inspection of, and engagement with, auditors on both a national and international basis. It is also hoped that the survey results will be of use to other regulators and policy makers and to those setting standards for auditors. IFIAR will continue to interact with the International Auditing and Assurance Standards Board, the Financial Stability Board, and others, as appropriate, on issues raised through inspection findings.

IFIAR plans to conduct periodic surveys to measure changes in these findings with the goal of allowing Members to identify those areas that need improvement and to share experiences about what practices seem to be most effective in reducing audit deficiencies.

## Introduction

The International Forum of Independent Audit Regulators (IFIAR) is an organization comprised of audit regulators (Members) from around the world that are independent from the audit profession.<sup>1</sup> IFIAR, currently comprised of 44 Members, focuses on:

- Sharing knowledge of the audit market environment and practical experience of independent audit regulatory activity with a focus on inspections of auditors and audit firms;
- Promoting collaboration and consistency in regulatory activity; and
- Providing a platform for dialogue with other international organizations that have an interest in audit quality.

In the last several years, Member updates at the IFIAR plenary meetings on the results of their inspections of audit firms<sup>2</sup> have included a number of common findings among the different jurisdictions. Findings in certain areas also have been identified by Members repeatedly from year to year. After the April 2012 plenary meeting, IFIAR Members agreed to conduct a formal survey to gather more information about the types and frequency of inspection findings and to do so in a common format that would yield information that could be aggregated and compared.

In June 2012, IFIAR surveyed its Members about their findings from the inspections of certain audit firms operating in their jurisdictions. The survey was designed to identify common inspection findings on a global basis. The survey also was designed to gather information in response to a request by the Financial Stability Board (FSB)<sup>3</sup> to IFIAR to obtain information on challenges and problems that Members have identified in their inspection programs relating to external audits of financial institutions.<sup>4</sup>

---

<sup>1</sup> More information about IFIAR and its activities can be found at [www.ifiar.org](http://www.ifiar.org).

<sup>2</sup> The term “audit firm” refers to an accounting firm that is a partnership, corporation, or other entity of professional accountants that, among other things, conducts audits of companies.

<sup>3</sup> More information about the FSB and its activities can be found at [www.financialstabilityboard.org](http://www.financialstabilityboard.org).

<sup>4</sup> Specifically, the FSB requested IFIAR to report on “(i) challenges and problems that its members have identified in their inspection programmes relating to external audits of financial institutions, including audits of SIFIs; (ii) responses by IFIAR members to those issues, including follow-up with external audit firms; and (iii) member recommendations concerning steps that could be taken by audit regulators and auditors to further strengthen external audits of

## I. Survey Methodology

The survey specifically focused on Members' inspections of audit firms that are members of the six largest international audit firm networks<sup>5</sup> and up to three additional audit firms that they considered to be significant in their own jurisdictions. Members completed the survey using their most recent inspection or activity reports issued in the last twelve months prior to 30 June 2012. Members also were asked to provide background information about their inspection programs.

The survey asked Members to identify findings from their inspections of audit engagements; it did not seek information regarding instances where auditors had met the required professional standards. Therefore, the survey summary is not a balanced scorecard.

The survey focused on findings in the following areas:

- Inspected audit engagements of Listed Public Interest Entities (Listed PIEs) – entities that have securities (equity or debt) traded on securities markets and exchanges, including entities with respect to which there is a significant public interest because of their business, size, or the fact that they have a wide range of stakeholders. These entities also included Listed SIFIs and G-SIFIs.
- Inspected audit engagements of Systemically Important Financial Institutions (SIFIs) (as defined by the FSB) – listed and non-listed financial institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity.
- Inspected audit engagements of Global Systemically Important Financial Institutions (G-SIFIs) – 29 SIFIs specifically identified by the FSB in November 2011.<sup>6</sup>
- Inspections of the audit firms' systems of quality control.

---

financial institutions. See FSB 15 March 2012 press release at [http://www.financialstabilityboard.org/press/pr\\_120315.pdf](http://www.financialstabilityboard.org/press/pr_120315.pdf).

<sup>5</sup> Each audit firm network is comprised of many independent audit firms located around the world in the various IFIAR Member jurisdictions. The representatives of the six largest international audit firm networks (BDO, Deloitte, Ernst & Young, Grant Thornton, KPMG, and PricewaterhouseCoopers) are members of the Global Public Policy Committee (GPPC) whose public interest objective is to enhance quality in auditing and financial reporting. IFIAR, through its Working Groups and plenary meetings, meets regularly with the GPPC leadership to discuss audit quality and other issues of concern to the audit regulators and the audit firms.

