

The Governance of the Audit Firm

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Governance of the Audit Firm

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International Standards on Quality Control

Elements of Quality Control

- Leadership
- Ethical Requirements
- Acceptance and Continuance of Engagements
- Human Resources
- Engagement Performance
- Monitoring

Leadership Responsibility

“The firm should establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements. Such policies and procedures should require the firm’s chief executive officer (or equivalent) or, if appropriate, the firm’s managing board of partners (or equivalent), to assume ultimate responsibility for the firm’s system of quality control.”

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Ethical Requirements

“The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements.”

IFAC Code

- a. Integrity
- b. Objectivity
- c. Professional competence and due care
- d. Confidentiality
- e. Professional behaviour

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Ethical Requirements – Independence

“The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements, maintain independence where required by the IFAC Code and national ethical requirements.”

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Ethical Requirements – Independence

Such policies and procedures should be:

- a. Communicated to staff
- b. Evaluate threats to independence and consider safeguards
- e. Require engagement partners to provide relevant information about client engagements including scope of services
- f. Should ensure that personnel promptly notify the firm of the circumstances that threaten independence
- g. That up-to-date records are maintained and appropriate actions are taken if threats are identified
- h. That there is proper communication of any breaches

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Acceptance and Continuance of Client Engagement

“The firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide it with reasonable assurance that it will only undertake or continue relationships and engagements where it:

- a. Has considered the integrity of the client and does not have information that would lead it to conclude that the client lacks integrity;
- b. Is competent to perform the engagement and has the capabilities, time and resources to do so; and can comply with ethical requirements.”

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Human Resources

“The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements, and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances.”

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Human Resources

The policies should address the following issues:

- Recruitment
- Performance and Evaluation
- Capabilities
- Competence
- Career Development
- Promotion
- Compensation
- Estimation of Personal Needs

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Engagement Performance

“The firm should establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and regulatory and legal requirements, and that the firm or the engagement partner issue reports that are appropriate in the circumstances.”

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Engagement Performance

Matters to be addressed:

- The briefing of engagement terms
- Processes for complying with engagement standards
- Supervision, staff training and coaching
- Methods of reviewing work performed
- Documentation
- Ensuring policies and procedures are up to date

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Monitoring

“The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm’s system of quality control, including a periodic inspection of a selection of completed engagements.”

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The Inspection Process

Inspection Bodies

There are two bodies responsible for the inspection of audit firms within the UK

- **The Audit Inspection Unit (AIU)**

Reporting directly to the Professional Oversight Board (POB)

This unit only deals with the very large audit firms

- **The Quality Assurance Department (QAD)**

This department deals with all other audit firms

Reports to the Practice Assurance Committee (PAC); this is part of the Institute of Chartered Accountants

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QAD outcomes

ICAEW	2008		2007		2006	
	Number	%	Number	%	Number	%
A&B outcomes	601	64	582	60	457	64
C outcomes	218	23	283	29	188	27
D outcomes	124	13	110	11	64	9
Total	943	100	975	100	709	100

ICAS visits:	2008		2007		2006	
	Number	%	Number	%	Number	%
A&B outcomes	20	37	21	51	33	50
C outcomes	22	41	14	34	21	30
D outcomes	12	22	6	15	15	20
Total	54	100	41	100	69	100

ACCA visits:	2008		2007		2006	
	Number	%	Number	%	Number	%
A&B outcomes	211	52	159	56	182	49
C+/- outcomes	126	32	85	30	97	26
D outcomes	64	16	41	14	92	25
Total	401	100	285	100	371	100

The QAD Visit

The visit covers the following aspects of the firm:

- Practice Assurance
- Audit Authorisation
- Investment Business Authorisation as a Designated Professional Body (DPB)

The QAD Visit



“Practice Assurance is designed to be a helpful and supportive process. It aims to reassure you that your practice is meeting the expected standards and to enhance the high reputation of chartered accountants. We endeavour to conduct all our visits in a friendly and professional manner.”

