

# Current state of play Audit Quality

*lessons learned and actions for the future*

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- » Current state of play Audit Quality (AQ) globally
- » Possible root causes to AQ issues
- » Current developments
- » Lessons learned
- » Actions for the future

*» Importance of shared learning and international cooperation*

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# **Current state Audit Quality globally**



# What is Audit Quality?

## Audit

- » Credence good – trust
- » Internationally agreed what a good audit looks like (ISAs)
- » Professional skepticism and professional judgment
- » No 100% level of assurance
- » Different regulations, structures (multidisciplinary partner or corporate / PE models), practices and cultures globally

## Audit quality

- » Not transparent to users
- » Hard to define – you know it when it is *not* there (incidents)
- » Hard to measure (input (drivers) versus outcome)
- » Expectation and performance gap
- » Who is responsible for AQ (firm /statutory auditor / dual / others in ecosystem?)
- » No consistency in audit quality globally

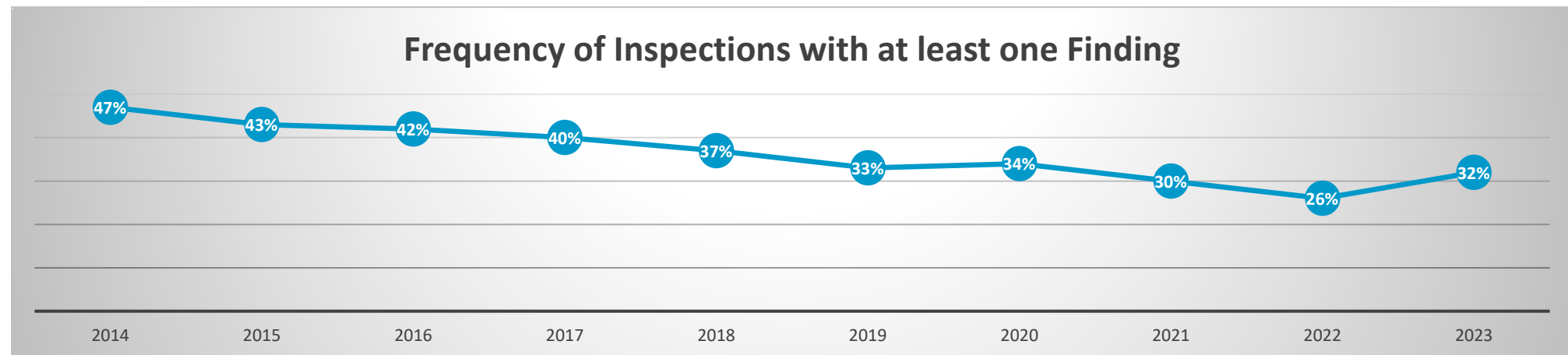
Ethics including independence is foundational

**Audit is key to protect investors and other stakeholders in the public interest**

*Importance of international cooperation: regulation, independent audit oversight and timely responsive audit and ethics standard setting and global adoption*

# Global measurement of Audit Quality

- » One single global measurement : IFIAR's Inspection Findings Survey
- » Global general trend in AQ (indicating % of inspected audit files with at least one finding indicating no sufficient appropriate audit evidence to support the opinion)
- » Dropped from 47% to approx. 30% of listed PIE audits (lagging indicator – 61% audits with year-ends 2021 or 2022)





# IFIAR's Deficiency rate trend and specific inspection areas

- » **Three years rolling average** shows a gradual declining trend in deficiency rate from 44% in 2016 to 29% in 2023
- » **Annual variations** may be due to varying inspection programs (firms, topics, files) and recently due to impact Covid pandemic
- » **Inspection areas** with the highest frequency :
  1. Estimates (incl Fair Value Measurement)
  2. Internal Control Testing
  3. Audit sampling
  4. Adequacy of Financial Statement Presentation and Disclosure
  5. Group audits



# IFIAR's Firm-wide procedures Outcomes

## Inspections of *Firm-wide System of Quality Control (ISQC1)*

Quality Control policies and processes established by audit firms to support audit quality, including compliance with independence requirements

