



2016 Annual Inspection Findings Survey

Deficient Audits Continue to Decline Slightly; Inconsistent Execution Still A Concern

March 3, 2017

IFIAR's annual Inspection Findings Survey shows a general decline in inspection finding rates; however, the high rates of findings continue to be of concern to IFIAR. The Survey notes similarities in the nature and extent of findings compared to the previous year. Overall, the results continue to show a lack of consistency in the execution of high quality audits and point to the continued need to address firm-wide systems of quality control, including in the critical area of auditor independence. IFIAR will continue its dialogue with the six largest network firms and its consideration of standard setting in the area of firm quality controls.

Robust root cause analysis and implementation of remedial actions are fundamental to raising the bar on audit quality. It is critical that firms implement processes that enable a timely, thorough assessment of recurring root cause issues – positive or negative – and take appropriate actions. IFIAR has observed that root cause analysis practices vary among the largest firm networks – and even within those networks – and has called for more consistent and robust programs in this area.

In 2015, IFIAR's Global Audit Quality Working Group (GAQWG) set a goal for the six largest network firms to reduce the number of deficient audits (those with at least one finding) reported by members of this Working Group in IFIAR's annual Survey by at least 25 per cent by 2019. Inspection findings are not the only measure of changes in audit quality. IFIAR will provide an update on progress with the next report in 2018.

Report on 2016 Inspection Findings

IFIAR 2016 Inspection Findings Survey summarizes key inspection results from the audits of listed PIEs, including systemically important financial institutions (SIFIs) and firm systems of quality control submitted by 36 IFIAR Members in jurisdictions around the world. Inspection findings for PIE audits are deficiencies in audit procedures that indicate that the audit firm did not obtain sufficient appropriate audit evidence to support its opinion, but do not necessarily imply that those financial statements are also materially misstated.

In the critical area of firm-wide quality control, too many audit firms continue to have high rates of inspection findings, including in the areas of engagement performance (49 per cent), independence and ethical requirements (40 per cent), human resources (31 per cent), and monitoring (28 per cent). Though the frequency of findings has decreased in every area of quality control, IFIAR believes more improvement is required. Firms should continue to explore practices to determine why recurring audit deficiencies continue and challenge existing quality controls to determine whether further system changes will drive more consistent audit execution.

Thirty-four IFIAR Members reported findings from their inspections of 855 audits of listed PIEs at 121 audit firms; 12 Members reported findings from their inspections of 35 audits of SIFIs. Some improvements have been noted, but IFIAR remains concerned about the frequency and total number of findings year over year. An unacceptably high 42 per cent of listed PIE audits and 49 per cent of SIFI audits inspected had at least one finding.

The inspection themes with the highest numbers of findings in individual audit engagements were largely consistent with the 2015 Survey. For audits of listed PIEs, these themes were accounting estimates, including fair value measurement (32 per cent), internal control testing (18 per cent), revenue recognition (13 per cent), and a new theme added to the 2016 survey, audit sampling (17 per cent). For SIFI audits internal control testing was a recurring theme.

This year's Survey results are derived from inspection reports issued during Members' most recent annual reporting periods ended June 2016, therefore it is important to note the Survey includes a lagging factor and may not reflect the state of the auditing profession at the current time. The Survey is not meant to measure empirically or for statistically significant changes in audit quality – rather, it provides a useful point of reference for discussions about the areas for improvement in audit performance and informs IFIAR's efforts to better evaluate the challenges in improving the reliability of the auditor's opinion regarding the financial statements.

Next Steps

In addition to the reduction target in inspection findings, IFIAR will continue to work directly with audit network leadership and the profession to discuss inspection findings, recurring audit quality themes and the firms' strategies and actions to improve audit quality overall.

IFIAR continues to monitor developments in audit quality, including conducting Surveys and engaging with the largest audit firm networks. Members expect audit firms to take actions that result in demonstrable quality improvements. The results of our Surveys inform IFIAR's collective efforts to promote audit quality globally, complementary to individual regulators' audit firm inspection and oversight regimes.

IFIAR will further discuss with standard setters how standards in the areas of most frequent inspection findings, such as quality controls, can contribute to more consistency and compliance in auditor behavior, along with other regulators and policy makers on issues raised through Members' inspections.

About IFIAR

Established in 2006, the International Forum of Independent Audit Regulators (IFIAR) comprises independent audit regulators from 52 jurisdictions representing Africa, North America, South America, Asia, Oceania, and Europe. Dedicated to serving the public interest and enhancing investor protection, IFIAR provides a platform for dialogue and information-sharing regarding audit quality matters and regulatory practices around the world, and promotes collaboration in regulatory activity. IFIAR's official observer organizations are the Basel Committee on Banking Supervision, the European Commission, the Financial Stability Board, the International Association of Insurance Supervisors, the International Organization of Securities Commissions, the Public Interest Oversight Board and the World Bank. For more information about IFIAR, please visit <www.ifiar.org>.