QUALITY ASSURANCE FOR AUDIT
A GOOD-PRACTICE GUIDE

Why? What? How?

ADB

CAPA
Confederation of Asian and Pacific Accountants

CAPA Guidance Series for the development of PAOs

The Confederation of Asian and Pacific Accountants (CAPA) Guidance Series is produced to support the *CAPA Maturity Model for the Development of Professional Accountancy Organisations* publication.

The Guidance Series is supported by the Professional Accountancy Organisation Development Committee (PAODC) of CAPA which is focused on the development of strong and sustainable professional accountancy organisations (PAOs) through the identification, development and sharing of relevant knowledge, tools and guidance.

Further information on the maturity model and linkage to the Guidance Series is highlighted in Annex 6 of this document.

The Guidance Series and other development materials may be accessed and downloaded from the CAPA website at: www.capa.com.my.

About CAPA

CAPA is recognised by the global accountancy profession, represented by the International Federation of Accountants (IFAC), as a regional organisation representing national PAOs in Asia Pacific.

The mission of CAPA is to develop, coordinate and advance the accountancy profession in the region by:

- Contributing to the formation and growth of sustainable accountancy organisations;
- Facilitating relationships and sharing knowledge;
- Promoting high-quality financial reporting;
- Influencing the development of public sector financial management;
- Influencing the development of efficient and effective capital markets;
- Promoting the value of the profession; and
- Providing input to, and supporting the global profession in, matters of public interest.

Table of Acronyms

ADB	Asian Development Bank
AQA	Audit Quality Assurance
AQM	Audit Quality Monitoring
CAPA	Confederation of Asian and Pacific Accountants
ICAEW	Institute of Chartered Accountants in England and Wales
IFAC	International Federation of Accountants
IFIAR	International Forum of Independent Audit Regulators
ISAs	International Standards on Auditing
ISQC1	International Standard on Quality Control 1
KSAs	Key Success Areas
PAO	Professional Accountancy Organisation
PIE	Public Interest Entity
QA	Quality Assurance
QAR	Quality Assurance Reviews
ROSC	World Bank's Report on the Observance of Standards and Codes
SMO1	IFAC's Statement of Membership Obligations 1
SMPs	Small and Medium-sized Practices

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Contents

Introduction

Who is this good-practice guide for?

This guide is intended for all those responsible for the regulation of accounting and auditing, including policymakers, regulators, and PAOs.[1] The guide is designed to be relevant to all countries and legal frameworks. The guide will be of particular value to countries wishing to set up a QA for audit function for the first time. The purpose of the guide is to:

- convey the essential building blocks of audit regulation and QA for audit;
- provide an understanding of the variations in audit regulation/QA for audit;
- help countries to design and implement in-country roadmaps for QA for audit; and
- drive the journey to greater improvement in financial reporting and auditing.

This guide is for everyone: policymakers, regulators and PAOs

The guide complements other good-practice guides involving QA for audit, including the IFIAR Core Principles for audit regulators and the IFAC SMO1 for PAOs (See: *Are there international standards for systems of QA for Audit?*). It applies equally to countries where the regulator and standard setter are the same organisation or different organisations.

What is the difference between audit regulation and QA for audit?

At one time, it was possible to set yourself up as a doctor or dentist without any training. Today most countries regulate companies, professions and services to some extent or another. However, in many countries the regulation of auditors is minimal.

As the regulation of auditors improves auditing and financial reporting, it should be a national priority. QA for audit involves the periodic review of auditors and audit firms. It ensures that auditors perform to high professional and ethical standards. QA for audit is one of the key components of audit regulation. Successful QA for audit and consequent improvements in audit quality also depend on having good education and learning programmes both for students and qualified auditors. This is illustrated in the model below.

Components of audit regulation

1 The governance and decision making responsibility for audit regulation and QA for audit may sit with a national regulator, with a PAO or with a combination of both. The same applies to operational and reporting responsibilities. This guide highlights the various options and remains equally relevant across the options.

Why does QA for audit matter?

QA for audit drives better quality and more reliable financial information.

Auditors provide assurance about the quality of financial information. Their professional judgements play a key role in building public trust and investor confidence.

Like doctors, auditors need to be regulated. Regulating audit firms of all sizes through QA for audit improves audit quality leading to many national benefits through improved quality of financial reporting:

- increased potential to strengthen public revenues;
- increased international confidence and investment; and
- stronger foundations for sustainable economic growth.

The ultimate beneficiary of QA for audit is the public, as improved governance and accountability strengthens the economy.

QA FOR AUDIT – ALTERNATIVE TERMS

Countries do not always use the term *QA for audit*. The alternative terms include Audit Quality Assurance (AQA), Audit Quality Monitoring (AQM), Quality Assurance Monitoring (QAM), Quality Assurance Review (QAR) and Quality Assurance System (QAS). Here for consistency, we use the term *QA for audit* throughout.

Are there common features in QA for audit?

If QA for audit is to be effective, it must have all of the following pillars.

