



# **International Forum of Independent Audit Regulators**

## **Report on 2014 Survey of Inspection Findings**

### ***March 3, 2015***

#### **Executive Summary**

In 2014, the International Forum of Independent Audit Regulators (IFIAR) conducted its third annual survey of findings (Survey) identified by its Members in their individual inspections of significant audit firms in their jurisdictions, including in particular those affiliated with large, international audit firm networks.<sup>1</sup> The current Survey reveals high levels of findings in key aspects of the audit and the inspected audit firms' systems of quality control, consistent with the results of IFIAR's two prior Surveys.

IFIAR collected information on inspections of the audits of public interest entities listed on a national securities exchange (listed PIEs); the audits of systemically important financial institutions (SIFIs), including global systemically important financial institutions (G-SIFIs); and overall quality control systems in place within the audit firms. The Survey relates to two types of "findings" communicated in writing to an inspected firm in a formal inspection report at the conclusion of an inspection: those related to audit engagements and those related to the systems of quality control of the audit firms. For purposes of the Survey, findings for audit engagements are defined as observed audit and/or accounting deficiencies; a deficiency is typically a matter with respect to which the firm did not obtain sufficient audit evidence to support its opinion or a failure to identify or address a potentially material error in the application of an accounting principle.<sup>2</sup> Quality control findings relate to firm-wide systems for quality control, rather than to a specific audit.

---

<sup>1</sup> These six networks are BDO International Limited, Deloitte Touche Tohmatsu Limited, Ernst & Young Global Limited, Grant Thornton International Limited, KPMG International Cooperative, and PricewaterhouseCoopers International Limited. Collectively, these network firms are referred to in this report as the "GPPC firms", reflecting their common membership in the Global Public Policy Committee (GPPC). In certain cases, Members provided data on inspections of all or some of the local audit firm associated with the GPPC firms' networks, and also on additional firms considered significant in the reporting Member's jurisdiction.

<sup>2</sup> This report uses "finding" and "deficiency" interchangeably.

Twenty-nine IFIAR Members reported on their inspections findings related to listed PIEs (compared to 30 in 2013 and 22 in 2012). Seventeen Members reported on findings from audits of SIFIs (compared to 13 in 2013 and 10 in 2012). Thirty Members reported on findings related to the firms' quality control systems (compared to 30 in 2013 and 23 in 2012).

In the 2014 and 2013 Surveys, IFIAR Members reported that the most findings from listed PIE audits related to procedures for Fair Value Measurement and Internal Control Testing. In the 2014 Survey, IFIAR found that the rate of inspection findings (or the percentage of inspected audits with deficiencies) in these areas were also high, by comparison to rates of findings in most other inspection themes surveyed; 20% of audits reviewed for Fair Value Measurement had findings, while 24% of audits reviewed for Internal Control Testing had findings. Revenue Recognition findings were the third most pervasive in total numbers in the 2014 Survey (fourth in the 2013 Survey), and 14% of audits in which Revenue Recognition was reviewed had at least one finding.<sup>3</sup>

The areas of findings reported in the 2014 Survey for inspections of SIFI audits were similar to prior Surveys. The top three areas of findings in 2014, 2013 and 2012 relate to the audit of the Valuation of Investments and Securities (in the 2014 Survey, 27% of inspected audits had findings); Internal Control Testing (27%); and the audit of the Allowance for Loan Losses and Loan Impairments (17%).

A finding does not necessarily indicate that the financial statements are misstated. When a deficiency is observed, some audit regulators require the audit firm to perform the procedures necessary to satisfy the auditing standards. This process typically does not identify material misstatements of the underlying financial statements – though in some cases this has occurred. Findings do, however, imply that the auditor's performance falls below the expected level of diligence to satisfy the public interest role the audit is meant to fulfill, and that the audit failed to provide the level of assurance about the financial statements that it purported to do and that is required by professional standards. Confidence in the auditor's execution of this assurance function should not await the *ex post* result of an audit inspection. Accordingly, audit regulators do not measure the sufficiency of audit performance based on whether or not the financial statements were misstated, but rather by whether the auditor fulfilled the requirements of the auditing standards designed to position the auditor to detect a material misstatement, in the event one exists.

---

<sup>3</sup> It should be noted that the findings in this survey are aggregated and that the levels of findings vary among individual regulators. Further, as described in "Interpreting the Results", the survey responses reflect year-over-year variations in the number of audits inspected, areas of inspectors' focus, and IFIAR Members reporting their inspection results.

Many IFIAR Members take a risk-based approach, resulting in inspections of those audit areas that are inherently more complex to audit. While this complexity presents challenges to fulfillment of audit standards, it also calls for high levels of scrutiny and professional responsibility in the course of completing the audit. The frequency of findings in areas that are among the key aspects of an audit is of continuing concern to IFIAR.

IFIAR Members were asked in the 2014 Survey about any significant changes in audit quality observed in their jurisdictions compared to the prior inspection cycle. The responses were based on the judgment of the responding IFIAR Members, and may or may not reflect an evaluation of audit quality based on measurable factors. The views expressed vary. Seven regulators indicated overall improvement, while eleven regulators did not see significant changes and six regulators reported a mix of both improvements and declines. Only one regulator reported an overall decline in audit quality in its jurisdiction.

IFIAR, through its GPPC Working Group, carries out an ongoing dialogue with the six large international audit networks that are members of the GPPC with the objective of improving audit quality on a global basis. Regular meetings are held with the networks to understand actions that are being undertaken to address the specific audit quality issues most frequently identified by IFIAR and the underlying, or “root”, causes of these systemic findings. Additionally, many IFIAR Members individually engage with audit firms in their jurisdictions to understand the possible causes behind inspection findings and the actions necessary to correct and deter recurrence of audit deficiencies. In some cases, this involves evaluation of practices behind successful audit engagements, as well as those that fall short.

A factor underlying many audit deficiencies is insufficient exercise of professional skepticism during performance of the audit. IFIAR believes that enhancing professional skepticism of practitioners contributes significantly to quality financial statement audits and should be a high priority for audit firms, given the recurrence of audit deficiencies. Audit firms should pursue initiatives to improve audit quality and the consistency of audit execution across their national firms and international audit firm networks. This includes reviewing staffing structures to ensure that sufficient and appropriate expertise and experience is available for increasingly complex entities and audits that require significant judgments.

