

Lewis H. Ferguson, IFIAR Chair

**Opening Statement on the International Forum of Independent Audit Regulators
Report on 2014 Survey of Inspection Findings**

March 3, 2015

Welcome and thank you all for participating in this press briefing on the 2014 survey of IFIAR members' inspection findings.

I am IFIAR Chair Lewis Ferguson and I will be presenting the survey results together with IFIAR Vice Chair Janine van Diggelen.

IFIAR's new survey of inspection findings shows persistent, high levels of deficiencies in audits of listed companies reviewed by independent regulators around the world. This confirms the conclusions we drew from last year's survey -- audit firms need to pursue initiatives to improve audit quality and the consistency of audit execution.

We continue to see these high levels of inspection deficiencies in vital areas of listed company audits. This is a problem for investors and other users of financial statements around the world.

In the survey we ask regulators to categorize their findings according to a number of themes. This year, our survey was improved to capture the rate of inspection findings for each theme. Specifically, for each audit area included in the survey, such as Revenue Recognition, we report the percentage of audit files inspected for that theme that had a finding. In other words, first did the reporting regulator "look" for a particular problem. And second, did the regulator "find" that problem. This gives a more informative indication of audit quality issues in key areas of audit. Another improvement to the survey was the addition sub-categories for three of the listed PIE (which is a public interest entity, or a listed entity) inspection themes – Fair Value Measurement, Internal

Control, and Revenue Recognition – and for two quality control areas – Human Resources and Engagement Performance. For example, for fair value measurement, we were able to learn that the most frequently cited sub-category of findings was in the area of testing the accuracy of data used and reasonableness of assumptions when testing how management arrived at measurements. With respect to Internal Controls, the most common finding was failure to appropriately test Information Technology Controls. With respect to Revenue Recognition, the most common failure was the failure to assess and respond to fraud risks. These refinements to the survey enabled us to provide more information about the types of findings in those areas with high rates of deficiencies

Janine and I will describe the survey results in detail, and then open the floor to your questions, first from reporters in the room, followed by those on the phone. You also may e-mail your questions to s.broom@frc.org.uk. This meeting is available to the public and journalists through teleconference.

IFIAR

First – an introduction of IFIAR. As our name says, the International Forum of Independent Audit Regulators is an association of *independent* audit regulators. Our mission is to provide a forum to share knowledge and experience in overseeing audit around the world.

Independence means that all IFIAR members are independent of the auditing profession. IFIAR presently has 51 members from countries in Africa, the Americas, Asia, Europe, the Middle East and Oceania.

We are presenting today the results of our third annual survey of inspection findings from our members. This year, 30 countries submitted results, which are primarily from inspections of audit firms affiliated with the six largest international audit firm networks.

IFIAR publishes the results of its surveys to inform regulators, investors, the financial community, auditors, and the public about the current state of inspections of audits of public companies, including financial institutions, around the world. IFIAR members together and separately pursue improvements in the reliability of audit firms' work and of the opinions expressed on financial statements.

RESULTS

The report on 2014 findings summarizes key inspection results from audits of listed companies, including systemically important financial institutions. These results came from inspection reports issued during the members' most recent annual reporting periods that ended by July 2014. A note of caution about these results. They represent a backward look at audit quality and the audits inspected took place from 2011-2014 and were for financial statements as old as 2010, so they do not necessarily reflect changes that have taken place since the inspections were done. Nonetheless, they do give a picture of what regulators around the world are finding.

IFIAR members reported findings from inspections of three categories of audit firm activities—audits of listed public interest entities (PIEs); audits of systemically important financial institutions (SIFIs), including global systemically important financial institutions (G-SIFIs); and internal systems for firm-wide quality control, that is, inspections of the audit firms' own quality control systems.

Inspection findings are deficiencies in audit procedures that indicate that the audit firm did not obtain sufficient appropriate audit evidence to support its opinion. Findings identify areas where the auditor's performance fell below the expected level of diligence to satisfy the public interest role the auditor is meant to fulfill; they also mean that the

audit failed to provide the level of assurance about the financial statements that it purported to do and that is required by professional standards.