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The Key to a Successful Visit

- Preparation
- Preparation
- Control



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The QAD Visit

THE LETTER

- Dates
- The names of the inspectors
- The likely length of the visit
- Scope of visit
- A list of documents required

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List of Documents and Records

A Firm information

1. PII policy, most recent renewal/proposal documentation and details of claims history and of any current claims or notifiable events
2. Records of any formal complaints and of any internal or ICAEW disciplinary action
3. Correspondence with ICAEW, including most recent annual return
4. Brief overview of firm's management structure
5. Sample of firm's letterhead
6. Copies of any promotional or marketing material (eg, newsletters, budget circulars)
7. Copy of current client engagement letter templates (eg, for corporate work, for taxation work)

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List of Documents and Records

B Personnel information

1. Access to staff files, including training and appraisal records
2. Access to principal training and appraisal files (if maintained)
3. CPD records for the last two years
4. Subcontractor and consultant agreements, (if applicable)

C Accounting records

1. List of practice bank accounts and of current mandated signatories
2. Bank statements and cashbook records for the above accounts for the last 12 months
3. Fee notes for the last 12 months

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List of Documents and Records

D Client records

1. Client base details (eg, latest analysis of work in progress and debtors listings or client listing if readily obtainable from firm's systems)
2. Access to client files

E DPB visit information - only relevant to DPB licensed firms

1. Records of your most recent and, if applicable, previous DPB compliance review
2. DPB compliance manual/procedures
3. Correspondence with the Institute concerning DPB arrangements
4. Records of complaints received and, if applicable, internal disciplinary cases
5. Records of clients' property held
6. File of any published recommendations or advertisement approvals
7. Commission received statements for the last 12 months

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The QAD Visit

THE OPENING MEETING

- A very detailed and structured agenda forwarded in advance



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QAD Visit – Opening Meeting Topics

A Background data

General matters

1. Ownership and structure of the firm
2. Connected entities (including nominee entities)
3. Locations
4. Control and consistency of procedures
5. External business interests
6. Connections with other practices, training and similar organisations
7. Details of staff, subcontractors, consultants, including rewards, recruitment and retention

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QAD Visit – Opening Meeting Topics

8. Client base: activities, types (limited companies, partnerships, sole traders, etc), services provided (including non-audit assurance opinions issued and the provision of financial references), specialisms, niche markets and potential growth areas
9. Gaining new clients including marketing initiatives, mail shots, website, etc
10. Retaining clients and reasons for client losses
11. Fee billing, recoveries, overhead and cash-flow control, incidence of credit notes, level of WIP and debtors
12. PII, complaints, disciplinary history (including any audit, DPB-related matters)
13. Future plans and current limiting factors
14. Succession issues

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QAD Visit – Opening Meeting Topics

Further issues for audit and DPB firms

15. Audit client details: client activities and audits with perceived risks - examples could include specialist or complex clients, entities based or reporting overseas, entities with a wide accounts circulation, audits which required consultation on technical or other matters (eg, going concern issues)
16. Criteria for and audits assessed as requiring engagement quality control reviews
17. Issues arising with external regulators (eg, the Pensions Regulator, Charity Commission)

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QAD Visit – Opening Meeting Topics

18. Other services provided to audit clients (eg, accountancy, tax, IT, internal audit)
19. Other reports signed as registered auditor
20. DPB activities including referrals to permitted third parties and stockbrokers; execution-only; corporate finance; private company shares; trustee and power of attorney activities; film partnership and other unregulated collective investment schemes; acting as agent; custody of clients' property
21. Involvement with networks, stakeholder pension schemes, mortgages, financial promotions, general insurance

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QAD Visit – Opening Meeting Topics

B Principles-based standards Laws, regulations and professional standards

General matters

22. Technical material maintained by the firm or to which the firm has access
23. Laws and regulations applicable to clients
24. Consultation arrangements, use and membership of professional and training organisations, etc
25. Code of Ethics: statements which the firm has difficulty in interpreting or applying (if any)
26. Clients' money (Members' Handbook, section 6.6)
27. Money laundering (www.icaew.com/moneylaundering)
28. Data protection
29. Fee protection insurance
30. No DPB activities (unlicensed) firm
31. SME funding advisor scheme

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QAD Visit – Opening Meeting Topics

Further issues for audit and DPB firms

- 32. Approach to communicating requirements of APB ethical standards, identifying and resolving issues arising including appointment of ethics partner for firms with 3+ RIs
- 33. Common ethical considerations include financial, business, employment and personal relationships (including interests held in trustee capacity), acting for 10 years, regular fee levels > than 10% or 15% of practice income, the provision of other services (including tax and accountancy - both requiring safeguards beyond informed management) and the use of PASE exemptions
- 34. DPB commission disclosure and retention