<sup>6</sup> See FSB *Policy Measures to Address Systemically Important Financial Institutions* Annex issued 4 November 2011 at [http://www.financialstabilityboard.org/press/pr\\_111104cc.pdf](http://www.financialstabilityboard.org/press/pr_111104cc.pdf).

Members were asked to include findings relating to audit engagements that resulted in an audit opinion issued by the audit firm in a Member's jurisdiction, including joint audits. Referred work audit engagements performed in support of a group audit<sup>7</sup> were not included in the scope of the survey.

Members were asked to include findings that were observed audit and/or accounting deficiencies that were communicated in writing to an inspected audit firm in a formal inspection report.<sup>8</sup> A finding is a significant matter where the auditor did not perform sufficient work to meet the applicable auditing standards and other related requirements. A finding should not be interpreted to imply that the financial statements were necessarily materially misstated.

The survey focused on findings related to inspection themes (areas of focus during an inspection of an audit engagement) commonly identified in Members' activity reports of inspections of audit firms. The survey included 13 specific inspection themes for audits of Listed PIEs and an additional eight inspection themes specific to audits of SIFIs and G-SIFIs.

**Cautionary note on data:** All of the data presented in this report should be treated as indicative, rather than definitive evidence about the frequency and meaning of findings with respect to particular inspection themes. IFIAR compiled the information as reported by the Members and did not test or validate the completeness or the accuracy of the information submitted by the Members. The information presented should not be interpreted to imply that each inspection theme was selected by Members for inspection at every audit firm or for every audit engagement. Additionally, readers should note that not all audit engagements inspected had a finding. Many inspected engagements had no findings and others had one or more findings. The percentages of inspected audit engagements with findings varied widely among Members. This report does not include an aggregate percentage of engagements with findings because such a number may not be reflective of any individual Member's experience. Particular types of findings also were not uniformly distributed among Members. Additionally, the size of inspection staff and level of development of inspection programs varies among Members. Finally, auditing standards and professional practices differ among Members' jurisdictions. These factors mean that caution must be exercised in interpreting these statistics. Nonetheless, at a high level, the data shows that certain findings are more common than others and this

---

<sup>7</sup> The International Auditing and Assurance Standards Board (IAASB) defines a group audit as an audit of financial statements that includes financial information of more than one component (entity or business activity) or combined financial statements aggregating the financial information prepared by components that have no parent but are under common control. See International Federation of Accountants (IFAC), *2012 Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*, Glossary of Terms at <http://www.ifac.org>.

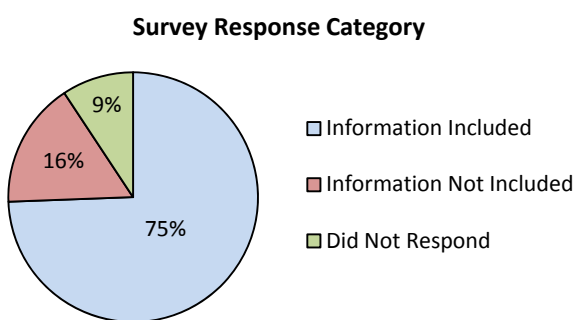
<sup>8</sup> Members used the applicable auditing standards in their jurisdiction to determine the findings.

information may be useful to both regulators and audit firms in their efforts to strengthen audit quality.

Members also were asked to provide their own thoughts and views on five questions designed to solicit open-ended, unrestricted feedback. In addition to providing information about inspections of Listed PIE audit engagements, the discussion questions also were designed to address the FSB’s request for specific information about audits of SIFIs and G-SIFIs.

## II. Results of 2012 Survey of Inspection Findings

A substantial majority of the Members,<sup>9</sup> 91 percent, responded to the survey. Thirty-two Members provided inspection information for at least one area of the survey. The remaining



Members did not complete the survey for the following reasons, among others: their inspection programs were in the development stage, or they were prohibited from submitting a response due to confidentiality requirements applicable to the type of information requested.

The Members’ reported inspection information was based on their most recent inspection period, which ranged over various periods beginning between January 2010 and May 2012 and ending between December 2010 and June 2012. The Members also reported that their inspection programs included inspections of GPPC and non-GPPC audit firms. The table below illustrates the frequency of different Members’ inspection programs for three categories of audit firms.

Members’ Programs for Inspection of Audit Firms	Number of IFIAR Members					
	Annually Inspected	Every 1 - 3 years	Every 2 years	Every 3 years	Every 4 years	Between 5 and 10 years
GPPC (Big Four) <sup>10</sup> Firms	13	2	6	11	0	0
Other GPPC Firms <sup>11</sup>	9	1	7	12	1	1
Non-GPPC Firms	3	1	2	12	2	7

Members inspected a variety of audit engagements, including Listed PIEs, SIFIs, and G-SIFIs where applicable.

