



**INTERNATIONAL FORUM OF  
INDEPENDENT AUDIT  
REGULATORS (IFIAR)  
Thematic Review: Principles 9 & 11**

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# 1. Introduction

The International Forum of Independent Audit Regulators (IFIAR) hereby presents the outcome of the thematic review of Principles 9 & 11. The thematic review was conducted in close cooperation with the IFIAR members and was coordinated by the IFIAR Secretariat.

A key objective of the Officers' Work Plan, agreed by the Members in April of 2013 at the Noordwijk plenary meeting, is that IFIAR would conduct an information-gathering exercise with respect to two of IFIAR's Core Principles in order to assist the Members in developing their own national arrangements, while benefiting from the experience of others. Specifically, this objective proposes gathering information from IFIAR Members regarding the following two core principles:

- **Principle 9:** Audit regulators should ensure that a risk-based inspection program is in place; and
- **Principle 11:** Audit regulators should have a mechanism for reporting inspection findings to the audit firm and ensuring remediation of issues with the audit firm.

This Thematic Review was not intended to be a benchmarking or rating exercise on the level of implementation of, or compliance with, these Principles. On the contrary it aims to identify, compile and share practices on the implementation of Principles 9 and 11.

The exercise may also:

- Identify possible trends and developments in approaches and measures.
- Provide insights for those developing independent audit oversight.

This report describes how the Thematic Review was conducted, and sets out key findings and areas for potential further study by IFIAR.

## **Methodology**

The Thematic Review was undertaken as a desk-based exercise, using responses provided by IFIAR members to a questionnaire delivered through a purpose-built online survey tool.

All IFIAR members were encouraged to participate in the Thematic Review. Twenty-eight members participated in the survey. The outcomes of this review provide an overview of Members' arrangements at the time of the cut-off date (March 2014).

Apart from summarizing the outcomes, the review report identifies and highlights certain observed practices. The term **observed practice** refers to supervisory measures and practices identified through the survey responses that have been developed by one or more IFIAR Members. In some cases, the observed practice relates to a regulator that, through the survey response, provided specific information on a practice followed in the Member jurisdiction. In other cases, the **observed practice** reflects examples highlighted within multiple Members' surveys.

All examples provided are illustrative. Not all examples are necessarily most suitable for all IFIAR Members' jurisdictions or regulatory programs. The examples are included for the consideration of those evaluating or developing regulatory functions in a national context.

The **areas for further study** are intended to identify further considerations raised by the survey responses in specific areas of Principles 9 and 11. Pursuant to its normal process for initiating projects, IFIAR may wish to consider these areas for further analyses.

The results are presented as a percentage or number of the participants for which the question is applicable. It is not always the case that 28 respondents answered all questions.

### **Report structure**

The report starts with the key findings and areas for potential further study in chapter 2. Chapter 3 describes the general information of the respondents to the survey. Chapter 4 contains detailed findings and examples of observed practices for Principle 9. Chapter 5 contains detailed findings and examples of observed practices for Principle 11.

## 2. Executive Summary

The IFIAR members agreed in 2013 to **conduct a thematic review** (the Review) with respect to two of IFIAR's Core Principles<sup>1</sup> in order to assist the Members in developing their own national arrangements, while benefiting from the experience of others.

The Review aims to identify, compile and share practices concerning risk based inspection programs (Principle 9) and their mechanisms for reporting inspections findings (Principle 11). The outcomes of the Review provide an overview of Members' arrangements at the time the Review was conducted (March 2014).

IFIAR members that responded to the survey cover more than 70 % of the global capital markets.

**Almost all respondents report their findings from reviews of audit engagements to the firm and/or audit partner and all respondents report the findings from quality control inspections to the firm.** Of those, the vast majority of respondents make those communications in writing. The Review also pointed to possible areas where IFIAR could explore further work.

Further, it was clear that **the vast majority of respondents have a risk-based program in place.**

### ***Monitoring trends in reported inspections findings and communications with audit committees***

The Review shows an interesting **trend towards the communication of inspection findings to the audit committee.** IFIAR will monitor this trend in the coming years to further understand practices in communications with audit committees. Communicating inspection findings to audit committees could improve the information available to them about the external auditor, which could contribute to audit quality.

IFIAR's increased coordination with IOSCO should enhance understanding of audit committee practices and may identify opportunities for improved engagement about audit quality with those charged with governance.

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<sup>1</sup> The IFIAR Core Principles cover the following areas: (i) the structure of audit oversight, (ii) the operations of audit regulations and (iii) principles for inspection processes. They are intended to promote the common goal of IFIAR Members to serve the public interest and enhance investor protection by improving audit quality globally, including through independent inspections of auditors and/or audit firms.

The core principles seek to promote effective independent audit oversight globally, thereby contributing to Members overriding objective of serving the public interest and enhancing investor protection by improving audit quality, and were approved by the members in May 2011.

- **Principle 9: Audit regulators should ensure that a risk-based inspection program is in place; and**
- **Principle 11: Audit regulators should have a mechanism for reporting inspection findings to the audit firm and ensuring remediation of issues with the audit firm.**

IFIAR membership is not dependent on its status in implementing the principles; however members are encouraged to work towards implementing them where appropriate in their own jurisdictions.

