

Sharing experiences on audit quality

A SELECTION OF IDEAS AND INITIATIVES INTENDED TO ASSIST
THE PROMOTION OF CONSISTENT AUDIT QUALITY IN AUSTRALIA

ABOUT THIS PAPER

This paper was prepared by staff at the Institute of Chartered Accountants Australia, with input from the Audit Quality and Public Reputation Working Group of the Australian Auditing and Accounting Public Policy Committee (APPC) with a shared interest in enhancing audit quality in Australia.

The APPC includes BDO, CPA Australia, Deloitte, EY, Grant Thornton, KPMG, PwC, the Institute of Chartered Accountants Australia and the Institute of Public Accountants.

The ideas in this paper have been shared by selected firms in Australia – BDO, Deloitte, EY, Grant Thornton, KPMG and PwC – based on work they have undertaken over recent years to improve their audit quality control systems. They are being shared to help other firms when considering their own systems and whether any of the ideas would be of relevance or assistance to them as they seek to enhance their audit quality processes.

Practitioners should use professional judgment in determining whether and how to apply any of the suggestions contained in this paper.

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Introduction and purpose of the paper

All professional services firms offering assurance or audit services must establish and maintain a system of quality control. This is to provide reasonable assurance that the firm and its personnel comply with relevant standards and requirements when undertaking audit and assurance work and the issued reports are appropriate.

ASQC¹ and APES 320² provide material, including specific requirements and guidance, in relation to such systems. Professional accounting bodies also offer material to assist smaller firms to apply the standards³.

However achieving audit quality requires a multi-faceted approach and relies on people. Systems can only help to promote, foster and enforce the required behaviours.

In December 2012, the Australian Securities and Investments Commission wrote to the CEOs of the six largest audit firms in Australia – BDO, Deloitte, EY, Grant Thornton, KPMG and PwC – asking them to develop action plans to improve audit quality. The focus of these plans was on:

- The culture of the firm, including messages from firm leadership focusing on audit quality and consultation on complex audit issues
- The experience and expertise of partners and staff, including increased and better use of experts
- Supervision and review, including greater partner involvement in working with audit teams in the planning and execution of audits, and new or increased real time quality reviews of engagements
- Accountability, including impacts on remuneration of engagement partners and review partners for poor audit quality, often extending the impacts to firm leadership.

The six firms have shared their experiences in challenging themselves to identify new ways to address the above issues. This paper summarises some of the initiatives being adopted.

The ideas set out in this paper are provided for an individual firm's consideration only, to help facilitate internal discussions on an individual firm's own systems and processes.

The size, structure, client base and existing processes within a firm will impact which, if any, of the ideas may be relevant. All firms will have different starting points and many existing processes will already address the purpose of some of the ideas set out in this paper.

It is not appropriate to attempt to adopt all the ideas in this paper. Many of the ideas set out are overlapping and merely represent different approaches to address the same objective. All the different ideas are listed only so that individual firms have a range of ideas to help their own discussions.

KEY MESSAGES

A clear message from the experiences shared is the importance of a robust root cause analysis prior to implementing any additional systems or processes. A number of the ideas listed in this paper address specific root causes. As such they may not be applicable if that root cause is not an issue within an individual firm.

There are a number of tools for undertaking a root cause analysis. One of the simplest ideas is the '5 whys' theory. This presumes that it will take around five rounds of questioning on why a certain thing happened to understand the root cause and real issue. For example if an engagement team did not apply a particular auditing standard, the first question should be 'why not?'. It may be that the team were not aware of the standard, in which case training may be an applicable remediation. However it may be that the team did not consider it of importance or relevance, in which case the remediation may be more focused on supervision and coaching.

The importance of establishing root causes prior to considering remediation activities is vital. This was strongly reinforced by the firms sharing their experiences for this paper.

1. Auditing Standard: Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, and Other Assurance Engagements.
2. Australian Professional and Ethical Standard Quality Control for Firms.
3. Institute of Chartered Accountants Australia Quality Control Guide, June 2013/CPA Australia Quality Control Questionnaire, December 2012.