Legislation and regulations

These are essential if a QA system is to be legally binding

Institutional governance

A QA Board or committee, ideally independent, is required to oversee QA for audit

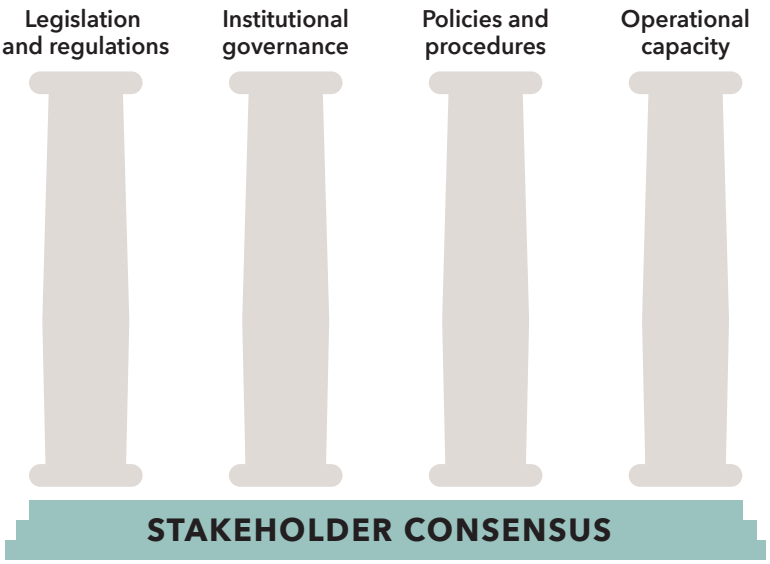
Policies and procedures

These set out to all how the QA system will work transparently

Operational capacity

People with a background in audit and trained in QA to conduct audit reviews

The foundation for the pillars is stakeholder consensus. This is required for a fully functional, effective and sustainable system for QA for audit.



Are there differences in systems of QA for audit?

There are many different types of QA system. This good practice guide covers the most common types. A key variable across all of these is cost. Each country needs to opt for a system that provides a good balance between costs and benefits. This guide will help decision makers to consider the options and to opt for a system that is affordable, achievable, proportionate, fair, transparent and sustainable.

- A system called **peer review** – where one audit firm reviews another – is a form of **self-regulation** and is relatively inexpensive. However this system provides little independence compared to others and managing conflicts of interest can be challenging.
- A system involving a dedicated unit within a PAO, a form of **shared regulation**, is more independent, but also more expensive due to the costs of governance and operational capacity.
- High-end systems involving an independent regulatory agency and enhanced governance provide the highest levels of independence but incur the highest costs.

Are there international standards for systems of QA for audit?

There are no international standards for QA for audit, only benchmarks. There are two main sets of benchmarks (1) for PAO members of IFAC, called *IFAC SMO 1* and (2) for audit regulator members of IFIAR called *IFIAR Core Principles of Audit Regulation*. The boxes below summarise each of these.

Other good-practice frameworks

The IFAC Statement of Membership Obligations 1 (SMO1) is for IFAC member PAOs. It sets out the role that PAOs should play in a system of QA for audit.

SMO1 requires that ISQC1[2] be adopted and implemented by all auditing firms. It addresses the design of a system for QA for audit, including the practical application of the system.

It covers how PAOs should implement QA for audit, providing guidance on the review cycle, on the QA team procedures and competencies, the reporting of corrective and disciplinary actions, and the interaction with public oversight.

SMO1 helps accountancy and audit organisations with QA for audit

The IFIAR Core Principles for Independent Audit Oversight set out how its member organisations should perform QA for audit or oversight of QA for audit, independently from the audit profession.

IFIAR members – regulators that are independent of the audit profession – are encouraged to comply with them. The core principles cover good practice for QA for audit, including a well-developed legal and corporate governance framework for corporate reporting and auditing.

They highlight the specific requirements for audit regulators to work in the public interest and to be independent and transparent operationally.

The core principles also cover inspections of public interest entities (PIEs), with a risk-based system, ensuring inspections of both firm-wide procedures (ISQC1) and audit files as well as the requirements for reporting effectively.

IFIAR core principles help audit regulators with QA for audit

2 ISQC1 – Quality Control for firms that perform audits is defined later in this document.

The IAASB Audit Quality Framework covers the IAASB foundations of high quality audit. This helps to define what QA for audit should achieve in order to verify the quality of auditing.

The IAASB's *A Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality* aims to raise awareness of the key elements of audit quality, encourage key stakeholders to challenge themselves to do more to increase audit quality in their particular environments, and facilitate greater dialogue between key stakeholders on the topic.

In some countries, the PAO has overall responsibility under law for QA. In some countries an accounting and auditing regulator is responsible under law for QA.[3] In most countries it is a combination of regulator and PAO. This good practice guide supports all of these situations. An IFAC paper highlights these variations and sets out policy recommendations.

What is IFAC's view on regulating the accountancy profession?

IFAC position paper

The Regulation of the Accountancy Profession (2011)[4] is an IFAC policy paper that summarises the different regulatory systems in place around the world, namely self-regulation by the profession, self-regulation with public oversight and external regulation.

The paper summarises IFAC's policy position on the regulation of the accountancy profession. It focuses primarily on audit regulation. It recognises the need for each country to find balance, based on its own circumstances and pragmatic considerations. The areas covered include:

Shared regulation: There is no 'one size fits all' regulatory model. Self-regulation and external regulation can be combined in different ways. Usually there will be some level of government oversight involved. Similarly, a national regulator will usually involve the PAO to some extent, perhaps by delegating the operational work involved in QA for audit to the PAO.