<sup>9</sup> There were 43 Members when the survey was conducted; one additional regulator became a Member in October 2012.

<sup>10</sup> Deloitte, Ernst & Young, KPMG, and PricewaterhouseCoopers.

<sup>11</sup> BDO and Grant Thornton.

## A. Inspected Audit Engagements of Listed PIEs

Twenty-two Members provided information about their inspections of firms' audit engagements of Listed PIEs. These Members inspected 961 audit engagements at 98 audit firms. Members reported a total of 1,072 individual findings related to 13 inspection themes specified in the survey. Although the number of findings is greater than the number of audit engagements inspected, not all audit engagements inspected had a finding. Many inspected audit engagements had no findings and others had one or more findings. The percentage of inspected audit engagements with findings varied widely among Members. This report does not include an aggregate percentage of engagements with findings because such a number may not be reflective of any individual Member's experience.

The table below presents the number of findings listed by particular inspection theme in descending order of frequency of occurrence. The percentage represents the frequency of findings for each inspection theme as a proportion of the 1,072 individual findings.

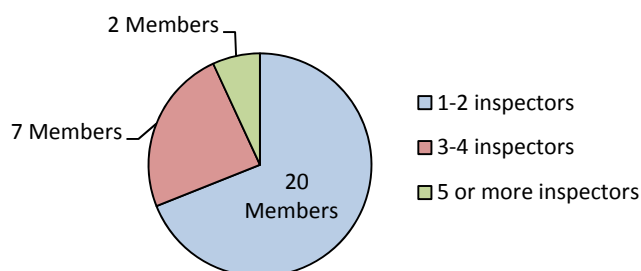
Survey Inspection Themes	Number of Findings Related to Listed PIEs	
	#	%
Fair Value Measurements	169	16%
Internal Control Testing	117	11%
Engagement Quality Control Reviews <sup>12</sup>	116	11%
Adequacy of Review and Supervision	115	11%
Adequacy of Financial Statements and Disclosures	109	10%
Revenue Recognition	86	8%
Substantive Analytical Procedures	75	7%
Group Audits	75	7%
Inventory	57	5%
Related Party Transactions	44	4%
Audit of Allowance for Loan Losses and Loan Impairments	43	4%
Use of Experts / Specialists	41	4%
Going Concern	25	2%
	1,072	100%

Some Members also noted that they had findings in other inspection areas, including for example, risk assessment, procedures to detect material misstatement due to fraud, external confirmations, communication with those charged with governance, compliance with laws and regulations, and audit documentation.

<sup>12</sup> An independent review performed to provide an objective evaluation of the significant judgments the audit engagement team made and the conclusions it reached in formulating the audit report.



Twenty-nine Members also provided the following information presented in the chart regarding the average number of inspectors the Member assigns to inspect an audit engagement of a Listed PIE.



## B. Inspected Audit Engagements of SIFIs and G-SIFIs

Ten Members provided information relating to their inspections of firms' audit engagements of SIFIs<sup>13</sup> and G-SIFIs.<sup>14</sup> These Members inspected 108 audit engagements at 28 audit firms. Specifically, nine Members inspected a total of 101 audit engagements of SIFIs and four Members inspected seven audit engagements of G-SIFIs. Members reported a total of 117 individual findings related to eight inspection themes specified in the survey. Although the number of findings is greater than the number of audit engagements inspected, not all audit engagements inspected had a finding. Many inspected audit engagements had no findings and others had one or more findings. The percentage of inspected audit engagements with findings varied widely among Members. This report does not include an aggregate percentage of engagements with findings because such a number may not be reflective of any individual Member's experience.

The table below presents the number of findings listed by particular inspection theme in descending order of frequency. The percentage represents the frequency of findings for each inspection theme as a proportion of the 117 individual findings.

Survey Inspection Themes	Number of Findings Related to SIFIs and G-SIFIs	
	#	%
Internal Control Testing	33	28%
Valuation of Investments and Securities	32	27%
Audit of Allowance for Loan Losses and Loan Impairments	15	13%
Insufficient Challenge and Testing of Management's Judgments and Assessments	12	10%
Testing of Customer Deposits and Loans	10	9%
Audit Methodology Including Programs and Tools	9	8%
Adequacy of Financial Statements and Disclosures	4	3%
Group Audits	2	2%
	117	100%

<sup>13</sup> Seventeen Members stated that they either did not inspect SIFIs during the specified inspection period or do not have SIFIs in their jurisdiction.