### » Overall volatile downward trend

- » Ethics & Independence: drop deficiency rate from approx. 40% in 2022 to 30% in 2023

- » Monitoring, Client acceptance and Leadership: overall drop to approx. 20% and 10% deficiency rate

- » Human Resources: recent drop from approx. 30% to 25%

### » Engagement Performance (incl. **Engagement Quality Review**) upward trend

- » Upward trend towards a 48% deficiency rate in 2023 (compared to 39% in 2022)



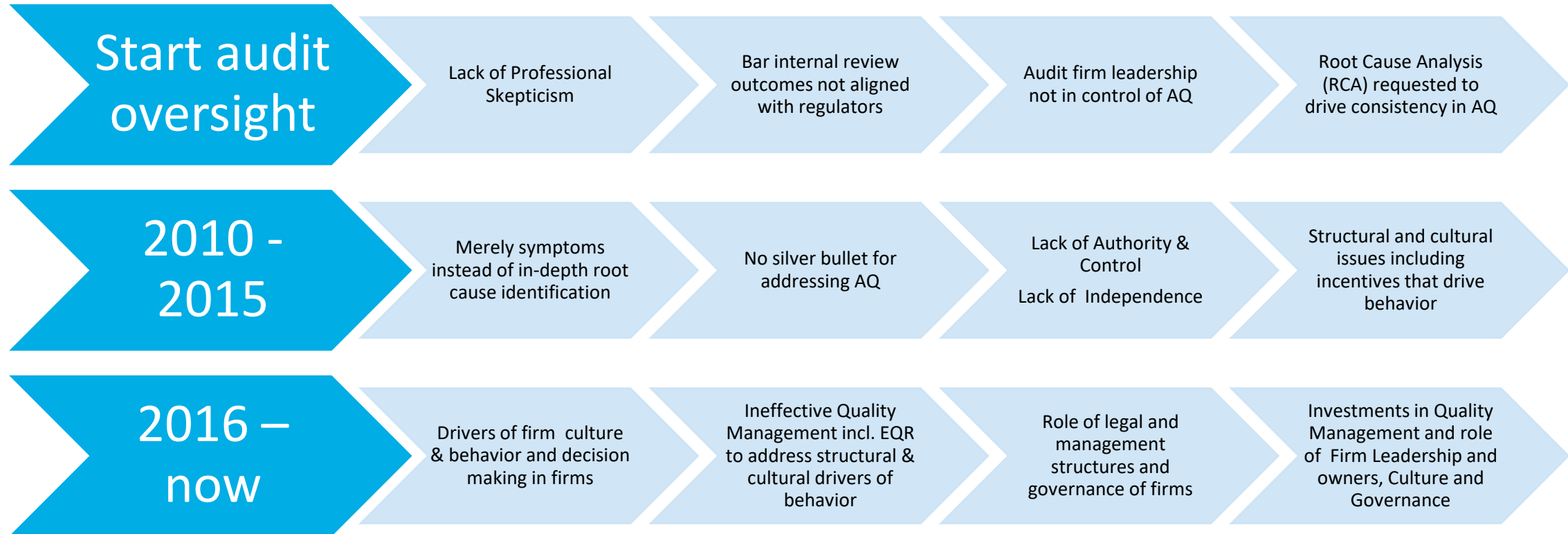
# IFIAR's Inspection Findings Reduction Target

- » Requested by the FSB for financial institution audits
- » 25% Reduction Target is agreed with the GPPC Firms globally (big 6) for a 4-year period collectively
- » From 2019 – 2023 target of < 24% against 30% realization based on subset of IFIAR members
- » For 2024 - 2027 a new target of 32% in 2023 to < 24% by end of 2027 based on all IFIAR members reporting to the IFIAR Survey
  - » *No consistency in audit quality across firms and within their global networks*
  - » *Quality control system firms not operating effectively*



# Possible Root Causes to AQ issues

# Evolution of identified Root Causes to AQ issues



Driven by emerging *independent* audit oversight, input into international standard setting (IAASB/IESBA), strengthening role of audit committees vis a vis the auditor and international cooperation through IFIAR

