

21st Audit & Assurance Conference

12 & 13 May 2011

Edinburgh, Scotland

Hosted by the Institute of Chartered Accountants of Scotland (ICAS)

Supported by Aston Business School, UK

Panel Session:

“Inspection of audit firms: national or international?”

***Joanne Jamieson*, ICAS Audit Monitoring**

***Brynjar Gilberg*, Accounting and Auditing Supervision, FSA Norway**

***Martin Kocks*, Deputy Head, Inspection Unit, Auditor Oversight
Commission, Germany**

***Andrew Jones*, Director of Audit Inspection Unit (AIU), UK**

***Lewis Ferguson*, PCAOB Board Member, USA**

***James Gunn*, Technical Director, IAASB/IFAC**



Inspection of audit firms: national or international?

Joanne Jamieson

ICAS

Monitoring visits

- Compliance with International Standards on Auditing (ISAs)
- Compliance with Audit Regulations
- Is there sufficient and appropriate audit evidence on the file?
- Have audit judgements been recorded?
- UK specific laws, reporting and disclosure requirements, including regulatory and specialist aspects

An international regulator?

- Increased coordination and cooperation would be beneficial
- Difficult to be cost effective
- Too many barriers:
 - Local, specialised knowledge
 - Consistency
 - Confidentiality
 - Monitoring follow up action
 - Discipline

