The Consultative Committee of Accountancy Bodies

CCAB AUDIT CONDUCT AND TRAINING PROJECT

REPORT OF THE STEERING COMMITTEE TO THE FINANCIAL REPORTING COUNCIL (FRC)

JULY 2009

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EXECUTIVE SUMMARY

The background to this CCAB project on audit conduct and training in the UK and Ireland, and how the steering committee has carried out its work, is explained in the next section. In summary the steering committee has identified some key issues that it believes are crucial to effective auditing and makes recommendations regarding further actions that ought to be taken in response to its findings:

- Having the best people to carry out audits is of critical importance to ensuring quality audits. Standard setters, regulators, professional bodies and audit firms therefore need to ensure that the audit regulatory framework, requirements and detailed procedures are determined in the light of this top priority. Mechanistic rules-based approaches are likely to be detrimental to recruiting and retaining the best people in the profession. The profession needs to remain attractive to the best people otherwise there is a significant risk to audit quality.

- More should be done to promote the importance of auditors having good people skills and to help firms develop the people skills of audit staff. Such skills are crucial to auditors approaching their work with the appropriate mindset of professional scepticism and audit firms should prioritise the need for this mindset in determining their approaches to audits.

- The CCAB bodies can play a useful role in emphasising what is needed on key aspects of the audit including the crucial importance of good audit planning, professional judgement and post audit reviews.

- There is a strong international dimension to the various matters considered by the steering committee and actions taken in response to the findings need to be taken reflecting that dimension. One key action that is proposed is for the CCAB bodies to discuss with IFAC how the various requirements of education standards (IESs) and auditing standards (ISAs) fit together.

More information regarding the steering committee's key conclusions and specific recommendations is provided below.

Key conclusions

The steering committee's key conclusions from the project can be summarised under five headings:

1. Firms need the right people in audit teams

The steering committee considers that the key to achieving quality auditing is to ensure that the people employed on audits are of the highest quality with excellent people skills as outlined in the next section. Making the profession attractive so as to help the recruitment and retention of the best people should therefore be a top priority for all those involved in the debate about audit quality. The feedback to the steering committee emphasised the need for a principles-based approach and with a focus on audit judgement in order to make the profession attractive to the top people. Whilst there are undoubtedly other factors that impact on the ability of firms to recruit and retain these people, for example the state of the economy, there is a clear belief that mechanistic rules-based approaches to audit would make the profession less attractive.

Involving juniors[1] in audits at an early stage of their training and mentoring them as appropriate is positive for the profession and ultimately enhances the profession given the need to develop future audit professionals. Firms already do this and this approach is supported by the various stakeholders consulted by the steering committee. The audit team as a whole should contain the appropriate skills and experience and juniors can be involved in a meaningful way, supervised as appropriate. Firms' processes, being based on the requirements of standards, are designed to ensure that the audit engagement partner does take responsibility for all significant audit judgements with matters being fed up to the partner as necessary.

It should also be seen as positive that audit teams are refreshed with new members each year. All team members should be encouraged to contribute to audit team discussions.

The feedback from firms emphasises that they aim for balanced teams with appropriate experience and continuity, but there are practical scheduling challenges for firms in achieving this. The balance of partner/senior staff time needs to be considered by firms, particularly in relation to more complex audits. There is also a risk that partners will not be involved as much as they need to be in areas that are important but assessed as lower risk.

When determining their audit teams and the need for the appropriate balance, it is important that firms not only look at technical skills and experience, but also the people skills and the personal attributes of team members.

The CCAB bodies might helpfully give further consideration to providing more guidance on the practical challenges for firms in achieving balanced audit teams with the appropriate experience and continuity.

With respect to the norms for auditing that are developing worldwide, it is of critical importance that UK and Ireland representatives advocate the importance of auditing being an attractive option for the brightest people which would be undermined by rules-based mechanistic approaches.

The companies the steering committee consulted were clear that the experience that audit juniors obtain by being part of audit teams across a range of organisations not only gives them good audit experience, but also makes them attractive to future employers in financial reporting or management roles. Whilst firms do generally seem to be successful in recruiting good people, the steering committee believes that more might be done to promote the considerable benefits of gaining audit experience, and not just for a career in audit. Of course the hope is that a large proportion of these high-quality recruits will see the benefits of career progression within audit, thus providing the quality audit partners of the future.

2. *The mindset and people skills of auditors are crucial*

This project has highlighted that having the right type of people skills is as important as technical skills for effective audits and there is therefore a need to promote a greater understanding about what an audit is and what it is designed to achieve.

Whilst it is true that having excellent technical skills, based on in-depth knowledge and experience, is very important, particularly given how complex and voluminous are the current accounting and auditing requirements, this project has emphasised the critical importance of auditors also having excellent people skills of relevance in order to carry out

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[1] This term is used throughout this report to refer to trainees who are employed as 'junior' members of staff in audit firms.

quality audits. For example, effective communications and team working are essential features of quality audits.

This emphasis on the need for these good people skills has been prominent in the feedback to the steering committee, both from firms themselves, who are clearly paying attention to the need for the development of these skills, and also from all the other stakeholders in the audit process who were consulted as part of the project. The need for these skills is already recognised in the FRC's *Audit Quality Framework* (see link to this in Appendix 4).

It is therefore important that firms are supported in their efforts to further develop the people skills of auditors that are needed for effective audits through the requirements and approaches taken by regulators, and by the practical guidance provided to firms by the CCAB bodies. It might be helpful to define the people skills that are needed and to outline how these contribute to effective audits.

The steering committee also recognises what might be a far more challenging and longer-term task, which is the need to change the perception of the general public and potential recruits to the auditing profession. As highlighted in point 1 above, attracting the best people to auditing is essential if quality auditing is to be achieved, and these potential recruits need to be aware of the wide range of qualities that auditors should have. The profession as a whole should therefore prioritise the need for the marketing of what auditing really involves, particularly to universities and other institutions providing careers advice to students. There is a feeling that there might be a mismatch between the skill-set that people outside the profession believe auditors ought to have and the skill-set that firms are actually looking for in potential recruits.

The feedback to the steering committee has also emphasised the essential requirement for auditors to approach their audits with a mindset of professional scepticism and for this to flow from firms' leadership so that it is embedded in the firms' culture. Much has already been written regarding this topic, for example it is part of *The Auditors' Code* issued by the APB (see Appendix 4), but this project has highlighted how firms pay attention to the development of the appropriate mindset in practice and how the other stakeholders in the process regard this as fundamental and something that can not be taken for granted.

It can be challenging for graduates to develop this mindset as it is quite different to much of the training and development they have experienced before entering the profession. The steering committee therefore recommends that the CCAB bodies communicate with firms regarding what is needed on this subject and that regulators and others promote its importance.

The development of this mindset goes hand in hand with acquiring good people skills and this is emphasised by the challenge for young juniors to maintain this mindset in their communications with clients and within their audit teams. This is not always easy, for example if faced by senior and assertive people, and these juniors need to be given the confidence and support from their firms to approach their audit tasks in the appropriate way. But above all they need the people skills to succeed when confronted by this type of difficult situation.