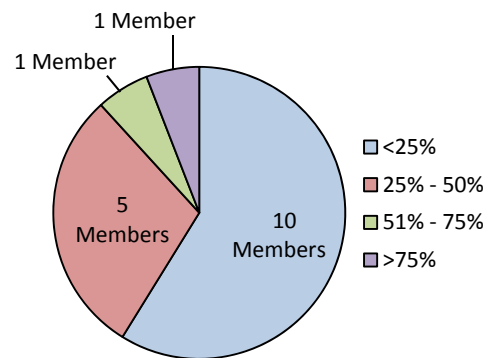
<sup>14</sup> A total of 28 G-SIFIs are located in 11 Member jurisdictions (this excludes one G-SIFI located in a jurisdiction that is not a Member of IFIAR).

Some Members also noted that they had findings in other inspection areas, including for example, use of experts and specialists, procedures to detect material misstatement due to fraud, substantive analytical procedures,<sup>15</sup> and communication with those charged with governance.

### C. Professional Skepticism

Professional auditing standards require the auditor to exercise professional skepticism when planning and conducting an audit of an entity’s financial statements and related disclosures. Professional skepticism is an attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to error or fraud, and performing a critical assessment of evidence.<sup>16</sup>

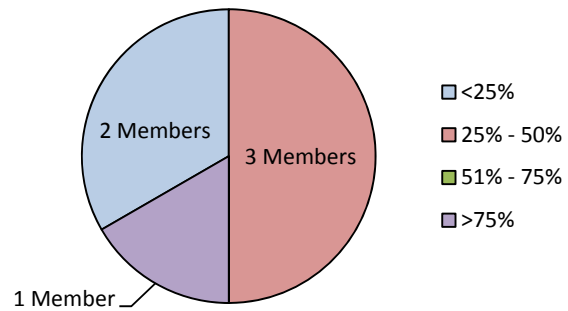
*Listed PIE audit engagements:* Of the 22 Members who provided information regarding their inspections of Listed PIE audit engagements and who had findings in the 13 inspection themes specified in the survey, 17 Members stated that they cited, in an inspection report to the firm, the auditor’s lack of professional skepticism as a possible cause for certain of the inspection findings. These 17 Members provided the following percentage ranges, representing the portion of the inspection findings in which lack of professional skepticism was a possible cause.



<sup>15</sup> Substantive analytical procedures are analytical procedures (evaluations of financial information through analysis of plausible relationships among both financial and non-financial data) used by the auditor as substantive audit procedures to test account balances and transactions in an audit.

<sup>16</sup> See e.g., IFAC 2012 *Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*, Glossary of Terms at <http://www.ifac.org>.

*SIFI and G-SIFI audit engagements:* Of the 10 Members who provided information regarding their inspections of SIFI and G-SIFI audit engagements and who had findings in the eight inspection themes specified in the survey, six Members stated that they cited, in an inspection report to the firm, the auditor’s lack of professional skepticism as a possible cause for certain of the inspection findings. These six Members provided the following percentage ranges, representing the portion of the inspection findings in which lack of professional skepticism was a possible cause.



#### D. Inspection of the Audit Firms’ Systems of Quality Control

Twenty-three Members provided information on their inspections of the audit firms’ systems of quality control. The findings are organized using the six defined elements of a system of quality control as outlined in the IAASB’s International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*.<sup>17</sup>

These Members inspected a total of 109 audit firms, of which certain firms had at least one finding related to six inspection themes specified in the survey, resulting in 767 findings. This information should not be interpreted to imply that all audit firms inspected had a finding; certain audit firms did not have any findings while other audit firms had one or more findings. The table on the next page presents the number of findings listed by particular inspection theme in descending order of frequency. The percentage represents the frequency of findings for each inspection theme, in relation to the 767 findings.

<sup>17</sup> See IFAC 2012 *Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*, ISQC 1 at <http://www.ifac.org>.

Survey Inspection Themes	Total Number of Findings	
	#	%
Engagement Performance <sup>18</sup>	261	34%
Human Resources (e.g., technical competence) <sup>19</sup>	166	22%
Independence and Ethical Requirements <sup>20</sup>	130	17%
Client Risk Assessment, Acceptance and Continuance <sup>21</sup>	100	13%
Monitoring <sup>22</sup>	77	10%
Leadership Responsibilities for Quality within the Firm (i.e., Tone at the Top) <sup>23</sup>	33	4%
	767	100%

<sup>18</sup> In most jurisdictions the audit firm is required to establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and applicable legal and regulatory requirements, and that the firm or the engagement partner issues reports that are appropriate in the circumstances. See e.g., ISQC 1.