Introduction – European Audit Regulators

Colleges of Regulators - Andrew Jones

Director, Audit Inspection Unit of the FRC

IFIAR - Brynjar Gilberg

Special Advisor, Financial Supervisory Authority of Norway

EAIG - Martin Kocks

Deputy Director Inspections, Auditor Oversight Commission of Germany



FINANSTILSYNET

THE FINANCIAL SUPERVISORY
AUTHORITY OF NORWAY

21st Audit & Assurance Conference

Brynjar Gilberg

Special Advisor – Financial Supervisory Authority of Norway

Edinburgh May 12th, 2011

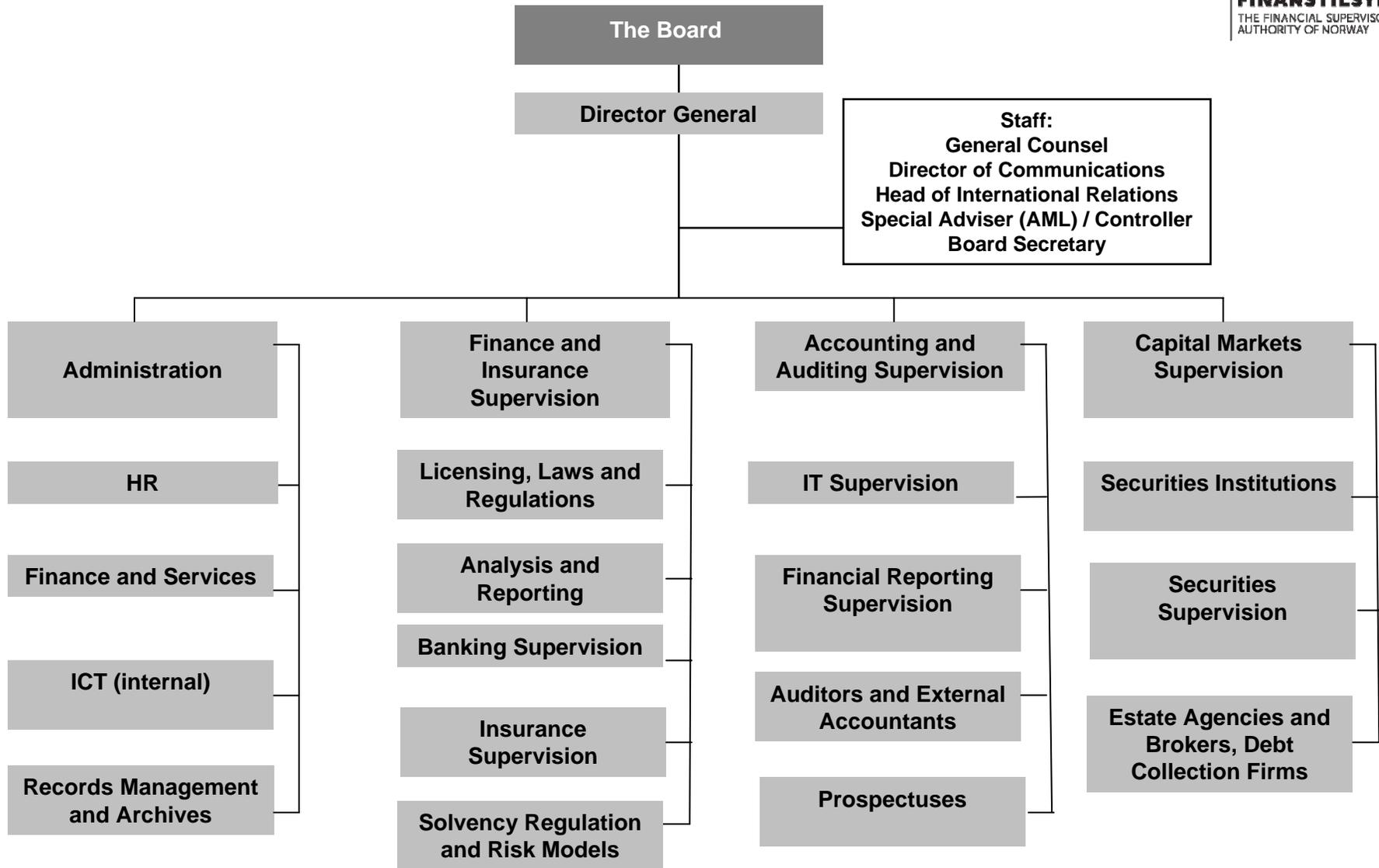
Overview

- A Few Words About FSA Norway
- The International Forum of Independent Audit Regulators – IFIAR
- Public Inspection Reporting Models
- Auditor Independence

A few words about FSA Norway

- Finanstilsynet (<http://www.finanstilsynet.no/en/>) is an independent government agency that builds on laws and decisions emanating from the Parliament (“Stortinget”), the Government and the Ministry of Finance
- Finanstilsynet’s responsibilities also include the supervision of
 - Audit firms and auditors – 1992
 - External accountants – 1999
 - Issuers’ financial reporting – 2005
 - Issuers’ prospectuses – 2010
- Through its supervision of enterprises and markets, Finanstilsynet strives to promote
 - Financial stability and
 - Orderly functioning of markets

The FSA's Organization Chart

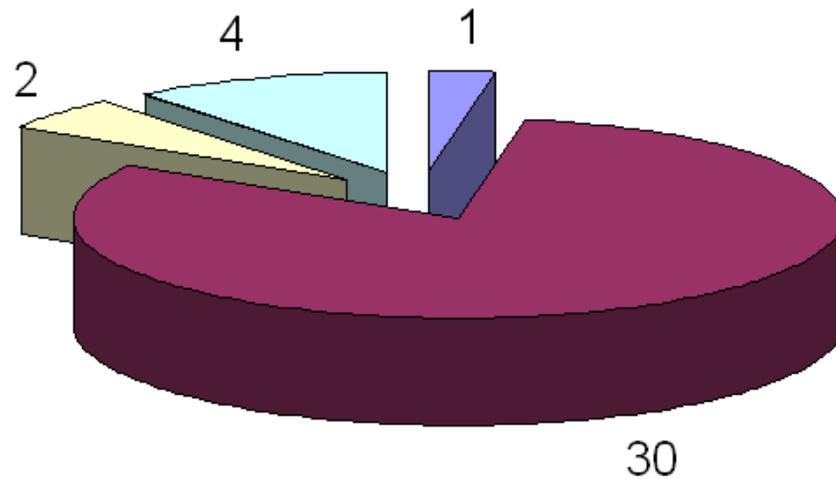


- IFIAR was formally created by its 12 founding members at a meeting in Paris on September 15th, 2006
- IFIAR now has 38 members, reflecting a significant growth
 - <https://www.ifiar.org/aboutus/index.cfm>
- IFIAR has three core functions:
 1. Sharing information about the audit market environment and regulatory activity
 2. Promoting collaboration in regulatory activity
 3. Interacting with other international organizations interested in audit quality

- IFIAR's Core Principles were approved by its members in Berlin on April 13, 2011
 - <https://www.ifiar.org/documents/pagemanager/IFIAR/Final%20Core%20Principles.pdf>
- The 11 Core Principles cover audit regulators'
 - Structure
 1. Responsibilities and powers serving the public interest
 2. Operational independence
 3. Transparency and accountability