3. *Judgement, good audit planning and post audit reviews are key components of quality audits*

The steering committee received some mixed feedback regarding whether recent changes in the regulatory framework, for example new standards and regulatory arrangements, have improved the quality of audits. There is a real concern that the audit has become less principles-based and too concerned with compliance with statute and regulations. As a

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result there is a danger that mechanistic approaches will be developed by firms with insufficient emphasis on the need for professional judgement. There is also a danger of taking the emphasis away from the primary responsibility of the audit engagement partner as decisions on complex accounting and auditing matters are effectively delegated to firms' technical experts. Whilst it is understandable and correct for firms to emphasise the technical accuracy of judgements made, diminishing the role of audit engagement partners would concern a number of the stakeholders the steering committee consulted as they believe these partners are more likely to have a better all-round understanding of the circumstances of the entities they are auditing. Where there is a need to consult with the firm's technical experts, it is important that this happens on a timely basis and "last-minute panics" should be avoided wherever possible   Of course the ongoing training programmes for engagement partners should already ensure a high level of knowledge and understanding of the technical issues of relevance to the audits they are responsible for. The risks of effective delegation to the technical experts can be compounded by the approach of regulators if the approach concentrates on box-ticking and whether firms have complied with all the requirements of standards. The mechanistic approach is also likely to make auditing less attractive to the best people and this will undermine the achievement of quality auditing (see point 1 above).

Despite these real concerns, which should be raised at every opportunity with those responsible for the regulatory environment, particularly on the international stage, the steering committee also received a considerable amount of positive feedback regarding recent changes in the audit approach that is taken by firms. In particular there is a greater focus on planning and identification of key risks, and a greater emphasis on the effective operation of the audit team as a whole with full team meetings taking place on key issues. As more specialists are involved in the major judgements, it is very important for the audit team to involve them in a timely way where this is required so as to avoid pressure for 'last minute' decisions.

In the light of increasing complexity in financial reporting, the CCAB bodies might review the impact of this complexity on preparers of financial statements, audit firms and the process by which technical issues are identified and resolved. Such a review should include the role of technical departments in the larger firms and engagement quality control review procedures, the need for the highest standards of expertise, and the timing and means of communications. It should also cover the technical skills and resources available to preparers and sources of technical advice.

Given the concern that regulators will simply want to see box-ticking and documentation, irrespective of how material matters are, it is worth mentioning that both the FRC's Audit Inspection Unit and the ICAEW Quality Assurance Department emphasised the importance of professional judgement and could relate to the risks of taking an overly mechanistic approach to carrying out audits. The key point is that evidence needs to be sufficient to support the audit opinion.

With respect to audit planning, the steering committee considers that firms have been enhancing their processes and best practice is to involve the client and at the right time. Working teams planning meetings with both sides involved should be encouraged. The client side should include those staff likely to interact with the auditors on a day to day basis during the audit. There should also be regular communication with the audit committee and at the planning stage the auditors should pick up the audit committee's identification of key risks. It would therefore be helpful for the CCAB bodies to emphasise key messages on these matters, perhaps providing further practical guidance on ISA 300 *Planning an Audit of Financial Statements* and the related 'risk ISAs' (ISAs 300, 315, 330 and 240).

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The feedback has also highlighted the importance of firms carrying out effective post audit reviews taking forward learning points for the next year's audit, other audits and for the development of the individuals involved in the audit. The audit team discussion after the audit should lead to points for the next year's planning process. The post-audit reviews of individuals should play an important part in firms' appraisal processes and the way in which they develop the competencies of staff. Good practice on post audit reviews, for both audit teams and individuals involved on audits, is therefore a topic where the CCAB bodies might communicate with members regarding the practical issues involved in this.

4. International

Whilst the feedback to the steering committee was from firms and stakeholders based in the UK and Ireland, it is clear that all the matters arising have a strong global dimension. The various standards and requirements are, to a large and increasing extent, determined internationally, and firms are operating in a global market-place. The key messages (as summarised above) need to be promoted in an active way by the UK and Ireland representatives in the various forums and committees with responsibility for the standards and requirements, and the firms need to pick up the key messages themselves through their international networks. For quality auditing to be a reality in the modern world, it has to become the reality throughout the globe as UK and Ireland auditing does not take place in isolation from the rest of the world.

As highlighted in the Introduction in the next section, concerns about the possible implications of the international education standard 8 *Competence Requirements for Audit Professionals* featured heavily in the original setting up of the steering committee. However, given IFAC's plans to itself review its pronouncements (see Appendix 4), the focus for the steering committee regarding these issues is now to communicate its findings with IFAC in the hope of this being helpful to IFAC's review. One matter the steering committee has identified is to discuss with IFAC how the various requirements of education standards (IESs) and auditing standards (ISAs) fit together.

5. Firm-wide issues

The project has also highlighted a number of important issues to be picked up at firm-wide level, for example, see points 9 to 11 in the feedback from firms section. There are also various matters covered by the quality control standard ISQC 1. The steering committee believes it would be helpful for the CCAB bodies to reinforce key messages to firms on these issues. Smaller firms might benefit from further practical guidance on ISQC 1 and for example, the ICAEW Audit and Assurance Faculty and the ACCA could review their guidance on the standard. Those firms auditing public interest entities will be producing transparency reports (see Appendix 4) and will therefore be focussing on these issues in these reports. It will be helpful for firms' transparency reports to explain the firms' core values and how these are embedded in everything the firms do. The FRC is likely to maintain a close interest in these matters, particularly as it reviews the *Audit Quality Framework,* and the AIU is likely to cover these matters in its reports on the larger audit firms. The POB has recently issued a report on transparency reports including points for firms to consider in their 2009 reports (see Appendix 4).

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SPECIFIC RECOMMENDED ACTIONS ARISING FROM THE PROJECT

The CCAB will initiate the recommended actions with the CCAB bodies in communication with the FRC. More detail regarding the recommended actions is provided in the section starting on page 15.

1. The steering committee suggests that the interaction of ISAs (with their 'collegiate' or team approach) and IES 8 (with its focus on individuals) is discussed with IFAC in connection with IFAC's further work on IES 8. It is also suggested that discussions between the CCAB bodies and IFAC review the definition of 'audit professional' in IES 8. Currently this definition focuses solely on the making of significant judgements which seems to exclude the broader range of skills and personal qualities that audit professionals need to have.

2. Making the profession attractive so as to help the recruitment and retention of the best people should be emphasised by UK and Ireland regulators and the CCAB bodies in all international debates on audit quality in which they participate. Maintaining a principles-based approach to audit is vital in order to make the profession sufficiently attractive to these people.

3. Firms need to have an inclusive culture which empowers all staff and training/development programmes designed to ensure that staff are sufficiently independent and approach audits with a mindset of professional scepticism. Firms need to pay attention to the competencies of the individuals they employ and link appraisals with training programmes and audit selection processes. The CCAB bodies have a role in emphasising the key messages to firms on these issues and in keeping the syllabus for professional training under review.

4. International aspects are a key feature of the issues arising from this project including the relevance of international adoption and enforcement of good quality global standards. There is a need for an active UK and Ireland role in helping to achieve such adoption and enforcement which is preferable to the need for extensive direct involvement, e.g. by UK group auditors on significant components overseas or AIU visits to overseas auditors of companies with a London listing. The danger of lengthy and overly complex accounting and auditing standards should also be emphasised.

5. The CCAB bodies should review the guidance they have provided on audit quality. For example, the ICAEW Audit and Assurance Faculty should consider reviewing its *Audit Quality* publication in the light of the matters identified in this report and in particular whether to produce a revised publication, possibly concentrated on the priority themes highlighted in the report. An alternative might be to produce a series of guides on the specific topics that have been identified by the steering committee as important issues for the CCAB bodies to communicate with firms on.

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INTRODUCTION AND CONTENTS OF THIS REPORT

Background to this CCAB project

The steering committee was set up following the publication of the FRC's feedback paper on *Promoting Audit Quality* in October 2007 and comments in that paper regarding the way in which audit fieldwork is conducted in practice and also issues connected with the requirements of International Education Standard (IES) 8. More information on this, including the relevant extract from the feedback paper, is provided in Appendix 4. Appendix 4 also contains details of other relevant sources of information.

