AUDITS: QUALITY MATTERS

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Although the auditing profession can trace its roots back to ancient Persia, modern auditing evolved in 1844 when the British Parliament passed the Joint Stock Companies Act, introducing the concept of limited liability and setting the stage for a growth in capital markets, which would fuel the Industrial Revolution. In 1900, amendments to the British Companies Act required auditors to be independent of their clients, and organizations such as the Institute of Chartered Accountants in England and Wales were the pioneers in establishing auditing procedures for their members to follow. More recently, independent standard-setting organizations, such as the *International Auditing and Assurance Standards Board (IAASB)* founded in 1978, have steered the global development of Generally Accepted Auditing Standards.

Arguably, the financial market's broad expectations of auditors have changed little since the 1844 Act, which required auditors to report to the shareholders whether, in their opinion, the balance sheet and accounts were drawn up to exhibit a "true and correct view" of the state of the company's affairs. But, nowadays, global corporations are much larger and more complex than their predecessors of the 19th or 20th centuries, and the accounting requirements they must apply are far more voluminous.

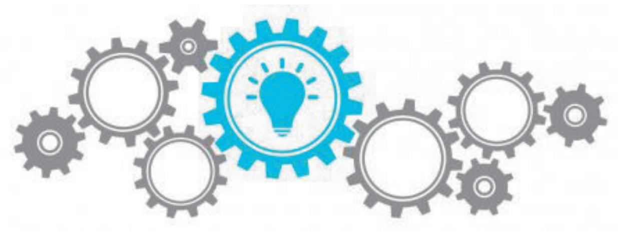
To service modern multinational clients, audit firms have necessarily evolved from regional and national practices, in which the partners (the owners of the business) could manage their firm's affairs by making collective decisions around a board table, to global networks employing hundreds of thousands of professionals across many jurisdictions. Financial market regulators are also more coordinated across borders and expect the consistent application of professional standards by the audit firms they are responsible for monitoring, regardless of the country in which the audit work is performed.

The ever-present role of auditors in maintaining public trust in global capital markets cannot be understated, although, unfortunately, this role sometimes receives little attention other than in the event of a corporate failure. It is therefore critical for the audit profession to continue to strive to maintain the utmost levels of integrity, objectivity, and compliance with professional standards.

In the context of our increasingly connected global environment, what steps are standard-setters and audit firms taking to ensure that the profession continues to maintain this public trust that is so critical regardless of whether the audit work is being performed in Chicago or Shymkent?

Ownership structures and control

Although the largest audit and accounting firms operate as global networks with a common brand, from a legal perspective they generally exist as networks of independent member firms that are privately owned by partners in a particular country or region. In certain cases, this local ownership structure may be due to legal or professional requirements. Such independent partnerships may vary significantly in size and resources, depending on the size of the market. This structure is very different from the ownership models employed by most multinational corporations, whereby international subsidiaries are owned and controlled by a corporate head office whose ultimate shareholders normally have no involvement in the day to day running of the business.



To support consistent quality and the consistent application of standards, global accounting networks continue to develop common policies and procedures, and decision-making structures that are increasingly centralized compared to more traditional partnership models. Over the last several years, there have also been moves by networked firms to consolidate their operations, which may provide greater opportunities to share resources across borders.

Network and firm monitoring

To supplement external regulatory reviews of audits, the consistent application of internal policies and professional standards by member firms within large networks is monitored through regular internal review programs that typically involve experienced partners from different jurisdictions. Such reviews are made both at the level of the firm and for individual audit engagements. Where there is non-compliance with professional standards, a root cause analysis is performed and action is taken to address the cause. There may also be financial sanctions against audit partners concerned or the firm itself. The effective operation of an internal monitoring system is key to ensuring engagement quality across different countries and is of particular relevance for cross border engagements where reliance is placed by a group auditor on the work of a component team.

Increasing communication among international audit regulators – IFIAR

The International Forum of Independent Audit Regulators (IFIAR) was established in 2006 and currently includes audit regulators from 55 jurisdictions. Its mission is to serve the public interest and enhance investor protection by improving audit quality globally. Among other things, IFIAR provides a platform for external audit regulators from many different countries to share issues and best practices. Such an organization allows for the development of a more consistent approach to audit regulation globally and the transfer of knowledge and experience between regulators. This helps to address the potential risks of each regulator developing their approach and areas of focus in isolation.

Systems of quality management

External and internal regulatory inspections of audit firms often focus on whether a particular audit engagement was performed in accordance with all relevant professional standards. This is, of course, the key goal of any audit, but there is an increasing focus on the need to create an environment that supports audit quality at the level of the firm itself. Without such an environment in the firm, the delivery of audit quality at the individual engagement level may be compromised.

This is borne out by the IAASB's release of the proposed *International Standard on Quality Management 1*, which introduces requirements for audit firms to document and annually test a *"System of Quality Management" (SOQM)*. The draft standard recognizes the importance of processes and controls that support quality objectives both at the network level and at the level of individual member firms. It requires audit firms to analyze the risks to audit quality and related responses (controls) to address risks across the following components of the firm's operations:

- *Governance and leadership*
- *The firm's risk assessment process*
- *Relevant ethical requirements*
- *Acceptance and continuance of client relationships and specific engagements*
- *Engagement performance*
- *Resources*
- *Information and communication*
- *Monitoring and remediation processes*

Certain aspects of the proposed standard are consistent with existing requirements, but the key requirements to assess and document risks to audit quality in the firm's particular environment, and to identify specific controls to address those risks, represent significant enhancements. These will likely place new demands on audit firms to ensure continued compliance with International Standards.

Conclusion

The audit profession has a long history, and certain aspects, such as its traditional partnership structure, can trace their roots back many years. The increasingly complex financial reporting requirements of global businesses require higher levels of expertise and cross-border cooperation amongst audit firms in order to ensure consistent and appropriate levels of compliance with professional standards. Maintaining public trust must remain the auditor's highest priority. Although the profession has seen many changes since 1844, trust remains the foundation on which it is built.