# Issues in the audit sector (non-exhaustive root causes)

- » Audit quality and ethics not sufficiently embedded in **audit firm strategy**
- » **Short-term focus** driven by ownership/remuneration structures versus long term investments in AQ
- » **Balancing commercial side** of (multidisciplinary/client pays) business **with ethical/quality side** of audit instead of aligning both
- » **Lack of talent** (labor market)
- » **Firm reward & recognition** and **risk tolerance** not decisively driven by audit quality
- » **Lack of leading by example** (tone at the top at all levels) and **speaking-up culture**
- » **Negotiated audit fees determining audit work effort**
- » **Focus on damage control** instead of preventative quality management incl. effective EQCR (safe learning environment)
- » **Focus on efficiency** versus effective audits (standardization, overreliance on IT tools and non-control reliant audit approaches)
- » **Lack of project management** (incl. managing audit clients due to considering auditee as the client)
- » **Lack of partner / (senior) manager involvement** (not enough time, other priorities, client portfolio etc.)
- » Audit team failed due to **not enough knowledge / experience**

**Examples of most common root causes – from in-depth to symptomatic**

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# **Current developments audit sector**



# Current developments audit sector

- » Focus on emerging and challenging **sustainability assurance** side of business
  - » Continued **lack of consistency in audit quality**
  - » **Increasing use of technology** (emerging AI/algorithms) at clients and firms
  - » **Emerging PE investments and other (corporate) structures** in audit sector
  - » **Impact ISQM1 (quality management) and ISQM2 (EQCR)** first years of implementation
  - » **Impact ISA 600 Group Audits (Revised) with strengthened Direction, Supervision and Review (role group auditor)**
  - » **Perceived lack of attractiveness profession** (incorrect narratives, remuneration, culture, qualification pathway, external factors incl. regulation)
- » **Increased pressure on capabilities/resources audit firms**

**Lessons learned**



# Lessons learned

- » There is **no silver bullet** to address AQ issues
  - » *Addressing firm specific root causes requires leadership audit firms to take responsibility for driving a culture of ethics and quality by leading by example*
- » An **ethics culture is foundational** to AQ and trust
  - » *RCA and remediation by firm's leadership to address underlying structural, cultural etc. root causes that drive ethics and quality oriented behaviors*
  - » *Should also include other service lines in the network*
- » **Risks** of overreliance on IT, lack of internal controls testing, standardization and bias contributing to **lack of professional skepticism**
- » **Risks of lack of talent/resources**
- » **Early days audit oversight practices no longer fit to address current state of play**
  - » *Adaptive audit oversight and enforcement strategies required (**effective and efficient**)*

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**Actions for the future**





# 10 Focus areas for effective/efficient audit regulation going forward

1. Require **ISQM1** and **ISQM2 (EQR)**: Focus inspections on **operating effectiveness** of **quality management** with particular focus on role **leadership** firms, and hold them accountable – **leverage audit oversight strategy on ISQM1 and ISQM2**
2. **Thematic inspections** focused on audit firm strategy, leadership, ethical culture & behavior and whether ethical requirements are implemented for all business lines / network firms
3. Implement **informal enforcement strategy** by requiring firms to do own follow-up inspections/ investigations and **in-depth RCA** and **effective remediation**
4. Investigate **impact** of **alternative ownership structures** (corporate, PE) on AQ and independence to address
5. Requiring **independent governance body** with specific legal tasks (Supervisory Board) for **PIE audit firms**