The detailed terms of reference for the steering committee are included in this report at Appendix 1 and the membership is provided at Appendix 2. The main purpose is to understand more about the detailed processes behind key audit judgements. For example, how individual members of the audit team are trained and communicate with each other to ensure key issues are identified and appropriate judgements are made by properly qualified people. The main output from the steering committee is this report to the FRC and it is hoped that audit firms and other stakeholders will take a keen interest in the matters covered in the report (see below).

What the steering committee has done

We obtained information from firms about their detailed audit processes through a paper/questionnaire sent to those firms auditing "public interest entities" (as defined by the FRC's Audit Inspection Unit (AIU)) in September 2008. This paper/questionnaire is included in this report at Appendix 3.

There were ten responses compromising of responses from the following types of firm:
- Big 4: four firms
- Group A: three firms
- Others: three firms

The steering committee considered these responses and the committee's conclusions regarding the key themes arising from them are outlined in this report in the next section.

A number of meetings were then set up with various other stakeholders to discuss these themes and any particular concerns those stakeholders have on the issues identified or any other audit conduct matters arising from their experiences. In particular meetings were held with representatives of the following groups:
- Regulators: the AIU and the ICAEW Quality Assurance Directorate
- Preparers: the Hundred Group financial reporting committee and the Quoted Companies Alliance corporate governance committee
- Audit committee members: hosted by KPMG's Audit Committee Institute
- Investors

The key matters arising from these meetings are outlined in this report in the section starting on page 12.

A large part of the reason for setting up the steering committee arose from concern about the possible implications of international education standards issued by IFAC and the need for those making significant audit judgements to be suitably qualified. The steering committee sought to obtain a greater understanding of the standards issued by IFAC but learnt, during the course of the project, that IFAC itself would be reviewing these

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requirements and would possibly issue further guidance in the near future. This meant that the focus became a commitment to communicate our findings to IFAC for its review rather than seeking any specific clarification of existing requirements from IFAC.

The FRC's feedback paper on *Promoting Audit Quality* referred to "research that has been recently commissioned into the practical training of auditors" (see Appendix 4). This review was published by the Professional Oversight Board in November 2008 and a separate working group has been established to consider the issues arising from this review.

The steering committee has considered all the evidence arising from the feedback from firms and other stakeholders and has determined specific actions that would be helpful with a particular emphasis on areas of further communications to firms from the CCAB bodies. An outline of these recommended actions is given in the section starting on page 15.

The steering committee's key conclusions are summarised and recommendations are outlined in the report's Executive Summary at the front of this report.

What we hope happens next

The steering committee calls on the CCAB bodies and others to take the actions outlined in the report and for the CCAB bodies to maintain an ongoing dialogue with the FRC regarding progress on these.

With respect to the international education standard 8 *Competence Requirements for Audit Professionals*, the CCAB bodies should discuss the matters arising from this project with IFAC and call on IFAC to take account of these comments in its review of the standards (see Appendix 4) and any further guidance it issues.

Although this report is addressed to the FRC there are matters arising which we expect will be of interest to various other stakeholders in the audit process, including audit firms themselves, companies, audit committees and investors. We also hope that those outside the UK and Ireland, including IFAC and other international groups, will take an interest in the report as all the issues raised have a global dimension.

The steering committee considers that the CCAB bodies should maintain ongoing communications with these various stakeholders in the audit process and consider any concerns they express on audit conduct matters on an ongoing basis. The Audit Quality Forum (see Appendix 4) provides a helpful forum for discussion of any such concerns.

We would welcome any further feedback regarding the findings and the recommendations made. Please send any comments regarding any aspect of this report to chris.cantwell@icaew.com.

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THEMES ARISING FROM THE FEEDBACK FROM FIRMS

<u>Core audit processes</u>

1. Information regarding the processes that firms have in place

Firms' processes are based on the collegiate audit team approach that is taken by the ISAs with these processes being designed to ensure that all 'significant' issues[1] come from the team to the attention of the audit engagement partner who takes full responsibility for the judgements on these issues. Processes are designed to ensure good communication within the team and this happens within the framework of review, quality control and culture in the firm as a whole in compliance with the quality control standard ISQC 1.

2. Different sizes and types of firms and audits

Whilst recognising that the responses were mainly from the larger firms, there is a fair degree of consistency in the responses received and little difference on matters of principle between the answers from large and small firms and between the approaches taken for different sizes and types of audit. This is probably unsurprising in that all audits are carried out in accordance with ISAs. However, the complexity of the processes involved varies, e.g. the audit engagement partner might be further removed from the fieldwork in larger and more complex audits. In smaller audits the communication lines between the partner and audit staff tend to be shorter and more simply defined. In larger audits there can be several layers of qualified and managerial/director staff engaged in the audit and firms consider that the staff involved in these audits are sufficiently well trained and experienced to fulfil these roles.

3. Types of judgement

Significant judgements include key accounting judgements, ethical judgements and pure audit judgements as all of these can impact on the conduct of the engagement and/or the auditor's opinion. Professional scepticism is regarded as key to good judgements and firms consider that they have ways of developing this in junior staff. They report that this can initially be lacking just as much as technical knowledge and experience.

4. Supervision and review

Firms say that a key to ensuring that judgements are made by the audit engagement partner (as stated in point 1 above) is appropriate supervision and review of the work, supported by adequate documentation. All significant audit judgements made by the engagement partner are clearly documented and the partner ensures that the audit files contain sufficient appropriate audit evidence to support the audit opinion.

5. Make-up of audit teams

The responses on how firms ensure that they have appropriate audit teams emphasise the need for the appropriate knowledge/experience for the job, but balance this with recognition of the need for training, development and appropriate personal challenges for all members of the team. Some level of prior engagement experience and continuity seems to be encouraged by firms, particularly in the lower levels of the team. However, there was little information in the responses

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[1] The responses provided a considerable amount of material on what issues are regarded as 'significant' and the processes that lead to these matters being considered by the audit engagement partner. This material (not reproduced in any detail in this paper) seems to be based on the detailed requirements of standards including assessment of risk.

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about the processes for achieving balanced teams in practice.

6. Role of juniors in particular

There is a view from the firms that it is important that juniors play their part in audit teams and that excluding them from involvement in audits would be detrimental to the quality of the audit profession and the development of future audit professionals.

Specialist support which may sometimes be required

7. Technical resources for firms

Technical departments and other technical resources for smaller firms, e.g. the technical helplines of the CCAB bodies, are seen to play an important role in providing guidance on issues where appropriate. The responses suggest different approaches from the larger firms when technical departments are consulted: from one extreme of decisions remaining totally with the engagement partner to a procedure at the other extreme where the technical experts' conclusions should be followed (with a dispute resolution process if the engagement partner disagrees).

8. Engagement quality control review

Firms report that there can also be disagreements on significant audit judgements between the engagement partner and the engagement quality control reviewer appointed in accordance with ISA 220. Escalation processes exist in firms to resolve such disagreements.

Wider issues not linked to specific audits

9. Firms' training programmes

Firms emphasise that they have structured training programmes to build the required core technical knowledge and to ensure that partners and staff are kept updated on recent or forthcoming changes. Larger firms organise this internally whereas smaller firms look to external sources to assist them with this task. There is only a limited amount of information in the responses regarding how firms' training/development programmes actually develop the mindset of professional scepticism that firms themselves regard as so important (see point 3 above). It might be that 'on the job' development is seen as the key way in which this is currently achieved by firms but it is clear that success in this area is perceived as being of the greatest importance and represents a big challenge for firms.

10. Post audit appraisal reviews

Post audit appraisal reviews for individuals seem to be well established (on larger audits at least) and these link into the firms' overall annual appraisal processes.