INTERACTION WITH ASQC 1 REQUIREMENTS

Under ASQC 1 firms already need to document policies and processes. Many of the ideas set out in this paper may assist firms in relation to their quality control policies and processes. This table sets out the ASQC 1 areas and how the elements in this paper (using the focus areas identified for those plans) may interact. ASQC 1 requires policies and processes designed to provide reasonable assurance that:

- The firm creates an internal culture of quality, led by a person with sufficient and appropriate experience and authority
- Partners and staff comply with specified ethical and independence standards
- The firm only accepts or continues engagements where it is competent to do so and can comply with requirements, and where the client has integrity
- The firm has sufficient people with the right competence, capabilities and commitment, and assigns them to work appropriately
- Engagements are consistently performed in accordance with standards, are supervised and reviewed, include appropriate consultations, are managed in relation to differences of opinion, include an engagement quality control reviewer where necessary and engagement documentation is retained
- The firm undertakes ongoing consideration and evaluation of the system, including evaluating deficiencies and taking remedial action.

The ideas in this paper do not replicate processes or functions which are requirements of ASQC 1, for example holding a team discussion at the start of an engagement. The ideas set out are only those which are incremental to the standard.

SMALLER FIRMS

The ideas in this paper have been shared by the larger auditing firms in Australia. These firms have a larger resource pool and require more structured processes to manage engagements than many other audit firms in Australia.

When considering the ideas raised in this paper, firms will not only need to consider which, if any, may address the root causes for their firm, but also may need to apply some additional thinking to customise the options. For example, if a smaller firm, or one partner firm, considers that additional review or a specialist review is appropriate, the firm may need to consider options such as sharing arrangements with other firms, use of consultants, or introduction of senior but non-partner staff to meet the objective.



Culture & Accountability

The culture set by leadership drives the behaviours adopted by partners and staff. If a policy states that quality is the most important element, but partner actions focus on cost, staff will prioritise cost over quality. It is a difficult balance to implement and good intentions can often misfire. Here are some ideas of ways to prioritise quality in a more systematic manner.

SELECTION OF IDEAS – PROVIDED FOR INFORMATION ONLY

Many of these ideas cover the same objective. Which, if any, are appropriate will depend on many things, including existing systems and the structure, make-up and client base of a firm. They are not requirements and are not appropriate for all firms.

PARTNER ACCOUNTABILITY

A meaningful proportion of partners' income is based on quality criteria.

Criteria may be quantitative or subjective and may include:

- Results of internal or external inspections. As well as individual file results being considered for engagement and review partners, they may also be considered as part of evaluation of those in leadership positions (for example divisions, units, groups, offices or practices if relevant)
- Feedback from staff on coaching/supervision experiences with individual partners
- Feedback on consultation behaviour by individual partners
- Chargeable hours of staff on partner's engagements
- Partner attendance at training events
- Partner active participation at training event, including supporting discussions and sharing experiences
- Partner independence compliance
- Type or number of client issues, for example unqualified opinions with subsequent material errors, or misstatements, frauds or solvency issues in following year.

Individual job recovery is not included as a criteria for partner evaluation. The firm's approach to quality should recognise that if the approach is applied appropriately it does not compromise efficiency.

Partner rankings against quality criteria are shared with other partners.

FIRM FOCUS

Communications make clear that individual partners must espouse quality by including quality as an agenda item for all partner and/or staff meetings and/or having it as an evaluation criterion.

Communications are regularly made on quality (not just once a year)

Audit quality and standards are promoted through office posters, screen savers etc.

Recognition is given, and communicated, to partners and staff who demonstrate good audit quality behaviours or actions.

The risks associated with clients are ranked. For high risk clients, additional safeguards are put in place. Examples, depending on the size and structure of the firm, may include second partner review, more scheduled partner time to supervise and evaluate evidence, a 'hot review'⁴, or allocating specialist staff.

Quality standards and the public interest objectives of an audit are incorporated in communications with clients as well as internally.

The feedback or updates provided to partners and staff on the results of the firm's reviews, and any external review processes (required under ASQC 1) includes new issues arising and references to firm or other support available.