Good dialogue, interaction and oversight: Dialogue and cooperation between stakeholders ensures an appropriate balance in regulation. Good regulation should involve some oversight from an independent agency. IFAC considers that whatever the balance in a particular jurisdiction, the outcome is more likely to be positive where there is a collaborative relationship between stakeholders.

Recognition of the difference between PIE audits and other audits. In countries with a national regulator, delegation of QA for audit to the PAO can be based on public interest and risk eg:

- PIE audits being regulated by the national regulator and non-PIE audits by PAOs; or
- smaller PIE audits being regulated by PAOs with oversight from the national regulator.

Regulation and ethical behaviour: Regulation will not be effective unless it is accompanied by ethical behaviour. Regulatory systems should be designed to promote and achieve this behaviour. It is ethical behaviour that ultimately guarantees good service and quality.

Governments, PAOs and value for money. Government policy should ensure that regulation serves the public interest and that it appropriately balances quality and cost. Those responsible for regulating should be formally monitored and changes made if and when required. PAOs should actively help government and external regulatory agencies to design and implement high-quality regulation.

International convergence. Global regulatory convergence of the accountancy profession enhances the ability of capital markets to work globally, allows investments to move more efficiently across borders, and reduces the risks and uncertainties in capital markets. To achieve international convergence, national regulation should aim to endorse and implement internationally developed principles and approaches.

3 In Cambodia for example it is the *National Accounting Council* and in Myanmar, it is the *Myanmar Accountancy Council*.

4 To read the full paper see: https://www.ifac.org/system/files/publications/files/PPP1-Regulation-of-the-Accountancy-Profession.pdf

Overview of the QA journey

The four key stages in the QA journey

The four stages have been identified in the journey towards implementing a QA system for audit:

Stage 1: Conducting a diagnostic review

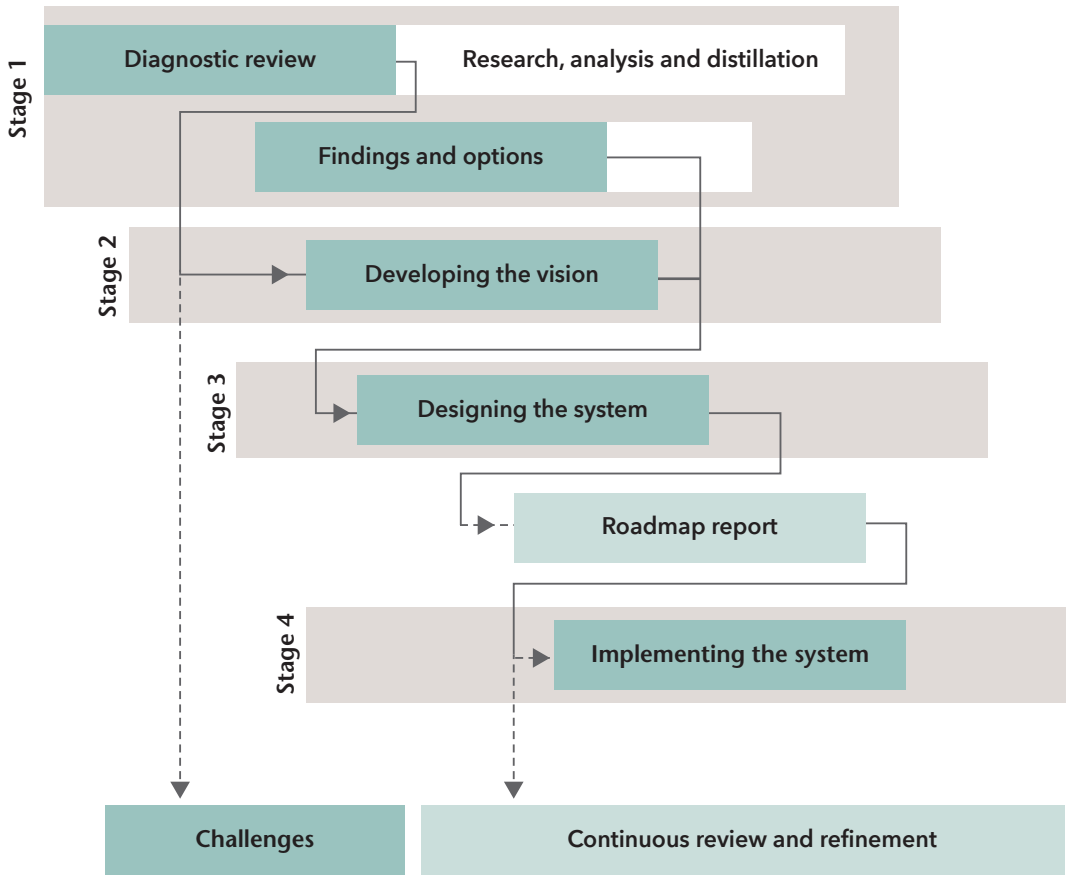
Stage 2: Developing the vision

Stage 3: Designing the system

Stage 4: Implementing the system.

