



# International Forum of Independent Audit Regulators

## Report on 2016 Survey of Inspection Findings

### March 2017

## 1 Highlights

In 2016, IFIAR conducted the fifth annual survey (“Survey”) of its Members’ findings from inspections of audit firms that are members of the six largest global audit firm networks. This report summarizes the results of the 2016 Survey, which reflects responses from 36 of IFIAR’s 52 Members. IFIAR is a membership organization of independent audit regulators from around the world that individually are responsible for the systems of recurring inspections of audit firms in their respective jurisdictions.

- In the critical area of **firm-wide systems of quality control**, the general trend of decreased rates of findings continued for most categories of findings. However, too many audit firms continue to have high rates of inspection findings. The following quality control elements are among those with high rates of inspection findings (of the audit firms inspected for the element, the percentage with at least one finding):

Engagement Performance	49%
Independence and Ethical Requirements	40%
Human Resources	31%
Monitoring	28%

- The Survey also collected data on findings from **inspections of individual audit engagements**. Inspected audits of listed public interest entities (PIEs) with at least one finding remained unacceptably high at 42%. The audit areas with the most frequent findings (based on the percentage of audits inspected in that area and with at least one finding) were:

Accounting Estimates, including Fair Value Measurement	32%
Internal Control Testing	18%
Audit Sampling	17%
Revenue Recognition	13%

- Responsibility for improving audit quality lies with audit firms. Root cause analysis is one of the key components in realizing such improvements. When a firm identifies why a behavior that impacts audit quality is occurring, it is more likely that the firm will be able to design and implement appropriate and responsive measures that either encourage those behaviors that support audit quality or remediate to prevent those that do not. The continued enhancement of root cause analysis should offer a better understanding of what drives audit quality. IFIAR expects that successful root cause analyses will enable firms to undertake more effective remedial action, and ultimately improve and sustain audit quality. IFIAR intends to continue its ongoing dialogue with the largest global audit firm networks and work toward the shared objective of improved audit quality.



## 2 Introduction

During 2016, IFIAR conducted its fifth annual survey of Member audit regulators' findings from their individual inspections of audit firms affiliated with the six largest global audit firm networks ("GPPC networks").<sup>1</sup> Thirty-six IFIAR Members provided the results of inspections of audit firms that are members ("member firms") of the GPPC networks. IFIAR's Survey includes results reported to the inspected firms during the twelve-month period ending in the middle of the Survey year (e.g., the 2016 Survey includes findings from reports issued during the year ended June 30, 2016).

IFIAR collected information about two categories of inspection activities – inspections of firm-wide systems of quality control (addressed in Section 3 of this report) and inspections of individual audit engagements (addressed in Section 4 of this report). A brief overview of these categories and highlights from the audit areas with the most findings reported in the 2016 Survey are provided below and in the Highlights Section of this report.<sup>2</sup>

Information gained through the Survey contributes to IFIAR's efforts to provide a platform for knowledge sharing and collaboration in pursuit of its Members' common objective of high-quality audit performance. Within its membership, 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 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 a shared understanding of a finding as defined for purposes of the Survey, thus providing ongoing improvement in the consistency in reporting for IFIAR Survey purposes.<sup>3</sup> The Survey also is constructive for IFIAR's engagement with outside organizations that have an interest in audit quality. Insights from the Survey form part of IFIAR's regular dialogues with the GPPC networks and with international organizations such as the Financial Stability Board. In addition, IFIAR utilizes information learned through the Survey to inform its ongoing work to promote the development of high-quality international standards of auditing and of ethics for professional accountants.

The purpose of IFIAR's Survey is not to measure empirically changes in audit quality. However, Members were asked in the 2016 and 2015 Surveys to indicate how they measure such changes.

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<sup>1</sup> Each of the GPPC networks is comprised of a group of legally separate firms operating locally in countries around the world. The GPPC networks participate in the Global Public Policy Committee (GPPC), represented by the following entities: BDO International Limited, Deloitte Touche Tohmatsu Limited, Ernst & Young Global Limited, Grant Thornton International Limited, KPMG International Cooperative, and PricewaterhouseCoopers International Limited.

<sup>2</sup> Annex A provides additional information about IFIAR and the Inspection Findings Survey. Additional details about the results of the 2016 and prior Surveys are included in Annex B.

<sup>3</sup> See Annex A, page A-2 for the definition and descriptions of "findings" for purposes of the Survey.



Certain Members indicated that they measure changes from a national perspective by the *number* of inspection findings; many also indicated that the relevant measure is the *nature* of findings. The number of findings should not be the sole means to evaluate the information reported in IFIAR's Survey. Audit deficiencies identified and reported over the course of an inspection are not intended to serve as "balanced score cards" or overall rating tools. While an individual regulator may have the ability to assess the nature and severity of its findings, the Survey does not provide this level of detail.

IFIAR also cautions against empirical review of the data because of variations across Survey years in the composition of audit firms inspected and the topics of focus in certain Members' inspection programs. Some Members, for example, may focus on different themes between inspection cycles, such that some inspection themes may receive varying levels of inspection attention across Survey years. Further, though the Members responding were largely consistent for the 2016, 2015, and 2014 Surveys, there are differences in composition across Survey years.<sup>4</sup>

In addition to the caveats outlined above, further background relevant to understanding the information presented in this report, including definitions of a "finding" and "frequency" of findings, is provided in Annex A. Despite the limitations in the Survey data as described in Annex A, the recurrence and level of findings reflected in the Survey indicate 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.

### Firm-wide Systems of Quality Control

Inspections performed on firm-wide systems of quality control address those policies and processes established by audit firms that affect the quality of their audits, including by monitoring for compliance with independence requirements. For most quality control areas reported in the 2016 Survey, the percentage of inspected firms that had findings generally was lower than reported in prior Surveys. (See Section 3 for further details.) Though the rates of findings decreased, IFIAR regards their continued frequency as an indication that further improvement is needed, and plans to continue its dialogue with the GPPC networks and consideration of standard setting in this area.

The dialogue with the GPPC networks focuses on how they use the results of their monitoring programs, including internal inspections and root cause analyses, to identify ways to strengthen their systems of quality control. An effective internal quality monitoring function is essential for a firm to identify and understand the factors giving rise to audit deficiencies. This better positions a firm to take responsive actions to improve audit quality. Further, auditor independence is a critical aspect of

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<sup>4</sup> Of the Members reporting in the 2016 Survey, 13 indicated that they inspect each Big Four firm each year; these Members account for 81% of the total inspected listed PIE audits reported on in the 2016 Survey. Seven Members indicated they inspect the non-Big Four GPPC networks annually. To better understand the impact of changes in reporting Members, IFIAR determined that 23 Members had reported inspection findings on listed PIE audits for each of the past three Survey years (2014-2016). Responses from these 23 Members account for 93% of the listed PIE audits inspected and reported on in the 2016 Survey, and 96% of the inspected listed PIE audits in the 2015 and 2014 Surveys. See Annex A for further information.



auditor objectivity. The high frequency of findings in this area is of concern to IFIAR and will remain a matter for attention.

## Inspections of Individual Audits

IFIAR collected data through the 2016 Survey on the results of inspections of individual audit engagements. Thirty-four IFIAR Members reported findings from their inspections of 855 audits of listed PIEs at 121 audit firms. These Members reported that 42% of the listed PIE audits inspected had at least one finding; the rate of inspected listed PIE audits with findings reported in the 2015 Survey was 43%.<sup>5</sup> The four inspection themes with the most findings in the 2016 Survey are Accounting Estimates, including Fair Value Measurement; Internal Control Testing; Revenue Recognition; and a new theme added to the 2016 Survey, Audit Sampling.<sup>6,7</sup> IFIAR Members provided supplemental detail on the nature of findings in key areas with recurring, high frequencies of inspection findings. (See Section 4 of the report for additional details on inspections of listed PIEs audits.)

To provide further data specific to audits of systemically important financial institutions (SIFIs), twelve IFIAR Members reported findings from their inspections of 35 audits of SIFIs; 49% of the SIFI audits inspected had at least one finding. The two areas with the most frequent findings from inspections of SIFI audits were the Use of Experts and Specialists and Internal Control Testing.

IFIAR provided additional guidance on the determination of which financial institutions should be included as SIFIs for purposes of reporting in the Survey. This, along with individual IFIAR Members' determination of which firms and audits to inspect during the years covered by this Survey, resulted in a decrease in the number of SIFI audit inspections reported in the 2016 Survey. (See Section 4 of the report for additional details on inspections of SIFI audits.)

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<sup>5</sup> It is important to note that an inspection at the engagement level addresses the procedures performed by the auditor. A finding from an inspection of the audit does not necessarily indicate that the financial statements are misstated; therefore, it is important to recognize that the frequency of findings addressed in this report is not indicative of the frequency of financial statement misstatements. IFIAR has not sought to quantify misstatements associated with Member findings because 1) the transparency and manners of addressing errors in financial statements vary in Members' jurisdictions, including in some cases not restating and 2) the regulatory mandates of many IFIAR Members do not extend to the determination of whether or not financial statements are misstated.