11. Awareness of IESs in firms

As stated in point 1 above, the focus of firms in establishing their processes tends to be on the auditing and ethical standards issued by the APB. There is less awareness of or concentration on IESs because the view is that these requirements should be met through the CCAB bodies' qualifications and CPD programmes.

POINTS ARISING FROM THE MEETINGS WITH OTHER STAKEHOLDERS

Feedback from regulators

The steering committee sought information from regulators regarding the project's findings and in particular has discussed the themes emerging with the ICAEW Quality Assurance Department (QAD) and the FRC's Audit Inspection Unit (AIU). The senior staff who were consulted for this purpose have practical experience of the issues emerging from inspections across the full range of inspections carried out by the QAD and the AIU. Some overall conclusions from this feedback are provided below:

- More might be done on developing professional scepticism and an independent mindset. This could be looked at in the context of the competency frameworks that firms have along with the development of other people skills of practical use to auditors.

- Mentoring and post audit appraisals are a key part of the process.

- Audit partners need to be involved early in the process and take responsibility for key planning points with audit findings being linked back to this. Firms might develop the ways they assess partner performance (in line with the audit quality priority as per ISQC 1).

- Firms might develop their analytical review procedures with greater senior involvement in this.

Feedback from other stakeholders

Comments on the themes identified by the steering committee have also been sought from investors, preparers and audit committee members (as described in the Introduction to this report). Key matters from the feedback from these stakeholders are outlined below:

Investors

Active consideration should be given to determining recommendations for further actions on a range of issues including:

- the need for professional judgement to be central to the audit process in practice;

- international matters arising in group audits and the use of different firms and firms from within the same network as component auditors; and

- the importance of the role of audit committees in reassuring investors regarding audit quality.

Matters raised included the following:

- Investors will want audit committees to take steps to reassure themselves that audit quality in the field is maintained so as to ensure a reliable audit opinion. Investors will look for evidence that audit committees have received and read the AIU reports on the firm's performance and evidence of a clear dialogue between auditors and the audit committee on the key audit findings and the impact the audit has had.

- Investors are concerned that mechanistic standards can give too much emphasis to the process and insufficient emphasis on the need for professional judgement. There is also a

risk of firms taking mechanistic approaches to the application of standards and this can be compounded by the approach of regulators if the approach concentrates on box-ticking and whether firms have complied with all the requirements of standards. This is a particular concern in jurisdictions where the profession is not well developed, where resources are scarce, and where regulation is likely to be process-driven. The changes in requirements for group audits should mean that group auditors have to consider the quality of the component auditors and the regulation of these firms. Having a single network firm involved on a group audit is not necessarily the best solution and group auditors must still be satisfied regarding the audit work done throughout the group, even if done by the same network firm.

- Investors are interested in ensuring that being a good auditor is the main criterion for promotion within the firm. Making the profession attractive to the best people is central to audit quality as audits require people with the ability to apply critical thinking to their work.

- The concentration of audit work around 31 December year ends puts pressure on the audit judgements being made. This is a structural issue which would be very difficult to resolve, but there is a public interest issue associated with it. Clearly if the work was spread out, it would be much easier for firms to manage the process.

Preparers

- Generally preparers have little interest in detailed audit processes but do want active communications with the auditors throughout the audit so that the audit is well planned and sufficiently focussed and key issues are discussed in a timely way as they emerge.

- There should in fact be a full cycle of communications as there is a need for detailed two-way feedback post audit regarding how things went which can then be taken forward by both sides, e.g. for the next year's arrangements.

- The pyramid structure used by audit firms generally works well and the involvement and development of juniors enables well qualified people to emerge who are attractive potential recruits for companies. However, the ability to develop individuals on the audit team is diminished if timetables are too tight. More might be done by the profession to promote the benefits of gaining audit experience.

- Preparers are not always aware of how the important issues are fed up to the engagement partner but they see that this does happen.

- Preparers have witnessed an increase in the involvement of technical departments which is inevitable given the number of requirements that there are now and the complexities involved. Preparers believe it is important for engagement partners to be involved in discussions with the technical departments as they will sign the audit report and might have a better all-round understanding of the circumstances of the company. There is a need to identify issues that are likely to require consultation early in the process to avoid last-minute pressures and an unnecessary increase in the preparers' workload. There is also a risk that if this does not happen, the decision will be the 'quick' answer rather than the 'right' answer.

- Preparers agree about the importance of people skills and also emphasise the importance of acquiring business understanding.

- Preparers are concerned about the partner rotation rules and favour partners being involved longer to increase their understanding of the business and thereby improve audit quality.

- The perception is that there is not uniform audit quality around the globe and this is an important issue for the audit firm to manage and consider in forming a group audit opinion. Ineffective or late communications with foreign offices/firms can create difficulties although this situation should be improved as a result of the revised ISA 600 on group audits.

Audit committee members

- People skills are key to the effectiveness of audit, e.g. the ability to be brave and courageous as necessary. The importance of scepticism was emphasised.

- Good audit planning is essential and communication with the audit committee should be wide-ranging and take place throughout the period of the audit rather than concentrated in the closing meeting, particularly if there are significant issues emerging. The need for specialist input should be identified as early as possible and last-minute input from technical departments should be avoided.

- The audit committee's identification of key risks should feed into audit planning and the audit committee should do a 'sense check' that there is consistency between the work of external and internal auditors regarding the key risks.

- The audit committee has little interest in detailed audit processes but does need comfort regarding the firm's control of these processes, particularly relating to audit work overseas. The AIU role is an important part of audit committees obtaining the necessary comfort regarding the audit. The effectiveness of the audit can be assessed by reference to the originally agreed scope of the audit.

- Different opinions were expressed about whether audit approaches have improved in recent years. There is a risk of too much focus on compliance with statute and regulations rather than an independent view of the business. However, there is also some experience of greater communication with the audit committee and greater concentration on the key risk areas.

- The need for specialists and firm control of the audit process has changed the nature of the relationship with the engagement partner. Gaining a thorough understanding of the business and discussing the business with the audit committee should be a very important part of the partner's role and this understanding should not be diminished.

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CONCLUSIONS AND FURTHER ACTIONS THAT IT IS RECOMMENDED SHOULD BE TAKEN

1. Implications of the collegiate approach taken by firms and definition of audit professional

The collegiate audit team approach taken by firms in line with the ISAs (see point 1 in the feedback from firms section) appears to contrast with that implied by IES 8 which seems to focus more narrowly on the capabilities and competencies of individual audit professionals making significant audit judgements who will be members of the engagement team. The steering committee suggests that this key finding from this work is raised with IFAC in connection with its review of IES 8 and related pronouncements (see Appendix 4).

It is also suggested that another issue to discuss with IFAC on IES 8 is the definition of 'audit professional' which focuses solely on the making of significant judgements. In reality the requirements of audit professionals are much broader, e.g. they must have the organisational and management skills needed to conduct or manage an audit. Indeed an audit opinion is based on a combination of judgements and other matters including compliance with various requirements where judgement is not really a factor. The issue here might just be to do with the definition in IES 8 as the detailed requirements in the standard do seem to cover the broader range of skills and personal qualities that audit professionals need to have.

Recommendation 1:
The steering committee suggests that the interaction of ISAs (with their 'collegiate' or team approach) and IES 8 (with its focus on individuals) is discussed with IFAC in connection with IFAC's further work on IES 8. It is also suggested that discussions between the CCAB bodies and IFAC review the definition of 'audit professional' in IES 8. Currently this definition focuses solely on the making of significant judgements which seems to exclude the broader range of skills and personal qualities that audit professionals need to have.

