

# IFIAR Brief - 2020

## *Enhancing Audit Quality Globally: The Role of IFIAR and New Initiatives (audit quality)*

The International Organisation of Independent Audit Oversight Regulators (IFIAR) is committed to improving and maintaining high-quality global standards for auditing. To achieve this, IFIAR emphasizes integration with other standards, strengthening certain requirements, and enhancing the application of these standards. The organization monitors audit quality by inspecting public interest entity (PIE) audit programs for deficiencies. Findings reveal that a strong system of quality control is crucial in enhancing audit quality.

To further promote improvement, IFIAR approved the International Standard on Audit Quality Management (ISQM), aiming to identify risks and develop controls to manage those risks. The organization also keeps track of findings survey results over time as a measure of audit quality, though these changes do not necessarily illustrate improvements or deterioration.

For improvement of audit quality, IFIAR uses various activities as a platform for its members to share knowledge and experiences. This collaboration allows them to engage with global network firms to encourage continuous enhancement of audit quality. However, they acknowledge that the survey designed for this purpose doesn't provide a complete measure of firms' progress.

The firm-wide systems of quality control are a primary focus area, with the goal to establish and implement policies and procedures for timely engagement supervision and review. Keeping track of business relationships, audit firm financial interests, and regulations is considered critical for maintaining audit quality. Through these efforts, IFIAR aims to continuously influence progress towards consistent, high-quality global audits, despite an inability to fully measure this progress.

## *Analysis of Audit Inspection Themes and Results (accounting estimates)*

The text focuses on common audit inspection themes such as 'accounting estimates, fair value measurement, internal control testing' among others in relation to listed PIE audits. Various challenges in these audits like the failure to test the accuracy of data, incomplete risk assessment procedures, and insufficient verification of internal controls are identified. Issues regarding revenue recognition, inappropriate use of audit sampling and insufficient understanding of complex arrangements also surface. Shortfalls are also noted in group audits, especially in the coordination with component auditors. The text further highlights the critical nature of subjective factors like allowances for loan losses, inventory reserves, and tax-related estimates, which warrants the auditor's keen attention due to their susceptibility to management bias and material misstatements.

## *Analysis of Securities Fraud Litigation and Provisions (fraud)*

There is an acknowledgment of widespread securities fraud litigation. The Private Securities Litigation Reform Act has implemented protective measures including advanced pleading norms in fraudulent actions. Reported fraudulent activities revolve around initial coin and cryptocurrency offerings, manipulation of derivatives, and breaches of fiduciary duty. The frequency of cases with long gaps between the revelation of alleged fraud and filing of

associated claims has decreased. Factors influencing settlements include the size of the case, market capitalization of the issuer, types of securities involved in the fraud, merit proxies of allegations, associated accounting irregularities, existence of a parallel derivative action, and an institutional lead plaintiff. There exist legal procedures requiring allegations to specify falsified statements and reasons. Prohibitions against future legal violation of antifraud provisions, and requirements to cease and desist from such activities have been instituted. An effort is being made to provide elderly investors and retirement plans with further protection against securities fraud and abusive litigation.

### ***Enhancing Audit Quality and Ethical Standards in Global Networks (ethics)***

The focus is on International Forum of Independent Audit Regulators' (IFIAR) continuous interaction with international auditors, ethics standard setters, and global audit firm networks to bolster their members' quality control systems and ensure conformity to high-quality audits globally. A deficiency, defined as a deviation from auditing standards or requirements, such as quality control and ethical or independence requirements, may impact audit quality due to its significance or systemic nature. This is likewise applicable to the quality control findings. Audit firms within the network commonly adhere to the same auditing, quality control, and ethical policies. Stricter restrictions are observed in the auditing and ethical standards. An email to Mr. Stavros Thomadakis, Chair, International Ethics Standards Board for Accountants (IESBA), discusses the forum's comments on the exposure draft about non-assurance services for audit clients. Despite the IESBA Code of Ethics being utilized by some IFIAR members, it is not universally adopted.