<sup>6</sup> The description of the theme "Accounting Estimates, including Fair Value Measurement", was revised for the 2016 Survey. Previously, the description was "Fair Value Measurement". Findings previously reported under the separate themes of "Fair Value Measurement" and "Audit of Allowance for Loan Losses" in the 2012-2015 Surveys now are reported under the "Accounting Estimates, including Fair Value Measurement" theme.

<sup>7</sup> The theme "Audit Sampling" was added to the 2016 Survey in order to improve the identification of this recurring area of inspection findings. In prior Survey years, findings related to audit sampling may have been reported under other themes (for example, Revenue Recognition or Inventory) based on the audit area in which sampling was performed. IFIAR has not sought to reclassify prior Survey years' sampling findings.



As described in IFIAR's report on the 2015 Survey, IFIAR's Global Audit Quality (GAQ) Working Group and the GPPC networks undertook an initiative aimed to reduce the frequency of inspection findings. In accordance with a target established by the GAQ Working Group, the GPPC networks seek to improve audit performance, reflected in a decrease of at least 25%, on an aggregate basis across the GPPC networks over four years, in the percentage of their inspected listed PIE audits that have at least one finding. Measurement of the targeted reduction at the end of four years will use as a baseline the 2015 Survey results of 39% reported by the nine GAQ Working Group members. When the GAQ Working Group began this initiative, it planned not to report annually the percentage of audits inspected with findings; this was in recognition that actions taken by the firms at the time the initiative was announced, or that are already underway, would not necessarily be reflected in the 2016 Survey results. As reflected above and in Annex A, inspection findings are not the sole measure of changes in audit quality. Further, variation in inspection activity between years may cause analyses of changes over short time periods to be an incomplete indication of progress. For these and other reasons, IFIAR plans to report on progress in connection with the 2017 Survey for information and with the 2019 Survey. Those future Surveys, respectively, correspond with the mid- and end-points of the four-year measurement period. The GAQ Working Group's reduction target and other IFIAR initiatives to improve audit quality are described in Section 6 of this report.

### 3 Findings on Firm-wide Systems of Quality Control

Under international standards on quality control, as well as many of the national standards in place in IFIAR Member jurisdictions, audit firms are required to establish a system of quality control. A system of quality control involves a firm's organizational structure and the policies and procedures in place to provide reasonable assurance that 1) the firm and its personnel comply with professional standards and applicable legal and regulatory requirements and 2) reports issued by the firm or engagement partners are appropriate in the circumstances.

Through its Surveys, IFIAR collects information on inspection findings specific to a firm's system of quality control. For purposes of the Survey, quality control findings are departures from quality control or ethics standards, or from independence requirements, that may have had an effect on audit quality due to the significance or the systemic nature of the departure. The Survey's categories or inspection themes for quality control findings are based on the different elements of ISQC 1.<sup>8</sup> Inspections of firm-wide systems of quality controls address topics such as systems and processes to manage compliance with auditor independence requirements; procedures to assess risk before accepting or continuing an audit engagement; and personnel systems regarding staff development, promotion, and work assignments.

<sup>8</sup> See International Auditing and Assurance Standards Board (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*. ISQC 1 is required in many, but not all, IFIAR Member jurisdictions.



Specific engagement-level findings are reported in the listed PIE section of this report. Quality control findings addressed in this section of the report do not relate to specific audit engagements, but instead address the policies and procedures in place at the audit firm to provide for overall quality control. Quality control findings are more systemic in nature and therefore are relevant to the firm's audit practice. There is, however, an interaction between engagement-level and quality control findings. While quality control findings are attributed to a firm in general, deficiencies in its quality control system may impact the firm's environment for individual audit engagements. Consequently, a deficient system of quality control would likely be manifested in engagement-level findings. In addition, issues observed in inspections of specific engagements determined to be systemic (not engagement-specific) in nature may be considered Engagement Performance quality control deficiencies.

Thirty-three Members reported the results of their inspections of firm-wide systems of quality control in 2016 at 127 member firms of the GPPC networks. Members inspecting these audit firms did not necessarily report on each quality control theme included in the IFIAR Survey, as some Members select specific areas for inspection of quality control at the firm level and do not inspect all elements during the annual Survey period.

**Table 1 Quality Control 2016 Survey Results: Audit Firms with at Least One Finding and Total Findings by Inspection Theme**

Inspection Theme	Audit Firms with at Least One Quality Control Finding		Total Number of Findings
	#	%	
Engagement Performance	55	49%	202
Independence and Ethical Requirements	43	40%	72
Human Resources	29	31%	76
Monitoring	29	28%	81
Client Risk Assessment, Acceptance, and Continuance	26	25%	48
Leadership Responsibilities for Quality within the Firm	12	12%	18
			497





The following table sets forth the results by quality control inspection theme over the past three Surveys regarding the percentage of firms with at least one finding.

**Table 2 Quality Control 2016 Survey Results: Percentage of Audit Firms with at Least One Finding by Year and by Inspection Theme**

Inspection Theme	Percentage of Audit Firms with at Least One Quality Control Finding		
	2016	2015	2014
Engagement Performance	49%	59%	60%
Independence and Ethical Requirements	40%	40%	48%
Human Resources	31%	36%	45%
Monitoring	28%	33%	34%
Client Risk Assessment, Acceptance, and Continuance	25%	30%	33%
Leadership Responsibilities for Quality within the Firm	12%	12%	19%

Though the frequency of findings has decreased in every area of quality control, IFIAR believes more improvement is warranted. Additionally, the lower frequency of quality control inspection findings has not yet been reflected in sufficiently decreased levels of findings from inspections of individual audit engagements. Firms should continue to explore practices to determine why recurring deficiencies continue and to challenge the adequacy of their current systems of quality control to determine whether further changes to these systems will drive improved audit quality.

In the 2016 Survey, Members reporting quality control findings were asked, where possible, to provide additional details on the nature of findings in the areas of Engagement Performance, Independence and Ethical Requirements, Human Resources, and Monitoring. IFIAR selected these areas because they have had the highest frequency and/or number of quality control findings reported in past Surveys. IFIAR sought additional details about these findings as part of its effort to understand better, at a global level, the nature of systemic quality issues that may impact the continuing high level of engagement findings reported in IFIAR's Surveys. Members provided supplemental details about a majority of the findings in these areas. Highlights of areas with larger numbers of findings reported are provided below, with more complete information listed in Annex B.

**Engagement Performance (202 findings):** Nearly half of the findings in this area related to the failure to establish policies and procedures for **engagement quality control review** that provides an objective evaluation of the significant judgments made by the engagement team. Other findings related to **audit methodology and guidance**.

**Independence and Ethical Requirements (72 findings):** Two types of findings made up over half of the Survey findings in this area. One related to failures to consider and evaluate **non-audit and/or**



**audit-related services** provided to the audited entity. The second related to failures to monitor effectively compliance by firm staff and partners with **personal independence requirements**.

**Human Resources (76 findings):** Findings in this area were less concentrated by type of findings. Notable themes include matters concerning **engagement team assignments** and the evaluation of audit quality as part of **partner performance evaluations and admissions**.

**Monitoring (81 findings):** Approximately half of the Monitoring findings related to **root cause analysis / remedial actions**. This area of quality control activity has received increased attention by IFIAR, in particular through its annual inspection workshops and the GAQ Working Group's discussions with the GPPC networks (see further discussion at Section 5 of this report). Reported findings also include failures to identify audit performance issues when performing **internal inspections** in order to effectively monitor audit quality and respond to possible related systemic deficiencies. The GAQ Working Group discusses the GPPC networks' internal quality monitoring programs at regular meetings (see further discussion at Section 6 of this report).

## 4 Audit Engagement Inspection Findings

### Audits of Listed PIEs

Thirty-four IFIAR Members reported findings from their inspections of 855 audits of listed PIEs performed by 121 audit firms. Forty-two percent of the audits inspected had at least one finding.

Since the Survey's inception, IFIAR has understood and communicated in its Survey reports that the data may not reflect the current state of audit performance. This is in part due to the time necessary, after completion of a financial statement audit, for the inspection to occur and for the inspected firm and the audit regulator to complete any required processes that precede issuance of a final inspection report. Members are instructed to submit data related only to final inspection reports issued to audit firms by June 30 of the Survey year. As a result of this reporting time lag, actions undertaken to improve audit quality may not be reflected immediately in IFIAR's published Survey results.

To better understand the extent of the time lag, IFIAR asked Members to indicate the financial statement fiscal year ends for the listed PIE audit inspections reported in the 2016 Survey. Two-thirds of the inspected listed PIE audits relate to financial statement fiscal year ends of 2015 or 2014. See Annex B for additional details.