2. Quality control standards within firms

The feedback from the firms and from other stakeholders has highlighted the importance of firm-wide quality control (and compliance with ISQC 1) to ensuring quality on individual audits. The FRC's *Promoting Audit Quality* initiative has already resulted in other outputs of relevance to this including the FRC's Audit Quality Framework (see Appendix 4). As a follow-up it would be helpful to explore how these matters are being dealt with by firms in practice and to consider using this information in further communications with firms and in discussions with the regulators. The ICAEW Audit and Assurance Faculty's review of its guidance on ISQC 1, intended primarily for smaller firms, should take place in the light of this and should also consider the latest guidance from IFAC on the standard (see Appendix 4).   Emphasis should be given to the fact that ISQC 1 requires audit quality to take precedence over any commercial considerations and for this to be reflected in firms' procedures, e.g. on acceptance and continuance. ISQC 1 requirements should also be linked in with the development of competency frameworks.

3. Quality of the people carrying out audits and need for high quality professional judgement

The steering committee and the various stakeholders consulted all consider that good judgements depend on the quality of the people employed on audits and therefore making the profession attractive so as to recruit and retain the best people should be top priority to achieve audit quality. This should be emphasised in all debates in audit quality as a principles-based approach to audit is vital in order to make the profession attractive to the top people. There is a risk of firms taking mechanistic approaches to the application of standards (and insufficient

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emphasis on the need for professional judgement) and this can be compounded by the approach of regulators if the approach concentrates on box-ticking and whether firms have complied with all the requirements of standards.

Recommendation 2:
Making the profession attractive so as to help the recruitment and retention of the best people should be emphasised by UK and Ireland regulators and the CCAB bodies in all international debates on audit quality in which they participate. Maintaining a principles-based approach to audit is vital in order to make the profession sufficiently attractive to these people.

4. Skills needed on audit teams, including human skills, and audit team culture

Firms need to ensure that audit teams have the full range of skills represented, particularly for larger or more complex audits. Skills required include excellent inter-personal skills as well as knowledge of the business and industry, and technical skills and knowledge. An overriding inclusive culture within the team is also important which empowers all staff to have the confidence to contribute and ask appropriate questions. This culture and the firms' training/development programmes should ensure that staff are sufficiently independent and approach the audit with a mindset of professional scepticism. The commitment of firms to this culture needs to be seen to be coming from the top so that juniors will believe that this is of the greatest importance. It is worth mentioning the perception that trainees identify more with their firm than the professional body so the firms' procedures in practice are arguably more important to the way they will actually approach their jobs than the various pronouncements on these issues made by the CCAB bodies or the regulators. The CCAB bodies should keep the syllabus for professional training under review to ensure that it gives sufficient emphasis to these matters. But the firms themselves need to link these points to the way they approach the assessment of competencies of individuals. Matters that are key to the audit, e.g. significant risks and materiality, should be willingly shared amongst the whole team. The steering committee's discussions with various stakeholders have emphasised the critical importance of human skills in achieving audit quality, e.g. the ability to be brave and courageous as necessary, and developing the required professional scepticism and independence is a major challenge for firms. It would be helpful to obtain more information about how firms are currently meeting this challenge as the steering committee only received a limited amount of information regarding this (see point 9 in the feedback from firms section). These human factors should have a prominent place in competency frameworks, training/development programmes, on the job training, and generally in the cultural approaches to carrying out audits in practice. Further communications to firms on these issues would be helpful.

Recommendation 3:
Firms need to have an inclusive culture which empowers all staff and training/development programmes designed to ensure that staff are sufficiently independent and approach audits with a mindset of professional scepticism. Firms need to pay attention to the competencies of the individuals they employ and link appraisals with training programmes and audit selection processes. The CCAB bodies have a role in emphasising the key messages to firms on these issues and in keeping the syllabus for professional training under review.

5. Involvement of juniors in audits and balance of audit teams

The steering committee supports the view that involving juniors in audits is positive for the profession and ultimately enhances the profession given the need to develop future audit professionals (see point 6 in the feedback from firms section). The collegiate approach needed for an audit means that it is the team as a whole that must bring the appropriate skills and experience and juniors can be involved in a meaningful way, supervised as appropriate. It

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should also be seen as positive that 'new blood' is brought into audit teams each year, particularly if the prevailing culture really is that all members are encouraged to contribute to audit team discussions. The firms emphasise that they aim for balanced teams with appropriate experience/continuity (see point 5 in the feedback from firms section), but there are practical challenges for firms in achieving this. When determining their audit teams and the need for the appropriate balance, it is important that firms not only look at technical skills and experience, but also the people skills and the personal attributes of team members. The balance of partner/senior staff time needs to be considered particularly in relation to more complex audits. There is also a risk that partners will not be involved as much as they need to be in areas that are important but assessed as lower risk.

The CCAB bodies might helpfully give further consideration to the practical challenges for firms in achieving balanced audit teams with the appropriate experience and continuity.

6. Audit planning

The steering committee considers that good audit planning is of critical importance to the efficiency and effectiveness of audits. This is a view that has been reinforced by the feedback from the various stakeholders consulted. There is a need to involve the client as part of the audit planning process and at the right time. Good practice would be to have working teams planning meetings with two-way communication being encouraged. The engagement partner should be involved in this meeting but so should the rest of the audit team. The client should also be represented by a wider group, i.e. involving those staff likely to interact with the auditors on a day to day basis during the audit. There should also be communication with the audit committee at the audit planning stage and the auditors' planning should pick up the audit committee's identification of key risks. It would be helpful for the CCAB bodies to emphasise key messages on these matters, perhaps providing further practical guidance on ISA 300 *Planning an Audit of Financial Statements* and the related 'risk ISAs' (ISAs 300, 315, 330 and 240),.

7. International aspects

The steering committee is aware that audit quality in the UK cannot be divorced from that which prevails overseas. If there is low audit quality overseas it might impact on the quality of UK audits given the international nature of many of these audits. Audit committees might want to pay more attention to audit processes in connection with material components overseas. The focus on the quality of overseas auditors will be enhanced with the introduction of the IAASB's revised and redrafted ISA 600 on group audits (NB: in the UK and Ireland this will apply to audits of group financial statements for periods ending on or after 15 December 2010 – see Appendix 4). With respect to this topic, the ICAEW Audit and Assurance Faculty has recently issued practical guidance for both group auditors and component auditors – see Appendix 4. This issue highlights the importance of international adoption and enforcement of good quality global standards and the need for an active UK and Ireland role in helping to achieve this. In particular the UK and Ireland regulators should play a leading part in the ongoing discussions between international regulators regarding how they might communicate and co-operate with each other. The steering committee considers that cultural differences can impact on audit quality, as can the availability or non-availability of audit professionals with the appropriate technical and people skills.

Recommendation 4:
International aspects are a key feature of the issues arising from this project including the relevance of international adoption and enforcement of good quality global standards. There is a need for an active UK and Ireland role in helping to achieve such adoption and enforcement which is preferable to the need for extensive direct involvement, e.g. by UK group auditors on significant components overseas or AIU visits to overseas auditors of companies with a London listing. The danger of lengthy and overly complex accounting

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and auditing standards should also be emphasised.

8. Role of technical departments, specialists and engagement quality control review procedures

Different approaches are taken by firms on these matters (see points 7 and 8 in the feedback from firms section), but the steering committee considers that it is likely that in most or all cases, firms actually achieve the same end result but by way of the different approaches taken. The engagement partner must take full responsibility for the final audit report but this will be done in compliance with the standards and procedures set by the firm. It is important for the stakeholders the steering committee consulted that engagement partners do retain this responsibility in practice as communications between the auditors and the companies should not become a 'faceless' exercise and the engagement partners' understanding of the all-round circumstances is crucial to the appropriate judgements being made. Increasingly, more specialists are involved in important judgements, e.g. on tax, valuations and pensions, and it is vital for them to be involved in a timely way where this is required so as to avoid pressure for 'last minute' decisions. The decision-making process can now be longer due to the need for the engagement partner to consult as appropriate.