## Reporting Inspection Findings to Firms

Almost all respondents report their file reviews to the audit firms and/or auditors and all respondents report their quality findings to the firm. In the case of audit engagement reviews all communications are in writing. Various processes are followed for such communications. For example, the threshold used to decide whether to report all or only more significant findings varies among respondents. In this regards it is interesting to note that, within IFIAR's GPPC Working Group and through the Inspection findings survey, IFIAR **has developed a common definition of an inspection finding** to be used for discussing within IFIAR and with the GPPC firms common types of issues identified in inspection programs.

While the common definition of a finding provides helpful terminology for IFIAR-level discussions and for discussions with the largest audit networks globally, IFIAR members' differing regulatory, legislative and cultural circumstances may call for other thresholds for determining which "findings" would be reported at the conclusion of an inspection. Regulators' differing approaches to reporting were discussed at the IFIAR inspection workshop in London in March 2015. The goal of that discussion is for members to learn from each other's experiences and to promote members' common understanding of what meets the "finding" definition used for IFIAR's survey of inspection findings and therefore should be included in members' responses to IFIAR's annual survey.

### *Assessing risks in audit oversight*

The Review results indicate that the vast majority of the respondents have a **risk-based program** in place for inspections of audits of public interest entities (PIE<sup>2</sup>).

The Review results show that around half of the respondents currently assign a **risk rating to firms** for internal purposes, with almost the same amount of respondents internally assigning a risk rating to individual **audit files**.

A solid risk-based program leading to the regulator's internal determination of risk ratings at the level of a firm as well as individual audits can enhance both efficiency and effectiveness of oversight activities. IFIAR could further explore how the risk rating process takes place among its members and which (general) sources of information can be used. The main goal of further investigation of this topic can be to promote IFIAR members' awareness of (micro and macro) approaches available as they establish, evaluate and build upon their risk-based approach to inspections.

Almost all respondents indicated that the results from the risk-based inspection process **serve as input for enforcement activities**. This could imply that the risk analysis process may be integrated into various aspects of the auditor oversight program, including selection of files for inspection as well as identification of areas for potential investigation.

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<sup>2</sup> PIEs generally included listed companies, banks and insurance companies, although the precise definition varies between jurisdictions.

IFIAR published a report summarizing results of a survey of its members' inspection findings<sup>3</sup>. This annual survey and report can be used by IFIAR members to identify common risk areas, potentially as an input for their own risk rating process. In turn, as IFIAR periodically evaluates the topics about which inspection findings data is collected, discussions among IFIAR members on their respective risk ratings process may prove insightful to future inspection findings survey topics.

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<sup>3</sup> See <https://ifiar.org/IFIAR-Global-Survey-of-Inspection-Findings.aspx>

## Summary of Key Findings & Examples of Observed Practices P9

- The survey results indicate that the vast majority (93%) have a **risk-based program** in place for inspections of audits of public interest entities (PIE). In the risk assessment the following types of information are mostly used: financial information released by PIEs, PIE press releases and/or calls and industry reports.
- Important input information can be obtained by having an **outside reporting system**, such as a whistleblowing hotline. Via this system, individual stakeholders can communicate their observations to the audit regulator (“whistleblowing policy”). These signals can be used as part of the “risk-based” approach for selecting firms, PIEs, QC areas, and focus areas for review.
- A strong majority (86%) of the respondents indicated that they employ a **risk-based approach** when selecting firms for review. Furthermore, 75% of the respondents employ a risk-based approach when determining focus areas for quality control (QC) work. In addition, 89% of respondents apply a risk-based approach when selecting files for review. When selecting focus areas for review, 75% of the respondents indicated that they use a risk-based approach.
- 75% of the respondents use a risk-based approach when selecting focus areas but on top of that, 81% of audit regulators have **fixed focus areas** (e.g. materiality, fraud risks, significant risk areas, judgmental account balances, internal QC inspections and engagement quality control reviews) that will always be inspected regardless of the risk analysis outcome. It seems that the majority of audit regulators reviews at least some important fixed focus areas and additionally reviews a number of focus areas based on the outcomes of the risk analysis.
- Now that the European Union has adopted a firm rotation requirement, regulators may wish to focus on the risk rating assigned to issuers rather than only the risk rating assigned to a firm. This is because the auditor of a “risky” file may change in the coming years.
- An interesting result of the survey is that roughly 57% of the respondents perform thematic inspections. Members who conduct thematic inspections believe that they provide in depth knowledge about possible issues in a specific sector or branch and can be used to respond to developments in the markets (i.e. financial crisis).

## Summary of Key Findings & Examples of observed practices P 11

- Almost all respondents (27) report the findings from the file reviews to the firm and/or auditor and all 28 respondents report the findings from the quality control inspections to the firm. In the case of file reviews all communication is in writing (27) but when it concerns quality control findings, a majority uses both oral and written communication (18);
- All 28 respondents indicate that firms have the opportunity to respond to the individual findings communicated to the firm;
- The vast majority of respondents send the draft report to the firm (24) and schedule a meeting with the firm to discuss the findings in the draft report;
- The vast majority of respondents have an internal process in place to review the draft report before it is sent to the firm (24);
- The vast majority of respondents do not make their final inspection reports public (23);
- For three members, when a partial report is made public, only significant findings are disclosed;



- Most respondents publish annually summarized, general, overall, aggregated inspection results without mentioning the names of audit firms and/or their clients (19);
- None of the respondents provide a rating of the quality control systems in the public report;
- Although not a common practice yet, there seems to be a trend towards the communication of findings to the audit committee. Three respondents are allowed to communicate findings to the audit committee or others charged with governance of the audit client. In the near future, three more respondents will have the ability to report findings to the audit committee;
- The vast majority of respondents (27) have a remediation process in place. The time period for remediation activities varies greatly. The time period for remediation activities of a firm is mostly determined individually (19), sometimes by law (3) and sometimes in another way (5), for example, at the next inspection of the firm.