4. Reviews taking place during the engagement can be called a number of names, including hot reviews, real-time reviews, engagement reviews etc. For the purposes of this paper, a review by someone other than the engagement team and other than the Engagement Quality Control Review required under ASQC 1, which takes place during the engagement and before the opinion is finalised and signed is referred to as a 'hot review'.

RESOURCING

Senior resources to promote quality are funded and promoted, for example:

- Dedicated partner for promoting and supporting quality
- Engagement Control Review Partners
- Second partner reviews
- Industry specialists
- Technical specialists (auditing and financial reporting)
- Peer consultation individuals and/or sessions.

In smaller firms, if specialists or other resources are deemed relevant, consider whether arrangements can be made to obtain these externally, for example on a contract or outsourced basis, through a mutual agreement with another firm, or through specialist service providers.

Where in-firm specialists are available, their use is actively encouraged. This is through communications which explain clearly their availability and purpose, and how and when to access and use them.

Practice staff are allocated as champions or on-the-ground coaches in audit quality matters.

There is a competency list for recruitment and evaluation which covers quality behaviours as well as technical or educational skills. Examples of behavioural competencies may include:

- Project management or organisational skills
- Moral fortitude
- Achieving results
- Business acumen
- Curiosity
- Teamwork
- Ethical behaviour
- Interpersonal skills
- What it means to act in the public interest
- Commitment to development
- Professional judgement.

Clients and engagements and their allocation to partners and staff are reviewed annually. The review includes consideration of client and engagement risk, any specialisms, skills or experience required, and resource implications to address risks, as well as independence or rotation requirements.

Experience & Expertise

Auditing requires a team with experience and expertise, to obtain and assess sufficient appropriate audit evidence and apply appropriate professional scepticism. Increasing use of judgements and estimates in financial reporting standards are leading to junior staff increasingly needing to assess and evaluate estimates as well as undertake re-calculations or re-performance procedures. The expertise and skills required of more junior staff is therefore changing. Here are some ideas to help institutionalise expectations and application of these skills.

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TRAINING

Partners run training or knowledge sharing sessions with staff, to share war stories or experiences and drive quality messages.

Programs are developed to cover relevant levels of seniority. Training topics include:

- Applying professional scepticism
- Developing audit plans or strategies
- Responding to audit risks
- Client acceptance objectives
- Implications of related parties and transactions
- How to use a tax specialist
- How to use and document evidence from specialists or experts (including internal)
- Fraud risk factors and common signs (as set out in Appendix to ASA 240)
- Fraud presumption for revenue and what it means for audit approach (ASA 240)
- Assessment and evaluation skills
- Verification of source documents
- Skills and confidence to challenge management effectively
- Consideration of management bias theories and impact on audit
- Demonstrating professional scepticism in documentation
- Working paper design
- How to use internet information as audit evidence
- Project management or organisational skills
- Competencies and expectations of new role (provided on promotion milestones)
- How to review a file.

For small firms, the training program may be weekly sessions where the partner(s) works through a list of topics relevant to the engagements and staff of the firm, including matters highlighted above.

Findings from public inspection reports as well as firm specific matters are utilised as a filter and guide to developing training programs.

The training program for junior staff covers audit fundamentals (focusing on the auditing standards and their application). External options may be available for this, for example through the professional bodies.

The training program for partners highlights particularly judgemental or difficult areas and covers both technical aspects and also how to delegate, coach, review, and assess the work of the team. For small firms, this may be managed through formal external training options, through collaboration with other firms, or through a partner obtaining one-on-one coaching from a specialist.

Training is given to any internal specialists who undertake audit support work on the objectives of an audit and how their work will be used as audit evidence.

TRAINING
(CONTINUED)

Lateral hires are trained in the firm's culture and working practices in addition to making sure they are up to date with technical matters.

Tests or assessments are used as part of training.

Case studies, scenarios, exercises or worked examples are used. Sessions are workshop, hands-on style to embed training messages (learn by doing not by hearing).

'Lunch and learn' or other discussion style meetings are held, by grade of staff, to allow sharing of ideas and overcoming common problems for topical or commonly difficult areas.

Monitoring is undertaken to see if people are reading updates and attending training, and there are processes to identify and address those who are not keeping competencies updated or not using the most up to date tools.