- The 11 Core Principles cover audit regulators' (cont.)
 - Operations
 4. Comprehensive enforcement powers
 5. Independent and competent staff
 6. Objectivity, no conflicts of interest, and confidentiality arrangements
 7. Cooperation with other audit regulators and third parties
 - Inspections
 8. Recurring inspections of public interest entity auditors
 9. Risk-based inspection program
 10. Effective procedures for firm wide and file reviews
 11. Mechanism for reporting and remediation of inspection findings

Public Reporting Model Survey



- Model 1 - no public results of supervisory activities
- Model 2 - public results but anonymity of firm
- Model 3 - public results of audit review inspections but not firm-wide results
- Model 4 - public results by firm of all supervisory activities

Three countries noted that they also provided results of individual audits reviewed directly or indirectly to the company

Auditor Independence

- After the EC Green Paper – new independence requirements?
- Development the last 10 years – Example: Norway
 - Thematic inspection – performed in 2002
 - Summary Report with guidance – issued in 2003
 - New independence regulation – introduced in 2005
 - Regulates the type and extent of additional services permitted
 - Drop in additional services relative to audit fees (BIG4 / BIG 5 in 2001)
 - 2001 – 58 %
 - 2008 – 25 % (Source: Auditor returns submitted to the FSA)
- Auditor Independence at present – a level playing field?
 - National laws and regulations
 - EU Directive on Statutory Audit – of 17 May 2006
 - Commission Recommendation – of 16 May 2002
 - IESBA Code of Ethics – effective 1 January 2011

“Inspections of audit firms: national or international?”

Martin Kocks
Deputy Head of Inspections – AOC Germany

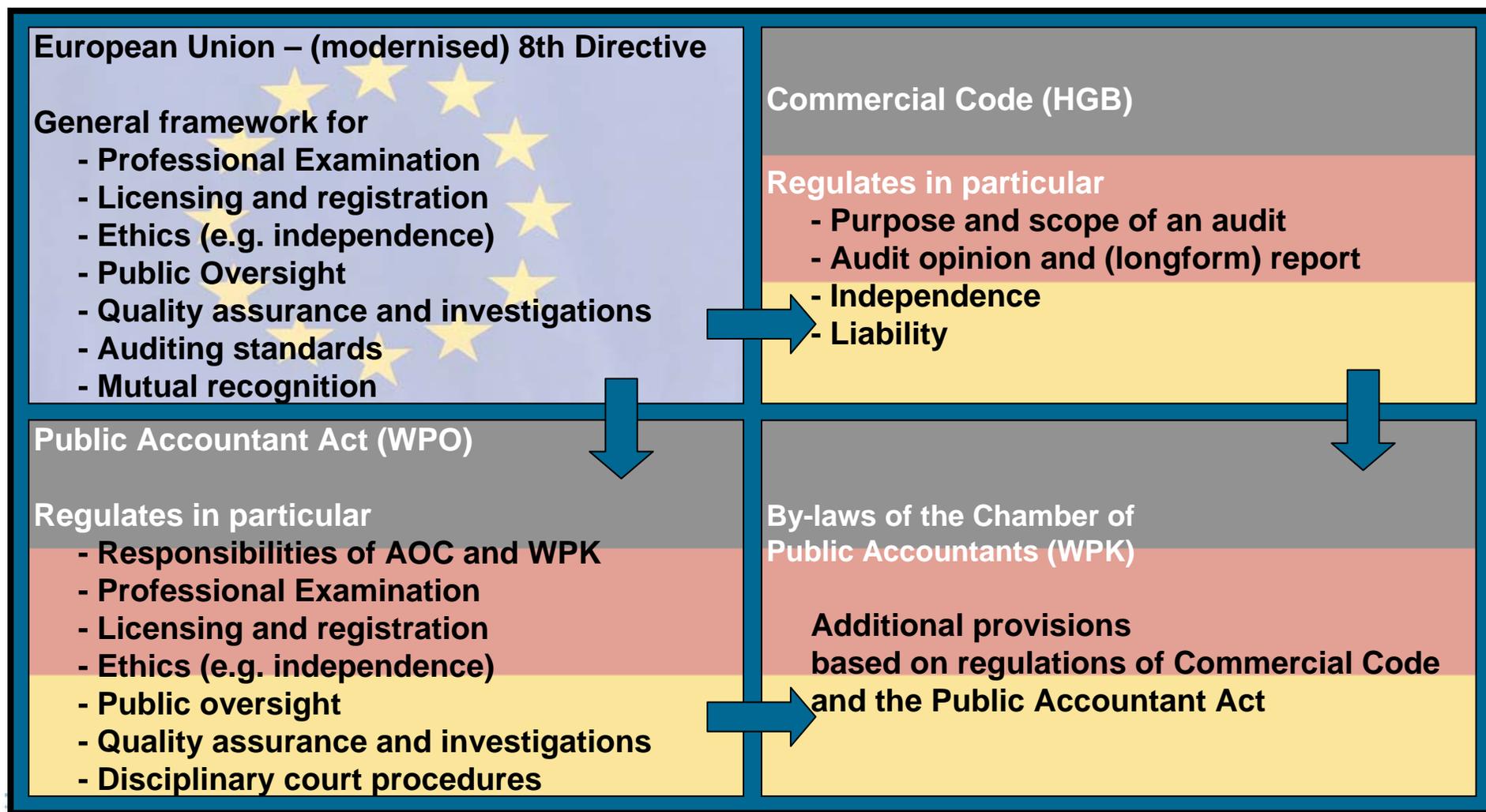
***21st Audit and Assurance Conference
organized by the
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of the British Accounting & Finance Association (BAFA)***