### 3. General Information

Number of total audits of PIEs<sup>4</sup> (including listed PIEs) covered by the inspection regime of the responding jurisdiction:

Total # of PIEs	# of Respondents
<20	1 (4 %)
20-100	3 (11%)
100-1000	10 (36%)
>1000	14 (50%)

Number of audits of listed PIEs covered by the inspection regime of the responding jurisdiction:

# of Listed PIEs	# of Respondents
<20	4 (14%)
20-100	6 (21%)
100-1000	11 (39%)
>1000	7 (25%)

Number of audits of non-PIEs covered by the inspection regime of the responding jurisdiction

# of non-PIEs	# of Respondents
None	10 (36%)
1 < 20	0 (0%)
20-100	3 (11%)
100-1000	1 (4%)
>1000	14 (50%)

#### **Responsibility for conducting inspections**

The survey shows that the majority of respondents (64%) have sole responsibility in their jurisdictions for conducting inspections of PIEs.

Of the 18 respondents who also have non-PIEs under their inspection regime, only 4 have sole responsibility for conducting inspections of non-PIEs (i.e. no other organization inspects non-PIEs).

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<sup>4</sup> For purposes of this survey, respondents were asked to apply the definition of a PIE followed in its own jurisdiction. A common definition was not provided for the survey.

## 4. Key Findings & Examples of Observed Practices Principle 9

### **Principle 9**

*Audit regulators should ensure that a risk-based inspection program is in place.*

Further explanation of the principle is as follows:

Audit regulators should have a process for assessing risks in the audit environment and audit risks in individual regulated firms and their audit engagements. Audit regulators should have a process for taking into account their risk assessment in allocating their inspection resources and in the inspection approaches they adopt. These processes should be in line with the size and complexity of the audit firms and their clients. Audit regulators should have an established minimum cycle regarding the frequency of inspections.

***Most respondents follow a risk-based inspection program and many consider similar information when assessing risk.***

### **Risk assessments**

Regarding the process for selecting firms, PIEs, QC areas and focus areas for review in an inspection, the survey demonstrates that the following types of information are used by the respondents in their risk assessments:

- Financial information released by PIE – 24 (out of 26)
- Company press releases and/or earnings/press calls – 20 (out of 26)
- Industry reports – 19 (out of 26)
- Data/information from external providers – 17 (out of 26)
- Macro-economic outlook reports – 16 (out of 26)
- Analyst reports on PIEs – 13 (out of 26)

The vast majority of the respondents indicated that they use the first three types of information the most. This information focuses on the industry of and information from the PIE itself. While external information is also used, the focus seems to be on the information provided by the PIE. The answers indicate that it is common to use multiple sources of information instead of one. Further, the two most frequently used types of information are reported by the PIE subject to audit.

### **Selections based on risk-based criteria**

Random selections are used by 35% of respondents in their inspection program in addition to the selections based on risk-based criteria. Reasons for such an approach may be to test compliance with local requirements or to provide for unpredictability of the inspection process as is described in the example below.

### ***Observed Practice***

One respondent has the practice of using random selection of issuers to inspect in addition to risk-based issuer selection. It has done so because it believes that firms can anticipate on this risk-based approach, based on their experience of a previous inspection cycle and the size or listing of the PIE. It uses random selections to mitigate this risk and avoid blind spots in inspections.

“Each year we have a small part of inspections randomly selected not based on risk factors, depending on remaining capacities in the inspection department, to assure unpredictability of inspection process.”

### **Output of risk analysis**

In terms of the deliverables (output) of the risk analyses, the respondents indicate they are provided with risk reports / analyses which indicate that oral communications about risk occur within inspection teams. Hence, most of the respondents provide standardized analyses on an annual basis to the inspection teams. A very interesting point in this context is that 92% of the respondents indicated that the results from the risk-based inspection process serve as input for enforcement activities. This could mean that the risk analysis process is integrated into various aspects of the auditor oversight program, including selection of files for inspection as well as identification of areas for potential enforcement consideration. Given a “risk-based” selection approach, some level of enforcement activity seems a reasonable outcome of effective risk-based inspections.

### ***Area for Further Study***

The survey results show that half (54%) of the respondents assign a risk rating to firms, with also almost the same amount of respondents (46%) assigning a risk rating to individual files. This could be a potential area for more in-depth analysis.

A potential input source for the risk analysis is an outside reporting system (whistleblower system) as the following example describes.