The four stages can be sequential, the outputs of one stage providing the inputs to the next. Given the overlap in stages 1 to 3, a semi-parallel approach can be taken at these stages. This situation is reflected in the diagram below. There are likely to be challenges at each stage of the process, such as the preferred regulatory framework or the source of funding. In resolving the challenges effectively, it is best to have the support of key stakeholders.

QA journey overview



Stage 1 – the diagnostic review – involves a review of the current situation. It includes consultation with stakeholders and reviews of the national context and priorities. This stage may also include foreign visits by a delegation of key decision makers to view the QA systems elsewhere in the region. This stage may also involve a consulting team with international experience working in partnership with the key in-country decision makers.

Stage 1
Where are you now?

Stage 2
Where do you want to be?

Stage 2 – developing the vision – involves a distillation of all relevant factors, including appropriate options, costs and funding sources. This should aim to secure stakeholder consensus on the way forward and to provide a set of policy recommendations.

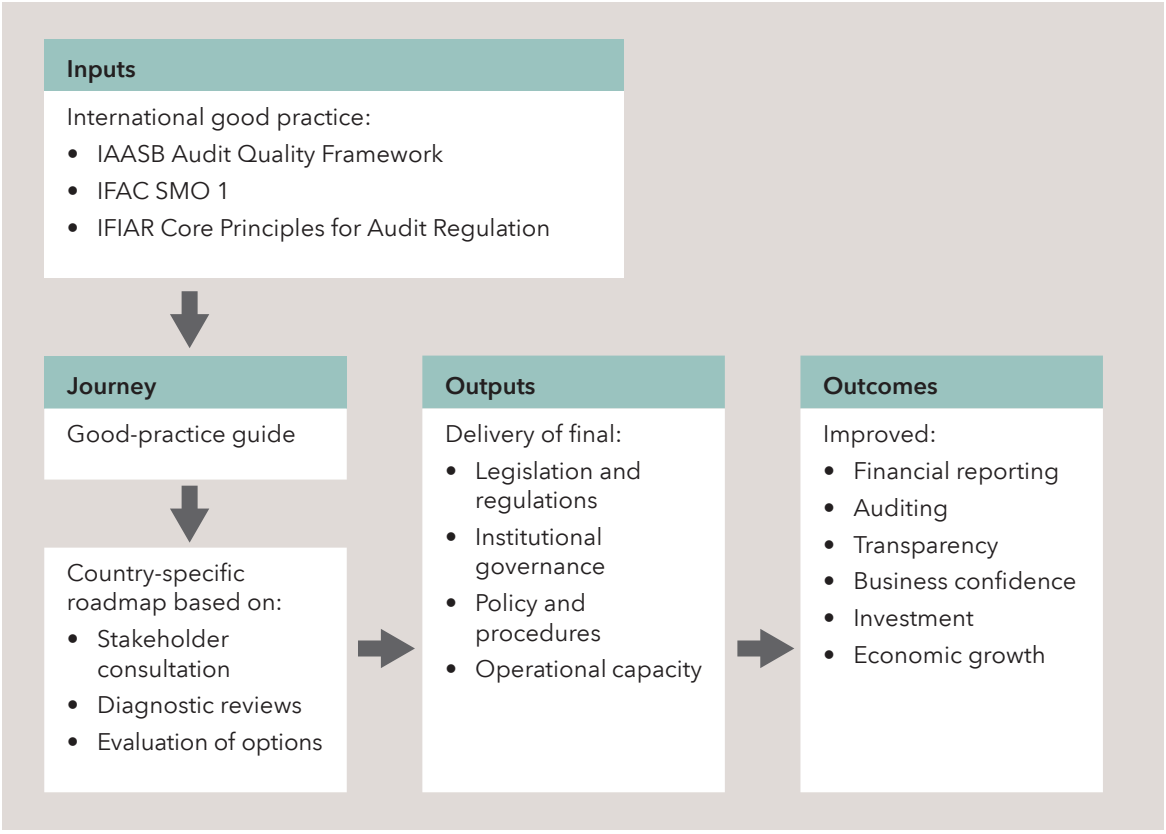
Stage 3
How do you get there?

Stage 3 – designing the system – involves setting out the roadmap steps that will deliver appropriate, practical, affordable, achievable and sustainable outcomes that reflect the vision.

Stage 4
Getting there …

Stage 4 – implementing the system – requires a set of coordinated interventions – carefully managed under a project to deliver the recommendations and roadmap steps involved. This is often called 'capacity building'. It will ideally include an international partner experienced in the different QA systems to mentor those selected to participate in the governance as well as the audit reviewers who will conduct QA for audit operationally.

In summary, the journey to QA for audit can be represented by the diagram below. This good-practice guide is a tool to support the journey, taking into account good practice and country specific considerations to achieve the required outcomes.



Good-practice guide coming next …

Stage 1: conducting a diagnostic review

Stage 1 in developing a QA system for audit involves reviewing the current accountancy landscape, especially in relation to regulation and listening to the views of stakeholders.

Who should be involved?

A national regulator and/or a PAO may conduct the diagnostic review. Alternatively, external assistance may be possible involving a team of international experts with experience of similar previous processes. A key consideration in a QA for audit system is funding, especially the cost of implementation.