May 12th 2011, Edinburgh

Content

1. Public Oversight in Germany
2. European Audit Inspection Group (EAIG)
3. Current Issue:
Using the Work of an Auditor's Expert (ISA 620)

Public Oversight in Germany – Legal Framework (I)

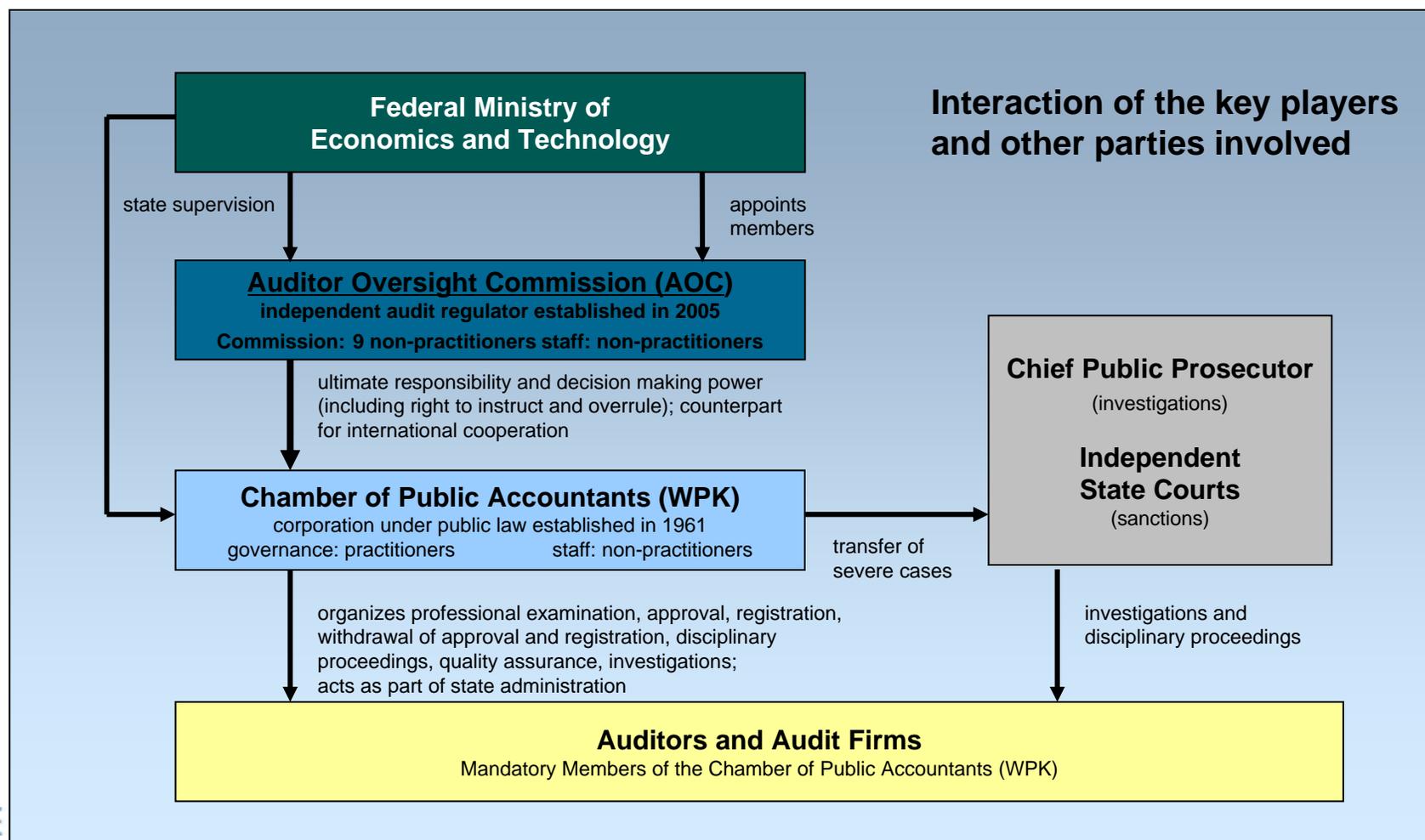


Public Oversight in Germany (II)

Auditor Oversight Commission (AOC)

- Established in 2005 to practice independent public oversight over the Chamber of Public Accountants (WPK) and as a counterpart for international cooperation
- Governed by independent non-practitioners
- Ultimate responsibility and decision making power regarding all auditor oversight activities in Germany including inspections carried out by WPK staff since 2007
- Right to initiate procedures, instruct and overrule the WPK
- Public report on the results of inspections in 2007-2010 available (<http://www.apak-aoc.de/english>)

Public Oversight in Germany (III)



European Audit Inspection Group – EAIG (I)

- First meeting in London on March 22nd, 2011; further meetings on a quarterly basis
- Continuing the work of the Inspection subgroup of the EGAOB
- Open to EU/EEA regulators; the Swiss regulator is invited as a guest; the European Commission participates as an observer
- Primary purpose of EAIG: create awareness of important issues and promote cooperation and consistency amongst European audit regulators on inspections

European Audit Inspection Group – EAIG (II)

Internal activities

- Exchanging and discussing inspection findings
- Identifying root causes for deficiencies (standards, policies procedures)
- Discussion on inspection approaches and challenges/barriers on inspections

External activities

- Exchange of information with the EGAOB
- Exchange on specific points of interest with external professional organizations and standard setters (e.g. ECG, IESBA, CAG of IAASB)
- Exchange with audit firms on specific issues at European level

European Audit Inspection Group – EAIG (III)

Work done so far in EAIG/EGAOB subgroup

- Survey on inspection findings to the quality control system (ISQC1)