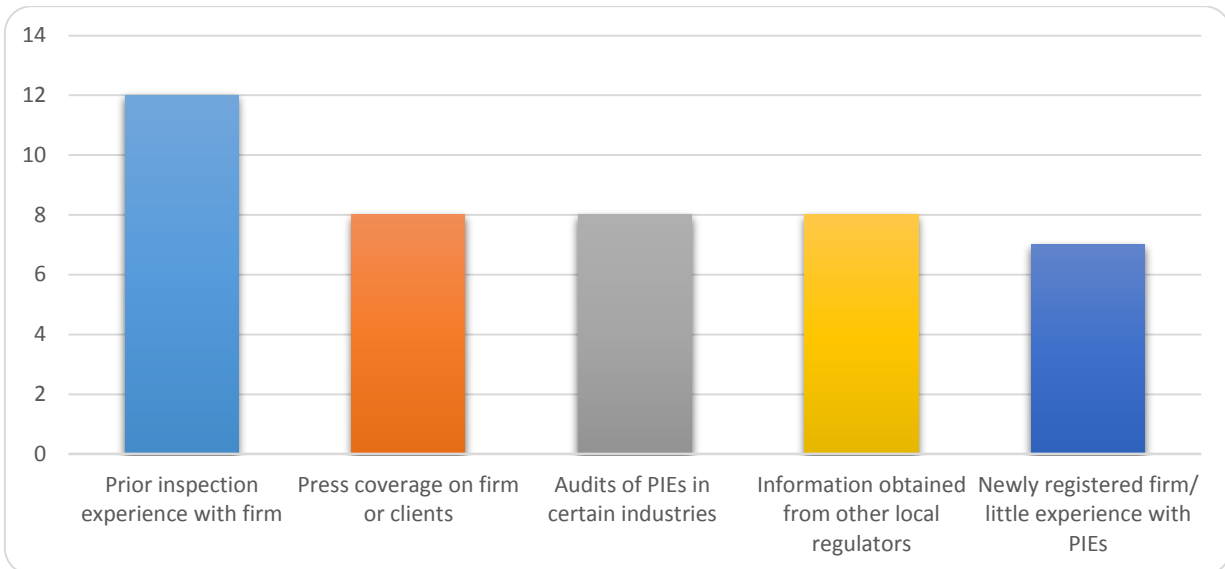
### ***Observed Practice***

Important input information can be obtained by having a system to gather information from external tips. Via this system, individual stakeholders can communicate their observations to the audit regulator (“whistleblowing policy”). These signals can be used as part of the risk-based approach for selecting firms, PIEs, QC areas, and focus areas for review. The response on this question indicates that 58% (15) of the audit regulators have an whistleblower tip system in place and 42% do not (11).

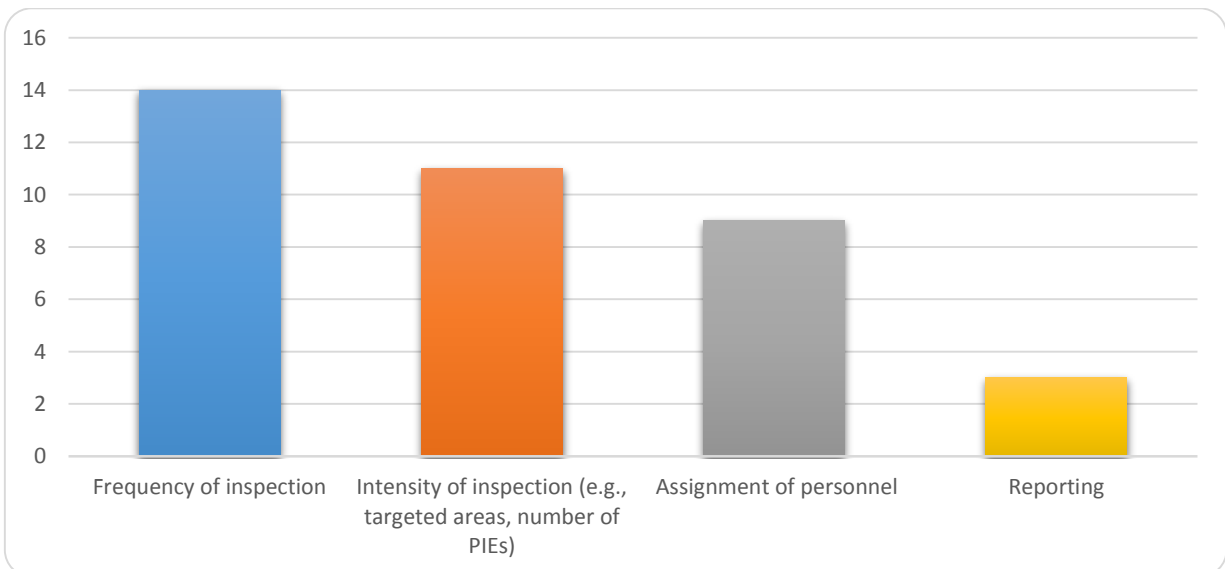
### ***Approaches concerning Risk Ratings of Firms and Files appear to be done differently across the respondents***

The survey results show that half of the respondents (14) assign a risk rating to firms, with almost the same amount of respondents assigning a risk rating to individual files. This could be a potential area for more in-depth analysis, for example to gain further insight into how risk ratings are determined in various Members’ programs.