<sup>19</sup> In most jurisdictions the audit firm is required to establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the technical competence, capabilities and commitment to ethical principles necessary to perform engagements in accordance with professional standards and applicable legal and regulatory requirements, and enable the firm or the engagement partner to issue reports that are appropriate in the circumstances. See e.g., ISQC 1.

<sup>20</sup> In most jurisdictions each audit firm is required to establish policies and procedures to provide it with reasonable assurance that the firm and its personnel comply with the relevant ethical and independence requirements. See e.g., ISQC 1.

<sup>21</sup> In most jurisdictions each audit firm is required to establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide the firm with reasonable assurance that it will only undertake or continue those engagements where the firm is competent to perform the engagement and has the capabilities, including time and resources, to do so; can comply with the relevant ethical requirements; and has considered the integrity of the client, and does not have information that would lead it to conclude that the client lacks integrity. See e.g., ISQC 1.

<sup>22</sup> In most jurisdictions each audit firm is required to establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. See e.g., ISQC 1.

<sup>23</sup> In most jurisdictions each audit firm is required to establish policies and procedures designed to promote an internal culture recognizing that quality is essential in performing engagements. Such policies require the audit firm’s Chief Executive Officer or Board of Partners to assume ultimate responsibility for the firm’s system of quality control. See e.g., ISQC 1.

## E. Discussion Questions

In addition to providing specific information about their inspection findings, the survey instructed Members to provide their own views in response to the following five open-ended, unrestricted questions:

- What are the most significant challenges and audit quality issues that you have identified in the firms' audits of Listed PIEs;
- What measures have the audit firms taken to overcome these challenges and issues;
- Have the audit firms taken any specific quality control measures in relation to their audits of Listed PIEs;
- What measures have Members adopted to achieve improvements in audit quality that they would recommend to others; and
- What changes do Members consider are most necessary to achieve the required improvements in audit quality?

Members provided a wide variety of answers to one or more of the discussion questions regarding their inspections of Listed PIE audit engagements, including specific answers as they relate to audits of SIFIs and G-SIFIs.

The information presented in this section is a compilation of the Members' opinions and should not be interpreted to imply that all Members identified the same challenges or recommendations to address those challenges. Likewise, the information is not intended to suggest that all audit firms have implemented or are in the process of implementing the noted quality control and improvement measures.

1. What are the most significant challenges and audit quality issues that you have identified in the firms' audits of Listed PIEs?

Twenty-four Members noted 25 different matters in response to this question. The most frequently noted challenges and audit quality issues were 1) lack of professional skepticism by the auditors; 2) failure to gather sufficient appropriate audit evidence to support significant judgments; and 3) insufficient execution of the engagement quality control review, including technical competence of the engagement quality control reviewer, with 54, 46, and 42 percent of the Members' responses noting these challenges respectively.

### Conduct of Audit

Many Members who responded to this question stated that lack of professional skepticism and over-reliance or inappropriate reliance by auditors on work performed both by management's

and the auditor's own experts were significant audit quality issues. Many Members who responded to this question observed that some auditors failed to gather sufficient, appropriate audit evidence to support the significant judgments and conclusions reached by the auditors, including failing to test underlying assumptions employed by management (e.g., impairment assessments, cash flow projections, going concern, goodwill impairments, fair value, etc.). Several Members who responded to this question also stated that they identified the following financial statement line item areas where they most commonly found shortcomings in the procedures performed by some of the auditors: commitments and contingencies, subsequent events, related party transactions, revenue recognition, and inventory.

#### Risk Assessment, Testing of Balances and Internal Control

Several Members who responded to this question noted that some auditor's risk assessment procedures and their responses to risk factors were inadequate. A few Members who responded to this question observed that some auditors in their jurisdictions lacked sufficient understanding about how to design and perform effective substantive analytical procedures to provide the necessary level of assurance. Many Members who responded to this question also found insufficient and poor quality work when some auditors tested or relied on internal controls or related processes, including the assessments of information technology systems and the involvement of information technology experts. Many Members who responded to this question noted that auditors in some cases didn't adequately document the nature, timing and extent of audit procedures and consultations with technical firm personnel.

#### Supervision and Review, Technical Competence

Many Members who responded to this question noted instances of inadequate supervision and review to critically evaluate the quality of audit evidence obtained, including insufficient involvement of the engagement partner in the review process. Many Members who responded to this question stated that some audit engagement teams failed to recognize fully the relevant accounting requirements, including their impact on the audit approach and financial reporting requirements. Several Members who responded to this question also noted that some auditors didn't spend enough time and didn't allocate appropriate resources to identify financial statement misstatements due to fraud.