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QAD Visit – Opening Meeting Topics

Client acceptance and disengagement

General matters

- 35. Establishing potential new client bona fides and identity
- 36. Liaison with previous accountants
- 37. Risks considered in assessing whether to act and continue to act for potential new and existing clients (eg, client integrity, firm's independence, competence, time, adequacy of resources)
- 38. Confirming terms of engagement with clients and records maintained
- 39. Client disengagement procedures
- 40. Handling and recording the receipt and return of client records

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QAD Visit – Opening Meeting Topics

Further issues for audit and DPB firms

- 41. Engagement letter requirements
- 42. Considerations in AR 3.04, APB ethical standards and ISQC1

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QAD Visit – Opening Meeting Topics

Competence

General matters

- 43. Recruiting (including references and confirmation of qualifications), retaining and motivating principals, staff, subcontractors and consultants
- 44. Adequacy of current staff levels and skills
- 45. Individuals' strengths and controlling weaknesses
- 46. Internal and external training
- 47. Providing feedback to principals and staff (including subcontractors and consultants) on their performance
- 48. Continuing professional development, including profile declaration (Members' Handbook, section 5.2)
- 49. CPD accreditation and ACCA conversion (pathways)
- 50. Access to technical reference sources
- 51. Consultation arrangements
- 52. Training office

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QAD Visit – Opening Meeting Topics

Further issues for audit and DPB firms

- 53. Approach to assessing partner and staff audit training needs (including training on ISAs, APB's ethical standards and ISQC1) and subsequent monitoring
- 54. Fit and proper, (annual) independence and confidentiality declarations
- 55. Audit consultation policy and documentation of nature, scope and conclusions of consultations
- 56. Approach to maintaining competence in DPB activities undertaken

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QAD Visit – Opening Meeting Topics

Quality control

General matters

- 57. Organisation and control within the firm (eg, structure, accountability, constraint on committing the firm to an opinion)
- 58. Alternate arrangements (sole practitioners)
- 59. Supervisory and review procedures
- 60. Recording the work conducted on behalf of clients (including file retention policy)
- 61. Controls over outgoing communications including emails (use of email disclaimers)
- 62. Use of IT and software, (eg, accounts, disclosure, tax packages, licences, IT back-up procedures and testing, firewalls, virus protection)
- 63. Electronic filing with HMRC
- 64. Handling complaints and disciplinary matters
- 65. Feedback from clients, intermediaries, etc
- 66. Internal monitoring (eg, annual compliance review)

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QAD Visit – Opening Meeting Topics

Further issues for audit and DPB firms

- 67. Audit procedures (including approach to updating for ISAs, ethical standards, ISQC1)
- 68. Approach to meeting and documenting ISQC1 requirements on leadership (eg, promotion of audit quality), ethics (compliance emphasis), acceptance and continuance, human resources (eg, sufficient competent personnel, engagement partner role understood and identity communicated to client)
- 69. Engagement performance (including engagement quality control review procedures), monitoring (scope of audit compliance reviews, dates, who did it, results, communication of findings, effect of deficiencies evaluated, action plans)
- 70. DPB compliance review (scope, dates, who did it and results)
- 71. Issues at previous audit or DPB visit

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The QAD Visit

FIELD WORK

- Review of audit files
- Review of tax/trust files
- Review of the firm's own accounting records
- Review of HR records
- Review of Insurance Certificates
- Review of Policies and Procedures
- Review of any other documents they choose to look at (apart from money laundering reports)

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The QAD Visit

CLOSING MEETING

- This goes over the factual information which they have established concerning the firm
- Raises any specific issues of review of the files
- It raises any breaches minor or otherwise of the regulations
- Finalise report



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The QAD Visit

REPORT BACK

- Corrects any inaccuracies in the QAD report, deals with any breaches and proposed remedies

AFTER THE VISIT

- If completely satisfied, letter confirming the fact with no report to the Practice Assurance Committee (PAC)
- If there are significant breaches then a report is made to the PAC

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Future Developments

The Audit Firm Governance Code

- 'Voluntary Code'
- Top 8 Firms of Auditors
- For financial years starting after 1 June 2010