Through the Survey instructions, when determining under which theme to report individual findings, Members are asked to identify the one theme that best describes an inspection finding. However, many inspection findings involve multiple aspects of an audit; in these cases, IFIAR Members must make judgments when submitting data for the Survey. For example, insufficient risk assessment may result in an inappropriate approach to audit sampling. Improper supervision and review, including engagement quality control review (EQCR), may allow the deficient audit performance to remain unaddressed. Because IFIAR Members select one theme under which to report a finding in the Survey, data presented in this report is likely to simplify instances of interactions between various





aspects of an audit and the issues that may underlie audit deficiencies. IFIAR promotes consistency in reporting by providing examples and detailed Survey instructions; however, the judgments made by individual IFIAR Members may differ when selecting the one theme under which to report the finding. Information in the report should be understood as one reference point in addressing the interrelated activities and factors that together impact overall audit quality. Despite these limitations, the recurrence and level of findings in inspection themes reported in the Survey provide useful context for discussions about areas for improvement in audit performance. The table below includes 2016 Survey information about listed PIE audit inspections.

**Table 3 Listed PIE Audits 2016 Survey Results: Inspected Audits with at Least One Finding and Total Findings by Inspection Theme**

Inspection Theme	Percentage of Listed PIE Audits with at Least One Finding	Number of Listed PIE Audits with at Least One Finding	Number of Listed PIE Audits in which the Topic was Inspected	Number of Findings (a single PIE may have multiple findings for the same theme)
Accounting Estimates, including Fair Value Measurement	32%	166	514	258
Internal Control Testing	18%	124	689	278
Audit Sampling	17%	85	507	109
Revenue Recognition	13%	88	680	105
Substantive Analytical Procedures	13%	47	368	65
Inventory Procedures	12%	38	329	43
Group Audits	11%	44	408	53
Adequacy of Financial Statement Presentation and Disclosure	9%	48	539	53
Use of Experts and Specialists	9%	25	284	27
Related Party Transactions	6%	12	205	12
Engagement Quality Control Review	6%	20	361	20
Adequacy of Review and Supervision	5%	21	406	22
Risk Assessment	5%	39	815	51
Fraud Procedures	5%	26	568	35
Going Concern	4%	9	224	12
Audit Report	3%	14	438	18
Audit Committee Communications	2%	9	508	10
				1,171

In the 2016 Survey, Members were asked to provide additional details regarding findings in the areas of Accounting Estimates, including Fair Value Measurement; Internal Control Testing; and Revenue Recognition. These areas were selected for supplemental information based on their recurring, high frequency of inspection findings shown in past Surveys. Many, but not all, IFIAR Members



participating in the Survey provided supplemental detail about their findings. Highlights of areas with larger numbers of findings reported are provided below, with more complete information listed in Annex B.

**Accounting Estimates, Including Fair Value Measurement (258 findings):** Nearly half of the findings related to failures to assess the **reasonableness of assumptions** including consideration of contrary or inconsistent evidence where applicable. Other areas with findings include failures to perform sufficient **risk assessment** procedures, to test sufficiently the **accuracy of data** used, or to take **relevant variables** into account.

Members provided additional information about the balance sheet accounts most frequently associated with findings in the area of Accounting Estimates. Audits of accounting estimates related to **Goodwill and Indefinite Lived Assets** had the most findings. **Property, Plant, and Equipment** was the next most commonly cited area with Accounting Estimates findings, followed by **Investments and Securities**.

**Internal Control Testing (278 findings):** The category of internal control testing with the most findings was the failure to obtain sufficient persuasive evidence to support **reliance on manual internal controls**. The failure to sufficiently **test controls over, or the accuracy and completeness of, data or reports** produced by management was observed in a number of cases and, to a lesser extent, the failure to test sufficiently **information technology general and application controls**.

**Revenue Recognition (105 findings):** Findings in this area were less concentrated by type. Reported findings relate to the failure: to appropriately assess and respond to the **risk of fraud** in revenue recognition; to perform procedures to determine whether revenue was recorded in the **appropriate period**; and to understand sufficiently the terms and conditions of **complex arrangements** and the impact on the accounting.

## Audits of SIFIs

IFIAR Surveys request that Members report findings related to financial institutions deemed to be systemically important in their respective jurisdictions. SIFIs are both listed and non-listed financial institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity.

Twelve IFIAR Members reported findings from their inspections of 35 audits of SIFIs. Forty-nine percent of the SIFI audits inspected had at least one finding. Most of these SIFIs are banks, though a number of audits of insurers also were inspected.

Globally, the number of SIFIs is significantly smaller than the number of listed PIEs. The small number of SIFIs in certain jurisdictions may introduce confidentiality considerations that prevent a Member from reporting SIFI inspection results for purposes of the Survey. Further, in some jurisdictions, the IFIAR Member responsible for audit oversight of listed PIE audits may not have authority for oversight of financial institution audits. Finally, for the 2016 Survey, IFIAR provided



additional guidance to assist Members' identification of which financial institutions are considered to be systemically important in their jurisdiction; this effort was designed to collect more targeted data specific to this important category of reporting companies with aspects of financial reporting that require extensive judgment and estimates and, therefore, present particular audit considerations. For these reasons, the Survey reports on a significantly lower number of inspected SIFI audits than of inspected listed PIE audits.

IFIAR collects information on 15 inspection themes for SIFIs; nine of these themes are the same as for listed PIEs and address issues common to both SIFI and listed PIE engagements. In addition to these nine common inspection themes, IFIAR collects inspection results in six audit areas that are more relevant when auditing a financial institution. Most of these six areas address aspects of the Accounting Estimates, including Fair Value Measurement theme reported for listed PIE audits (e.g., Testing of Customer Deposits and Loans or Valuation of Investments and Securities). The SIFI themes, in summary, are tailored to provide supplemental insight into unique SIFI audit situations. Because of the larger number of themes relevant to Accounting Estimates, the frequency numbers may be lower than if the related SIFI audit inspection results were reported collectively as Accounting Estimates findings.



**Table 4 SIFI Audits 2016 Survey Results: Inspected Audits with at Least One Finding and Total Findings by Inspection Theme**

Inspection Theme	Percentage of SIFI Audits with at Least One Finding	Number of SIFI Audits with at Least One Finding	Number of SIFI Audits Inspected	Number of Findings (a single SIFI may have multiple findings for the same theme)
Use of Experts and Specialists	31%	5	16	6
Internal Control Testing	25%	8	32	10
Audit of Insurance Contract Liabilities	17%	2	12	2
Audit Methodology, including Programs and Tools	16%	3	19	5
Fraud Procedures	16%	3	19	3
Valuation of Investments and Securities	15%	3	20	3
Testing of Customer Deposits and Loans	14%	3	21	3
Insufficient Challenge and Testing of Management's Judgments and Assessments	14%	3	22	3
Substantive Analytical Procedures	13%	3	23	3
Audit of Allowance for Loan Losses and Loan Impairments	12%	3	25	3
Adequacy of Financial Statement Presentation and Disclosure	8%	2	25	2
Audit Report	8%	2	25	2
Group Audits	7%	1	15	1
Audit Committee Communications	0%	0	27	0
Risk Assessment	0%	0	26	0
				46

Because of the number of SIFI audits inspected, the frequency percentages above could be impacted notably by a small change in the number of SIFI audit inspections reported in the Survey; they therefore should not be considered indicative of SIFI audit inspection findings more broadly. Further information about SIFI audit inspection findings is available at Annex B.

## 5 Root Cause Analysis

IFIAR views robust root cause analysis and implementation of responsive actions to be fundamental to improving audit quality. The high frequency of inspection findings indicates the importance of efforts toward enhanced audit quality. Improvement requires an understanding of factors causing deficiencies. It also benefits from identifying characteristics of well-executed audits. It is therefore critical that firms have processes in place that enable a timely, thorough assessment to identify recurring root cause issues – whether positive or negative – and to take appropriate actions.



This is why IFIAR seeks, through its engagement with the GPPC networks, to address the need for a deeper understanding of the causal factors that lead to ongoing audit quality challenges. IFIAR emphasizes at the GPPC network level the importance of audit firms' attention to root cause analysis approaches that do not stop with identification of superficial explanations, but that challenge auditors to identify actual root causes.

For several years, IFIAR's GAQ Working Group has discussed with the GPPC networks their efforts to identify causal factors behind inspection findings, plan actions that address the underlying causes, and establish processes to monitor the effectiveness of those actions. These discussions have focused on understanding the processes developed at the global level for use by member firms, and on the priority global leadership places on promoting audit quality through the root cause analysis process.

Many IFIAR Members similarly have undertaken their own initiatives at the national level to address root cause analysis at the member firms these Members oversee. To assist and to promote all IFIAR Members' awareness of developments in the area of root cause analysis, the GAQ Working Group seeks to share within IFIAR the insights gained through its discussions with the GPPC networks. Through knowledge-sharing on root cause practices, national audit regulators are better positioned to evaluate member firms' implementation of those and other relevant programs to improve audit quality locally.

The level of attention the networks place on their discussion with the GAQ Working Group about root cause analysis demonstrates the networks' commitment to a dialogue on improving audit quality. The discussions have become increasingly detailed in recent years, and the GAQ Working Group has observed progress by the GPPC networks in implementing measures to expand and enhance root cause analysis.

