

## AUDIT QUALITY ASSURANCE SEMINAR

### AUDIT QUALITY FRAMEWORK

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# Outline

- Background ( Audit Quality Framework)
- What is audit quality?
- Elements of audit quality
- Players in audit quality and their interactions

# Background

- The IAASB believes the development of the Framework is in the **public interest** as it aims to contribute to improving audit quality. It describes a number of factors (inputs, outputs, interactions, and contextual factors) that contribute to **quality audits being consistently performed** and encourages audit firms and other stakeholders to challenge themselves about whether there is more that they can do to increase audit quality in their particular environments

# Background (cont...)

- While the primary responsibility for performing quality audits rests with auditors, audit quality is best achieved in an environment where there is **support from other participants in the financial reporting supply chain.**

# Objectives of the Framework

- **Raising awareness** of the key elements of audit quality;
- **Encouraging key stakeholders**(national audit firms, international networks of audit firms, and professional accountancy organizations) to **explore ways to improve audit quality**;
- Facilitating **greater dialogue** between key stakeholders on the topic.
- Auditors are required to comply with **relevant auditing standards and standards of quality control within audit firms**, as well as ethics and other regulatory requirements. The Framework is not a substitute for such standards, nor does it establish additional standards or provide procedural requirements for the performance of audit engagements.

# Defining Audit Quality- Challenges (Cont..)

- The purpose of an audit is **to enhance the degree of confidence** of intended users in the financial statements. This is achieved by auditors **gathering sufficient appropriate audit evidence** in order **to express an opinion** on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

# Defining Audit Quality- Challenges

## (Cont...)

- While national laws and accounting standards provide criteria for “fair presentation,” many aspects of the financial reporting process, and therefore the audit of the financial statements, **involve judgment**.
- Auditing standards provide an important **foundation** supporting audit quality. International Standards on Auditing (ISAs) issued by the IAASB describe the auditor’s objectives and establish minimum requirements. However, the majority of the requirements in ISAs either provide a framework for the judgments made in an audit or need judgment for them to be properly applied.

# Defining Audit Quality- Challenges ( Cont...)

- Audit is therefore a discipline that relies on competent individuals using their **experience** and **applying integrity, objectivity, and skepticism** to enable them to make **appropriate judgments** that are supported by the facts and circumstances of the engagement.

# Defining Audit Quality- Challenges ( Cont...)

In addition to the **judgmental nature** of aspects of the underlying Financial statements, there are a number of factors that make it challenging to describe and evaluate the quality of an audit, including that:

- The existence, or lack, of material misstatements in the audited financial statements provides only **a partial insight** into audit quality.
- Audits **vary** and what is considered to be sufficient appropriate audit evidence to support an audit opinion is, to a degree, judgmental.
- **Perspectives of audit quality vary** among stakeholders.
- There is **limited transparency** about the work performed and audit findings

# Defining Audit Quality- Challenges ( Cont..)

- The **existence of material misstatements** in the financial statements that were not detected by the audit may be an indicator of audit failure.
- However, **the absence of material misstatements** in the financial statements cannot, be the only measure of audit quality because there may have been no material misstatements to detect

# Defining Audit Quality- Challenges ( Cont...)

- Even the existence of **undetected material misstatement** in the audited financial statements may not necessarily indicate a poor quality audit as **audits are designed to obtain reasonable**, not **absolute**, assurance that the financial statements do not contain material misstatements. This especially relevant when misstatements result from **frauds that have been concealed** through forgery, collusion and intentional misrepresentations.

# Defining Audit Quality- Challenges ( Cont..)

- **No two entities are exactly the same** and therefore the audit work and judgments required will necessarily vary. What is considered to be “sufficient appropriate audit evidence” is therefore, to a degree, a matter of professional judgment, reflecting **the nature and complexity of the entity** as well as the **auditor’s assessment of the risks** that the financial statements prepared by management could be materially misstated.

# Defining Audit Quality- Challenges

## ( Cont...)

- Audit firms are usually profit-making entities and the profitability of an audit firm is usually linked to the relationship between the **audit fees charged** and the **cost involved** in gathering sufficient appropriate audit evidence.
- Notwithstanding the application of auditing standards and ethics requirements, audit firms may have a short-term incentive to **limit the work performed** while recognizing that in the **longer term, sustained audit quality** is needed to protect the audit firm's reputation and to avoid damaging regulatory or legal actions.