In the light of increasing complexity in financial reporting (as recognised by the FRC in its discussion paper *Louder than Words* (see Appendix 4)), the CCAB bodies might review the impact of this complexity on preparers of financial statements, audit firms and the process by which technical issues are identified and resolved. Such a review should include the role of technical departments in the larger firms and engagement quality control review procedures, the need for the highest standards of expertise, and the timing and means of communications. It should also cover the technical skills and resources available to preparers and sources of technical advice.

9. Post audit reviews

The steering committee considers it important for firms to carry out post audit reviews and to take forward learning points for the next year's audit, other audits and for the development of the individuals involved in the audit. It is good practice for the audit team as a whole to brainstorm after the audit and for this discussion to lead to points for the next year's planning process. The responses from the firms in this area concentrated on the individual appraisal process post-audit which is also very important. The general approach to these reviews of individuals should be positive and constructive in finding ways to improve. Use of disciplinary measures should only be considered by firms in exceptional cases where there are serious shortcomings. Good practice on post audit reviews, for both audit teams and individuals involved on audits, is a topic where the CCAB bodies might communicate with members regarding the practical issues involved in this. Any communications to firms related to the development of individuals should pick up the point about the interaction of IES 8 and competencies as referred to in point 11 below.

10. CCAB bodies' guidance on audit quality

The CCAB bodies should consider providing further practical guidance for firms, picking up the various issues raised above. For example, the ICAEW Audit and Assurance Faculty should consider reviewing its *Audit Quality* publication (see Appendix 4) and if appropriate produce revised guidance, possibly concentrated on the priority themes identified in this report. See also point 2 above regarding the Faculty's ISQC 1 guidance which is intended primarily for smaller firms.

Recommendation 5:
The CCAB bodies should review the guidance they have provided on audit quality. For example, the ICAEW Audit and Assurance Faculty should consider reviewing its *Audit*

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Quality **publication in the light of the matters identified in this report and in particular**
whether to produce a revised publication, possibly concentrated on the priority themes
highlighted in the report. An alternative might be to produce a series of guides on the
specific topics that have been identified by the steering committee as important issues for
the CCAB bodies to communicate with firms on.

11. Promotion of international education standards (IESs)

There is a possible role for the CCAB bodies in promoting awareness of the IESs in firms and
better awareness of IES 8 in particular (see point 11 in the feedback from firms section), although
it might be appropriate to wait for further pronouncements from IFAC (based on its review, see
Appendix 4) before doing this. For example, the bodies can help to explain the relevance of the
requirements to what firms do on the competencies of individuals they employ and select for
particular audits, and the training/development programmes provided by firms that tie in with this.
However, the key issue is for the bodies to ensure that the various regulations for individuals and
firms and the syllabus for the professional audit qualification fully comply with the standards and
as long as this is the case, there is probably little need for much more. In this context it is worth
mentioning that IESs are not specifically referred to in the Audit Regulations but the substance is
there through the various requirements including ISQC 1. Member bodies should set the right
framework regarding the IESs. However, the steering committee believes that the emphasis
should be on providing appropriate communications to firms and to avoid imposing *de facto*
requirements that are unnecessarily burdensome.

12. Other stakeholders in the audit process

A further task for the CCAB bodies, taking into account information the steering committee has
received from other stakeholders (see previous section), is to improve communication with these
stakeholders and to deal with the concerns they express. Part of this task is likely to be to
explain more about the practicalities of auditing and the reasons why firms operate as they do,
and also how the various components of the audit tie together in compliance with the ISAs. For
example, it might not be obvious to outsiders how it is that the audit engagement partner
becomes fully confident that he/she is taking responsibility for all the significant audit judgements
that combined lead to the audit opinion.

It would be helpful for the CCAB bodies to maintain ongoing communications with the various
stakeholders in the audit process and consider any concerns they express on audit conduct
matters on an ongoing basis. The Audit Quality Forum (see Appendix 4) provides a helpful
forum for discussion of any such concerns.

APPENDIX 1: TERMS OF REFERENCE FOR THE STEERING COMMITTEE

Overall objective: to review the way audits are conducted and the interaction of IES 8 and the training of auditors with a view to increasing confidence in audit judgements.

Scope

All statutory audits but with a particular focus on audits of public interest entities (as defined for Audit Inspection Unit purposes).

Output and timescale

Output: report of findings with recommendations and suggested actions to the FRC. To also be promoted as widely as possible to professional bodies and firms, and in addition to FTSE companies, audit committees and investors as well as IFAC and other international bodies as appropriate.

Timescale: report to be issued in 2009.

Areas to be covered

1. *Audit judgement*
   - Can we define what is a 'significant audit judgement'?
   - How do firms make significant audit judgements?
   - Are there different types (levels) of judgement and how do firms deal with these?
   - What is the impact on audit judgements of the time auditors spend on analysing accounting issues in order to form an opinion on them and what proportion of the judgements made by auditors are on pure audit issues?
   - What is the role of junior staff, audit managers and senior managers in taking significant audit judgements and in what circumstances are matters passed to the engagement partner and/or technical departments?

2. *Structure of audit teams*
   - How are teams structured and how does communication work within teams?
   - What is the prevailing culture? E.g. is there openness to ideas from all members of the team?
   - What is the role of juniors and how do they see their role and responsibilities?
   - How are team members assessed to ensure they have the necessary competencies?
   - What are the arrangements for the supervision and mentoring of junior staff?

3. *Concerns of preparers and others*
   - What are the specific concerns of preparers and others regarding the conduct of audits including audit judgement and training?
   - This should pick up the concerns and experiences of those in direct contact with field auditors, e.g. finance staff at various levels within companies.

4. *Training and qualifications including IES 8*
   - What is a fair application of International Education Standard 8 (IES 8) and are firms' current procedures compliant with the standard?

- What is the practical meaning of the terms 'audit professional' and 'significant audit judgements' as used by the standard and what are the consequential practical implications of this for firms and/or the CCAB bodies?
- Does the UK want a higher standard than the minimum which is acceptable internationally?
- What is the role of the CCAB bodies regarding these matters?
- Is it appropriate for there to be significant differences in the audit experience requirements of the RQBs for the award of audit qualifications?
- What is the interaction of the above with the legal requirements in this area?

Methodology (NB: each of these relates to the areas described above)

1. *Information gathering on firms' processes*
   - Obtain information from firms regarding what the processes are and how audit judgements are made in practice.
   - Different sizes and types of firm to be covered.

2. *Information gathering on how audit teams operate in practice*
   - Based on the feedback from firms, obtain an understanding of the operations of audit teams including how communication works within teams.
   - Different sizes and types of audit team to be covered.

3. *Independent survey of preparers and others*
   - Meetings with preparers, audit committee chairs and others to establish any concerns they have regarding the conduct of audits including audit judgement and training.
   - Obtain evidence that the FRC already has.

4. *Training and qualifications including IES 8*
   - Obtain information from IFAC, firms and the FRC so as to gain an understanding of the relevant issues in IES 8 and how firms consider they apply the requirements in practice.
   - Generate ideas as appropriate regarding how processes might be changed to better meet the requirements of the standard.
   - CCAB education directors task force.
   - Provide feedback to IFAC on the standard as appropriate.

Modus operandi for the steering committee

The group operates as a steering group (rather than a task force) and decides how detailed work for particular work streams are carried out.