The GAQ Working Group meets primarily with senior audit representatives of the GPPC networks. The GAQ Working Group asks these representatives to address initiatives undertaken at the global level, illustrated by examples of national-level implementation of those measures. During 2016, each GPPC network discussed with the GAQ Working Group common root causes and responsive action plans to address recurring issues in four audit areas with frequent inspection findings: Accounting Estimates, including Fair Value Measurement; Group Audits; Internal Control Testing; and Revenue Recognition.

A recurring challenge observed by the GAQ Working Group is that causal factors can be specific to a situation and therefore are difficult to address at a general level. While discussions around specific areas of recurring audit deficiencies have been productive, the main focus needs to remain on understanding the processes being implemented throughout the GPPC networks and on how they are probing deeply to find systemic causes that are not case-specific.



## Networks' Root Cause Approach

Each GPPC network has informed the GAQ Working Group that it has established guidance to assist member firms in conducting root cause analysis. Application of the guidance is not necessarily mandatory but is strongly expected. Member firms generally are not limited to the guidance provided by the network; additional procedures are sometimes incorporated at the member firm level.

Root cause analysis is primarily the responsibility of the individual member firm. Often, the GPPC network plays a role beyond providing guidance, for example offering training on the guidance and sometimes making additional resources available to the member firm. The GPPC network may assist in sharing examples of national initiatives between member firms, providing feedback on national initiatives, and monitoring the overall impact of actions undertaken.

Findings from the networks' internal quality monitoring program are subjected to root cause analysis; typically, findings from external inspections (e.g., by an independent audit regulator) are also analyzed. The nature and severity of findings may factor into whether a root cause analysis is performed.

Efforts to identify and conduct root cause analysis on positive quality events are more limited, though practices are evolving in this area. Some GPPC networks have encouraged such analysis, or are refining processes to include evaluation of high-quality audits. The GAQ Working Group is interested in continuing to hear from the GPPC networks about their progress in identifying attributes of high-quality audits.

The GAQ Working Group has asked each GPPC network about measures or indicators of audit quality they are tracking. Many GPPC networks measure the proportion of hours spent on an audit engagement by the audit partner and senior staff, and the relevant experience of these individuals (e.g., industry expertise and years of work experience) for tracking as indicators of audit quality. Another consideration the GAQ Working Group has addressed with each GPPC network is the timing and effort put into individual phases of the audit, such as during planning, and work done before, close to, or after the balance sheet date of the audited financial statements. The GAQ Working Group intends to continue its dialogue with the GPPC networks about their experiences with measures and indicators of audit quality.

The GPPC networks have indicated to IFIAR that they continue to develop frameworks to assist member firms' monitoring of root cause analysis with a goal of enhancing rigor, quality and consistency of root cause analysis across the networks. A common practice is for firms to group and evaluate findings to identify systemic issues in need of attention. This often is done at the member firm level, but some GPPC networks also seek to evaluate recurring audit deficiencies across their network.

Another area of evolving practice, which has been encouraged by many audit regulators, is the development of action plans and monitoring actions for effectiveness. Monitoring for effectiveness primarily occurs at the member firm level, though in many cases the member firm's work is subjected to review by the GPPC network. National audit regulators increasingly are emphasizing the importance of monitoring actions for effectiveness so that audit firms identify on a timely basis those





actions that do not have the desired impact, and make adjustments accordingly. Further, early identification of effective measures may be informative to proactive efforts to improve audit quality.

While it is helpful to understand expectations and programs developed at the global level of the GPPC networks, root causes analysis is implemented at the member firm level. The GAQ Working Group shares insights on global-level programs with other IFIAR Members so that individual audit regulators can consider this network-level information when developing expectations of the member firm-level root cause analysis programs. In addition to guidance at the global level, member firms may, and in some cases do, implement root cause processes and practices that go beyond what is required by the GPPC network. The GAQ Working Group expects that pressing GPPC network leadership to promote robust root cause analysis by their member firms, combined with national-level attention by audit regulators to the rigor of implementation and monitoring, will retain focus on continual improvement in audit quality. IFIAR's annual inspection workshop is one way of increasing individual IFIAR Members' understanding of root cause analysis processes and practices. At the workshops, root cause analysis is a regular topic offered for discussions among inspectors; this promotes knowledge sharing and provides an opportunity to hear the experiences of inspectors familiar with individual audit firms' practices in this evolving area.

### Root Cause Analysis at the National Level

IFIAR Members were asked in the 2016 Survey to provide information on their interactions about root cause analysis with member firms of the GPPC networks. Not all Members responding to the Survey provided information on this subject. However, the responses received were largely consistent with discussions between IFIAR's GAQ Working Group and representatives of the GPPC networks. Members' responses reflect their individual observations or experiences, and are not intended to indicate an IFIAR view or recommended practices.

A number of Members' responses indicated that root cause analysis is mandated by either the audit regulator or another body external to the audit firm, while other Members indicated they encourage, but do not require, root cause analysis.

Several Members observed that, with respect to the larger networks, root cause analysis generally was performed in accordance with network guidance. In some instances, inspectors observed interactions between global resources and the local firm's implementation of root cause analysis (for example, through training or assistance in reviewing analyses or remediation plans). These observations were less frequent with respect to smaller networks.

Members responding generally observed the member firms' increased attention over the past year to: 1) root cause analysis in general, 2) the development of remediation or action plans to address the identified root causes, and 3) monitoring actions taken to assess effectiveness. This change was observed more in the larger networks. Further, these Members indicated that root cause analysis was formally documented, was typically performed only to investigate significant findings, and often was performed on findings from internal as well as external regulatory inspections.



Members' responses varied more with respect to the adequacy and effectiveness of root cause analysis. This variability was seen in response to questions about whether the firms: 1) adequately addressed the root causes underlying audit deficiencies, 2) monitor the actions taken to determine the effectiveness of those actions, and 3) revised plans when actions taken are determined not to be fully effective.

In some cases, IFIAR Members indicated that they perform their own root cause analysis of key external inspection findings. Some Members share the analysis with the firm, and request that the firm prepare and communicate an action plan in response.

IFIAR anticipates that root cause analysis, including firm efforts to establish and maintain an effective process for continual monitoring, will continue to be a leading topic for discussion with the GPPC networks. The GAQ Working Group remains interested in the GPPC networks' efforts to identify those characteristics of high-quality audits that can be better understood and replicated, to the extent feasible. The GAQ Working Group aims to share with IFIAR Members insights gained on these and other topics that address audit quality.

## 6 Other Related IFIAR Activities

IFIAR is focused on achieving its mission of improving audit quality through collaboration among those who are charged nationally with auditor oversight and with other stakeholders. The annual Survey of Inspection Findings informs this mission and contributes directly to certain IFIAR activities. This is specifically true with respect to IFIAR's dialogue with the GPPC networks, content development for annual inspection workshops, and consideration of the agendas and projects of international audit-related standard setters.

### Dialogue with the GPPC networks

IFIAR engages with the GPPC networks on a range of topics that impact audit quality. Discussions with the GPPC networks at IFIAR plenary meetings and at meetings with the GAQ Working Group have included topics such as how changes in the economic environment and the market for audit services have impacted or may in the future impact the audit industry and audit quality, the expanded auditor's report, and developments in technology used in audits. These discussions go beyond analysis of past audit and inspection results to consider developments and trends that currently do, or may in the future, affect audit. IFIAR also engages with the GPPC networks about their timely monitoring of audit performance, including about inspection findings.

Each GPPC network has discussed with the GAQ Working Group the key elements of their internal quality monitoring programs. Each GPPC network requires internal inspections of member firms. Internal inspections address firm-wide quality controls and reviews of individual audit engagements. Prior year inspection results generally factor into development of training content, as well as identification of focus areas. GPPC networks provide training annually to member firms' staff involved in internal quality reviews. Additionally, to promote consistency in approaches, all GPPC networks



have made tools and resources available to member firms, and all require use of standardized templates to report results. Examples of tools include standardized questionnaires and web-based applications. All GPPC networks determine severity of individual findings, and apply a rating to each engagement file based on a review that differentiates between levels of compliance. Each GPPC network monitors those reviews for consistency, and can serve as a resource available to individuals involved with member firm internal reviews. In each GPPC network, global leadership receives the results of, at a minimum, inspections of audits determined to be non-compliant.

Annually, the GPPC networks each provide the GAQ Working Group a summary of the results of internal inspections, with discussion about differences between the results of internal and regulators' external inspections. These discussions are part of an ongoing dialogue about key areas of recurring findings, intensified as part of an initiative that began in 2015 between the GAQ Working Group and the GPPC networks. The objective of this initiative is to achieve a significant improvement in audit quality across all IFIAR Members' jurisdictions, indicated by decreases in future regulatory inspection findings.