Consequences for non-attendance at training are in place (for example, mandatory follow up or retaking of training session, non-attendance is included as criteria for the individual's evaluation or ranking).

RESOURCES

All staff have easy access to auditing standards (online, hard copy, or incorporated into working papers).

If using audit programs, they are up to date and there is a process in place to update them at least annually.

Scoping or planning questionnaires are used to help highlight areas of focus or audit risk and to manage resources.

Technology tools for specific areas are used (available from professional bodies in Australia or internationally for purchase or online).

Where relevant, there is a policy for mandatory use of specialists for particular clients, industries or financial line items (e.g. corporate finance, actuaries, valuers, tax specialists, IT, forensics, geologists). This policy is based on assessment of risk of particular matters.

There are 'centres of excellence', or particular staff are supported to assist in particular work that they have special talent for. This may be technical (e.g. substantive analytics experts) or behavioural (e.g. project management, negotiation, client interview, writing). These staff are provided with appropriate time to give assistance on other engagements and are recognised for their work with other teams.

TIME

A time budget is prepared covering expected level of work, which specifically includes time for reviewing work, file assembly, client communications, 'hot reviews', etc. This may be part of a planning meeting for a smaller firm, or may be part of the decision on whether to accept an engagement or client.

There is a policy for leadership approval of engagement pricing or fee, which articulates the importance of budgeting appropriate time and resources for a quality audit.

Leadership annual review of the firm's portfolio of audit clients includes considerations of whether to continue particular engagements, based on the ability of the firm to fund sufficient time and resource to undertake quality audit work across the whole portfolio.

REMEDIATION

A root cause analysis⁵ is undertaken of findings from reviews and other activities, to establish reasons for findings and why processes or behaviours are not being applied consistently or appropriately. Reasons may be diverse, including for example:

- Not being aware of the requirements
- Not understanding the requirements
- Not appreciating that the requirements were necessary or important (and so the requirements were not prioritised over other demands)
- Individuals or teams believing that they would not get found out if didn't comply.

5. The 6 Sigma methodology uses a '5 Whys' approach and has a 'fishbone' template which is freely available.

Supervision & Review

An important element of professional standards is the supervision and review of an individual's work by someone more senior on the engagement team. This is a key process to assist quality through understanding audit work, providing on-the-job coaching, directing ongoing activities and assessing basis for conclusions. Supervision and review are also relevant in relation to the extent of reliance on the work of others and levels of professional scepticism.

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FOCUS

The template work programs include time for involvement by the partner at the start of the engagement and throughout the site work. The importance of proper planning and set up of team members is emphasised.

There are regular and consistent leadership messages about the importance of partners and managers setting aside time to supervise and review staff (even if there are engagement cost overruns).

On-the-job coaching is a criteria for evaluation.

There is a 'hot review' program where key areas are reviewed by someone external to the engagement team before the report is finalised. This can be by a different firm subject to agreements on confidentiality, privacy and other commercial terms.

TOOLS

There is an agreed format within each team or for each engagement on how the working papers will be reviewed, e.g. oral, at the client, using software. There is a policy on how the review will be documented.

The template work programs include sign off sheets for reviewers which include a listing of what the reviewer needs to assess.

Agendas for team discussions include the specific allocation of team responsibilities including how the team will use other specialists or experts, who will supervise whom, how review of work will be documented, and the accountability for fulfilling the responsibilities. This is applicable even for a team of two.

SKILLS

Training is provided to all levels of staff on:

- Effective supervision techniques
- How to undertake a critical review of work
- Coaching skills and behaviours
- How to review and assess reports of experts or specialists used as part of the audit (both internal and external specialists)
- Matters to consider when assessing management's use of accounting policies, including critical evaluation, determining when aggressive choice of policies impacts the audit, what follow up is required (e.g. team member challenge, escalation policy) and how to document considerations, actions and conclusions.

Training is provided to senior staff on how to coach team members through reviewing and assessing reports of experts or specialists.

When staff use the internet for research (e.g. industry or client news), senior staff are trained on how to coach them through what the data means, its reliability as audit evidence, and how to use and document the information as audit evidence.

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