The decision makers on legislation and policy should be closely involved. The team leading the diagnostic review will need to consult with the key stakeholders. These include the regulator for companies, the regulator(s) for financial services such as banking, insurance and pensions, the regulator for accounting and auditing (if this is separate from the PAO), as well as the audit market itself, namely audit firms of all sizes.

What should the diagnostic review cover?

The diagnostic review should examine the current status of the country in relation to all of the four pillars required for QA for audit.

How to perform the diagnostic review

Step 1 – Assess the existing information available. The inputs to the diagnostic review should include appropriate documentation such as:

- the current legislation;
- any draft and proposed legislation;
- IFAC Compliance Program reports;
- World Bank ROSC reports;
- relevant in-country information such as statistical information on the audit market; and
- the consultation notes with the key stakeholders.

Step 2 – Compile any new information as required. The following checklist of factors to assess may help in identifying the information required. Some of this may be readily available, while some information may require questionnaires to be sent to stakeholders.

Diagnostic review checklist

Pillar 1 – Legislation and regulations

- What does the existing legislation on accounting, auditing and company regulation require?
- Is there any draft or proposed legislation and what are the timescales for delivering this?
- Do key policymakers, regulators and PAOs have plans or intentions that are relevant?
- What PAO member regulations are in place and what do they say?
- What auditing and accounting standards are applied?
- Are any companies exempt from audit requirements?
- Are there any other regulations covering QA for audit eg, banking or securities regulations?

Pillar 2 – Institutional governance

- What are the governance arrangements for any existing QA for audit?
- Which regulators, departments and individuals have any responsibility for audit?
- What are the governance arrangements within the PAO?
- How might QA for audit fit within existing governance at the PAO or in another relevant body?

Pillar 3 – Policies and procedures

- Are all auditors subject to the rules of a PAO and/or to specific laws?
- What policies and procedures are auditors subject to?
- Are there policies and procedures already that cover QA for audit?
- What auditing standards are applied to audits (international and local)?

Pillar 4 – Operational capacity

- What is the size and maturity of the audit market?
- How many companies are subject to audit?
- How many Public Interest Entity (PIE) audits are there?
- What is the number of audit firms and relative sizes (offices, location(s), audit clients)?
- What is the capacity of any existing QA for audit function, at the PAO or elsewhere?
- What is the total of fees paid by auditors to allow them to carry out audit work?
- What is the relevant capacity of stakeholders or potential stakeholders to operate QA for audit?

Step 3 – Reporting on the diagnostic review. To help decision makers, the key diagnostic findings and key options identified for a QA system should be written up as a standalone report or part of a wider report that also contains the vision (**Stage 2 – the vision**) and roadmap (**Stage 3 – designing the system**).

Generally, the diagnostic review is better presented within a wider report as this gives decision makers all of the information they need in one document.

The in-country report itself might be best set out as follows.

Reporting on the diagnostic review

1. Executive Summary

A summary of the purpose and scope of the review, the options identified and conclusions of the review, using dashboard reporting and a summary of the policy recommendations.

2. Introduction and Background

Highlights of the review background, with a summary of the relevant laws, the corporate environment for financial reporting and auditing and the reasons why QA for audit is required.

3. Findings (gaps, issues and options)

- **Pillar 1 – Legislation and regulations**
  Findings on the current legislation, sub-legislation and regulations relevant to QA for audit.
- **Pillar 2 – Institutional governance**
  Findings on any relevant governance already in place in relation to good practice models.
- **Pillar 3 – Policies and procedures**
  Findings on policies and procedures for auditors and regulation that relate to good practice.
- **Pillar 4 – Operational capacity**
  Findings on any operational capacity in relation to the potential resource capacity required.

4. Recommendations and next steps

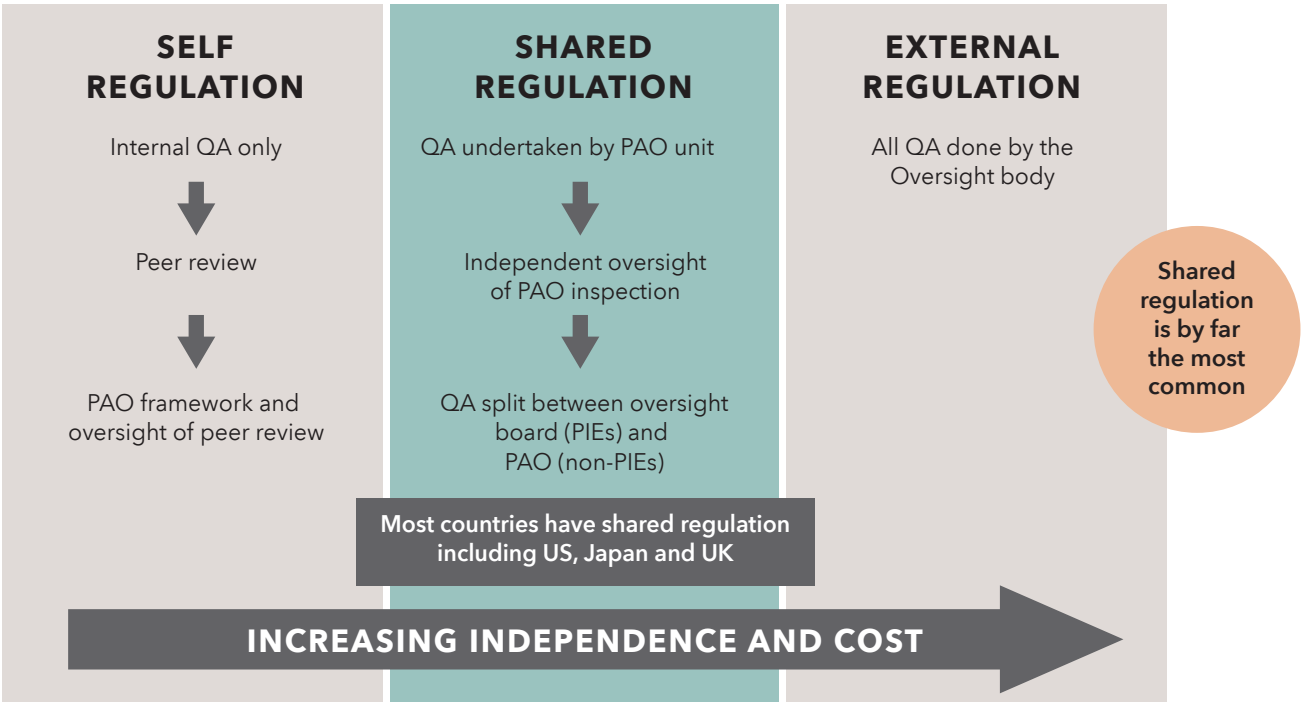
The report should conclude with setting out the way forward.