The audit firm “networks” are composed of individual audit firms that are members of the network. Many audits today involve practitioners from network member firms in a number of countries. The audit of a multinational company may involve significant work performed by many, legally separate audit firms that operate as a network, often with a

common name. Through IFIAR, audit regulators seek to coordinate their understanding and assessments of trends in and challenges to audit quality.

IFIAR provides a platform for knowledge sharing and collaboration in pursuit of its Members' shared objective of high quality audit performance. IFIAR ensures that, through its annual inspection workshops, audit inspectors have the opportunity to share knowledge and observations on recurring, common findings and themes identified by the Survey. The workshops help to create awareness among participants on common issues that may be considered in the IFIAR Members' annual work programs and inspection approaches. Further, the dialogue helps promote regulators' shared understanding of a finding for purposes of the Survey, providing ongoing improvement in the consistency in reporting for IFIAR Survey purposes. Finally, IFIAR utilizes information learned through the IFIAR Survey to inform its ongoing work to promote the development of high-quality international standards of auditing and auditor ethics.

## Introduction

### *About IFIAR*

IFIAR is a membership organization of audit regulators that are independent from the audit profession.<sup>4</sup> IFIAR's membership includes 51 Members from jurisdictions in Africa, the Americas, Asia-Pacific, Europe, and the Middle East. IFIAR focuses on the following activities:

- 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.

### *The Inspection Findings Survey*

In 2012, IFIAR initiated an annual survey of findings resulting from its Members' inspections of audit firms affiliated with the six largest international audit firm networks,

---

<sup>4</sup> More information on IFIAR and its activities can be found at <https://ifiar.org/Home.aspx>.

and other firms considered significant in the reporting Members' jurisdictions.<sup>5</sup> This report summarizes the results of IFIAR's third inspection findings Survey, conducted during 2014 (hereafter, the Surveys will be referred to based on the year in which the Survey was conducted; this report is on the "2014 Survey"). Individual Members conducted their inspections over various periods between October 2011 and April 2014.<sup>6</sup> In all cases, Members do not report findings from more than one annual inspection cycle; therefore, the findings from no more than one inspection report per audit firm can be submitted for the Survey.

The aim of the Survey is not to measure empirically changes in audit quality; rather, the Survey indicates areas of common audit shortcomings and informs IFIAR's efforts to better evaluate the challenges to improving the reliability of the opinion expressed by the auditor at the conclusion of a financial statement audit. The three IFIAR Surveys conducted to date illustrate commonality in the types of deficiencies observed by IFIAR Members in their respective programs to oversee audits of listed PIEs. This report also summarizes key areas of work being done within IFIAR to address the findings of this Survey, and to support IFIAR Members' efforts to address audit quality challenges identified through individual Members' inspection activities.

### *Summary of Survey Methodology*

The following is a summary of the methodology followed for the 2014 Survey.

All IFIAR Members were asked to respond to IFIAR's inspection findings Surveys. The 2014 Survey solicited data on Members' findings from inspections of:

- audits of listed PIEs;
- audits of SIFIs, including G-SIFIs; and
- audit firms' quality control systems.

The approach taken for the 2014 Survey was generally consistent with that used in 2013 and 2012. In all years, information was collected on the total number of inspection findings by audit inspection "theme". Respondents reported findings categorized into 16 inspection themes for audits of listed PIEs. Separately, the Survey solicited data on findings from inspections of audits of G-SIFIs and other SIFIs, reported using thirteen inspection themes relevant to audits of financial institutions. Findings from inspections of audit firms' quality control systems were reported using six themes. Quality control systems relate to

---

<sup>5</sup> See <https://ifiar.org/IFIAR-Global-Survey-of-Inspection-Findings.aspx>.

<sup>6</sup> These inspections relate to audits of financial statement with year ends that range from 2010 to 2013.

processes and procedures employed by the firm subject to inspection on a firm-wide basis, rather than to specific audit engagements.

A key change in 2014 was the addition of information about the number of audits that were reviewed for each theme, irrespective of whether a finding was identified. In the 2014 and 2013 Surveys, this information was collected about the number of *audit firms* reviewed for themes, but not for the number of *audits*. This improvement to the 2014 Survey enables IFIAR to report on the percentage of audits inspected and found to have an audit deficiency. Information on the rate of findings, relative to how often the topic was subject to inspection, will further refine IFIAR's consideration of areas for targeted attention.

Additionally, the 2014 Survey queried Members about the most frequent sub-categories of findings in three areas for listed PIE audits and two areas of quality control systems: Fair Value Measurement, Internal Control Testing, Revenue Recognition, Engagement Performance, and Human Resources. The objective in collecting this information was to enable further understanding of the types of issues IFIAR Members detect in these areas, facilitating exchange of insights and experiences about common issues encountered by audit regulators. Also, Members were asked to report on any significant changes in audit quality since the prior year.

## Summary of Key Results

This section of the report presents key results of the 2014 Survey. Additional details, including further information on findings reported in prior Surveys, can be found in Appendix 1.

### *Inspection Findings from Audits of Listed PIEs*

Twenty-nine IFIAR Members provided information on findings from inspections of audits of listed PIEs. These Members inspected the audits of 948 listed PIEs by 122 audit firms and found deficiencies in 449 (or 47%) of those audits. Inspections of these 948 listed PIEs did not necessarily include inspection of all themes included in the IFIAR Survey.<sup>7</sup> This reflects, in part, the risk-based approach to inspections undertaken by many IFIAR Members. Those areas selected for inspection often are areas inherently more complex to audit. Audit regulators typically do not inspect all audits conducted by an inspected firm; rather, they select and examine a sample of audits that may not necessarily be a representative sample of the audit firm's work. For these reasons, it would not be

---

<sup>7</sup> These themes are listed in Table 1.

appropriate to extrapolate the results presented in this report to broader conclusions about the frequency of deficiencies throughout firms’ audit practices. Further, it is challenging to evaluate overall audit quality solely on the basis of the number of deficiencies reported by IFIAR Members. Nevertheless, monitoring trends in areas of inspection findings can be useful in discussions among regulators and with audit firms, and in identifying challenges and necessary areas of focus in order to advance the objective of high-quality audit.