#### Engagement Quality Control Review

Many Members who responded to this question observed insufficient execution of the engagement quality control review, including lack of appropriate training, independence and technical competence of the engagement quality control reviewer.<sup>24</sup> Several Members who responded to this question also noted a failure to document the procedures performed, while other Members noted that some of the firms' own systems of quality control, including internal inspections, were inadequate.

---

<sup>24</sup> A partner, or other person in the firm or external to the audit firm, who is not part of the audit engagement team and who performs the engagement quality control review.

### Independence and Outsourcing of Services

Many Members who responded to this question noted that sometimes the audit firms failed to comply with independence requirements including, procedures related to client and engagement acceptance, partner rotation, and provision of additional services to audit clients. A few Members who responded to this question also stated that they were concerned with the trend of audit firms setting up shared service centers and outsourcing required audit procedures to jurisdictions where the labor costs were lower.

### Fee Pressure

Several Members who responded to this question observed that audit firms appear, in many instances, to be subject to downward pressure on audit fees as well as fee competition from other audit firms. Such pressures can have an impact on the nature and extent of audit procedures performed, and on the audit hours actually devoted to an audit, both of which can adversely affect audit quality.

### Audits of Major Financial Institutions<sup>25</sup>

In addition to the above matters, some Members who responded to this question also noted that obtaining audit assurance as to the reasonableness of the application of the fair value hierarchy for financial instruments and allowance for loan losses were significant challenges and audit issues for audits of SIFIs and G-SIFIs.

#### 2. What measures have the audit firms taken to overcome these challenges and issues?

Seventeen Members noted 12 different matters in response to this question. The most frequently noted measures that audit firms have taken were revising their audit methodologies and developing additional training; enhancing their internal quality control review programs; and communicating the inspection findings internally to firm leadership and personnel, with 65, 59, and 47 percent of the Members' responses noting these measures respectively.

### Response to Inspection Findings

Many Members who responded to this question stated that, in addition to developing short and long term action plans to address the inspection findings, many audit firms have communicated inspection findings to the firms' leadership, technical divisions and the partners and staff whose audit engagements were inspected, and, in some instances, the audited entity, as appropriate. The majority of the Members who responded to this question also noted that many audit firms have revised their audit methodologies, guidance, tools, disclosure checklists, and practice aids to further clarify areas highlighted in the inspection findings and developed additional training in response to specific inspection findings.

---

<sup>25</sup> In addition to providing information about inspections of Listed PIE audit engagements, the discussion questions also were designed to address the FSB's request for specific information about audits of SIFIs and G-SIFIs.

### Quality Control Activities, Enhanced Personnel Policies

The majority of the Members who responded to this question noted that some audit firms, in addition to revising their internal quality control review programs, have reinforced their commitment to comply with the relevant documentation requirements, increased areas for required consultations with more senior or technical resources, and enhanced the engagement quality control reviewer role. One Member who responded to this question noted that some audit firms have enhanced their performance evaluation methodologies for partners and staff to include more emphasis on audit quality. Several Members who responded to this question also noted that some audit firms have performed additional audit work as required on inspected audit engagements with noted deficiencies and adjusted adversely the compensation of the audit partners on those engagements where deficiencies were found, including rebalancing the partner's client portfolio and workload.

### Audits of Major Financial Institutions<sup>26</sup>

Several Members who responded to this question also highlighted certain measures some audit firms have taken as they relate to audits of SIFIs and G-SIFIs. For example, audit firms have revised their audit methodologies and developed additional training; they have enhanced their internal quality control review programs; and they have communicated the inspection findings internally to firm leadership and personnel.

3. Have the audit firms taken any specific quality control measures in relation to their audits of Listed PIEs?

Seventeen Members noted 11 different matters in response to this question. Sixty-five percent of the Members who responded to this question noted that many audit firms have enhanced their internal quality control review programs for Listed PIEs.

### Enhanced Personnel Management

The majority of the Members who responded to this question noted that many audit firms have restructured their engagement quality control reviewer programs to encompass a select group of technical and senior partners, while others enhanced their internal quality control reviews focusing on listed entities on a rotational or other basis. Several Members who responded to this question noted that some audit firms have reassigned some of their partners and staff by focusing on the auditor's experience and industry specialization, including assigning more senior level engagement personnel to higher risk audits. A few Members who responded to this question noted that some audit firms have implemented monitoring of specific ratios and risk measures relating to partner client hours and responsibilities. Additionally, several Members who responded to this question noted that some audit firms have changed their operating structures of regional as well as centralized offices.