A sub-group of CCAB representatives has been set up to consider IES 8 related issues, in particular those in area 4, *training and qualifications including IES 8*.

Frequency of meetings: depends on the timetables for the particular work streams but at least quarterly.

If necessary, funding for any information gathering that is decided upon will need to be approved by the CCAB. Consideration should be given to industry standards regarding such work.

APPENDIX 2: STEERING COMMITTEE MEMBERSHIP

Chairman
Gerry Murphy, (Deloitte and ICAEW Audit and Assurance Faculty Chairman)

Members
Andrew Baigent (National Audit Office)
Simon Figgis (KPMG)
John Hudson (Baker Tilly)
Henry Irving (ICAEW)
Paul Lee (Hermes)
Iain Lowson (BDO Stoy Hayward)
Vivienne Muir (ICAS)
Ronan O'Loughlin (ICAI)
Mark Protherough (ICAEW)
Ian Smellie (ex EMI Group)
Stuart Watson (PricewaterhouseCoopers)
Richard Wilson (Ernst & Young)
David York (ACCA)

Observer
Tracy Neilson (FRC)

CCAB Secretariat
Supplied by ICAEW – Chris Cantwell

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APPENDIX 3: PAPER/QUESTIONNAIRE SENT TO FIRMS IN SEPTEMBER 2008

The practical implications for audit firms of the requirements in International Education Standard 8 *Competence Requirements for Audit Professionals*

Questions we would like you to answer:

Q1 Can you define what your firm regards as a 'significant audit judgement' when you are carrying out audits in practice?

Q2 Who makes these judgements in your firm?

Q3 How do you ensure that only those people (as identified in your answer to Q2 above) make these judgements and what role do more junior staff play in this process?

Please provide your firm's answers to these questions in the space provided at the back of this questionnaire. To help you to do this we provide you with some explanatory text below which relates to each of the three questions. We would welcome receiving as much information as possible in your answers to cover your firm's perspective on the various issues and questions raised in the explanatory text.

Q1 Can you define what your firm regards as a 'significant audit judgement' when you are carrying out audits in practice?

The steering committee would like to gain an understanding of how firms interpret this term in practice. The term comes from International Education Standard (IES) 8 which was issued by IFAC's International Accounting Education Standards Board (IAESB) in July 2006 and is available at
http://www.ifac.org/Store/Details.tmpl?SID=1152117338646246&Cart=1213626691169.

IES 8 prescribes competence requirements for *audit professionals.* An *audit professional* is defined in the standard as "a professional accountant[1] who has responsibility, or has been delegated responsibility, for *significant judgments* in an audit of historical financial information". The aim of the standard is "to ensure that professional accountants acquire and maintain the specific capabilities required to work as competent audit professionals".

IES 8 sits within the overall suite of IESs issued by the IAESB and IES 8 states that it "is based on the platform for all professional accountants established by IES 1 to 7". More information about IAESB pronouncements is provided at http://www.ifac.org/Education/Pronouncements.php.

The audit engagement partner (as defined by standards) is responsible for the audit report and the performance of the audit engagement, but IES 8 recognises there will also be other members of the audit team (audit professionals) that make significant audit judgements that the engagement partner takes ultimate responsibility for. These judgements will be made in the context of audits conducted in accordance with International Standards on Auditing (ISAs) and the requirements of the ISAs therefore give meaning to what might be understood by the term "significant audit judgement". IES 8 makes audit firms responsible for ensuring that individuals

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[1] e.g. a member of the ICAEW

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have the necessary competence and experience if they are to make significant judgements on audits. The firm's professional/regulatory body, e.g. the ICAEW's Quality Assurance Directorate (QAD), has responsibility to monitor how firms are exercising this responsibility.

It is possible that there is some confusion regarding different levels of audit judgement and it could be that firms have different views regarding what would be regarded as 'significant' for this purpose. It is likely that there are key audit judgements which are crucial to the audit opinion but are there also other 'significant' audit judgements made (as understood by IES 8) that in practice will not alter the audit opinion? If there are judgements of this latter kind, will they need to be brought to the attention of the audit engagement partner?

The FRC's *Promoting Audit Quality* initiative highlighted key drivers for audit quality and the FRC has now published its Audit Quality Framework – see http://www.frc.org.uk/press/pub1517.html. Clearly firms need to establish the necessary environment and employ suitable people to enable good audit judgements to be made. In this context, what does your firm regard as the most important factors for making good audit judgements?

The steering committee understands that an increasing amount of audit time in recent times has been given to accounting issues. Clearly coming to an opinion on the client's accounting treatments is a key part of the auditor's role but are these accounting judgements part of the audit judgements envisaged by IES 8? We would like to understand whether in practice there is a distinction to be made between key accounting judgements and pure audit judgements. In your experience, how much time is spent by members of the audit team analysing accounting issues and does this have an impact on the 'pure' audit judgements that are to be made?

In recent years there has been considerable focus on the requirements of ISAs (UK and Ireland) but what significance has been given to the requirements of International Education Standards (IESs)? We would like information regarding firms' policies regarding compliance with these standards and in particular details of any policies in connection with IES 8.

Q2 Who makes these judgements in your firm?

The steering committee would like to gain an understanding of the level at which these judgements are made and whether this varies from audit to audit.

How much responsibility for making these judgements is in practice delegated to other members of the audit team? If judgements are delegated, we would like you to provide details of who are they delegated to, for example senior managers, audit managers or junior staff.

Do firms take the view that the audit engagement partner needs to be involved in all significant audit judgements and, if they do, how do they ensure this happens?

The steering committee would like to understand the interaction, if any, between these other audit team members making judgements, if they do, and the firm's listing of Responsible Individuals (RIs). It would be helpful to obtain details of your firm's policy for nominating Responsible Individuals (RIs).

We would like to understand what would be the circumstances for the key audit matters that are identified to be referred to the audit engagement partner and/or technical departments. If this does happen it would be helpful to know more about the process. If the technical department becomes involved in an issue is the judgement effectively made by the technical department in practice?

Q3 How do you ensure that only those people (as identified in your answer to Q2 above) make these judgements and what role do more junior staff play in this process?

Firms need to ensure that they have selected individuals for the audit that have the necessary competence and authority to make judgements if required. It would be helpful to understand how members of audit teams are determined by your firm in practice. For example, what are the firm's processes for ensuring that members of the audit team have the necessary knowledge and experience for the roles they will be expected to carry out on the audit? In connection with this, does the firm have a formal process for the assessment of competencies?

If judgements are delegated to lower levels in the audit team, we would like to understand how this is supported and supervised and the review processes you follow. Does your firm have specific processes that must be followed when it is necessary to make a 'significant audit judgement'?

We would like to understand the structures that firms have for audit teams. For example, is work allocated on the basis on seniority or can there be a genuine team approach to carrying out key parts of the audit? How much interaction is there in practice between senior and junior members of the audit team and is the active participation of junior members in discussing more complex audit matters encouraged by your firm? If so, how is this done?

Clearly ISAs 300 (audit planning), 315 (understanding the entity) and 330 (response to assessed risks) represent a key part of the audit process. We would like to understand the extent to which firms would expect significant audit judgements, and how they will be made, to be identified during the audit planning and risk assessment process. As part of this, it would be helpful to know about your firm's format for the ISA 315 audit team discussion and the extent to which this is controlled by those managing the audit.

If firms take the view that the audit engagement partner needs to be involved in all significant audit judgements how do they ensure this happens in practice? Any views or information you have regarding this would be helpful.

There is some concern that audit juniors might be taking judgements that should be taken by qualified people. At the same time there is also concern that auditing needs to be viewed as an attractive career option and that is therefore important that the work carried out by auditors is interesting and challenging. Do you have any feedback from juniors in your firm regarding whether they feel empowered to make decisions on the audit and do you have any views on the implications for the quality of people recruited for audit if juniors believe that they will not be involved in the decision-making process?