The GAQ Working Group expects that, based on data to be reported in the 2019 Survey by the GAQ Working Group members, the number of listed PIE audit engagements with one or more inspection finding should decrease by at least 25% from 2015 Survey levels on an aggregate basis across the firms that are part of the GPPC networks. The GAQ Working Group will measure progress specifically related to findings reported by the nine members of the GAQ Working Group, using the results reported in the 2015 Survey (39%) as the baseline for measurement. When the GAQ Working Group agreed upon this initiative with the GPPC networks, it planned not to report annually the percentage of audits inspected with findings over the four years of this initiative; this was in recognition that actions taken by the firms at the time the initiative was announced, or that are already underway, would not necessarily be reflected in the results of this Survey.<sup>9</sup> The GAQ Working Group plans to report on progress in connection with the 2017 Survey for informational purposes and again at the four-year mark using data from the 2019 Survey. Further, IFIAR recognizes that inspection findings are not the sole measure of progress in audit quality. The 25% reduction goal does, however, provide a measurable target for the collective results of the GPPC networks' respective efforts to improve audit quality. IFIAR believes that the GPPC networks' aggregate achievement of the minimum 25% goal would be a meaningful indication of progress along the longer-term path toward greater improvement in audit quality.

## Inspection Workshops

The core activity common to independent audit regulators that are IFIAR Members is the ongoing inspection of audit firms. Through its Inspection Workshop Working Group, IFIAR organizes an annual inspection workshop for those Members involved in inspection activities. The annual workshop addresses a number of inspection-related topics. A robust inspection workshop is central to IFIAR's aim to enhance investor protection by contributing to audit quality improvements through

<sup>9</sup> See Annex B, Section 2 for information on the time lag between audit execution and reporting of results in a Survey.



improved inspections. With Members from around the world, IFIAR is in a unique position to provide, through the workshop, a forum for audit regulators to discuss inspection approaches and to share experiences. This facilitates identification of similarities and differences in practices and, consequently, Members' respective consideration of additional measures that may develop their local inspection approaches further. The information from IFIAR's annual Survey, including the most frequent findings, is considered when deciding on the topics to be covered at each workshop. The annual workshop regularly includes a specific session to discuss the results of the most recent Survey.

### Supporting High Quality in Professional Standards

IFIAR is committed to improving audit quality globally through the promotion of high quality in auditing and professional standards. By providing insights from audit inspection activities of IFIAR Members, IFIAR provides a body of information that standard setters may find relevant to their deliberations. In addition, when standard setters seek public comment on particular issues or proposals, IFIAR considers the issues and frequently provides a perspective in a public comment letter. IFIAR in particular encourages standard setters' attention on whether the standards provide sufficient clarity regarding the requirements with which the auditor shall comply and whether the standards are driving auditors to consistent application and to exercise sufficient professional skepticism.

Inspection findings reported in the Survey generally relate to auditors' failures to comply with applicable standards or requirements. The fact that some auditors have failed to comply with applicable standards in a particular audit area does not in itself indicate a problem with those standards. Even so, IFIAR views inspection findings, and trends in those findings, as relevant to standard setters' consideration of whether standards governing particular audit areas might be changed or supplemented in ways that could result more consistently in high-quality audits globally. IFIAR has over recent years continuously encouraged the international standard setters to consider the themes identified in IFIAR Surveys in its standard-setting projects.<sup>10</sup> Standards that are robust, enforceable, and drivers of consistency are a means to enhance the quality of audits globally.

The IAASB has launched several projects which are related to areas where the levels of findings reported in previous IFIAR surveys were high. Those projects encompass the *audit of accounting estimates* (International Standard on Auditing (ISA) 540), *audit firms' systems of quality control* including engagement quality control review (ISQC 1 and ISA 220), *risk assessment and internal control* (ISA 315), *group audit* (ISA 600) and *professional skepticism*. The 2016 Survey results reflect that high frequencies of findings persist in those areas and continue to deserve the focus of the standards setters. IFIAR has encouraged the IAASB also to consider including the topics of *materiality*, *use of experts*, *response to assessed risks* and *analytical procedures* in future IAASB work plans, after having finalized the projects mentioned above.<sup>11</sup>

The IAASB and the International Ethics Standards Board for Accountants (IESBA) have expressed interest in understanding more about the nature of inspection findings. As IFIAR's collection and presentation of the Survey data evolves and becomes more detailed, it provides additional

<sup>10</sup> See IFIAR's 2014 Survey Report (page 17) and IFIAR's 2015 Survey Report (page 25).

<sup>11</sup> See IFIAR letter dated 11 October 2016 on the IAASB work plan for 2017 and 2018.



information for standard setters' reference. In the 2015 and 2016 Surveys, for example, IFIAR collected data on the types of findings in key areas with frequent inspection findings.<sup>12</sup> As another example, the 2016 Survey introduced a category that aggregates findings related to audit sampling; these sampling findings previously were included in other themes and therefore were not as identifiable.<sup>13</sup> The level of findings reported in this area is high and indicates this as a potential area for further evaluation by firms as they conduct root cause analysis. Information about the levels of audit sampling findings also may be of interest to standard setters as they consider the appropriateness of current standards and opportunities for enhancements.

The 2016 Survey also provides information about findings on quality control in the area of independence and ethics. The information about the areas of findings might be relevant for standards on quality control. The IESBA might find an interest in considering this information to determine whether the provisions in the IESBA Code of Ethics could contribute to drive further consistent and appropriate behavior by auditors globally.

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<sup>12</sup> See pages B-2 to B-3 of this report for details of findings for certain Quality Control areas and B-6 to B-7 for details of findings for certain inspection themes for listed PIE audits.

<sup>13</sup> See footnote 7 of this report for further explanations.



## Annex A: About IFIAR and the Inspection Findings Survey

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### About IFIAR

IFIAR is a membership organization of audit regulators that are independent from the audit profession.<sup>14</sup> IFIAR's membership includes 52 audit regulators 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.

An audit firm “network” is composed of individual audit firms that are members of a global organization. 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. The audit firms within the network often have a common name and common auditing, quality control, and ethics policies and requirements. The multinational aspects of audit, and the involvement of many local audit firms that are members of a global firm network, call for collaboration by regulators globally.

Through IFIAR, audit regulators seek to coordinate their understanding and assessments of trends in and challenges to audit quality. IFIAR's work positions its Members to evaluate the various issues discussed at the global level with the member firms in their own jurisdictions. 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.

### 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 global audit firm networks.<sup>15</sup> The aim of the Survey is not to

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<sup>14</sup> More information on IFIAR and its activities can be found at <https://ifiar.org/Home.aspx>.

<sup>15</sup> See [here](#) for past Survey reports. Prior to the 2015 Survey, Members also could choose to report inspection findings related to other firms considered significant in the reporting Members' jurisdictions (see footnote 10 of the 2015 Survey report for information about the impact of this change).





measure empirically, or for statistically significant, changes in audit quality; rather, the Survey indicates areas of common audit shortcomings and informs IFIAR's efforts to evaluate better the challenges to improving the reliability of the opinion expressed by the auditor at the conclusion of a financial statement audit.

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: (1) those related to audit engagements and (2) those related to audit firms’ firm-wide systems of quality control. With respect to audit engagement findings related to a financial statement balance or disclosure, a deficiency is either 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 material, or likely potential material, error in the application of an accounting principle. With respect to all other themes, a deficiency is a departure from auditing standards or requirements, including standards on quality control and ethics and independence requirements, that may or did have an effect on audit quality, either due to the significance or systemic nature of the departure. Quality control findings relate to processes and procedures employed on a firm-wide basis by the firm subject to inspection, rather than to work performed on specific audit engagements.

There may be a substantial passage of time from when an audit is completed until an inspection is performed, a final report issued, and the inspections results are reported in IFIAR's Survey. Because of this reporting time lag, actions already under way or taken now to improve audit quality may take time to be reflected in IFIAR's published Survey results. Therefore, the Survey is a lagging indicator and may not reflect the state of the auditing profession at the current time. (See Annex B for information collected in the 2016 Survey to understand the extent of the lag, indicating that two-thirds of the inspections reported in the 2016 Survey related to audits of listed PIEs' financial statements for years ended in 2015 or 2014.)

IFIAR Members are instructed not to report findings from more than one annual inspection cycle, and to report only on findings related to audit firms located in their jurisdiction. Therefore, the findings from no more than one inspection report per audit firm are submitted for the Survey.

All IFIAR Members are asked to respond to IFIAR's Surveys of inspection findings. The Surveys solicit data on Members' findings from inspections of:

- firms' firm-wide systems of **quality control**;
- audits of **listed PIEs**, including any listed SIFIs; and
- audits of **SIFIs**, whether or not a listed entity.<sup>16</sup>

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<sup>16</sup> The Survey also collected findings data on inspections of global SIFIs, or G-SIFIs. Due to national confidentiality limitations and the limited number of G-SIFIs, IFIAR does not publish the results of G-SIFI audit inspections but considers this information for internal purposes.



In all years, information was collected on the total number of inspection findings by inspection “theme”. Respondents reported findings categorized into 17 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 15 inspection themes relevant to audits of financial institutions. For each inspection theme, Members reported 1) the number of audits inspected, 2) the number of inspected audits with at least one finding, and 3) the total number of findings. The “frequency” of findings by theme is calculated as the number of inspected audits with at least one finding divided by the number of audits inspected for that theme. Findings from inspections of firm-wide systems of quality control were reported using six themes. For each quality control inspection theme, Members reported 1) the number of audit firms inspected, 2) the number of inspected audit firms with at least one finding, and 3) the total number of findings. The “frequency” of findings by quality control theme is calculated as the number of inspected audit firms with at least one finding divided by the number of audit firms inspected for that quality control theme.