# Defining Audit Quality- Challenges ( Cont..)

- Different stakeholders are likely to have different perspectives about the nature of audit quality. For example, users of the financial statements may see audit quality as **maximizing the amount of audit evidence** obtained and the challenge provided to management.
- Considering audit quality solely from this perspective would suggest that the quality of an audit would be higher, **the more resources** (both in quantitative and qualitative terms) that are allocated to an audit.

# Defining Audit Quality- Challenges ( Cont..)

- Management may have an interest in ensuring that the **cost of the audit is constrained, the audit is completed as quickly as possible and that the disruption to the entity's ongoing operations is minimized.** By considering audit quality from this perspective, management may suggest that the resources allocated to an audit should be minimized.

# Audit Quality:

- Balancing these different views suggests that **a quality audit** involves an **effective** audit being **performed efficiently**, on a **timely basis** and for a **reasonable fee**. There is, however, subjectivity around the words “effective,” “efficiently,” “timely,” and “reasonable.”
- Those charged with governance, including audit committees, are often well placed to consider these matters. For this reason, in many countries audit committees have responsibilities for considering audit quality and approving, or recommending for approval, the auditor appointment, and audit fees.

# Audit quality framework:

- Auditors are responsible for the quality of individual audits, and should aim to ensure that quality audits are consistently performed. A quality audit is likely to be achieved when the auditor's opinion on the financial statements can be relied upon as it was based on sufficient appropriate audit evidence obtained by **an appropriate engagement team**.

# Audit quality framework : ( Cont..)

**An appropriate engagement team is one which:**

- Exhibited appropriate values, ethics and attitudes;
- Was sufficiently knowledgeable and experienced and had sufficient time allocated to perform the audit work;
- Applied a rigorous audit process and quality control procedures;
- Provided valuable and timely reports; and
- Interacted appropriately with a variety of different stakeholders.

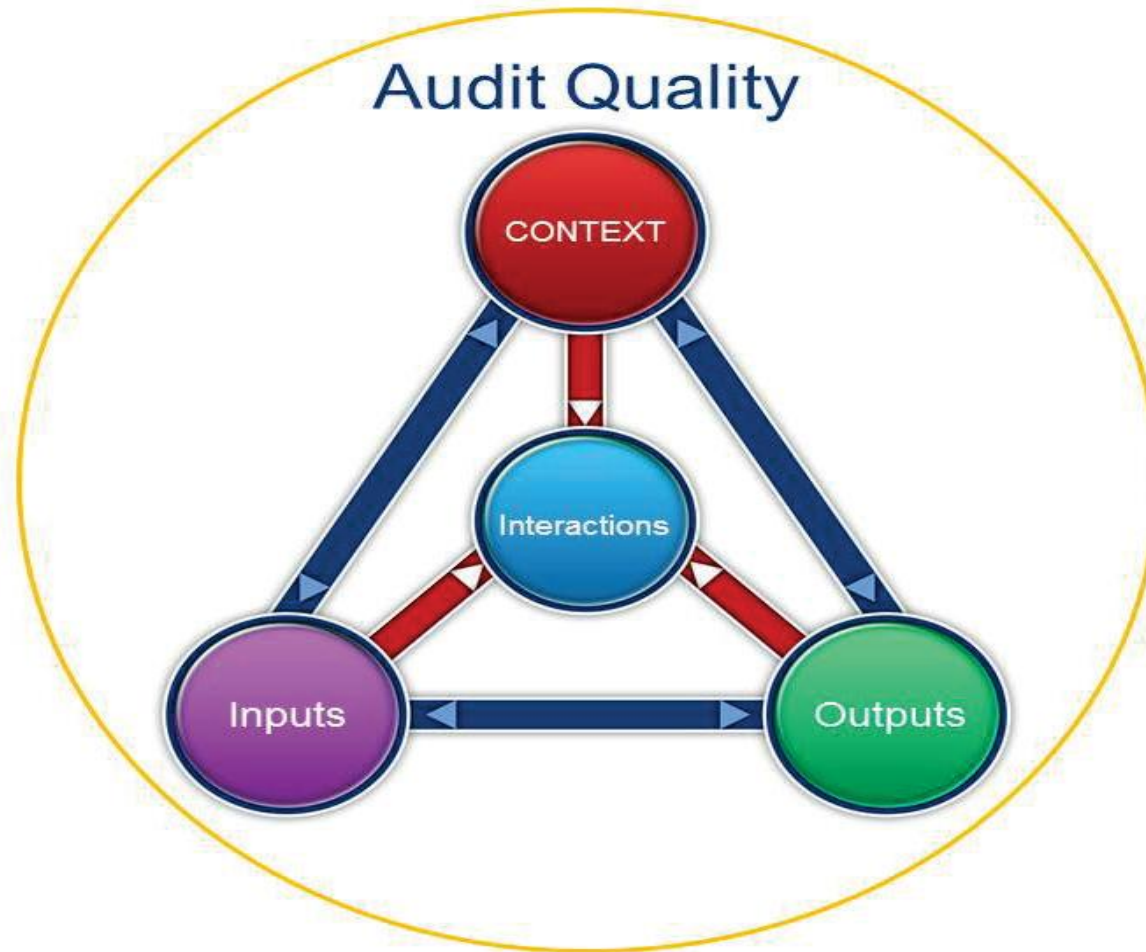
# Audit quality framework (cont...)