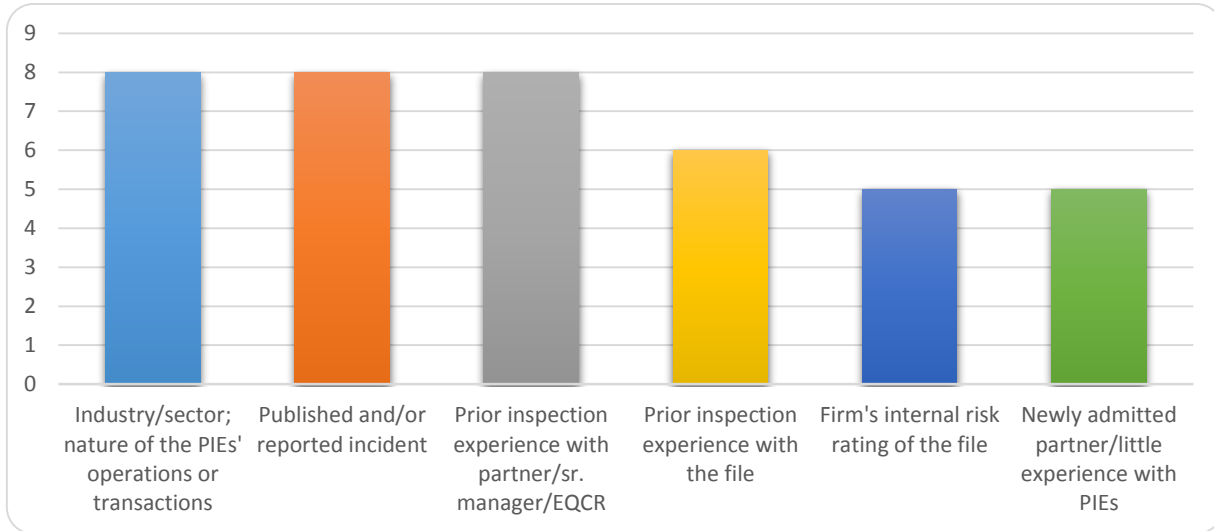
Respondents who assign a risk rating to firms (14) indicate that the following factors are taken into account for firm risk rating:



Respondents indicated the following impact on inspections when using a firm risk rating:



Respondents who assign a risk rating to individual files (12) indicate that the following factors are taken into account for file risk rating:



A risk rating assigned to an audit file may take on a different relevance as auditor rotation takes effect in more jurisdictions, as the following example describes.

### ***Observed Practice***

A respondent is in the process of combining different information systems in order to track a risk-rated file from one audit firm to another in light of the recently-adopted European Union legislation that will require rotation. This is because it anticipates that certain files designated as high risk may move from one audit firm to another. If the regulator only assigned risk ratings to the firms and not the files, it would potentially miss the opportunity to track risky files.

Given the adopted legislation on firm rotation in the European Union, it will become more useful to track the inspected files with a risk rating because all PIEs will replace their auditor in the coming years. There is a risk that the regulator only focuses on the audit firm instead of also focusing on an inspected file after a firm rotation.

***There appear to be commonalities among the respondents in the selection and determination processes in a risk-based approach***

A strong majority (86%) of the respondents indicated that they employ a risk-based approach when selecting firms for review. Furthermore, 75% of the respondents employ a risk-based approach when determining focus areas for quality control (QC) work. In addition 89% of respondents apply a risk-based approach when selecting files for review.

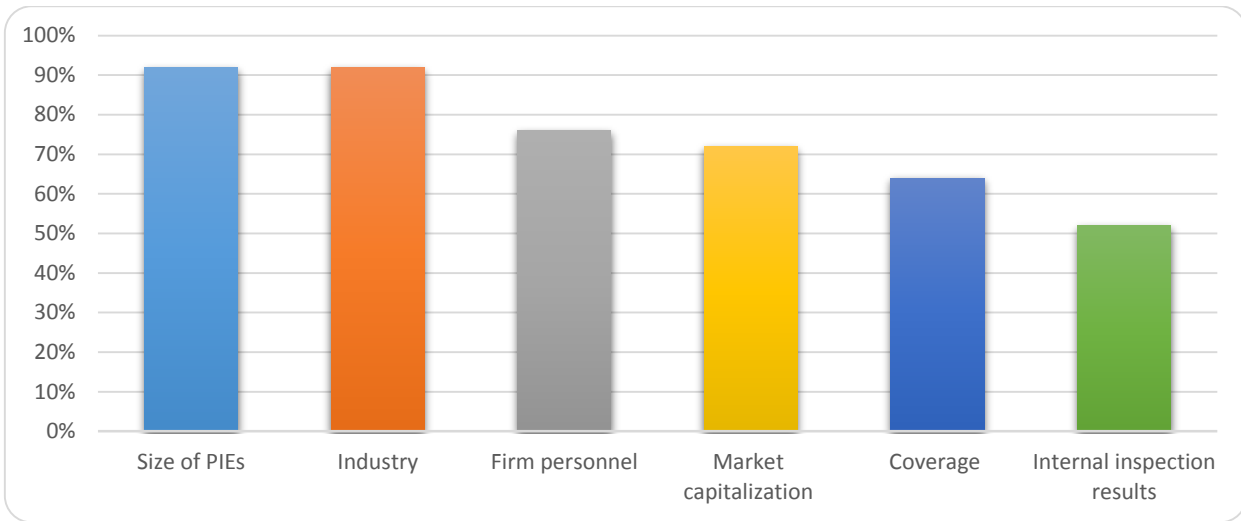
***Observed practices***

Around 75% of the respondents use a “risk-based” approach when selecting focus areas. In addition, 81% (17) of the responding audit regulators have fixed focus areas that will always be inspected regardless of the risk analysis outcome. It seems that the audit regulators want to review at least some important fixed focus areas and additionally want to review a number of focus areas based on the outcomes of the risk analysis. This may be because regulators seek to track certain areas of difficulty, monitor implementation of certain standards or maintain consistency in tracking certain areas.