- Survey on inspection findings to
 - ISA 240 Fraud risk assessment
 - ISA 315 Risk assessment
 - ISA 600 Group audits
 - ISA 620 Using the work of an Auditor's Expert
- Root cause analyses of the findings (deficiencies in or interpretation of ISA/ISQC1, deficiencies in firm's resources and procedures or deficiencies in application)

European Audit Inspection Group – EAIG (IV)

Next steps

- Preparation of papers for discussion with any external bodies for the findings on
 - Engagement Quality Control Review (EQCR)
 - Using the work of an auditor's expert (ISA 620)
- Meeting with the IAASB
 - Presentation and discussion regarding clarified ISA monitoring project
 - Discussion on the way forward for the dialogue between IAASB and EAIG

Using the Work of an Auditor's Expert – ISA 620 (I)

Main findings

- Insufficient use of experts
 - Policies and procedures do not require experts; not sufficient use of experts in areas where necessary
- Inadequate response to experts
 - Not performing additional procedures following up experts findings, e.g. when experts disagree with client's judgements
- Inadequate evidence or documentation of the work of internal experts
 - Internal experts do not follow documentation standards; they perform an “audit by conversation”; only a short memorandum on the conclusions no details of the procedures performed and evidence obtained

Using the Work of an Auditor's Expert – ISA 620 (II)

Root cause analysis of the findings

- Deficiencies in or interpretation of ISA 620
 - Documentation and the need to follow up issues raised by experts are not specifically addressed
- Deficiencies in firm's resources and procedures
 - Smaller firms may not have internal experts; experts are not qualified and trained for performing audit procedures
- Deficiencies in application
 - No use of experts for cost reasons; outsourcing of work by the auditor to the expert, but not taking appropriate responsibility; insufficient scepticism of the experts; no adequate integration of the expert in the audit; expert does not understand what is expected from him.