To what extent are more junior members of the team encouraged to become involved in the key audit issues in a meaningful way? How does communication between seniors and juniors take place in practice?

Finally, we would like to have information about the documentation requirements you have in place on these issues and your sign-off procedures for significant audit judgements that are made.

APPENDIX 4: REFERENCES AND OTHER RELEVANT INFORMATION

Financial Reporting Council (FRC)

The FRC is the UK's independent regulator responsible for promoting confidence in corporate governance and reporting.

***Promoting Audit Quality* project**

The FRC is consulting over how audit quality may be enhanced and promoted. The *Promoting Audit Quality* Discussion Paper proposed a number of drivers to the achievement of high quality audit and considered whether there are threats which weaken the effective operation of these drivers. More information is available at:

http://www.frc.org.uk/about/promotingauditquality.cfm

This website includes links to:
- The *Audit Quality Framework* (February 2008) and initial feedback
- Feedback paper on *Promoting Audit Quality* (October 2007)
- Responses to the FRC consultation on *Promoting Audit Quality*
- The original Discussion Paper *Promoting Audit Quality* (November 2006)

Paragraph 3.1(d) of the feedback paper on *Promoting Audit Quality* mentions work to be carried out by a new group on the international education standard IES 8 and the way audits are conducted and this CCAB steering committee was set up as a result:

"The responses indicate that a number of companies and investor representatives have reservations about **the way that audit fieldwork is undertaken.** These concerns arise from their view that much of the detailed work is undertaken by relatively inexperienced staff who, in order to ensure that their work is comprehensive and consistent, are required by their firms to adhere to somewhat rigid methodologies. As a consequence these commentators are concerned that:

• Staff undertaking the fieldwork may not be sufficiently experienced to audit the increasingly complex transactions undertaken by modern, global businesses;
• The methodologies may be demotivating; and
• This approach may mean that inexperienced staff may not be able to develop effective auditing skills from 'on-the-job' coaching and mentoring.

In raising this issue, the FRC is aware of the considerable contribution made to the British economy by the audit profession through training a large number of graduates who, when they leave the audit firms, use the skills they have acquired in business and commerce.

The FRC notes that the education committee of IFAC has recently issued IES 8 *[see item on IFAC below for more information on this]*. IES 8 introduces the concept of an audit professional as someone who exercises significant judgement in the audit of financial statements. In the FRC's view, the practical experience relevant to an audit professional suggested in IES 8 is greater than the current minimum requirements set by the UK professional accountancy bodies to meet the requirements of the UK Companies Act. The manner and extent to which the UK accounting profession adopts IES 8 may have an impact on the way that audit fieldwork is undertaken.

The FRC recognises this is a complex issue – and a very important one. It has therefore agreed with the accounting bodies that a task force, ideally comprising representatives of

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audit firms, professional bodies and other stakeholders, should be established to consider:
• The FRC's interpretation of IES 8
• The potential impact of IES 8 on the training of auditors and;
• The concerns expressed by companies and investor representatives.

The task force will also consider the results of research that has been recently commissioned into the practical training of auditors."

The review referred to in the last paragraph above was published by the Professional Oversight Board in November 2008 and more information is available at http://www.frc.org.uk/pob/press/pub1760.html. A separate working group has now been established to consider the matters arising from this review.

Complexity project

The FRC has issued a discussion paper arising from its project on reducing complexity in corporate reporting. *Louder than Words: Principles and actions for making corporate reports less complex and more relevant* is available from http://www.frc.org.uk/press/pub1994.html.

Professional Oversight Board (POB)
The POB has issued regulations requiring the auditors of public interest entities to publish annual transparency reports. These requirements apply in respect of any financial year of a relevant audit firm starting on or after 6 April 2008. The POB has stated that the *Audit Quality Framework* (referred to above) may provide a helpful framework for such reports.
http://www.frc.org.uk/pob/press/pub1563.html

The POB has now issued guidance material for those firms that are required to publish transparency reports. This includes an analysis of 2008 (voluntary) reports and puts forward points for firms to consider in their 2009 reports.
http://www.frc.org.uk/pob/press/pub1990.html

International Federation of Accountants (IFAC)
The standard IES 8 *Competence Requirements for Audit Professionals* and other international education standards (IESs) and pronouncements from the International Accounting Education Standards Board (IAESB) are available from http://www.ifac.org/Education/.

The IAESB has recently an exposure draft including recommendations to help improve the clarity of IESs including IES 8. As part of this process the IAESB will review each IES to determine whether it requires revision. The project is expected to last until 2012.
http://www.ifac.org/MediaCenter/?q=node/view/632

International Standards on Auditing (ISAs) and other pronouncements from the International Auditing and Assurance Standards Board (IAASB) are available from http://www.ifac.org/IAASB/.
These other pronouncements include International Standard on Quality Control (ISQC) 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*. IFAC has recently issued an implementation guide on ISQC 1 (following one previously issued on ISAs), focussed mainly on the needs of small- and medium-sized practices.
www.ifac.org

Auditing Practices Board (APB)
The APB issues Auditing Standards (ISAs (UK and Ireland)) and other pronouncements that apply in the UK and Ireland. More information regarding these pronouncements is given in the *Scope and Authority of APB Pronouncements.* This document includes *The Auditors' Code*

which outlines the qualities that auditors need to have, described as a "framework of fundamental principles" governing the conduct of audits.

The APB has recently issued a consultation on the IAASB's new clarified standards (with proposed supplementary requirements and guidance) that will apply to UK and Ireland audits of financial statements for periods ending on or after 15 December 2010.
http://www.frc.org.uk/apb/

Audit Quality Forum

The Audit Quality Forum brings together representatives of auditors, investors, business and regulatory bodies. Its purpose is to encourage stakeholders to work together by promoting open and constructive dialogue about transparency, accountability, reporting and confidence in the independent audit. This contributes to the work of government and regulators and generates practical ideas. Papers have been issued under three progammes:

- *Shareholder involvement*: 5 papers
- *Fundamentals*: 6 papers
- *Evolution of the audit*: 3 papers
www.icaew.com/auditquality

ICAEW Audit and Assurance Faculty
Publications of relevance include:
- *Quality Control in the Audit Environment* (May 2006)
- *Audit Quality* (November 2002)
- *Auditing in a Group Context* (November 2008)
www.icaew.com/aaf

International Forum of Independent Audit Regulators (IFIAR)
IFIAR's current workstreams include the drivers of audit quality.
http://www.ifiar.org/

European Commission
The regulatory arrangements for audit in the UK and Ireland are set in compliance with the EU Directive 2006/43/EC on statutory audit.
http://ec.europa.eu/internal_market/auditing/directives/index_en.htm

The European Commission has now issued a consultation on the implementation of Article 26 of the Statutory Audit Directive, specifically regarding the adoption of ISAs in the EU. This also covers quality control and the standard ISQC 1.
http://ec.europa.eu/internal_market/auditing/isa/index_en.htm

US Center for Audit Quality
The US Center for Audit Quality was created to serve investors, public company auditors and the markets. The Center's mission is to foster confidence in the audit process and to aid investors and the capital markets by advancing constructive suggestions for change rooted in the profession's core values of integrity, objectivity, honesty and trust.
http://www.thecaq.org/

Public Company Accounting Oversight Board (PCAOB)
The US PCAOB was created by the Sarbanes-Oxley Act of 2002 to oversee the auditors of public companies. The PCAOB is proposing an auditing standard on engagement quality review:
http://www.pcaobus.org/News_and_Events/News/2009/03-04.aspx