- Many factors contribute to enhancing audit quality within a jurisdiction, and increasing the likelihood of quality audits being consistently performed.
- The IAASB believes there is value in describing these factors and thereby encouraging audit firms and other stakeholders to challenge themselves about whether there is more they can do to increase audit quality in their particular environments.
- The Framework sets out the key attributes that are conducive to audit quality, reflecting the different perspectives of stakeholders.

# Audit quality framework (cont...)

- The Framework **applies to audits of all entities and all audit firms** regardless of size, including audit firms that are part of a network or association. However, the attributes can vary in importance and affect audit quality in subtly different ways. In particular:
- The Framework applies to **both private sector and public sector audits** although, due to their societal role and constitutional mandate, public sector audit bodies may give specific emphasis to certain factors; and

# Elements of Audit quality:



# Inputs:

**Inputs are grouped into the following categories:**

- (a) The **values, ethics and attitudes** of auditors, which in turn, are influenced by the culture prevailing within the audit firm;
- (b) The **knowledge and experience** of auditors and the time allocated for them to perform the audit; and
- (c) The **effectiveness of the audit process** and quality control procedures.

# Inputs- Values, ethics & attributes

## Engagement Level:

- The engagement team recognizes that the audit is performed in the wider public interest.
- The engagement team exhibits objectivity and integrity.
- The engagement team is independent.
- The engagement team exhibits professional competence and due care.
- The engagement team exhibits professional skepticism.

# Inputs- Values, ethics & attributes

## Firm Level

- Governance arrangements are in place that establish independence and the appropriate “tone at the top.”
- The firm promotes the personal characteristics essential to audit quality.
- Financial considerations do not drive actions and decisions that may have a negative effect on audit quality.
- The firm emphasizes the importance of providing partners and staff access to high-quality technical support.
- The firm promotes a culture of consultation on difficult issues.
- Robust systems exist for making client acceptance and continuance decisions.

# Inputs- Values, ethics & attributes

## National Level

- Ethics requirements are promulgated that make clear both the underlying ethics principles and the specific requirements that apply.
- Regulators and professional accountancy organizations are active in ensuring that the ethics principles are understood and the requirements are consistently applied.
- Information relevant to client acceptance decisions is shared between audit firms.

# Inputs – Knowledge, Experience and Time

## Engagement Level :

- Partners and staff have the necessary **competences**.
- Partners and staff **understand the entity's business**.
- Partners and staff make **reasonable judgments**.
- The audit **engagement partner is actively involved** in risk assessment, planning, supervising, and reviewing the work performed.
- **Staff** performing detailed “on-site” audit work have **sufficient experience, work is directed, supervised and reviewed**, and there is a reasonable degree of staff continuity.
- Partners and staff have **sufficient time to undertake the audit** in an effective manner.

# Inputs – Knowledge, Experience and Time

## Firm Level

- Partners and staff have sufficient time to deal with difficult issues as they arise.
- Engagement teams are properly structured.
- Partners and more senior staff provide less experienced staff with timely appraisals and appropriate coaching or “on-the-job” training.
- Sufficient training is given to audit partners and staff on audit, accounting and, where appropriate, specialized industry issues

# Inputs – Knowledge, Experience and Time

## National Level

- Robust arrangements exist for licensing audit firms/individual auditors.
- Education requirements are clearly defined and training is adequately resourced.
- Arrangements exist for briefing auditors on current issues and for
- providing training to them in new accounting, auditing or regulatory requirements.
- The auditing profession is well-positioned to attract and retain high-quality individuals

# Inputs – Audit Process and Quality Control Procedures

## Engagement Level:

- The engagement **team complies with auditing standards**, relevant laws and regulations, and the audit firm's quality control procedures.
- The engagement team makes **appropriate use of information technology**.
- There is **effective interaction** with others involved in the audit including, where applicable, internal auditors.
- There are **appropriate arrangements with management so as to achieve audit efficiency**.
- There is **appropriate audit documentation**.