Using the Work of an Auditor's Expert – ISA 620 (III)

The way forward

- Consistency between ISA 620 and the audit documentation requirements per ISA 230 could possibly be raised with the standard setter
- Deficiencies in firm's resources and procedures and in application could be discussed with the profession (ECG or EGIAN)

Thank your for your attention



21st Audit & Assurance Conference

International Colleges of Audit Regulators

Andrew Jones

Director, Audit Inspection Unit of the FRC

Edinburgh, 12th May 2011



EY & KPMG

- Both firms significantly changed their ownership structure
- EU Statutory Directive, firm ownership rules
- Both utilised a UK LLP as the new 'topco' in Europe
- Partners in European firms exchanged their ownership of local firms for an interest in EY Europe LLP or KPMG Europe LLP
- KPMG initially just UK and Germany, but now expanded
- EY more of a big-bang approach



Response of Regulators

- Recognise that firms more centrally controlled
- More decisions made at a European level
- Need to respond and co-ordinate approach to firms
- Formed 'College of Regulators' for each firm
- Of significant countries
- Where partners have become members of Europe LLP



What have the colleges done?

- As a group met key audit firm regional Leaders;
 - Head of firm in Europe
 - HR
 - Annual quality review
 - Independence
 - Head of Audit/Assurance
 - Partner matters
 - Professional practice
 - Quality & Risk Management
- Presentations from the above
- Over 2 days
- Questions and answers at the meetings
- Follow-up questions to the firm with written responses required



What has been achieved?

- Enabled all members of the college to have dialogue with most senior regional partners at firm
- Opportunity to ask direct face to face questions
- Enables a relationship/dialogue with heads of the region - may assist in resolving local problems
- Appointment of regulatory co-ordinating partners



How can this be taken further?

- How does the regional firm ensure compliance with policies ?
- Is there any central control/compliance function that can be reviewed?
- Can systems/policies be reviewed centrally such as
 - Methodology – compliance with ISA's?
 - Design of annual quality review ?
 - Overall results of annual quality review?
 - Independence systems and monitoring?
 - Design of common regional training programmes?

Audit Regulation in the U.S.

Lewis H. Ferguson III

PCAOB Board Member

Caveat

The views I express today are my views and do not necessarily reflect the views of the Board, its members or staff.

Overview of the PCAOB

- Mission – Oversee the audits of public companies, brokers, and dealers in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports
- PCAOB Program Areas
 - Division of Registration and Inspections
 - Division of International Affairs
 - Division of Enforcement and Investigations
 - Office of the Chief Auditor

Registration

- Forms the foundation of the Board's jurisdiction over accounting firms; starting point for the Board's inspections and enforcement functions
 - Accounting firms that prepare, issue or play a substantial role in preparing or issuing an audit report of an issuer, broker, or dealer must be registered with the PCAOB
 - 2,439 accounting firm registered
 - 1,532 firms located in U.S.; 901 firms located in more than 84 countries outside of the U.S.
 - 557 auditors of brokers or dealers registered since January 2009
 - Registered firms are required to file annual reports to provide the PCAOB with current information about the firm, its audit practice and events occurring at the firm that could merit follow-up by the Board

Inspections

- Inspections process designed to promote broad improvement in audit quality
- Process includes
 - Assessing the firm's quality control systems (tone at the top, partner management, monitoring functions, independence, client acceptance/retention, supervision of work by foreign affiliates)
 - Reviewing audit engagements (risk-biased selection method)
 - Issuing an inspection report for each accounting firm inspected
 - Remediation by accounting firm of the firm's quality control inspection findings (as applicable)
- Working on interim inspection program for broker-dealer audits

International Inspections

- Approximately 900 non-U.S. firms registered with PCAOB from 84 jurisdictions
- Approximately 250 firms from 65 jurisdictions must be inspected once every three years
- Office of International Affairs has a relationship with authorities in 54 jurisdictions
- To date, inspections have been conducted in 35 jurisdictions
 - Upcoming inspections are planned in the United Kingdom and Switzerland this summer