---

<sup>26</sup> In addition to providing information about inspections of Listed PIE audit engagements, the discussion questions also were designed to address the FSB's request for specific information about audits of SIFIs and G-SIFIs.



### Firm Methodology, Tools, and Practices

Several Members who responded to this question noted that many audit firms have implemented additional training, enhanced coaching of engagement teams, developed additional practice aids, and revised audit methodologies in areas where improvements are needed. Several Members who responded to this question noted that some audit firms have implemented mandatory consultations and added additional layers of review, often performed by a member of the audit firm's technical team for certain technical or higher risk areas depending on the nature, size and complexity of the Listed PIE. A few Members who responded to this question noted that some audit firms have centralized their client acceptance and retention decisions and enhanced their process for identifying high risk audit engagements through risk assessment.

### Audits of Major Financial Institutions<sup>27</sup>

Several Members who responded to this question also highlighted certain quality control measures some audit firms have taken as they relate to audits of SIFIs and G-SIFIs. For example, some audit firms have restructured their engagement quality control reviewer programs to encompass a select group of technical and senior partners; have enhanced their internal quality control reviews; have implemented additional training and revised audit methodologies; or reassigned their partners and staff focusing on the auditor's experience and industry specialization.

4. What measures have Members adopted to achieve improvements in audit quality that they would recommend to others?

Nineteen Members noted 13 different matters in response to this question. The most frequently noted measures that Members have adopted and would recommend to others are issuing reports of inspection findings and key messages to specific firms and addressing with audit firm leadership their personal responsibility for quality control systems, with 37 and 32 percent of the Members' responses noting these measures respectively.

### Public Inspection Reports and Root Cause Analysis<sup>28</sup>

Members who responded to this question have issued public reports of inspection findings and key messages to specific firms while other Members have issued private inspection reports to audit firms, which included suggested remedial actions to improve audit quality in the areas noted as deficient. One Member who responded to this question has performed a root cause analysis of audit findings and encouraged firms to design and conduct their own root cause

---

<sup>27</sup> In addition to providing information about inspections of Listed PIE audit engagements, the discussion questions also were designed to address the FSB's request for specific information about audits of SIFIs and G-SIFIs.

<sup>28</sup> A process of investigating and determining the underlying cause of a specific problem with the intention of building and implementing a solution that will prevent the reoccurrence of the problem.

analysis program to gain a deeper understanding of the causes of audit deficiencies, particularly repeated deficiencies. A few Members who responded to this question have identified the top three to five significant recommendations to improve audit quality and ensured the firms had remedial action plans in place to implement those recommendations.

#### Discussions with Firm Leadership

Many Members who responded to this question have addressed with audit firm leadership the latter's personal responsibility for quality control systems, encouraged firms to increase their engagement quality control reviewer time for higher risk audits, and ensured follow-up on relevant issues with the firm's management, including on relevant findings at an engagement level. Some Members who responded to this question have encouraged firms to have a clear linkage between audit quality and their partner appraisal and compensation programs (i.e., setting the right tone at the top). Some Members who responded to this question also have conducted regular meetings with the leadership of the GPPC firms to discuss topical audit, accounting and regulatory issues, and implementation of findings, including meeting with the firm's technical leaders to discuss emerging accounting issues.

#### Coordination with Other Regulators and Standard-setters

Some Members who responded to this question have conducted cross-sectional analysis on information obtained in cooperation with others (i.e., other regulatory organizations within a Member's jurisdiction) to focus the inspection plan on significant issues of the audit firms while other Members have worked with standard-setters, domestically and internationally, to improve auditing and ethical pronouncements. Several Members who responded to this question also provided educational courses to stress the importance of audit quality and focus on common known issues and findings. Several Members who responded to this question consider transparent reporting by audit regulators to those charged with governance on the performance of audit firms to be vital for improving audit quality.

#### Audits of Major Financial Institutions<sup>29</sup>

Several Members who responded to this question also highlighted certain measures that they have adopted and would recommend to others as they relate to audits of SIFIs and G-SIFIs. For example, some Members issue reports of inspection findings and key messages to specific firms, including suggested remedial actions; one Member performs a root cause analysis of audit findings and encourages firms to design and conduct their own root cause analysis programs; and some Members work with other regulators and standard-setters, domestically and internationally, to improve auditing.

---

<sup>29</sup> In addition to providing information about inspections of Listed PIE audit engagements, the discussion questions also were designed to address the FSB's request for specific information about audits of SIFIs and G-SIFIs.