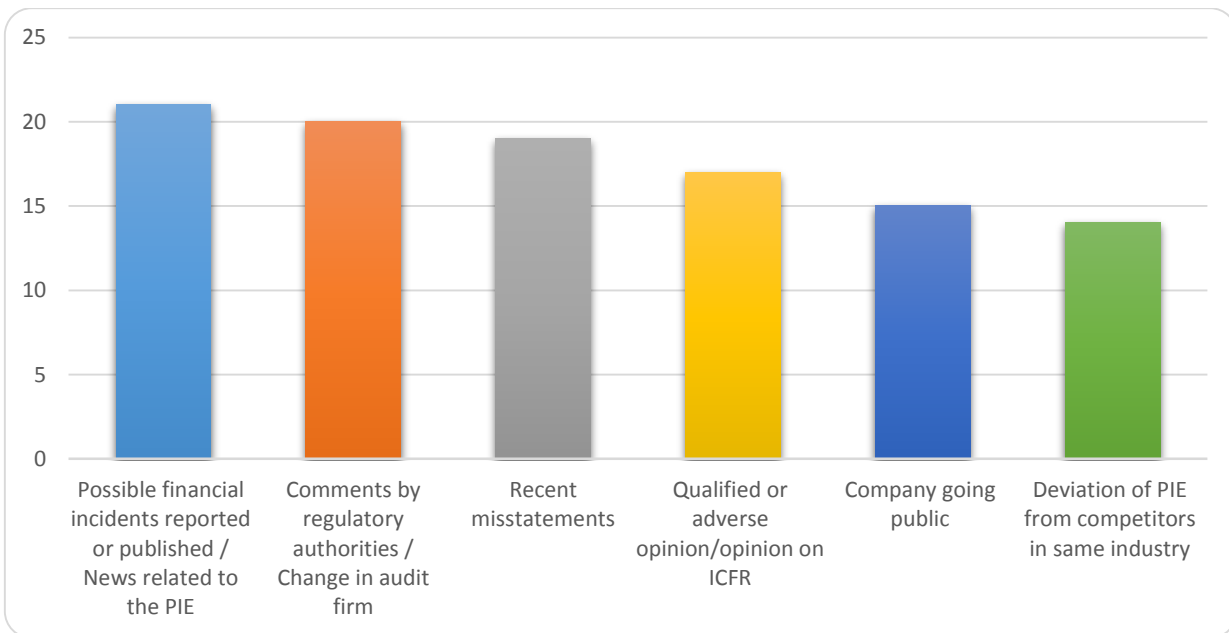
The answers of the respondents indicate that they focus to some extent on fixed areas for inspection, both for selected audit files and for firm-wide quality control. On the file level, it is common to focus on the planning of the audit (i.e. determination of materiality, fraud risk assessment and response), the (selection of) significant risk areas (e.g. revenue) and account balances which involve judgment (e.g. goodwill). On the quality control level, it is common to focus on quality control procedures including internal QC inspections and engagement quality control reviews.



The respondents indicated that the following factors play an important role when selecting files for inspection:



The respondents indicated that the following PIE-specific factors play an important role when selecting files for inspection:



An interesting result of the survey is that roughly 57% of the respondents perform thematic inspections (i.e. inspections that concentrate on one aspect/area only) and 43% do not. This could be a potential area for more in-depth analysis.

## ***Observed Practice Thematic Reviews***

An interesting result of the survey is that roughly 57% of the respondents perform thematic inspections. Regulators who conduct these inspections may evaluate such inspections for in-depth knowledge about possible issues in a specific sector or branch and can be used to respond to developments in the external circumstances (i.e. financial crisis).

Based on the answers given by the respondents the following thematic reviews have been performed:

- ✚ Significant operations in foreign jurisdictions (emerging markets)
- ✚ Group audit
- ✚ Specific industry concern (i.e. Asset Management)
- ✚ Specific clarified ISA
- ✚ ISQC-1 policies and procedures
- ✚ Auditor rotation and transparency reports
- ✚ Housing corporations
- ✚ Ban on non-audit services for PIEs
- ✚ Auditors use of materiality
- ✚ Auditors work on fraud and laws and regulations
- ✚ The audit of financial reporting and disclosures at smaller companies
- ✚ Audit of banks.

## 5. Key Findings & Examples of Observed Practices

### Principle 11

#### Introduction

According to principle 11 audit regulators should have in place a mechanism for reporting to the audit firm inspection findings and remediation of issues raised during the inspection.

#### Principle 11 – reporting inspection findings and remediation

Principle 11 reads:

*“Audit regulators should have a mechanism for reporting inspections findings to the audit firm and ensuring remediation of findings with the audit firm.”*

The Core Principles provide the following explanation to this principle:

*“Audit regulators should have a process that ensures that criticisms or potential defects in an audit Firm’s quality control systems and issues related to an audit firm’s performance of audits that are identified during an inspection are reported to the audit firm. Audit regulators’ reporting processes should include the preparation and issuance of a draft inspection report, a process for the audit firm to respond, and the preparation and issuance of a final inspection report. In addition, audit regulators should have a process for ensuring that audit firms satisfactorily address inspection findings that were reported to the audit firm by the audit regulator.”<sup>5</sup>*

Three topics can be derived from this principle. The audit regulator should:

- 1) report findings to the audit firm;
- 2) have a reporting process in place which includes providing an opportunity to respond to the draft report before the regulator issues a final report; and
- 3) have a process in place to remediate issues resulting from the inspection.