A deficiency does not necessarily mean that the audited financial statements themselves were materially misstated. The deficiencies simply mean that there is not enough evidence to know with assurance whether the financial statements are materially misstated. These findings go to the quality of the audit work done on those financial statements.

Our members reported on the inspections of 948 audit files. Of those 948 audits inspected, 449 (47%) had at least one finding reported. Our members also reported on inspections of 148 systemically important financial institutions' audits and made at least one finding in 41% of those inspections.

The results show that:

- The areas with the most deficiencies in inspected audits of listed public interest entities, or public companies, relate to internal control testing (24 percent); auditing fair value measurements (20 percent); and auditing revenue recognition (14 percent). These percentages reflect the number of times inspections had a finding in this area, out of the number of times the topic was reviewed.
- The areas with the most of deficiencies in audits of systemically important financial institutions, including globally systemically important banks and insurers, relate to internal control testing (27 percent); auditing of the valuation of investments and securities (27 percent); and auditing of allowance for loan losses and loan impairments (17 percent).
- Audit firms' own quality control systems had the highest number of inspection findings in the areas of engagement performance (60 percent); independence and ethics requirements (48 percent); and human resources (45 percent). What we mean

by human resources would include evaluation of criteria used to judge partners and determine compensation, and staffing ratios, and whether the right people are assigned to the audit.

IFIAR members also reported their impression as to whether audit quality in their jurisdictions had changed. Although it is encouraging that almost 30 percent of the respondents observed overall improvement, this is offset by almost half of the respondents noting no significant overall changes, and by mixed observations by the other respondents. This underscores that further efforts are needed.

I see this survey as a key step for IFIAR in promoting cross-border audit quality. Now, Vice Chair van Diggelen will walk you through IFIAR's attention to addressing root causes of these findings, and how IFIAR's work addresses audit quality.

Janine van Diggelen, IFIAR Vice-Chair
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Good morning, good afternoon and good evening to everybody here and on the call.

I am Janine van Diggelen, vice-chair of IFIAR and head of the Audit and Reporting Quality Division at the Netherlands Authority for the Financial Markets, AFM.

As IFIAR Chair Ferguson said, the persistence in the audit deficiencies as evidenced by this year's survey presents a problem for investors and other stakeholders in audit reports. IFIAR and its members have a strong focus on addressing the root causes that underlie these findings, and I will also elaborate on what we as IFIAR are doing to contribute to improving audit quality.

In order to substantially improve the outcome, I strongly believe that an analysis of the root causes is absolutely necessary. A well performed in-depth root cause analysis will provide the firms with a thorough understanding of the factors that underlie these findings, which includes the cultural and behavioral influences relevant to the deficiencies. Only with this understanding can audit firms develop the appropriate remedial actions. I am well aware that there is no silver bullet for the solution, and that many times

remedial actions consist of a series of measures taken by individual audit firms, but also by the audit networks at regional and global levels. The efforts taken will be monitored, both by IFIAR and by our individual members.

IFIAR

As IFIAR, we will continue monitoring developments in audit quality, including by conducting surveys and engaging with the largest audit firm networks. We expect the firms to improve root cause analyses, and to undertake specific action plans to remediate the underlying causes. Such plans will need to include measures directed at the methodology and tools, but also at governance and incentives that change behavior. IFIAR and its members will continue to monitor progress as we expect observable improvement in audit performance. In our ongoing meetings with the global network firm leaders, IFIAR expects the firms to provide information about the results of root-cause analyses, their actions taken on root causes identified, and whether measurable improvements are being made. The global network firms with which IFIAR meets have agreed to provide such information.

The Survey can also be used to inform standard-setting activities, both nationally and internationally, and our members can use the survey to inform their respective inspection programmes. Also, audit committees could use the outcomes of the survey for their interactions with their auditors.

We believe the only way to improve audit quality is to strive for sustainable solutions. Investors and other stakeholders need to be able to rely on the

auditor's work, without a doubt. During the financial crisis too many questions have been posed, and the trust need to be restored. We as regulators recognize our responsibility to stimulate firms nationally and globally in making fundamental changes. As regulators, we also see high quality audits, so we believe it is possible for firms to execute high quality audits consistently.

Thank you.