The Audit Firm Governance Code

- Intended benefits
 - a. Support firms in performing high quality work gives confidence to shareholders
 - b. Improve capital markets by enhancing choice and helping to reduce the risk for firm exiting the market for large audits because it has lost public trust
 - c. Enhance the stature of firms as highly visible exemplars of best Governance practice
 - d. Enrich firms transparency reports
 - e. Encourage changes in Governance which improve the way that firms are run
 - f. Strengthen the regulatory regime by achieving transparency and the effective Governance without disproportionate regulation

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The Code – Leadership

A.1. Owner accountability

The Management of the firm should be accountable to the firm's owners and no individual should have unfettered powers of decision



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The Code – Leadership

A.2 Management principle

A firm should have effective management which has responsibility and clear authority for running the firm

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The Code – Values

B.1 Professionalism principle

A firm should perform quality work by exercising judgement and upholding values of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour in a way that properly takes the public interest into consideration

B.2 Governance principle

A firm should publicly commit itself to this Audit Firm Governance Code

B.3 Openness principle

A firm should maintain a culture of openness which encourages people to consult and share problems, knowledge and experience in order to achieve quality work in a way that properly takes the public interest into consideration

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Code – Independent Non-Executives

C.1 Involvement of independent non-executives principle

A firm should appoint independent non-executives who through their involvement collectively enhance shareholder confidence in the public interest aspects of the firm's decision making, stakeholder dialogue and management of reputational risks including those in the firm's businesses that are not otherwise effectively addressed by regulation

C.2 Characteristics of independent non-executives principle

The independent non-executives' duty of care is to the firm. They should command the respect of the firm's owners and collectively enhance shareholder confidence by virtue of their independence, number, stature, experience and expertise

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Code – Independent Non-Executives

C.3 Rights of independent non-executives principle

Independent non-executives of a firm should have rights consistent with their role including a right of access to relevant information and people to the extent permitted by law or regulation, and a right to report a fundamental disagreement regarding the firm to its owners and, where ultimately this cannot be resolved and the independent non-executive resigns, to report this resignation publicly

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The Code – Operations

D.1 Compliance principle

A firm should comply with professional standards and applicable legal and regulatory requirements

D.2 Risk management principle

A firm should maintain a sound system of internal control and risk management over the operations of the firm as a whole to safeguard the owners' investment and the firm's assets

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The Code – Operations

D.3 People management principle

A firm should apply policies and procedures for managing people across the whole firm that support its commitment to the professionalism, openness and risk management principles of this Audit Firm Governance Code

D.4 Whistleblowing principle

A firm should establish and apply confidential whistleblowing policies and procedures across the firm which enable people to report, without fear, concerns about the firm's commitment to quality work and professional judgement and values in a way that properly takes the public interest into consideration

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The Code – Reporting

E.1 Internal reporting principle

The management team of a firm should ensure that members of its governance structures, including owners and independent non-executives, are supplied with information in a timely manner and in a form and of a quality appropriate to enable them to discharge their duties

E.2 Financial statements principle

A firm should publish audited financial statements prepared in accordance with a recognised financial reporting framework such as International Financial Reporting Standards or UK GAAP

E.3 Management commentary principle

The management of a firm should publish on an annual basis a balanced and understandable commentary on the firm's financial performance, position and prospects

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The Code – Reporting

E.4 Governance reporting principle

A firm should publicly report how it has applied in practice each of the principles of the Audit Firm Governance Code excluding F.2 on shareholder dialogue and F.3 on informed voting and make a statement on its compliance with the Code's provisions or give a considered explanation for any non-compliance

E.5 Reporting quality principle

A firm should establish formal transparent arrangements for monitoring the quality of external reporting and for maintaining an appropriate relationship with the firm's auditors

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The Code – Dialogue

F.1 Firm dialogue

A firm should have dialogue with listed company shareholders, as well as listed companies and their audit committees, about matters covered by this Audit Firm Governance Code to enhance mutual communication and understanding and ensure that it keeps in touch with shareholder opinion, issues and concerns

F.2 Shareholder dialogue principle

Shareholders should have dialogue with audit firms to enhance mutual communication and understanding

F.3 Informed voting principle

Shareholders should have dialogue with listed companies on the process of recommending the appointment and re-appointment of auditors and should make considered use of votes in relation to such recommendations

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