### ***Implications of Audit Committee Governance and Ethical Standards on Audit Quality (governance)***

The text discusses the pivotal role of governance bodies and audit report users being aware of the importance of independence and ethical standards. There's a suggestion for additional guidance linking governance communication with independence requirements. The document further details, quality control and engagement inspection findings of the audit firms are divided amongst their members. Significant emphasis placed on enhancing governance through an audit committee, it outlines audit committee requirements globally, where most listed companies have such committees with individuals possessing specific skills and expertise. Responsibilities of these committees include selecting the external auditor, determining audit fees, assessing auditor performance, setting policy for non-audit services, and maintaining active engagement with the auditor. The duration of these terms typically spans 1 to 3 years and could be aligned with other corporate governance requirements. Most European jurisdictions provide the audit committee a report about the audit firm's governance and its quality control system for financial statement audits. Crucial communication with those in charge of governance is encouraged concerning non-assurance services and related entities.

### ***Recommendations for Audit Team's Documentation and Evaluation Processes with Emphasis on Internal Controls (internal controls)***

Stakeholders suggest a need for documentation requiring the Group Engagement Team (GET) to record their logic when their perspectives on components diverge from management's views, impacting risk assessments, internal controls testing, and substantive testing. This necessitates extra application material to comprehend the correlation between ED and ISQM in relation to

GET's accountability and reliance on the company's internal control methods. The report details multiple failures in risk assessment procedures, testing of manual internal controls, evaluation of control severity, data accuracy testing and other areas related to the auditing process. Further intricacies of business and financial reporting, internal controls, and auditing impose broader responsibilities on the audit committee, including establishing complaint-alert mechanisms for auditing matters. The auditor's dependence on internal controls effectiveness is to be consistent with the audit committee's understanding of the relevant internal controls' reliability. Lastly, if non-audit service is provided by professionals outside the audit team, their work should be reviewed by professionals outside the audit team.

### ***Audit Deficiencies and their Impact on Audit Quality (auditing standards)***

The emphasis of the survey lies in understanding the significance of deficiencies found during auditing that fail to meet auditing standards. These can include departures from standards on quality control and requirements for ethics and independence. They are particularly impactful if they affect audit quality or are recurring. The fact that an audit engagement has an inspection finding does not necessarily imply the misstatement of financial statements. The actual entity's accounting and disclosure might be appropriate despite these inspection findings. The survey also emphasizes individual audit engagement inspections, focusing on audit firm's compliance with auditing standards. Alterations to these standards, such as the revision from 'inventory' to 'inventory procedures', add further depth to the audit process.

### ***Overview of IFIAR's Objectives, Actions, and Impact on Audit Markets (environment)***

The International Forum of Independent Audit Regulators (IFIAR) aims to share knowledge about the audit market environment and related experiences from independent audit regulators, focusing on the inspections of auditors and audit firms. The Group Engagement Team (GET) should acquire input from Component Auditors (CAs) for risk assessments relevant to group audits, leveraging the CAs' knowledge of the component and its environment. In response to recent office closures and remote work shifts, regulators have been modifying their inspection programs. Quality control findings are attributed to firms broadly, with quality deficiencies potentially impacting individual audits or oversight functions. IFIAR's actions involve sharing knowledge on the evolving audit environment, fostering collaboration in regulatory activities, and establishing dialogue with international organizations interested in audit quality.

### ***Ensuring Auditor Independence and Quality in Auditing Firms (auditor independence)***

Firm-wide systems, focusing on auditor independence, risk assessment, and personnel development, are essential for achieving high-quality auditing. The audit committee plays a significant role in maintaining auditor independence by controlling the provision of non-audit services, including tax and advisory, to the audited entity. This is applicable in nearly every reporting jurisdiction involved in the survey. Given the potential threats to auditor independence, most survey respondents either prohibit certain non-audit services or mandate audit committee approval for them. The potential inclusion of a requirement in the code, in which those charged with governance (TCWG) of the Public Interest Entities (PIE) have to be notified about the provision of non-audit services (NAS) to the parent firms was suggested, due to the potential challenges it could pose to the auditor's independence and therefore requires evaluation by the individual TCWG of the PIE.

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