Enforcement and Investigations

- The Board may investigate possible violations of the Sarbanes-Oxley Act, the Board's rules, the securities laws related to audit reports, or professional standards
 - Conducts informal inquiries as well as formal investigations
 - Sources of cases – Inspections, referrals from other regulatory agencies, public announcements, SEC filings, media reports, or tips
 - Jurisdiction – Limited to investigating possible violations by registered firms and associated persons, not issuers
- The Board may impose appropriate sanctions if violations are found, ranging from additional professional training to revoking or suspending a firm's registration, imposing monetary penalties, or barring or suspending a person from participating in audits of public companies
- As required by the Act, the Board's investigations are confidential and nonpublic.
- All disciplinary orders are made public upon settlement or when final decision imposing sanctions is issued; litigated disciplinary proceedings are non-public as required by Act

Standard-setting

- Board has authority to establish the auditing, attestation, quality control, ethics and independence standards to be used by registered firms in the preparation and issuance of audit reports for issuers, brokers, and dealers
- Standard-setting process is an open process which typically includes multiple public comment periods and coordination with other standard-setters and organizations
 - Concept release - may issue before a proposal to solicit comment relating to a topic under consideration
 - Proposed standard/rule
 - Re-proposed standard/rule – may issue after considering public comment and any other relevant input received
 - Adopted standard/rule – submitted to SEC for approval; includes a SEC public comment period
- Near term projects
 - Auditor's reporting model
 - Broker-dealer audits
 - Communications with audit committees

Audit Regulation in the U.S.

Lewis H. Ferguson III

PCAOB Board Member

IAASB

INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD

Inspection of Audit Firms: National Public Interest Served by an International Perspective

James Gunn, IAASB Technical Director

Auditing Special Interest Group, British
Accounting & Finance Association

12 May 2011, Hosted by ICAS



- An International Perspective
- Inspection–Standards Interaction
- Challenges and Opportunities

An International Perspective

- Inspections: An important voice
 - Audit quality depends, in part, on high quality standards; in turn, the strength of the underlying standard setting process. That process needs to be an *informed* process
 - Inspections provide the link between standards of behavior and actual behavior
 - International standards need to be enforceable and capable of driving performance that can be inspected
 - Important input to IAASB Clarity Project

An International Perspective

- Key question: Which approach will best serve to improve quality and consistency of audits globally and raise the overall level and quality of enforcement?
- A binary proposal, or rather a question of integration and optimization?
- Useful parallels and relevant influences/factors
 - International audit and assurance standards, the role of national standard setters, and IAASB initiatives
 - Oversight and regulatory regimes
 - Organization and structure of firms, including QC

An International Perspective

- Relevant factors (cont'd)
 - Mutual reliance/acceptance by other national oversight authorities
 - “European passport”
 - Coordination to avoid duplication of effort/cost; enhancing conformity and not becoming of itself a source of divergence
 - Local powers of inspection, ability to start investigations on a national level, responsiveness....

Inspection–Standards Interaction

- Historically ad hoc
 - Review of national inspection reports
 - Feedback through national standard setters and firms
- Developments
 - Greater dialogue with international regulatory/oversight bodies through established channels
 - Observer representation: EC, Japanese FSA, and US PCAOB (during Clarity Project)
 - IAASB Consultative Advisory Group
 - Fora and outreach initiatives

Inspection–Standards Interaction

- New dimensions
 - Increasing interaction with IFIAR and IFIAR’s SWG, European Audit Inspection Group, etc.
 - Comments on IAASB exposure drafts (e.g., UK AIU/APB, independent European audit regulators/ oversight bodies, regulatory groups in Canada, SA, etc.)
 - Regulatory participation in IAASB task forces
 - IAASB ISA Implementation Monitoring project
 - Effectiveness (as well as consistency and efficiency)
 - Impact assessments

Inspection–Standards Interaction

- Two way dialogue essential
 - To learn from inspection findings issues of international relevance
 - To enhance understanding of intent of IAASB in setting standards
 - Performance versus standards deficiencies
- How should future interaction look?

Challenges and Opportunities

- Root cause analysis
- Principles versus rules
 - Specificity of requirements
- Impact of approach to inspection and enforcement (e.g., on documentation, proportionate application)
- Effectiveness of Quality Control standards
- Audit Quality

IAASB

INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD

<http://www.iaasb.org>



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