**Table 1: Listed PIE Audits: Findings and Percentage of Audits with Findings<sup>8</sup>**

Inspection Themes	Number of Findings (a single PIE may have multiple findings for the same theme)	# of PIE Audits Inspected	# of PIE Audits with a Finding	% of Listed PIE Audits inspected with at least one finding
Fair Value Measurement	205	795	156	20%
Internal Control Testing	178	638	155	24%
Revenue Recognition	114	732	104	14%
Adequacy of Financial Statements and Disclosures	101	633	79	12%
Substantive Analytical Procedures	79	476	66	14%
Group Audits	75	506	53	10%
Inventory	69	409	64	16%
Adequacy of Review and Supervision	55	482	46	10%
Fraud Procedures	54	675	43	6%
Use of Experts and Specialists	54	446	47	11%
Engagement Quality Control Review	53	515	52	10%
Risk Assessment	49	652	45	7%
Audit of Allowance for Loan Losses and Loan Impairments	46	244	31	13%
Related Party Transactions	40	404	33	8%
Going Concern	24	418	23	6%
Audit Committee Communications	14	475	13	3%

1,210

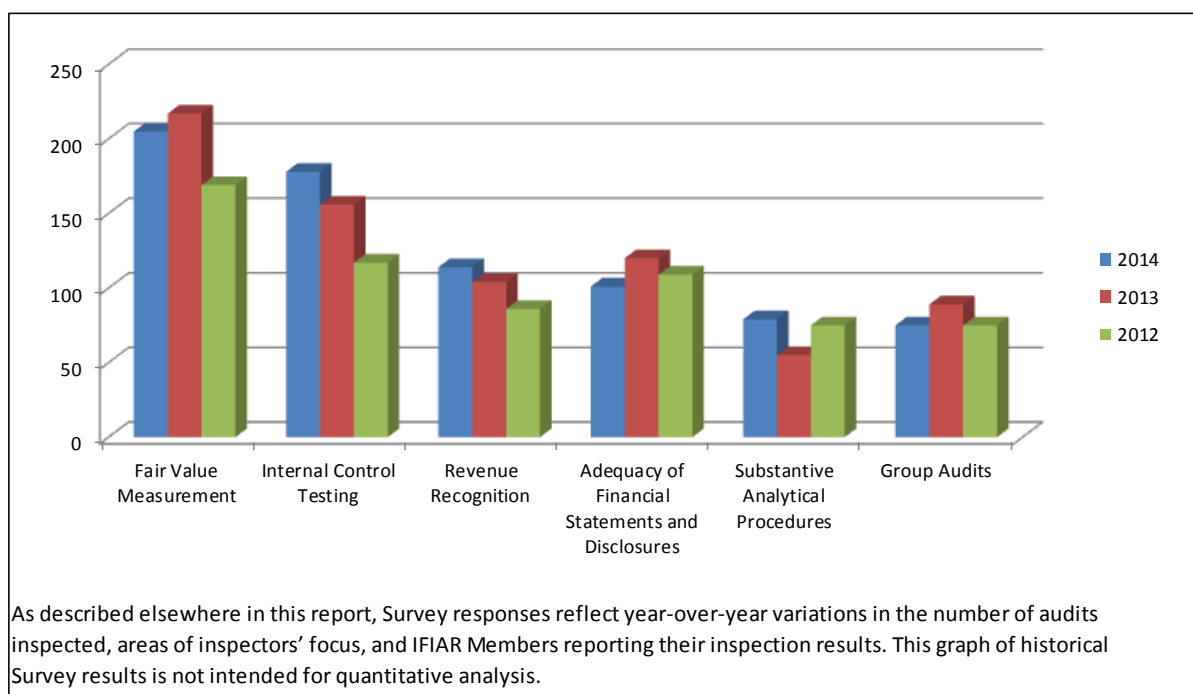
Table 1 illustrates that, in general, those inspection themes with the highest numbers of findings also have relatively higher rates of deficiencies across all audits where the theme was subject to inspection. Specifically, IFIAR Members reported the most findings and the

<sup>8</sup> Some findings may relate to multiple themes. Members were requested to select the one theme that they determined to be most relevant to the finding.

highest percentage of reviewed audits with findings relates to audit procedures for Fair Value Measurement (20% of audits reviewed yielded findings) and Internal Control Testing (24% of audits reviewed yielded findings). The number of findings reported in Table 1 can represent multiple findings reported for one listed PIE while the percentage of listed PIE Audits inspected with at least one finding is the number of listed PIE audits with a finding divided by the number of listed PIEs inspected.

IFIAR has not collected the information necessary to calculate the deficiency rates for the inspection periods covered in the 2013 and 2012 Surveys. Table 2 provides a three-year summary of the six inspection themes with the highest number of findings reported in the 2014 Survey. A complete summary of findings for the three Survey years is included in Appendix 1.

**Table 2: Listed PIE Audit Inspection Findings – 2014-2012 Selected Summary**



For the three categories with the highest number of inspections findings – Fair Value Measurement, Internal Control Testing, and Revenue Recognition – certain Members provided further information on the nature of findings that occur most frequently in their inspection programs. Common areas of audit deficiencies for each of these themes are summarized below.<sup>9</sup>

<sup>9</sup> It is important to note that not all Members reported on the nature of findings by inspection theme. While the examples provided here were observed with higher frequency by those Members reporting this



- **Fair Value Measurement:** The most commonly cited type of deficiency reported by Members is the failure to sufficiently test the accuracy of data used, and assess the reasonableness of assumptions, when testing how management arrived at the associated accounting measurement of fair value. This includes failure to consider contrary or inconsistent evidence, where available. Another area of frequent deficiencies is the failure to perform sufficient risk assessment procedures, including understanding and further consideration of the appropriateness of methodologies used by management to determine fair value.
- **Internal Control Testing:** Failure to sufficiently test information technology general and application controls was the most common type of finding for this inspection theme. Other frequent findings include the failure to obtain sufficient appropriate evidence to support reliance on manual internal controls and the failure to appropriately adjust testing as a result of ineffective controls (e.g., as indicated by audit adjustments and exceptions identified through substantive testing).
- **Revenue Recognition:** The failure to appropriately assess and respond to the risk of fraud in revenue recognition was a common category of findings in this inspection theme. Other types of findings include the failure to sufficiently understand the terms and conditions of complex arrangements and the impact on the accounting, and the failure to perform procedures to determine whether revenue was recorded in the appropriate period.