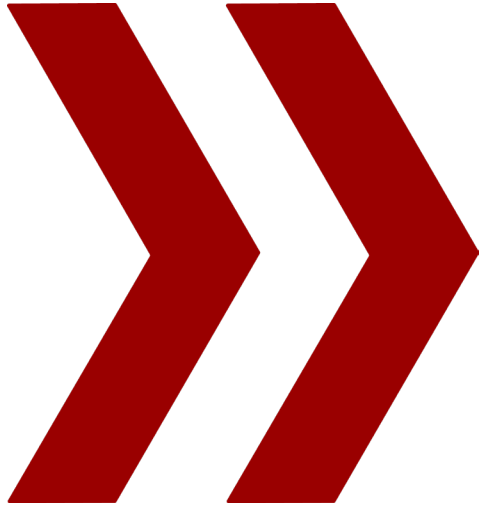
**Adaptive audit oversight is key to protect investors and other stakeholders in the public interest**



# 10 Focus areas for audit regulation going forward (cont.)

6. Consider **expanding** public oversight **mandate audit regulators** to include **sustainability assurance** (expectation gap)
7. Stimulate/require the audit sector to focus on **capability building** (human, technical and technological resources) to meet heightened demands (incl. sustainability assurance engagements)
8. Organize **roundtables** with PIE firms and professional bodies and audit committees to create commitment (outcome oriented)
9. Require **enhanced transparency** about ownership structure, ethics and quality culture, AQ issues and indicators for PIE audit(s) / PIE audit firms)
10. **Enforce** severe and/or pervasive violations **incl. lack of timely in-depth RCA & remediation** and **make transparent** (publish to expedite required change in culture & behavior and safeguard a level playing field)

**Adaptive audit oversight is key to protect investors and other stakeholders in the public interest**



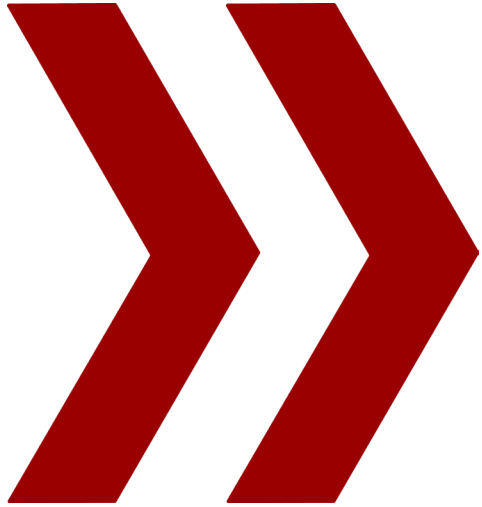
# Concluding Remarks



# Importance of strengthening international cooperation

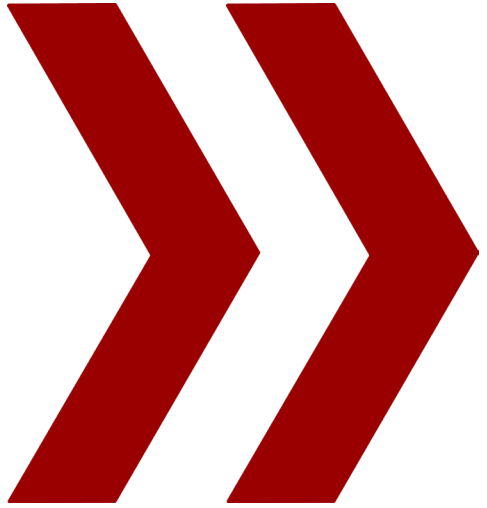
*Cross border audit and sustainability assurance / global financial markets require:*

- » **Consistency in high quality audits and sustainability assurance** engagements
- » **Ethics & quality tone at the top** international leadership network firms
  - » Cascades to jurisdictional network firms and other local audit firms
- » **Adaptive audit oversight strategies through shared learning and international cooperation**
  - » Accelerated learning
  - » Enhanced local Impact
  - » Coordinated input into international standard setting and local law making
  - » Facilitates addressing cross border incidents by MoUs to share confidential information
  - » Supports other regulatory bodies in their public oversight (eg. financial sector and securities regulators, AML etc.)
  - » Provides opportunity for strengthening effectiveness through Monitoring Group (MG) cooperation & powers



**Importance of cooperation through IFIAR with other MG members, including the World Bank to stimulate ongoing adaptive reform at both international and jurisdictional level**

**Conference – excellent example for shared learning**



**Q&A**