The Survey also included questions about Members’ observations from their inspection activities, with particular focus on root causes analysis practices.

The approach taken for the 2016 Survey was generally consistent with that used in prior Surveys. IFIAR made four main changes from the 2015 Survey.

First, one new category was added for findings from inspections of listed PIEs audits, and one new category was added for findings from inspections of SIFIs.

- For listed PIE audits, “Audit Sampling” was added to collect better information on findings related to specific audit procedures. In prior Surveys, sampling was an example listed under both the “Revenue Recognition” and “Inventory” themes. Certain audit regulators have observed that deficiencies in sampling occur irrespective of the income statement or balance sheet accounts that are the subject of the audit procedure; accordingly, IFIAR Members sought to collect specific information on the frequency of findings related to sampling.<sup>17,18</sup> IFIAR Members were asked to indicate whether the addition of the Audit Sampling theme resulted in an increase in the total number of findings reported; all participating Members confirmed that the new theme did not affect the total number of findings reported in the Survey, as compared to the Members’ approaches to reporting data for prior Surveys.

<sup>17</sup> Note that Audit Sampling findings reported on listed PIE audit engagements relate to deficiencies in a specific audit engagement in the application of audit standards on sampling. Findings related to a firm’s audit methodology for sampling would be considered a firm-wide quality control finding and reported as an “Engagement Performance” finding.

<sup>18</sup> Related to this change, the theme previously called “Inventory” was revised to “Inventory Procedures” to better reflect auditing standard that require specific procedures to test inventory quantities. Findings related to sampling approaches used when testing inventory are reported under the Audit Sampling theme, and findings related to inventory valuation or reserves are reported under the Accounting Estimates theme.



- For SIFI audits, a new theme of “Audit of Insurance Contract Liabilities” was added. This is an area with anticipated forthcoming changes in accounting standards and disclosures, increasing interest in understanding the extent of audit issues currently identified by regulators.

Second, the listed PIE inspection themes called “Fair Value Measurement” and “Allowance for Loan Losses” in previous Surveys were combined; the revised description of this theme is “Accounting Estimates, including Fair Value Measurement”. This renamed theme is broader than the prior themes; for example, accounting estimates related to a provision or reserve that is accounted for at an amount other than fair value would be included under this description. This change does not apply to reporting on SIFI audit inspection findings. Findings related to accounting estimates for SIFI audits are reported by more detailed themes to enable more specific reporting on customary matters addressed in financial institution audits. These more detailed accounting estimate themes include “Valuation of Investments and Securities”, “Insufficient Challenge and Testing of Management’s Judgments and Assessments”, and “Audit of Allowance for Loan Losses”.

Third, additional instructions were provided to assist Members in determining how to classify a finding that relates to multiple themes. For example, a finding about **risk assessment** related to **fraud procedures** in the area of **revenue recognition** could be placed under one of three themes (indicated in bold). To minimize differences in judgment between Members completing the Survey, Members were provided additional instructions to improve consistency of individual Members’ approaches to reporting for purposes of the Survey (in the example provided, under the “Revenue Recognition” theme). Members were asked to indicate the effect of the additional guidance on their classification of findings by theme. One Member indicated that the changes were significant; four Members indicated a minor effect.

Finally, IFIAR provided additional guidance to Members to assist in their determination of which financial institutions are considered to be SIFIs in their jurisdiction. This effort was aimed to collect more targeted data specific to this important category of reporting companies with aspects of financial reporting that require extensive judgment and estimates and, therefore, present particular audit considerations.

Previously, two main changes were made for the 2015 Survey. First, a new category of findings, “Audit Report”, was added. For those audits conducted using ISAs, a new standard for audit reporting, ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*, is applicable to audits of financial statements for periods ended on or after December 15, 2016.<sup>19</sup> In some jurisdictions, expanded reporting by auditors already had begun prior to ISA 701’s implementation date. IFIAR started collecting Survey data on findings related to the Audit Report to monitor trends in findings in this area as the form and content of the auditor’s report evolves.

<sup>19</sup> For more information about ISA 701, see [here](#).



A second key change from the 2014 Survey was to limit reporting on findings to those that relate to the six GPPC networks.<sup>20</sup> Not all GPPC networks' audit practices are of significant size in all IFIAR Member jurisdictions, and other firms not covered by this Survey may play a significant role in certain jurisdictions. However, the GPPC networks include the six audit firm networks that are most common across IFIAR Members' jurisdictions, and IFIAR's discussions with audit firms to date have focused on the GPPC networks. As discussed further in this report, the GAQ Working Group has deepened its discussions with the GPPC networks on findings, root cause analysis, and the firms' plans to take responsive action to improve audit quality. Collecting data about findings only on the firms that are part of the GPPC networks should assist IFIAR in a targeted discussion with the firms on trends in findings and audit quality.

## Interpreting the Results

The purpose of IFIAR's Survey is not to measure empirically the changes in audit quality. Members were asked in the 2016 and 2015 Surveys to indicate how they measure changes in audit quality. Certain Members indicated that they measure changes from a national perspective by the *number* of inspection findings; nearly as many indicated that the relevant measure is the *nature* of findings.

The number of findings should not be the sole means to evaluate the information reported in IFIAR's Survey. Audit deficiencies identified and reported through the course of an inspection are not intended to serve as "balanced score cards" or overall rating tools. While an individual regulator may have the ability to assess the nature and severity of its findings, the Survey does not provide this level of information.

Many IFIAR Members employ a risk-based inspection approach, meaning that inspectors are paying particular attention to those aspects of the audit deemed most likely to involve financial reporting and/or audit risk. This results in inspections of those audit areas that are inherently more complex to audit. The risk-based approach may contribute to the frequency of findings. Under such an approach, not all audit engagements and areas of inspection focus are selected randomly; therefore, selections of audits are not necessarily representative samples of the firm's audits. It is not necessarily the case that the auditor would do a better job in a lower risk audit engagement. Still, it is important to recognize the possibility that the risk-based inspection programs employed by most IFIAR Members may influence the frequency of inspection findings reflected in this report. While

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<sup>20</sup> IFIAR does not collect data by firm for the Survey's inspection findings themes. Because of this, it has not adjusted prior Survey information to remove findings related to audit firms that are not part of a GPPC network. To assess the general impact non-GPPC network audit firms had on Survey results prior to 2015, IFIAR considered the total number of audit firms and listed PIE audits inspected, and the frequency at which those audits had at least one finding. The 2014 Survey included findings from 62 listed PIE audits inspected at 18 non-GPPC network audit firms. Had these inspection results been excluded from the 2014 Survey, the frequency of listed PIE audit files inspected and with at least one finding would have been 46%; this compares to 47% with these non-GPPC network audit firms included, as reported in the report on the 2014 Survey. The exclusion of findings from inspections of non-GPPC network audit firms in the 2015 Survey is not expected to have a significant impact on general trends or frequency of inspection themes.



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.

IFIAR also cautions against empirical review of the data because the composition of audit firms inspected, topics of focus in certain Members' inspection programs, and the Members reporting may vary between Survey reports. The Members reporting were largely consistent between the 2016, 2015, and 2014 Surveys. However, some Members may focus on different themes between inspection cycles, such that some inspection themes may receive varying levels of inspection attention between Survey years. Further, the firms inspected by a Member may vary between Survey years. Of the Members reporting in the 2016 Survey, 13 indicated that they inspect each Big Four firm each year; inspections by these Members account for 81% of the total listed PIE audits inspected and reported on in the 2016 Survey. Seven Members indicated they inspect the non-Big Four GPPC networks annually.

To better understand the impact of changes in reporting Members, IFIAR determined that 23 Members had reported inspection findings on listed PIE audits for each of the past three Survey years (2014-2016). Responses from these 23 Members account for 93% of the listed PIE audits inspected and reported on in the 2016 Survey, and 96% of the inspected listed PIE audits in the 2015 and 2014 Surveys. In each of these years, the percentage of audits inspected by these Members that had at least one finding was not significantly different from the percentage that includes the results of all Members' Survey submissions in those years. Further, for each of the listed PIE inspection themes, IFIAR analyzed the percentage of listed PIE audits inspected by these 23 Members. During these periods, for each of the individual inspection themes with the most frequent and highest number of findings, these 23 Members represented at least 86% of the audits inspected for those themes, and in some cases as many as 99%.

IFIAR Members must make judgments when submitting data for the Survey in cases where a finding relates to multiple inspection themes. IFIAR promotes consistency in reporting through examples and instruction details; however, the judgments made by individual IFIAR Members may differ when selecting the one theme under which to report the finding. 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.



## Annex B: Inspection Findings Survey Response Details

This annex provides information on the current and past Survey results. For additional information, including prior reports and related press releases, please visit [ifiar.org](http://ifiar.org).