#### ***Observed practice***

There seems to be similarities among the respondents regarding the general characteristics of reporting inspection findings to the firm.

When a threshold is used to report a finding, minor findings are communicated mostly only orally and do not count towards the overall rating or reporting about a firm.

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<sup>5</sup> Cite to Core Principles document on the IFIAR website

## Key Findings

The survey summarizes the following general outcomes on the above-mentioned topics.

### *Observed Practice*

All respondents indicate that firms have the opportunity to respond to individual findings communicated to the firm.

## Report findings

Almost all respondents (27) report their file review to the firm and/or auditor and all 28 respondents report their quality control findings to the firm. In the case of file reviews all communication is in writing (27) but when it concerns quality control findings, a majority of members use both oral and written communication (18).

## Threshold reporting findings

The majority of respondents (16) do not use a threshold before an individual finding is reported but actually report all findings related to the review of files or quality control.

The remainder of the respondents use thresholds to report a finding related to file reviews (11) or quality control (12). These respondents also determine whether the finding is serious, significant, substantive, impactful and/or material in the overall context of the audit. Also 'failure to obtain sufficient and appropriate audit evidence' was a threshold used by at least one respondent. Generally, insignificant, minor or immaterial findings are not reported nor are findings that are not systematic 'by nature'. Some respondents indicate that minor findings are communicated only orally with the firm.

Regarding deficiencies in quality control, the same thresholds as mentioned above are used (significant, etc.). The same respondents who screen for a level of significance in reporting file review findings do not report a quality control finding, for example, when it is a single issue with no indication for systematic deficiency. One respondent notes that low risk and housekeeping matters are reported, but this does not count towards the overall rating of the firm. The vast majority of the respondents summarize the inspection results on a firm basis (24).

### *Observed Practice*

The majority of respondents (16) do not use a threshold before an individual finding is reported but actually report all findings related to the review of files or quality control.

## **Reporting process**

All respondents (28) indicate that firms have the opportunity to respond to the individual findings communicated to the firm. However, the process for responses differs greatly, as discussed below.

## **The draft report**

The vast majority of respondents share the draft report or parts thereof with the firm (24). However four respondents have a different kind of process in place. Two of those four respondents indicate that they have a different system of reporting in general, under which sharing the complete draft report with the audit firm would not be appropriate. One of those two respondents clarifies that audit inspection findings are included in a larger report. Individual findings are sent to the firm to get their responses and these are discussed with the firm before issuing the final report. Moreover, the final report of this respondent is not sent to the firm, but rather is sent directly to the audited client.

The other respondent does share a draft report to confirm the factual accuracy of the case details and audit work performed prior to the finalization of the report. Once the factual accuracy of the draft report is confirmed, the final report will be issued to the public accountant for him/her to respond on the findings raised. The auditor/firm has the opportunity of responding to the conclusive findings in the final report. The other two respondents clarified in their additional answers that they do not send a draft report, but share the preliminary findings only orally instead of sending a draft report.

Thus, in conclusion, the vast majority of the respondents (24) indicate that the firm does get the draft report, two respondents indicate that they share preliminary findings with the firm only orally, and the remaining two respondents indicate that they do not share a draft report with the firm.

### ***Observed Practice***

Most regulators give firms the opportunity to respond to the facts/preliminary findings of the draft report

## **Internal process before sending draft report**

The vast majority of respondents (24) have an internal process in place to review the draft report with file reviews before it is sent to the firm. Sometimes this is done by a technical department of the respondent (2) or a legal counsel (4), but mostly the review is done by another person(s) and/or department(s) within the organization (21), such as: team leader(s) of the single inspection or the inspection department, policy advisor(s), general council(s), senior manager, senior executive leader, chief executive, quality assurance team, the General Secretary, management team, subcommittee of the board, and/or the head of the respondent.

This review is often performed in different combinations. One respondent notes that outcomes of file reviews are determined by an independent committee.

### **Meeting with firms**

All respondents (28) indicate that firms have the opportunity to respond to the individual findings communicated to the firm. The overall majority has some kind of process in place (26). However, these processes vary greatly.

The majority of respondents indicate that a meeting is scheduled to discuss the findings in the draft report (17). Some respondents only schedule a meeting when requested by the firm (6).

Five respondents do not have a meeting with the firm. For three of them, the firm appears to have the opportunity to respond in writing instead of a meeting because the survey response indicates that the final report includes the firm's response on the draft report.

### **Final inspection report**

Half of the respondents (14) indicate that they include the firm's response to the preliminary findings in the final inspection report. The other half does not appear to include the firm's response in the final report, even where it has been asked for and provided.

For firms with multiple inspection findings, repeating findings in consecutive inspections, or deteriorating trends, almost half of the respondents perform additional communication (12). This communication varies from:

- more intense reporting;
- further discussion with the firm;
- performance of a root cause analysis;
- requiring the firm to report remedial actions;
- meeting the firm on a semi-annual basis to find out their progress on remediating the findings;
- taking disciplinary actions or other enforcement measures.

### **Internal process before sending final report to the firm**

The vast majority of the respondents have a process in place to review the final inspection report before it is sent to the firm (25), but three of them do not. This process is mostly done by the same persons and divisions as with the review of the draft report (14). In other cases, it is done by at a 'higher level' of person and/or divisions of the respondent, for example, at a level of management above the leader of the inspection department. One respondent indicates that there is no process in place for the final report, while there was such a process regarding the draft report.