# Inputs – Audit Process and Quality Control Procedures

## Firm Level

- The **audit methodology is adapted to developments in professional standards** and to findings from internal quality control reviews and external inspections.
- The **audit methodology encourages individual team members to apply professional skepticism** and exercise appropriate professional judgment.
- The **methodology requires effective supervision and review** of audit work.
- The **methodology requires appropriate audit documentation.**
- **Rigorous quality control procedures** are established and audit quality is monitored and appropriate consequential action is taken.
- Where required, **effective engagement quality control reviews** are undertaken.

# Inputs – Audit Process and Quality Control Procedures

## National Level:

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

# Inputs: ( Cont..)

- The inputs to audit quality will be influenced by the **context** in which an audit is performed, the interactions with key stakeholders and the outputs.
- For example, law and regulations (context) may require specific reports (output) that influence the skills (input) utilized.

# Outputs:

Outputs from the audit are often determined by the **context, including legislative requirements**. While some stakeholders can influence the nature of the outputs, others have less influence.

Indeed, for some stakeholders, such as investors in listed companies, the auditor's report is the primary output and currently this is relatively standardized.

# Outputs: Cont...

## Engagement level:

- (i) **From the Auditors:** Auditor's reports to users of audited FS; Auditor's reports to those charged with governance; Auditor's reports to management; Auditor's reports to financial and prudential regulators;
- (ii) **From the Entity:** The audited financial statements ; reports from those charged with governance, including audit committees
- (iii) **From Audit Regulators:** Providing information on individual audits

## Firm & National Levels:

- (i) **From the Audit Firm:** Transparency reports; Annual reports
- (ii) **From Audit Regulators:** Providing an aggregate view on the results of audit firm inspections

# Interactions of key stakeholders

While **each separate stakeholder** in the financial Reporting supply chain **plays an important role** in supporting high quality financial reporting, the way in which the stakeholders interact can have a particular impact on audit quality.

These interactions, including both formal and informal communications, will be influenced by the **context** in which the audit is performed and allow a dynamic relationship to exist between inputs and outputs.

# Interactions of key stakeholders:

## Cont..

For example, **discussions** between the auditor and those charged with governance at the **planning stage** can influence the use of Specialist Skills **(input)** and the form and content of the auditor's report to those charged with governance **(output)**.