Stage 2: developing the vision

Stage 2 in developing a QA system for audit is to get stakeholder consensus on the way forward. This means agreeing or modifying the recommendations presented in the diagnostic report. A number of models of QA for audit should be considered.

Models of QA for audit

Models of QA currently in operation around the world range from self-regulation through shared regulation to external regulation. The cost generally increases with the degree of external regulation. The common models of QA are illustrated in the diagram below:



All systems should be transparent, with effective governance arrangements and responsibilities across organisations clearly understood. The systems for PIE audits and non-PIE audits can potentially be different to reflect the higher profile and risk of PIE audits. Also early priority can be given to piloting QA for the audits of the largest companies, such as those listed on the stock exchange (venture exchange).

PAOs should work with governments and relevant regulators to ensure that regulation is effective and achieves the balance sought between self-regulation by the PAO and external regulation by a separate regulator.

While shared regulation is the most common system, some higher income countries have moved in recent years towards external regulation. Each of the different models of QA for audit has its own benefits and costs. The key factors to be considered are listed on page 12.

- **Affordability** – the options preferred in relation to the funding available.
- **Acceptance by audit firms and other stakeholders** – the consensus on what is proposed.
- **Sharing of skills** – the effective engagement of QA staff with audit firms.
- **Independence and transparency** – the level offered by the options preferred.
- **Consistency** – the procedures for ensuring that QA findings are treated consistently.
- **Division of responsibility** – the avoidance of regulators duplicating QA and related costs.
- **Accountability of firms** – the operational capacity and effectiveness of systems for investigation and discipline.[5]

A detailed description of the different models, with the advantages and disadvantages of each is provided in Annex 3.

Sources of funding

A key challenge is funding. Possible sources of funds include government, a levy on accountants, auditors or companies. Sometimes funding can be obtained from government or a donor for the initial establishment of the system. The amount of money available is a key factor in determining the preferred system.

Who Pays for QA for audit?

Who will pay for QA for audit is the most difficult challenge. There are a number of sources of potential funding for QA:

- direct government funding;
- a levy charged on companies which are audited;
- an audit charge or licence fee paid by the audit firms; or
- external funding.

Further information on funding is provided below:

Direct government funding. This has the benefit that companies and their auditors do not see this as an additional direct financial burden on their businesses. However, a government would have to fund a budget for this through some form of additional taxation and may be reluctant to do so.

A levy charged on audited companies. This can be based on the relative size or status of the company. A government agency would need to collect the levy and pay it to the organisation(s) providing the QA review process. Legislation to permit collection of the levy is required. Companies may perceive this as an extra burden on top of the audit fee they already pay to their audit firm.

An audit charge or licence fee. Audit firms will resist a cost of a QA review that they find difficult to pass on to their clients. The cost needs to be proportionate and fair if it is to be accepted. A common and fair method is to charge audit firms an annual fee based on the size of the firm (partners, offices and audit clients). This spreads the cost of the QA review visit over the visit cycle. The alternative would be for firms to pay for the costs and overheads when they were visited.

External funding. Countries with limited resources and at the start of the cycle of implementing a system of QA for audit might explore donor funding. Initial external funding could help establish the process with the understanding that the aim is to have sustainable in-country funding.

Funding can be a combination of these sources but the most common is a visit charge or licence fee paid by the audit firms.

In most cases it's the auditors themselves who pay

5 For further information see the document *CAPA maturity model in action: Investigation & Discipline*.

How much will it cost?

The total costs of maintaining a system of QA for audit are mostly operational and involve the following.