Before issuance of the inspection report, it is approved by a Governing body/Board (10), the leader of the inspection department (8), or by another senior official or division within the respondent (10), such as a Senior/General Manager or a General Secretary.

### **Publication of final reports**

The vast majority of respondents do not make public their final inspection reports they submit to the firm (23). A few respondents make only a portion public (3). One respondent indicates that some types of findings are published only if they are not remediated (see section hereafter 'remediation process'. When a partial report is made public, only deficiencies above a certain threshold are disclosed and more detailed discussions are not included. Only two respondents indicate that they make the inspection report public in its entirety, although one of these leaves out some less significant findings and the firms' action plan in response to the findings. The other makes the entire inspection report public with no difference at all between the private and public report.

#### *Observed practice*

When a partial report is made public, only significant findings are disclosed.  
None of the respondents apply ratings of the quality control systems in the public report.

In contrast, the vast majority of respondents do have other forms of public reporting in place (19). Most of them regularly publish summarized (general, overall, aggregated) inspection results without mentioning the names of firms and/or their clients. This is typically done on an annual basis. It appears that only two respondents publicly assign ratings to report the quality of the firms or audits performed by the firms. None of the respondents apply ratings of the quality control systems in the public report.

#### *Observed Practice*

Most respondents publish annually summarized, general, overall, aggregated inspection results without mentioning the names of firms and/or their clients

### **Communication with audit committee**

Only three respondents are authorized under their law to communicate findings to the audit committee or others charged with governance of the audit client. Another respondent states that audit firms are required to communicate with audit committees with respect to the findings.

When findings are reported these are: all findings in the report (1), only the most serious findings (1), or all significant findings along with the overall file review grade (1). One respondent stressed that audit committees are encouraged to ask their auditors for inspection findings relating to the audit of the concerned entity, although the regulator does not provide the report directly to them.

## Future changes

One respondent has recently been authorized to publish firm-specific findings. This makes a comparison between the firms possible; by presenting the outcomes of the anonymous files reviewed. When such numbers are available, the public can make a rating of the firms by its own. Furthermore, three respondents indicated that they expect their legislation will allow more possibilities to disclose inspection findings to the audit committees in the future. These entail:<sup>6</sup>

- a 'protocol for the communication of significant audit file inspection findings to audit committees';
- 'stressing to the audit committee the importance of communication with the auditor';
- the authority to communicate 'very severe findings related to file review to the Audit Committee or others charged with governance of the audit client in the future'.

### *Observed practice*

Although not a common practice yet, there seems to be a trend towards the communication of findings to the audit committee. In the near future six respondents will have the ability to report findings to the audit committee.

## Remediation process

Almost every respondent has a remediation process in place (27).<sup>7</sup>

Although these respondents all have a remediation process in place, two respondents indicate that firms are not required to remediate deficiencies. However, in one of these jurisdictions, when a firm has not remediated the finding(s), the full inspection report will be published for the public which might provide significant pressure to remediate.

A remediation of past deficiencies in files is not required according to a minority of the respondents (10). The minority only looks for remediation efforts to improve quality in future audits. The overall majority of respondents indicate that it depends on the facts and circumstances, whether a retrospective or a prospective remediation is needed (16).

Some firms may be required to enter into a dialogue regarding remedial actions to be taken (9), while others are only invited to do so upon request by the regulator (16). Two

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<sup>6</sup> One respondent anticipates changes with improvements on this topic, but these were only being discussed at the time of filling in the survey.

<sup>7</sup> Only one respondent has no process in place and did not answer the other questions about remediation. So the answers are based on the twenty-seven respondents that actually have a process in place.



respondents indicate that firms are not required to enter into a dialogue. Mostly firms are required to submit a remediation plan in writing (21).

### **Time period remediation**

The time period for remediation activities of a firm is mostly determined individually (19), sometimes by law (3) and sometimes in another way (5), for example, at the next inspection of the firm. This follow up inspection could also be shortened. Some respondents do a re-inspection within one year or shorter depending on the significance of the impact on the public interest.

In slightly more than half of the jurisdictions, firms are required to submit written evidence that remediation occurred and was appropriate (15). However, for the 12 other respondents this is not required. Almost every respondent has a process in place to evaluate a firm's remediation efforts (26), except one. However, this latter respondent indicates that changes are anticipated because they have only recently started the process of requiring remediation.<sup>8</sup>

The overall majority re-inspect areas in files in subsequent inspections to ascertain that deficiencies have been remediated (25).<sup>9</sup> A few respondents do this re-inspection at random (2), on a case by case basis (1), or only partly (1). However, the scope for these re-inspections is 'full and/or partly' (21).

### ***Observed Practice***

Almost every respondent has a process in place to evaluate a firm's effort to remediate deficiencies. Frequently, part of this evaluation is a re-inspection of certain areas of files.

The remediation processes have been followed by the respondents on average approximately three years. Some respondents indicate the duration of a single remediation process:

- until the firm improves its deficiencies;
- from one inspection to the next one;
- within a year from the date of receiving notification of measures;
- inspected firms are required to submit the status of their remediation plan on a quarterly basis;
- the period depends on an individual remediation plan.

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<sup>8</sup> At the same time, this respondent does re-inspect in subsequent inspections to ascertain that deficiencies have been remediated, so it might be fair to say that they already have a kind of process in place to evaluate a firm's remediation efforts.

<sup>9</sup> Only two respondents do not.