### 1 Quality Control Findings

Refer to Section 3 of this report for a description of firm-wide systems of quality control.

**Table B.1 Quality Control** 2012-2016 Surveys: IFIAR Members Reporting and Audit Firms Inspected

	2016	2015	2014	2013	2012
IFIAR Members Submitting Findings	33	33	30	30	23
Audit Firms Inspected	127	101	123	134	109

**Table B.2 Quality Control** 2014-2016 Survey Results: Audit Firms with at Least One Finding by Inspection Theme

	2016		2015		2014	
	Audit Firms with at Least One Quality Control Finding		Audit Firms with at Least One Quality Control Finding		Audit Firms with at Least One Quality Control Finding	
Inspection Theme	#	%	#	%	#	%
Engagement Performance	55	49%	53	59%	71	60%
Independence and Ethical Requirements	43	40%	34	40%	55	48%
Human Resources	29	31%	31	36%	52	45%
Monitoring	29	28%	27	33%	40	34%
Client Risk Assessment, Acceptance, and Continuance	26	25%	27	30%	36	33%
Leadership Responsibilities for Quality within the Firm	12	12%	11	12%	23	19%





**Table B.3 Quality Control 2012-2016 Survey Results: Total Number of Findings by Inspection Theme**

Inspection Theme	2016	2015	2014	2013	2012
Engagement Performance	202	222	377	380	261
Monitoring	81	63	74	93	77
Human Resources	76	77	111	146	166
Independence and Ethical Requirements	72	73	109	104	130
Client Risk Assessment, Acceptance, and Continuance	48	52	53	78	100
Leadership Responsibilities for Quality within the Firm	18	21	45	43	33
	497	508	769	844	767

In the 2016 Survey, certain IFIAR Members provided additional detail regarding quality control findings in the areas of Engagement Performance, Monitoring, Human Resources, and Independence and Ethical Requirements. Not all Members reporting quality control findings provided this supplemental information.

**Engagement Performance** (202 findings in total, of which):

- **99** relate to failure to establish policies and procedures for **engagement quality control review** that provides an objective evaluation of the significant judgments made by the engagement team.
- **12** relate to **audit methodology and guidance**.
- **6** relate to **consultations**.

**Monitoring** (81 findings in total, of which):

- **41** relate to **root cause analysis / remedial actions**. This area of quality control activity has received increased attention by IFIAR, in particular through its annual inspection workshops and the GAQ Working Group's discussions with the GPPC networks. (See further discussion at Section 5 of this report.)
- **23** relate to failures to identify audit performance issues when performing **internal inspections** in order to effectively monitor audit quality and respond to possible related systemic deficiencies concerning the performance of audits. The GAQ Working Group discusses the GPPC networks' internal quality monitoring programs at regular meetings. (See further discussion at Section 6 of this report.)
- **5** relate to failures to effectively design and implement **pre-issuance reviews** to monitor the effectiveness of the remedial actions.

**Human Resources** (76 findings in total, of which):

- **13** relate to **engagement team assignments**.
- **13** relate to the evaluation of audit quality as part of **partner performance evaluations and admissions**.
- **6** relate to compliance with the firm **training and learning** plan.



- **5** relate to impact of audit quality deficiencies in determining **partner remuneration and assignments**.

***Independence and Ethical Requirements*** (72 findings in total, of which):

- **23** relate to failures to consider and evaluate **non-audit and/or audit-related services** provided to the audited entity.
- **17** relate to failures to monitor effectively compliance by firm staff and partners with **personal independence requirements**.
- **6** relate to failures to **communicate to the audit committee certain relationships** that, in the firm's professional judgment, bear on independence.
- **4** relate to failures to maintain independence due to an individual on the audit engagement entering into an **employment relationship** with the former audit client (e.g., violation of "cooling off" requirements) or due to a **business relationship** that existed during the professional engagement period.
- **2** relate to failures to appropriately consider applicable **firm or partner rotation rules** (e.g. the audit partner performs the services of a lead partner or engagement quality reviewer for more than the maximum number of consecutive years).

## **2 Audit Engagement Inspection Findings**

The tables below provide data on inspection results reported in this and prior Surveys regarding audits of listed PIEs and of SIFIs. Refer to Section 4 of this report for further descriptive information on these categories of findings.

### **Listed PIE Audit Inspections**

IFIAR began collecting and reporting information in 2014 on the number of audits inspected with at least one finding. The table below indicates with dashes those years for which the related information is not available. As disclosed elsewhere in this report, inspection themes were added for the 2013, 2015 and 2016 Surveys.



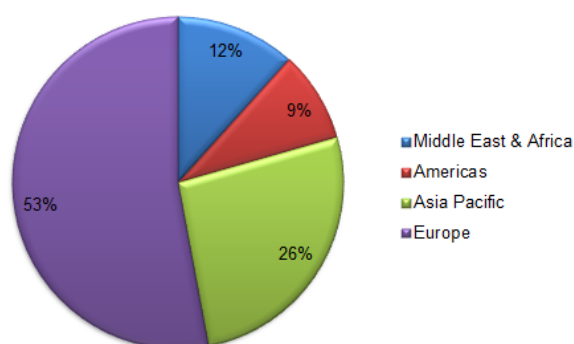
**Table B.4 Listed PIE Audits 2012-2016 Surveys: IFIAR Members Reporting and Audits Inspected**

	2016	2015	2014	2013	2012
IFIAR Members Submitting Findings	34	29	29	30	22
Audit Firms Inspected	121	98	122	113	98
Listed PIE Audits Inspected	855	872	948	989	961
Inspected Listed PIE Audits with at Least One Finding	363	376	449	-	-
Frequency of Inspections with at Least One Finding	42%	43%	47%	-	-

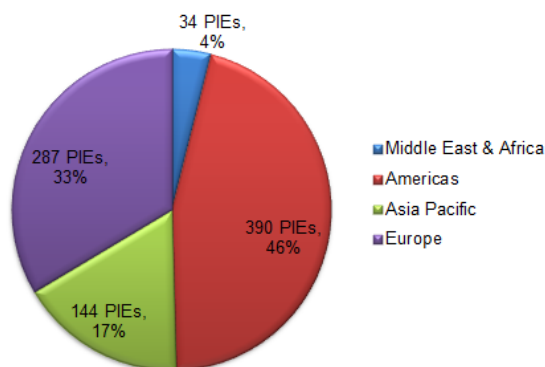
### Member Participation – Listed PIE Audit Inspection Results

The charts below illustrate the geographic distribution of the number of IFIAR Members contributing data for the 2016 Survey on listed PIE audit inspections, and the number of listed PIE audits inspected by these Members.

**Geographic Distribution of Members Providing Data on Findings from Inspected Audits of Listed PIEs**



**Geographic Distribution of Listed PIE Audits Inspected**



The table below provides details by year of the financial statement fiscal year end dates of inspected listed PIE audits reported in the 2016 Survey. As seen below, two-thirds of listed PIE audits inspected and reported on in this Survey relate to financial statement fiscal year ends of 2015 or 2014; one-third relate to earlier financial statement dates.



**Table B.5 Listed PIE Audits 2016 Survey: Financial Statement Year Ends of Inspected Listed PIE Audits**

Financial Statement Year End of Inspected Listed PIE Audits	Listed PIE Audits Inspected	
	#	%
2015	128	15%
2014	440	51%
2013	281	33%
2012 or earlier	6	1%
<b>Total</b>	<b>855</b>	<b>100%</b>

The table below provides details from the 2014-2016 Surveys for the calculation by inspection theme of the percentage of listed PIE audits with at least one inspection finding.



**Table B.6 Listed PIE Audits 2014-2016 Survey Results: Audits Inspected and with at Least One Finding by Inspection Theme**

Inspection Theme	2016			2015			2014		
	Number of Listed PIE Audits in which the Topic was Inspected	Listed PIE Audits with at Least One Finding		Number of Listed PIE Audits in which the Topic was Inspected	Listed PIE Audits with at Least One Finding		Number of Listed PIE Audits in which the Topic was Inspected	Listed PIE Audits with at Least One Finding	
		#	%		#	%		#	%
Accounting Estimates, including Fair Value Measurement*	514	166	32%	*	*	*	*	*	*
Fair Value Measurement*	*	*	*	661	118	18%	795	156	20%
Audit of Allowance for Loan Losses and Loan Impairments*	*	*	*	165	37	22%	244	31	13%
Internal Control Testing	689	124	18%	710	160	23%	638	155	24%
Audit Sampling	507	85	17%	**	**	**	**	**	**
Revenue Recognition	680	88	13%	688	105	15%	732	104	14%
Substantive Analytical Procedures	368	47	13%	384	44	11%	476	66	14%
Inventory Procedures	329	38	12%	365	71	19%	409	64	16%
Group Audits	408	44	11%	383	55	14%	506	53	10%
Adequacy of Financial Statement Presentation and Disclosure	539	48	9%	570	68	12%	633	79	12%
Use of Experts and Specialists	284	25	9%	326	29	9%	446	47	11%
Related Party Transactions	205	12	6%	300	16	5%	404	33	8%
Engagement Quality Control Review	361	20	6%	417	32	8%	515	52	10%
Adequacy of Review and Supervision	406	21	5%	434	35	8%	482	46	10%
Risk Assessment	815	39	5%	832	114	14%	652	45	7%
Fraud Procedures	568	26	5%	574	43	7%	675	43	6%
Going Concern	224	9	4%	321	5	2%	418	23	6%
Audit Report	438	14	3%	461	15	3%	**	**	**
Audit Committee Communications	508	9	2%	592	10	2%	475	13	3%

\* During 2012-2015, IFIAR collected data separately for findings related to "Audit of Allowance for Loan Losses and Loan Impairments" and "Fair Value Measurement". Data collected and reported in previous Survey reports for these two themes is included in this table. Beginning in 2016, IFIAR combined these themes as "Accounting Estimates, including Fair Value Measurement".