- **The number of regulator(s) and PAO(s) involved in the QA for audit process and the number of QA for audit units being set up** – the more regulators involved, the more expensive the process (Use the *QA system model calculator* in Annex 4 separately for each unit).
- **The number of audit firms to be visited and their relative size and location(s)** – firms can be categorised using this information.
- **The estimated number of days to carry out each visit** – together with the information on the number and size of firms this will establish the total visit resource required to cover firms across the full visit cycle.
- **The visit cycle** – the longer the visit cycle the less the annual resource requirement will be – how often firms will be visited will help set the annual resource requirement.
- **The number of reviewers and support staff needed to cover the firms in accordance with the visit cycle** – from the resource requirements identified in the above steps a calculation can be made as to how many full-time equivalent staff are needed.
- **Employment costs** – these will be very market dependent and will vary with the experience needed to carry out the visits, they will also include training and support costs like transport and communications.
- **Additional expenses of running any QA for audit committees** – the costs of running meetings and expenses of committee members will also have to be factored in.

To calculate an indicative cost of an inspection system of QA for audit in any specific country, based on the inputs desired by the country, use the *QA system model calculator* in Annex 4.

Once the cost of an 'ideal' system using the model is estimated this can then be compared against the amount of estimated funding available in the same country. If the costs exceed the funding, then the assumptions can either be varied, or other ways to raise extra funding considered.

The conclusions that result from the costs and funding calculation model can help policymakers to decide which system of QA for audit is right for their country at this time.

Institutional governance

Good institutional governance should enable effective independent QA for audit. There may be one or more than one body responsible for QA for audit. Good practice would suggest that each body would have an effective QA Board (or committee) with appropriate membership, powers and accountability. The components of institutional governance are highlighted on page 14.

What is good institutional governance?

The QA Board

This is a key part of the independent oversight of QA. It normally sits within the PAO or national regulator, depending on the chosen QA model. It is responsible for all aspects of QA, but would normally delegate some powers to the staff of the PAO or national regulator.

The QA Board representation

The composition will dictate how independent it is. If only PAO members are on the Board, this will reduce public confidence. Current good practice is that 50% of the members of a QA Board come from outside the PAO. It is also good practice for these 'lay' members to be representative of the key stakeholders as this strengthens external accountability.

Powers of the QA Board

The powers of an effective QA Board include:

- approval (or rejection) of an application for an audit licence or registration;
- imposing conditions and/or restrictions on an audit firm due to poor quality audit work;
- removal of an audit firm's licence where appropriate; and
- referring an audit firm or auditor for investigation or disciplinary action if appropriate.

Structure of institutional regulations

A QA Board needs to have regulations in place to operate effectively. The legislation should refer to the regulations. The regulations should specify:

- the composition of the QA Board;
- the powers to be delegated to an QA for audit unit; and
- the rules to be used to measure each audit firm's conduct.

Reporting

In terms of transparency and accountability it would be good practice for a QA Board to publish an annual report summarising the work it has done throughout the year. Such a report would normally include a summary of the work carried out by the QA for audit team, including the outcomes of the audit inspections.

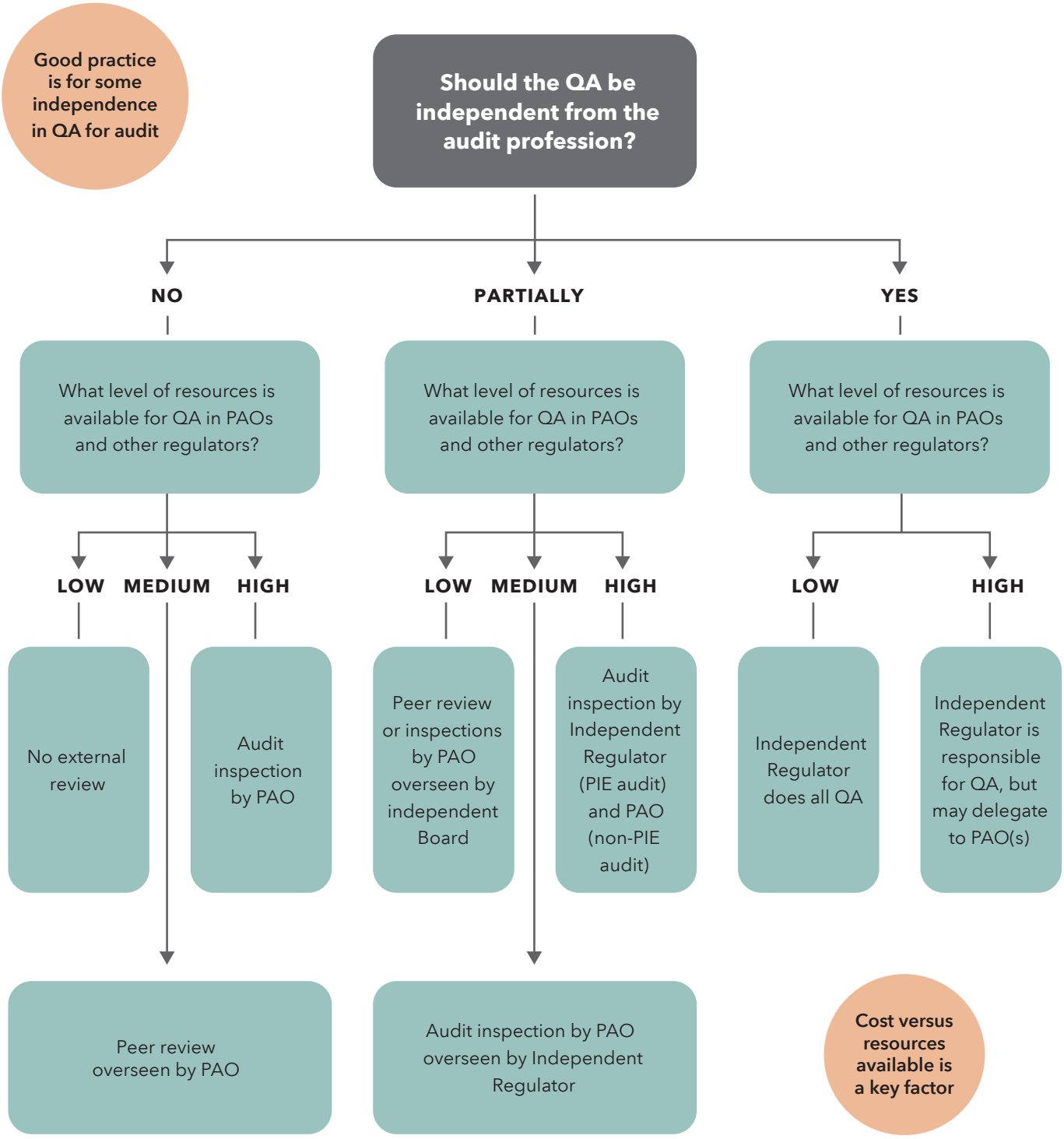
The following decision tree may be useful in considering the relevant factors and deciding what sort of QA system is best.