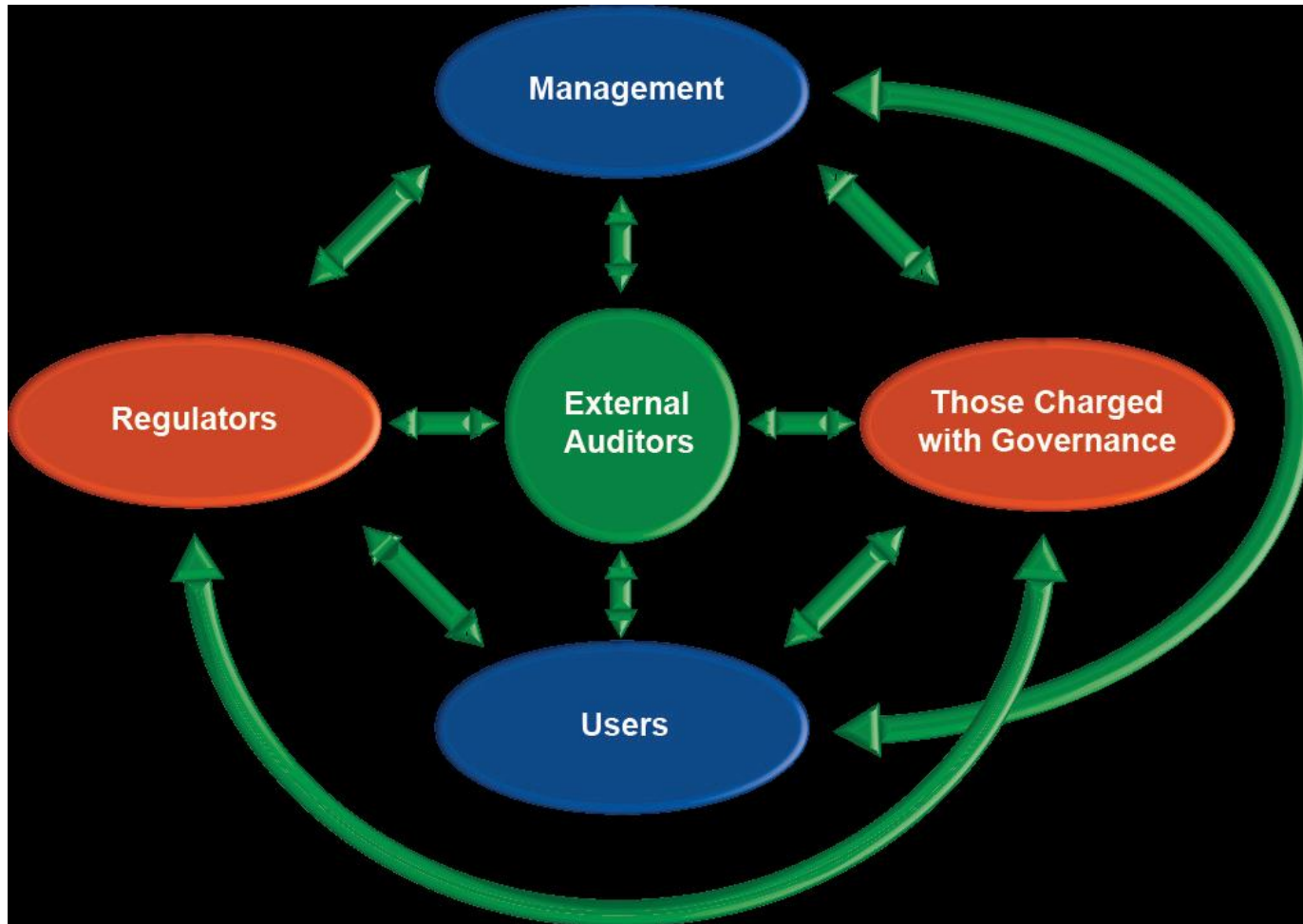
# Interactions of key stakeholders:

## Cont..

**There should be effective Interactions Between:**

- Auditors and management, those charged with governance, users, regulators
- Management and those charged with governance, regulators, users
- Those charged with governance and regulators, users
- Regulators and users.

# Important Interactions



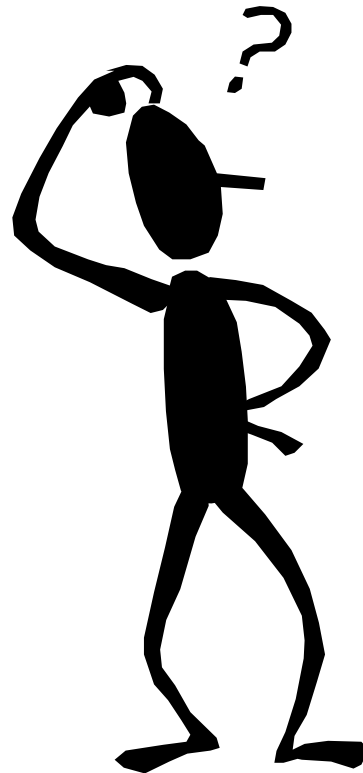
# Context:

- There are a number of contextual factors that can facilitate financial reporting quality, including **corporate governance** and the applicable **financial reporting framework**.
- The contextual factors, including **legislative and regulatory requirements**, also shape the interactions among key stakeholders. These factors can also impact audit risk, the nature and extent of audit evidence required and the efficiency of the audit process.

# Context: ( Cont..)

- Business practices and commercial law
- Laws and regulations relating to financial reporting
- The applicable financial reporting framework
- Corporate governance
- Information systems
- Financial reporting timetable
- Broader cultural factors

# Interactive Session



# Wrap up

- Audit quality framework does not replace/substitute the ISAs.
- The framework gives general guidance on what key factors influence audit quality and it applies to all audits.
- Audit quality varies with the context of the audit in question.
- The level of interactions between key stakeholders in the financial reporting supply chain significantly influence the quality of audit.
- **Have you used/referred to or considered the framework in your daily work routine.....?**

# Presenter's Contact

## Presenter's Contacts

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THANK YOU