### *Inspection Findings from Audits of SIFIs*

Seventeen Members reported findings from inspections of audits of systemically-important financial institutions. These Members inspected the audits of 148 SIFIs by 41 audit firms and found deficiencies in 60, or 41%, of those audits. Inspections of these 148 SIFIs did not necessarily include inspection of all themes included in the IFIAR survey. This reflects, in part, the risk-based approach to inspections undertaken by many IFIAR Members. Those areas selected for inspection often are areas inherently more complex to audit. Audit regulators typically do not inspect all audits conducted by an inspected firm; rather, they select and examine a sample of audits that may not necessarily be a representative sample of the audit firm's work. For these reasons, it would not be appropriate to extrapolate the results presented in this report to broader conclusions about the frequency of deficiencies

---

information, they are not necessarily the most common issues summarized in the tables of total findings included in this report.

throughout firms' audit practices. Further, it is challenging to evaluate overall audit quality solely on the basis of the number of deficiencies reported by IFIAR Members.

Findings from the inspection of a SIFI audit, where the SIFI is a listed PIE, also are reported in the listed PIE results. The survey information on SIFI audit inspections is therefore largely a subset of the listed PIE results.<sup>10</sup> Members are instructed that SIFIs should include those financial institutions whose distress or failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity; individual Members determine which financial institutions to report as a SIFI. The SIFI category includes all financial institutions reported by the Financial Stability Board (FSB) to be G-SIFIs.<sup>11</sup>

---

<sup>10</sup> For any SIFI that is not a listed PIE, the results of that SIFI's audit inspection would be included in the SIFI results, but not in the listed PIE results.

<sup>11</sup> As of the time of the Survey, the FSB's list of G-SIFIs included 29 banks and nine insurers. For more information on these G-SIFIs, see [http://www.financialstabilityboard.org/2013/11/r\\_131111/](http://www.financialstabilityboard.org/2013/11/r_131111/) and [http://www.financialstabilityboard.org/2013/07/r\\_130718/](http://www.financialstabilityboard.org/2013/07/r_130718/). Prior to release of this report, the FSB updated its list of Global Systemically Important Banks to include one additional bank.

**Table 3: SIFI Audits: Findings and Percentage of Audits with Findings**

Inspection Themes	# of Findings Related to SIFIs (a single SIFI may have multiple findings for the same theme)	# of SIFI Audits Inspected	# of SIFI Audits with a Finding	% of SIFI Audits inspected with at least one finding
Valuation of Investments and Securities	42	122	33	27%
Internal Control Testing	36	98	26	27%
Audit of Allowance for Loan Losses and Loan Impairments	21	95	16	17%
Insufficient Challenge and Testing of Management's Judgments and Assessments	13	92	13	14%
Audit Methodology Including Programs and Tools	11	39	7	18%
Use of Experts and Specialists	9	81	9	11%
Adequacy of Financial Statements and Disclosures	7	85	6	7%
Substantive Analytical Review Procedures	6	69	6	9%
Testing of Customer Deposits and Loans	6	37	4	11%
Fraud Procedures	5	84	5	6%
Risk Assessment	4	81	3	4%
Group Audits	4	36	4	11%
Audit Committee Communications	2	73	2	3%

---

 166

Table 3 illustrates that those inspection themes with the largest numbers of findings also have relatively higher rates of deficiencies across all audits where the theme was subject to inspection. Specifically, IFIAR Members reported the most findings and the highest percentage of reviewed audits with findings for audit procedures relating to the Valuation of Investments and Securities (27% of audits reviewed yielded findings) and Internal Control Testing (27% of audits reviewed yielded findings).

Overall the total number of SIFI findings is slightly lower than the prior year. However, this overall decrease in the number of findings does not apply to the two most common areas of findings. Findings for valuation of investments and securities have seen a significant increase, while the internal control testing remains high and consistent with the listed PIE results. While, as described in the *Interpreting the Results* section of this report, the

population of SIFI audits inspected and inspectors' areas of focus vary between years, the level of findings in complex and important areas of a SIFI audit remain of concern.

In response to continuing concerns over the quality of auditing of banks, one IFIAR Member launched a major thematic review of the quality of auditing of loan loss provisions and related IT controls in banks and similar credit institutions. Announcing in late 2013 the intention to conduct this work in advance of the completion of most of the relevant audits, this regulator observed that appropriate focus was given to these issues by the auditors. As a result, the regulator was able to report publicly that improvements in the quality of aspects of the audit of loan loss provisions and related IT controls had been made. These improvements were most noticeable at firms where the regulator had in recent years identified significant issues. Improvements were not consistent across all audits however and the report identified areas where further improvement was necessary.<sup>12</sup>

#### *Findings from Inspections of Quality Control Systems*

Findings from audits of listed PIEs and SIFIs, as reported above, relate to inspections of the financial statement audit of a reporting entity. Findings reported in this section do not relate to specific audit engagements, but instead address the systems in place at the level of the audit firm to provide for overall quality control.<sup>13</sup> Thirty Members reported the results of their inspections of firm-wide quality control systems in 2014 at 123 audit firms. Inspections of firm-wide quality control address topics such as monitoring for independence, procedures to assess risk before accepting or continuing an audit engagement, and the overall “tone at the top” of the organization.

---

<sup>12</sup> See the related [report](#) of the UK Financial Reporting Council for further information.

<sup>13</sup> The categories of findings in the IFIAR surveys align with the elements of the International Auditing and Assurance Standards Board's (IAASB) 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*.