\*\* Data for this theme was not collected during the Survey year.

While the table above details the number of listed PIE audits with at least one finding, the table below provides the total number of findings by inspection theme for each year the Survey was conducted. Note that an inspected listed PIE audit may have more than one finding under a single inspection theme. Because of this, the total number of findings (per the table above) for most themes exceeds the number of listed PIE audits with at least one finding (per the table below) for that theme.



**Table B.7 Listed PIE Audits 2012-2016 Survey Results: Total Number of Findings by Inspection Theme**

Inspection Theme	2016	2015	2014	2013	2012
Internal Control Testing	278	173	178	156	117
Accounting Estimates, including Fair Value Measurement*	258	*	*	*	*
Fair Value Measurement*	*	158	205	217	169
Audit of Allowance for Loan Losses and Loan Impairments*	*	45	46	55	43
Audit Sampling	109	**	**	**	**
Revenue Recognition	105	116	114	104	86
Substantive Analytical Procedures	65	50	79	55	75
Adequacy of Financial Statement Presentation and Disclosure	53	85	101	120	109
Group Audits	53	70	75	89	75
Risk Assessment	51	131	49	59	**
Inventory Procedures	43	86	69	76	57
Fraud Procedures	35	46	54	65	**
Use of Experts and Specialists	27	35	54	42	41
Adequacy of Review and Supervision	22	49	55	58	115
Engagement Quality Control Review	20	39	53	78	116
Audit Report	18	15	**	**	**
Related Party Transactions	12	17	40	28	44
Going Concern	12	5	24	24	25
Audit Committee Communications	10	10	14	34	**
	1,171	1,130	1,210	1,260	1,072

\* During 2012-2015, IFIAR collected data separately for findings related to "Audit of Allowance for Loan Losses and Loan Impairments" and "Fair Value Measurement". Data collected and reported in previous Survey reports for these two themes is included in this table. Beginning in 2016, IFIAR combined these themes as "Accounting Estimates, including Fair Value Measurement".

\*\* Data for this theme was not collected during the Survey year. Prior to 2016, Members generally reported Audit Sampling findings under other themes (e.g., Revenue Recognition or Inventory).

In the 2016 Survey, certain IFIAR Members provided additional details regarding findings in the areas of Internal Control Testing, Accounting Estimates and Revenue Recognition. Not all Members reporting listed PIE audit inspection findings provided this supplemental information.

**Internal Control Testing** (278 findings in total, of which):

- **106** relate to failures to obtain sufficient persuasive evidence to support **reliance on manual internal controls**.
- **77** relate to failures to sufficiently **test controls over, or the accuracy and completeness of, data or reports** produced by management.
- **19** relate to failures to test sufficiently **information technology general and application controls**.
- **9** relate to failures to adequately assess the appropriateness of placing **reliance on the work of others**.





- **2** relate to failures to appropriately **adjust testing as a result of ineffective controls** or to sufficiently evaluate the **severity of control deficiencies**.

**Accounting Estimates, Including Fair Value Measurement** (258 findings in total, of which):

- **117** relate to failures to assess the **reasonableness of assumptions** including consideration of contrary or inconsistent evidence where applicable.
- **38** relate to failures to perform sufficient **risk assessment** procedures.
- **25** relate to failures to test sufficiently the **accuracy of data** used.
- **17** relate to failures to take **relevant variables** into account.
- **8** relate to failures to evaluate how management considered **alternative assumptions**.
- **5** relate to failures to adequately consider indicators of **bias**.

**Revenue Recognition** (105 findings in total, of which):

- **36** relate to failures to appropriately assess and respond to the **risk of fraud** in revenue recognition.
- **26** relate to failures to perform procedures to determine whether revenue was recorded in the **appropriate period**.
- **13** relate to failures to sufficiently understand the terms and conditions of **complex arrangements** and the impact on the accounting.

### SIFI Audit Inspection Findings

Globally, the number of SIFIs is significantly smaller than the number of listed PIEs. The small number of SIFIs in certain jurisdictions may introduce confidentiality considerations that prevent a Member from reporting SIFI inspection results for purposes of the Survey. Further, in some jurisdictions, the IFIAR Member responsible for audit oversight of listed PIE audits may not have authority for oversight of financial institution audits. Finally, for the 2016 Survey, IFIAR provided additional guidance to assist Members' identification of which financial institutions are considered to be systemically important in their jurisdiction; this effort was designed to collect more targeted data specific to this important category of reporting companies with aspects of financial reporting that require extensive judgment and estimates and, therefore, present particular audit considerations. For these reasons, the Survey reports on a significantly lower number of inspected SIFI audits than of inspected listed PIE audits. While IFIAR's cautions on seeking to analyze trends in Survey results apply to all areas of the Survey, this is particularly important with the relatively small population of SIFIs.

The table below provides details from the 2014-2016 Surveys for the calculation by inspection theme of the percentage of SIFI audits with at least one inspection finding.



**Table B.8 SIFI Audits 2014-2016 Survey Results: Audits Inspected and with at Least One Finding by Inspection Theme**

Inspection Theme	2016			2015			2014		
	Number of SIFI Audits in which the Topic was Inspected	SIFI Audits with at Least One Finding		Number of SIFI Audits in which the Topic was Inspected	SIFI Audits with at Least One Finding		Number of SIFI Audits in which the Topic was Inspected	SIFI Audits with at Least One Finding	
		#	%		#	%		#	%
Use of Experts and Specialists	16	5	31%	31	8	26%	81	9	11%
Internal Control Testing	32	8	25%	85	34	40%	98	26	27%
Audit of Insurance Contract Liabilities	12	2	17%	**	**	**	**	**	**
Audit Methodology, including Programs and Tools	19	3	16%	27	5	19%	39	7	18%
Fraud Procedures	19	3	16%	29	2	7%	84	5	6%
Valuation of Investments and Securities	20	3	15%	70	19	27%	122	33	27%
Testing of Customer Deposits and Loans	21	3	14%	22	5	23%	37	4	11%
Insufficient Challenge and Testing of Management's Judgments and Assessments	22	3	14%	43	18	42%	92	13	14%
Substantive Analytical Procedures	23	3	13%	28	2	7%	69	6	9%
Audit of Allowance for Loan Losses and Loan Impairments	25	3	12%	53	27	51%	95	16	17%
Adequacy of Financial Statement Presentation and Disclosure	25	2	8%	33	6	18%	85	6	7%
Audit Report	25	2	8%	32	0	0%	**	**	**
Group Audits	15	1	7%	20	5	25%	36	4	11%
Risk Assessment	26	0	0%	84	18	21%	81	3	4%
Audit Committee Communications	27	0	0%	40	1	3%	73	2	3%

\*\* Data for this theme was not collected during the Survey year.

While the table above details the number of SIFI audits with at least one finding, the table below provides the total number of findings by inspection theme for each year the Survey was conducted. Note that an inspected SIFI audit may have more than one finding under a single inspection theme. Because of this, the total number of findings for some themes (per the table below) exceeds the number of SIFI audits with at least one finding (per the table above) for that theme.



**Table B.9 SIFI Audits 2012-2016 Survey Results: Total Number of Findings by Inspection Theme**

Inspection Theme	2016	2015	2014	2013	2012
Internal Control Testing	10	37	36	39	33
Use of Experts and Specialists	6	22	9	8	**
Audit Methodology, including Programs and Tools	5	7	11	1	9
Audit of Allowance for Loan Losses and Loan Impairments	3	31	21	42	15
Valuation of Investments and Securities	3	22	42	26	32
Insufficient Challenge and Testing of Management's Judgments and Assessments	3	20	13	21	12
Testing of Customer Deposits and Loans	3	7	6	3	10
Substantive Analytical Procedures	3	2	6	12	**
Fraud Procedures	3	2	5	7	**
Adequacy of Financial Statement Presentation and Disclosure	2	6	7	9	4
Audit Report	2	0	**	**	**
Audit of Insurance Contract Liabilities	2	**	**	**	**
Group Audits	1	6	4	8	2
Risk Assessment	0	22	4	10	**
Audit Committee Communications	0	1	2	2	**
	46	185	166	188	117

\*\* Data for this theme was not collected during the Survey year.