5. What changes do Members consider are most necessary to achieve the required improvements in audit quality?

Twenty-two Members noted 16 different matters in response to this question. The most frequently noted changes that Members consider are most necessary to achieve the required improvements in audit quality were the need for audit firms to establish and maintain the right tone at the top, to readjust their business models to focus on the quality of their audits, and to encourage audit partners to exercise greater professional skepticism with 36, 23 and 23 percent of the Members' responses noting these themes respectively.

#### Tone at the Top, Public Interest Focus

Many Members who responded to this question stated that audit firms, including firm leadership, need to establish and maintain the right tone at the top of the firms to drive change and improvement in partners and staff in relation to systemic issues and deficiencies, as well as focusing specifically on professional skepticism. Many Members who responded to this question stated that audit firms may need to readjust their business models to focus more on the quality of their audits rather than other activities such as selling non-audit services to their clients. Several Members who responded to this question stated that firms also need to appropriately understand their public interest responsibilities and make sure that there is greater accountability of individual firm personnel through internal quality control reviews and the ability to adjust the compensation and promotion, as appropriate. Several Members who responded to this question stated that audit firms also need to give greater focus to proper review and supervision of the audit engagement, as well as remediating the inspection findings and performing a robust root cause analysis of the identified findings.

#### Technical Training, Personnel Management

Many Members who responded to this question stated that audit firms need to improve the education of auditors by providing more in-depth training on audit issues and increase the focus and understanding of fraud risk areas in the overall performance of the audit, including identification of accounting fraud risks. Some Members who responded to this question stated that audit firms also need to increase consultation by engagement teams on technical or complex areas of the audit and provide greater guidance on use of other auditors and experts, as well as fair value measurements. Furthermore, many Members who responded to this question stated that audit firms need to have greater involvement by the audit partner, specialists and experienced staff in areas of focus and by the audit partner in all stages of the audit and they need to encourage audit partners to exercise greater professional skepticism, including during internal quality reviews and compensation decisions. Some Members who responded to this question stated that audit firms need to enhance their independence policies and procedures and strengthen internal quality control reviews, as well as engagement level reviews, by focusing on material audit issues.

### Audits of Major Financial Institutions<sup>30</sup>

Several Members who responded to this question also highlighted certain changes that they believe to be necessary to achieve the required improvements in audit quality in the audits of SIFIs and G-SIFIs. For example, audit firms need to establish and maintain the right tone at the top. Audit firms also need to appropriately understand their public interest responsibilities, and need to encourage audit partners to exercise greater professional skepticism.

### III. Conclusion

Although Members who responded to the survey noted that audit firms have taken remedial actions in response to the Members' inspection findings, the inspection results of the survey show that auditors still need to improve performance in certain audit areas for audits of Listed PIEs, including major financial institutions. The frequency of findings across jurisdictions in the various audit areas demonstrates that audit firms should continue to improve their auditing techniques and also their oversight policies and procedures. The fact that so many findings recur year after year in the same inspection theme areas, suggests that audit firms should take steps to develop a robust root cause analysis to gain a clearer understanding of the factors that underlie these findings and take appropriate actions to remediate those inspection findings.

Members will continue to inspect the Listed PIE audit engagements, including SIFI and G-SIFI audit engagements, and work closely with the audit firms in their jurisdictions to improve audit quality. Members also will continue to follow-up with the audit firms to evaluate and monitor the audit firms' remedial actions in response to their respective inspection findings. In addition, IFIAR will continue to work with the GPPC leadership to discuss inspection findings and the firms' strategies and actions to improve audit quality.

The results of this survey will contribute to its Members' ongoing work in promoting audit quality through their regulation and inspection of, and engagement with, auditors on both a national and international basis. It is also hoped that the survey results will be of use to other regulators and policy makers and to those setting standards for auditors. For example, IFIAR will continue to interact with IAASB and others, as appropriate, on issues raised through inspections findings.

Finally, IFIAR plans to conduct periodic surveys to measure changes in these findings with the goal of allowing Members to identify those areas that need improvement and to share experiences about what practices seem to be most effective in reducing audit deficiencies.

---

<sup>30</sup> In addition to providing information about inspections of Listed PIE audit engagements, the discussion questions also were designed to address the FSB's request for specific information about audits of SIFIs and G-SIFIs.

--

**Further details**

For further information about IFIAR or this report, please contact:

- The IFIAR Chairman – Paul George, Director of Conduct at the Financial Reporting Council in the United Kingdom, on +44 (0)20 7492 2300 or by e-mail to Jon Hooper, (j.hooper@frc.org.uk).
- The IFIAR Vice-Chairman – Lewis Ferguson, Board Member of the U.S. Public Company Accounting Oversight Board, on +1 202 207 9100 or by e-mail to Bella Rivshin, (rivshinb@pcaobus.org).