**Table 4: Quality Control Findings and Percentage of Inspected Firms with Findings**

Inspection Themes	Audit Firms with at Least One Quality Control Finding	
	#	%
Engagement Performance	71	60%
Independence and Ethical Requirements	55	48%
Human resources	52	45%
Monitoring	40	34%
Client Risk Assessment, Acceptance and Continuance	36	33%
Leadership Responsibilities for Quality within the Firm (i.e., Tone at the Top)	23	19%

Certain Members provided further information on the nature of quality control findings that occur most frequently for two of the areas above with a number of findings. Common areas of audit deficiencies for each of these inspection themes are summarized below:

- **Engagement Performance:** The firm's audit methodology and guidance often are the subject of inspection findings. Also, certain Members cited the failure to establish policies and procedures for engagement quality control reviews (EQCR) that provide an objective evaluation of the significant judgments made by the engagement team and conclusions reached.
- **Human Resources:** Members reported that they frequently have findings related to how the audit firm evaluates audit quality as part of partner performance evaluations and partner admissions. Another recurring type of finding relates to non-compliance with the firm's training and learning plan.

### *Changes in Audit Quality*

For the 2014 Survey, IFIAR Members were asked to indicate which among a number of categories best describes any significant changes in audit quality observed in their jurisdictions compared to the prior inspection cycle. The responses were based on the judgment of the responding IFIAR Members, and may or may not reflect an evaluation of audit quality based on measureable factors. Not all Members that submitted information on their inspection findings responded to this question. The responses received are summarized below.

Assessment Change in Audit Quality	# of Members
Overall improvement	7
Overall decline	1
Both improvement and decline	6
No significant overall change	11
	25

The views expressed are mixed and may, in some cases, be based on perception rather than measures of audit quality. The number of regulators indicating overall improvement may be a positive sign, albeit offset by a larger number of regulators not seeing significant changes.

### *Interpreting the Results*

The purpose of IFIAR's Survey is not to measure empirically changes in audit quality. In response to the 2014 Survey's question on changes observed in audit quality since the prior year, certain Members indicated that they measure changes by the nature and frequency of findings arising from the inspections they conduct. This measure should not be the sole means to evaluate the findings reported in IFIAR's Survey. First, unlike an individual regulator's ability to assess the nature and severity of its findings, the Survey does not provide this level of information. Second, the composition of audit firms inspected, topics of focus in certain Members' inspection programs, and Members reporting may vary between Survey reports. While the Members reporting were largely consistent between the 2014 and 2013 Surveys, some Members' inspection approaches involve a "thematic" focus for certain inspection cycles, such that some inspection themes may receive varying levels of attention by those regulators between years. Finally, while individual and aggregate responses are reviewed for reasonableness, IFIAR does not validate the information received, nor does it represent that the data is complete.

Despite these limitations, the recurrence and level of findings in inspection themes demonstrated by the Survey provide a useful point of reference for discussions about areas for improvement in audit performance. Further, the collection of information, beginning with the 2014 Survey, to enable reporting on the percentage of inspected audits that included a finding will enhance IFIAR's ability to analyze trends that continue to challenge audit quality.

It is critical to recognize that an audit deficiency does not necessarily imply that the financial statements are misstated. Instead, a deficiency is a matter with respect to which the firm did not obtain sufficient audit evidence to support its opinion, including a failure to

identify or address a potentially material error in the application of an accounting principle. Audit regulators often require the audit firm to perform the procedures necessary to satisfy the auditing standards, which may identify whether the financial statements were misstatements.

## **Relevant IFIAR Activities**

All aspects of IFIAR's work aim to improve audit quality through collaboration among those who are charged nationally with auditor oversight. Certain IFIAR activities draw explicitly from the annual Survey of findings to inform their efforts. This is specifically true with respect to IFIAR's dialogues with the largest international audit firm networks, content development for annual inspection workshops, and when considering the agendas and projects of international audit-related standard setters.

### *Dialogue with Network Audit Firms*

Members of IFIAR's Global Public Policy Committee (GPPC) Working Group meet with representatives of the six largest international audit firm networks that are members of the GPPC on a collective and individual network basis; in recent years, these meetings have been held at least three times annually. One of the primary objectives of these meetings is to obtain an understanding of the results arising from the networks' internal quality monitoring programs, and actions taken to identify and address the underlying root causes of the quality issues identified.

In the past, IFIAR through its GPPC Working Group asked the networks to focus their efforts on improving a relatively small number of specific areas where audit quality issues were frequently identified. These areas included the application of professional skepticism when auditing fair value measurements, the effectiveness of engagement quality reviews, testing of internal controls, the design and execution of substantive analytical procedures, and audits of group financial statements and revenue recognition. The networks responded to this request by developing remediation plans in 2010, to be implemented and updated in subsequent years.

Initially, the actions undertaken were predominately comprised of communications, training, and changes to the networks' policies and methodologies relevant to the specific quality issues. IFIAR's discussions with the networks have evolved in more recent years to acknowledge the importance of identifying and addressing the underlying causes of quality issues, and establishing reliable performance measures. Additionally, IFIAR has challenged the networks to consider how their business processes, models and structures may need to

be changed in order to influence behaviors and ensure the consistent execution of high quality audits. The IFIAR Survey of its Members' inspection findings contributes to the efforts of the GPPC Working Group by providing a basis for assessing the reliability of results arising from the networks' internal quality monitoring programs, and the effectiveness of actions taken by the networks to identify and address the underlying causes of audit quality issues over time.

### *Annual Inspection Workshops*

The Survey results are also a valuable source of information for the preparation of the agenda of IFIAR's annual inspection workshops. Beginning in 2007, these workshops are organized by the Inspection Workshop Working Group for the inspection staff of IFIAR Member bodies. In addition to a general update and presentation of the results from the inspection findings Survey at the workshop, participants discuss specific aspects and topics related to the performance and results of inspections in break out groups and elective sessions. Recurring, common findings and themes identified by the Survey provide a starting point for these discussions and allow for a joint reflection on potential root causes and measures for improvements to be taken by regulators and/or audit firms. In this way, the workshop helps to create awareness among participants on common issues that may be considered in the IFIAR Members' annual work programs and inspection approaches. Participants at the workshops provide meaningful feedback on the Survey's design as well as specific topics and relevant questions, contributing to further development of future Surveys. Overall, this drives further consistency in how IFIAR Members approach completion of future Survey submissions (e.g., the threshold for a reportable "finding").

### *Consideration of Standard Setting*

IFIAR is committed to improving audit quality globally by contributing to the development of high quality auditing and professional standards, and other pronouncements and statements. In this regard, IFIAR, through the Standards Coordination Working Group (SCWG), takes into account the results of the IFIAR Survey as part of its ongoing work to promote the development of high-quality auditing standards on an international basis and will continue to interact with the International Auditing and Assurance Standards Board (IAASB) and International Ethics Standards Board for Accountants on issues raised through inspection findings. Understanding the frequency and nature of inspection findings in a particular area helps inform the SCWG's consideration of projects envisaged or undertaken by international standard setters to develop or revise auditing or ethical standards.

IFIAR's Survey results were referenced in three recent IFIAR comment letters on IAASB standard setting projects relating to changes to the audit report, its strategy and work



program for 2015-2019, and proposed changes to the auditing of disclosures in financial statements.<sup>14</sup>

In addition, since the creation of IFIAR's SCWG, several mechanisms for interaction between IFIAR and the international audit and ethics standard setters have been developed and organized through dialogues with the international standard setting boards, including their Chairs. Recently, for instance, the SCWG has organized periodic and dedicated information calls with the Chairs and task forces of the international standard setting boards on selected projects in order to enhance the mutual understanding of issues, share perspectives, and allow for early interactions and input on specific key areas as well as enable IFIAR to obtain feedback on previous concerns and/or issues raised. The results of the IFIAR Survey are one of the sources of information presented and discussed during those calls and meetings.

While IFIAR recognizes that inspection findings do not on their own mean that changes are necessarily needed to the standards, IFIAR comment letters encourage the international standard setters to pursue their efforts to consider the themes identified by IFIAR's inspection Surveys in defining and conducting its standard-setting projects, with a perspective towards identifying how the international standards might further contribute to improving the quality of the audits globally. IFIAR believes these areas where the IFIAR Survey reports audit deficiencies, especially where those findings are numerous or recurring, deserve the specific attention in the international standard setters' processes. IFIAR believes further investigation in those areas, with a perspective to evaluate if and how standards could contribute to prevent a recurrence of those findings in audit firms and audit engagements, would be beneficial to their relevance.

A number of areas of findings within the IFIAR Survey have been included in the IAASB proposed work program for 2015-2019, such as professional skepticism, quality control, group audits, and fair value measurement. These topics have been identified as areas of concern in IFIAR's three Surveys of inspection findings and, in the view of the SCWG, will benefit from further consideration from a standard-setting perspective.

## **Initiatives to Improve Audit Quality**

Audit firms should pursue initiatives to improve audit quality and the consistency of audit execution across their firms. This often begins with a thorough evaluation and understanding of the root causes undermining consistent audit quality.

---

<sup>14</sup> IFIAR's comment letters can be found [here](#).

The measures described below illustrate initiatives that have been discussed by various IFIAR Members with the network firms in their jurisdictions, as well as between the global firm representatives and IFIAR Members through the GPPC Working Group. Some audit firms have undertaken actions similar to those mentioned below; these actions are not uniform across firms or across jurisdictions, either in nature or extent. IFIAR will continue to urge action across the global network firms, with the objective of achieving sustainable, consistent audit performance.

Firms should consider developing action plans, focusing on areas such as the examples below:

- (a) the culture of the firm, including messages from the leadership of the firm focused on audit quality and consultation on complex audit issues;
- (b) the experience and expertise of partners and staff, including consideration of effective use of experts;
- (c) timely supervision and review, including greater senior-level involvement in working with audit teams in the planning and execution of audits, and new or increased real-time quality reviews of engagements; and
- (d) accountability, including impacts on remuneration of engagement partners and review partners for poor audit quality, often extending to firm leadership.

Action plans should be regularly reviewed and updated as to matters such as:

- (a) timely and effective implementation;
- (b) effectiveness in practice through quality review results and other measures of audit quality; and
- (c) the need for new initiatives because earlier initiatives may become less effective over time.

Firms should review their staff structures as to whether changes are needed to ensure the firm has access to resources with appropriate experience and expertise for increasingly complex audits. Increasing complexity in financial reporting requirements, company business models and judgments on accounting estimates mean that audits require audit staff with a range of experiences and expertise. Many audits involve a number of types of experts, including, for example, valuation specialist, actuaries, geologists, and in the areas of financial instruments and information technology.

While auditors have the primary responsibility for audit quality, there are actions that others can take to promote and support audit quality. For example, non-executive directors in many jurisdictions are charged with recommending audit firm appointments

and setting audit fees. Audit committees can assess the commitment of the auditors to audit quality and their level of professional skepticism, monitor how the audit draws on experts in complex aspects of the audit, and have good two-way communication with the auditor about concerns and risk areas.

## **Conclusion**

IFIAR's dialogue among Members and with the largest international audit firms has expanded all parties' awareness of the need for deeper understanding of causal factors underlying ongoing challenges to audit quality. Many IFIAR Members, dissatisfied with the nature, extent, and persistence of audit deficiencies, evaluate the assessments by audit firms' in their jurisdiction of the root causes behind audit shortcomings, and follow up with consideration of whether responsive action is taken.

Gains in audit quality require improved consistency in how an audit firm performs across teams, offices, industries, and countries. Consistent performance benefits from understanding not only what can go wrong in an audit, but also the attributes of a high-quality audit engagement or systems for quality control across the audit firm.

Through collaboration among its Members, IFIAR's work positions its Members to evaluate nationally the various issues discussed at the global level with the network firms. Exchanges of perspectives and experiences with fellow IFIAR Members reinforces audit regulators' efforts to promote an audit function that provides the expected degree of confidence in financial reporting.

IFIAR is not yet satisfied that enough has been done by the audit profession to understand and address shortfalls in audit quality. IFIAR will continue its annual Survey of inspection findings, knowledge-sharing and collaboration among Members, and engagement with the large audit firm networks' leadership, to advance IFIAR Members shared goal of audit quality.

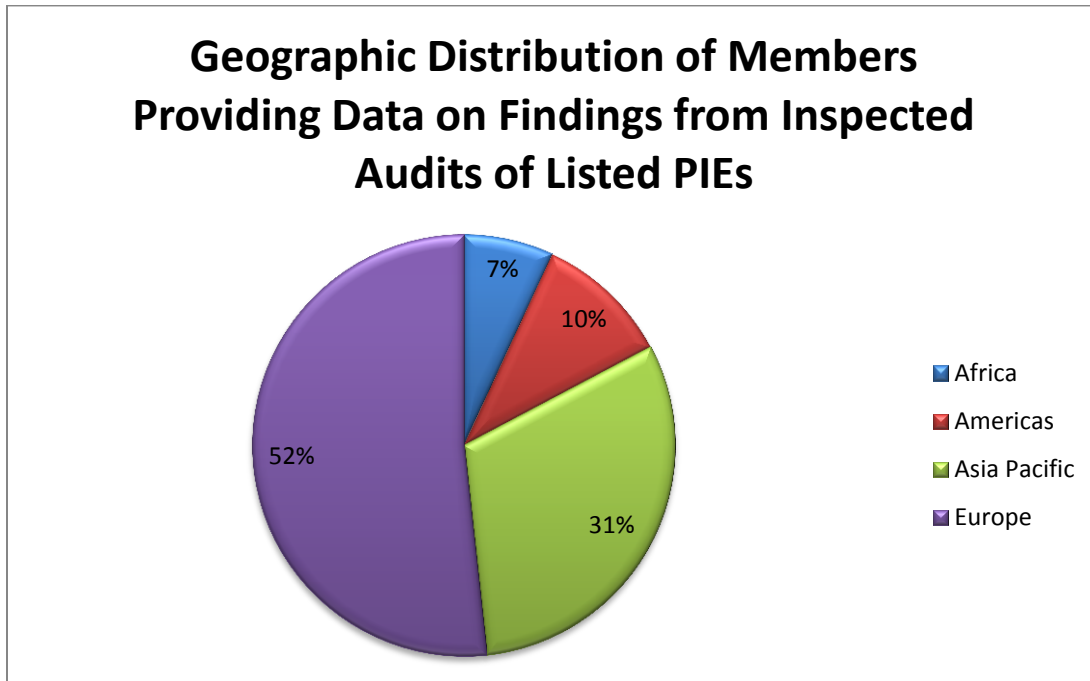
## APPENDIX 1: Supplemental Information

Additional information on the Survey results is provided in the tables below. As part of its ongoing work, IFIAR intends to evaluate this information over time to identify any trends and consider areas of significant and/or recurring audit deficiencies. Such identification assists IFIAR in developing its work programs, including its dialogue with the large network audit firms, evaluation of needs in audit or ethical standards, and information sharing through IFIAR’s annual inspection workshop.

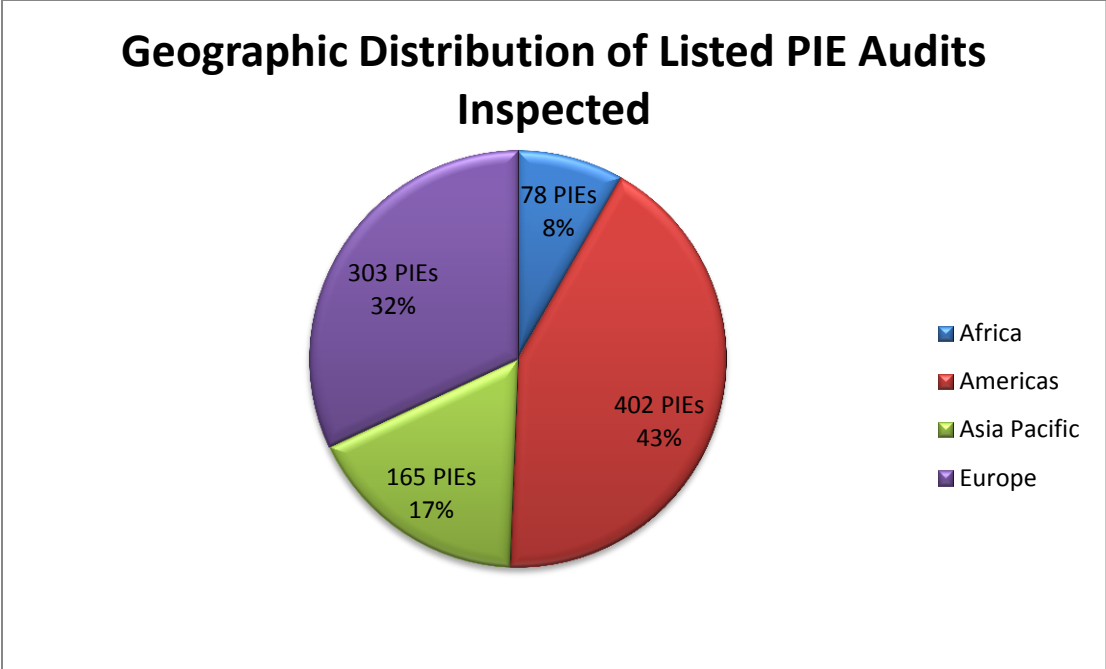
### *Listed PIE Audit Inspection Findings*

Twenty-nine IFIAR Members reported findings from inspections of audits of listed Public Interest Entities (PIEs). These Members inspected the audits of 948 listed PIEs and found deficiencies in 449 (or 47%) of those audits.

The geographic distribution of Members participating in the Survey and of audits inspected is illustrated below.



**APPENDIX 1: Supplemental Information**



The approach taken for the 2014 Survey largely followed that used in 2013 and 2012. IFIAR Members reported their findings by “inspection theme”. The themes remained consistent between the 2014 and 2013 Surveys; the 2012 Survey included three fewer themes for listed PIE audits and five fewer themes for SIFI audits; accordingly, the 2012 information below is marked “Not Applicable” for these themes first introduced in the 2013 Survey.

## APPENDIX 1: Supplemental Information

### Listed PIEs: Findings by Inspection Theme

Inspection Themes	2014	2013	2012
Fair Value Measurement	205	217	169
Internal Control Testing	178	156	117
Revenue Recognition	114	104	86
Adequacy of Financial Statements and Disclosures	101	120	109
Substantive Analytical Procedures	79	55	75
Group Audits	75	89	75
Inventory	69	76	57
Adequacy of Review and Supervision	55	58	115
Fraud Procedures	54	65	Not Applicable
Use of Experts and Specialists	54	42	41
Engagement Quality Control Review	53	78	116
Risk Assessment	49	59	Not Applicable
Audit of Allowance for Loan Losses and Loan Impairments	46	55	43
Related Party Transactions	40	28	44
Going Concern	24	24	25
Audit Committee Communications	14	34	Not Applicable
	1,210	1,260	1,072

The table above is provided for historical information. The composition of audit firms inspected, topics of focus in certain Members' inspection programs, and Members reporting may vary between Survey reports. While the Members reporting were largely consistent between the 2014 and 2013 Surveys, some Members' inspection approaches involve a "thematic" focus for certain inspection cycles, such that some inspection themes may receive varying levels of attention by those regulators between years.

## APPENDIX 1: Supplemental Information

The following table indicates the percentage of firms inspected with at least one finding in each of the inspection themes. This information was not collected for the 2012 Survey; comparative information therefore is available for 2014 and 2013 only.

### Listed PIEs: Number of Audit Firms Inspected and with Findings

Inspection Themes	2014			2013		
	Number of Audit Firms in which the Topic was Inspected	Audit Firms with at Least One Finding		Number of Audit Firms in which the Topic was Inspected	Audit Firms with at Least One Finding	
		#	%		#	%
Fair Value Measurement	112	66	59%	98	70	71%
Adequacy of Financial Statements and Disclosures	108	47	44%	107	49	46%
Internal Control Testing	109	43	39%	95	40	42%
Revenue Recognition	112	39	35%	99	42	42%
Group Audit	100	36	36%	98	42	43%
Fraud Procedures	111	35	32%	104	29	28%
Substantive Analytical Procedures	109	34	31%	92	27	29%
Use of Experts and Specialists	90	33	37%	83	25	30%
Inventory	92	31	34%	91	32	35%
Engagement Quality Control Review	100	31	31%	86	37	43%
Adequacy of Review and Supervision	95	28	29%	86	31	36%
Risk Assessment	113	27	24%	98	32	33%
Related Party Transactions	89	24	27%	86	20	23%
Audit of Allowance for Loan Losses and Loan Impairments	68	20	29%	73	25	34%
Going Concern	93	17	18%	89	17	19%
Audit Committee Communications	89	12	13%	83	20	24%

## APPENDIX 1: Supplemental Information

### *SIFI Audit Inspection Findings*

Seventeen Members reported findings from inspections of audits of SIFIs (compared to 13 in 2013 and 10 in 2012).

#### **SIFIs: Findings by Inspection Theme**

<b>Inspection Themes</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
Valuation of Investments and Securities	42	26	32
Internal Control Testing	36	39	33
Audit of Allowance for Loan Losses and Loan Impairments	21	42	15
Insufficient Challenge and Testing of Management's Judgments and Assessments	13	21	12
Audit Methodology Including Programs and Tools	11	1	9
Use of Experts and Specialists	9	8	Not Applicable
Adequacy of Financial Statements and Disclosures	7	9	4
Substantive Analytical Review Procedures	6	12	Not Applicable
Testing of Customer Deposits and Loans	6	3	10
Fraud Procedures	5	7	Not Applicable
Risk Assessment	4	10	Not Applicable
Group Audits	4	8	2
Audit Committee Communications	2	2	Not Applicable
	166	188	117



## APPENDIX 1: Supplemental Information

The following table indicates the percentage of firms inspected with at least one finding in each of the inspection themes. This information was not collected for the 2012 Survey; Survey results therefore are available for 2014 and 2013 only.

### SIFIs: Number of Audit Firms Inspected and with Findings

Inspection Themes	2014			2013		
	Number of Audit Firms in which the Topic was Inspected	Audit Firms with at Least One Finding		Number of Audit Firms in which the Topic was Inspected	Audit Firms with at Least One Finding	
		#	%		#	%
Valuation of Investments and Securities	38	13	34%	22	10	45%
Internal Control Testing	33	13	39%	28	13	46%
Audit of Allowance for Loan Losses and Loan Impairments	32	9	28%	29	13	45%
Insufficient Challenge and Testing of Management's Judgments and Assessments	34	7	21%	23	10	43%
Audit Methodology Including Programs and Tools	22	6	27%	15	1	7%
Use of Experts and Specialists	30	5	17%	20	3	15%
Adequacy of Financial Statements and Disclosures	30	5	17%	18	3	17%
Substantive Analytical Review Procedures	25	5	20%	23	7	30%
Testing of Customer Deposits and Loans	24	4	17%	17	2	12%
Fraud Procedures	31	4	13%	29	5	17%
Risk Assessment	28	3	11%	21	7	33%
Group Audits	21	5	24%	17	3	18%
Audit Committee Communications	25	2	8%	17	2	12%

## APPENDIX 1: Supplemental Information

### *Quality Control Systems Inspection Findings*

Thirty Members reported the results of their inspections of firm-wide quality control systems in 2014 and 2013; 23 Members provided this information in 2012.

#### **Quality Control: Findings by Inspection Theme**

<b>Inspection Themes</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
Engagement Performance	377	380	261
Human resources	111	146	166
Independence and Ethical Requirements	109	104	130
Monitoring	74	93	77
Client Risk Assessment, Acceptance and Continuance	53	78	100
Leadership Responsibilities for Quality within the Firm (i.e., Tone at the Top)	45	43	33
	<b>769</b>	<b>844</b>	<b>767</b>