The decision tree below demonstrates that most QA systems are designed taking into account two main variables:

i. the desired degree of independence from the audit profession; and

ii. the amount of resources available for the QA system (which includes staff of the right quality and funding).

A case study of how this worked in practice is set out in Annex 2.



Stage 3: designing the system

Stage 3 in developing a QA system for audit involves decision makers agreeing on the preferred system and a roadmap being prepared on the steps and actions to make it happen.

The roadmap should highlight the key steps, activities, deliverables and responsibilities for implementing the proposed QA system for audit. These may involve:

- any draft legislation required and the steps to the enactment of this;
- the steps to establishing the authority and oversight, including boards/committees;
- the plans for developing the rules, procedures, operations manual etc;
- the roles and responsibilities depending on the chosen type of QA; and
- the project for orchestrating the roadmap implementation and for monitoring progress.

Stakeholders should agree the timescale for the roadmap is appropriate, affordable and achievable

The roadmap should include a timescale. A minimum of one year will be required to have a fully functioning QA system. The roadmap will need to include work to strengthen the capacity of audit firms – especially small and medium firms – as audit firms will require assistance in order to be compliant. For this reason, two to three years may be required to have a fully functioning QA system.

A good way to improve the timescale is to have a twin-track approach involving:

1. a **fast track** to a fully-functioning QA system that focuses firstly on auditors of PIEs. This will cover the biggest audit firms; and
2. a **parallel track** to help other audit firms to improve audit firm procedures, based on monitoring ISQC1 compliance and to improve audit methodology, perhaps through an audit practice manual.

The roadmap should be clear and concise about the following:

- all key actions, activities and deliverables against a timeline;
- the responsibilities for each activity and deliverable, and who has overall responsibility for implementing the roadmap;
- the resources required and the likely costs;
- activities where help is needed from government or development partners; and
- the engagement strategy with stakeholders for maintaining consensus.

The roadmap can easily be converted to be a costed project plan to seek implementation support

The following subsections give overviews of international good practice in each of these areas and can be used to develop the roadmap.

Legislation and regulations

Once agreement is achieved on the overall QA system to implement, the legislation needs to be examined to ensure it provides the required authority for it. If not, drafting and enacting new legislation will be a key first step.

The legislation should recognise audit as being different to accounting and should recognise the need for audit regulation involving QA. Otherwise audit firms can go to court to challenge QA. In Asia Pacific, there are examples where audit firms – large or small – have gone to court to challenge QA. When this happens, QA implementation can be delayed for five or more years.

The following international good practice should be reflected in the enabling legislation and regulations.

- **Primary legislation**. This should ideally cover the high level framework only, leaving the details to be covered by regulations, policies and procedures.
- **The governance of QA for audit**. This can be shared between an independent regulator or committee and one or more PAOs. Other regulators as highlighted below, can be represented on a QA Board or committee.
- **Operations, powers and resources**. The system to be used for QA for audit should have the authority and resources to perform its day-to-day operations.
- **Functions such as audit registration, qualification, investigation and discipline**. These can be shared between an independent regulator and one or more PAOs.

Institutional governance

Good practice has developed in recent years to achieve a degree of independent regulation over QA for audit. There are a number of ways this has been achieved.

- **Oversight.** This can be performed by an organisation that is independent of the profession, such as a government agency, existing regulator or a bespoke regulator.
- **Involvement of other regulators.** The governance for QA should include representatives from government departments, banking, securities and insurance regulators and other independent relevant organisations.
- **Involvement of non-accountants**. The body/bodies or committee(s) for QA can include a majority of non-accountants.
- **Public interest audits**. The QA of PIE audits can be performed by a QA function that is independent of the profession.

Policies and procedures

International good practice in this area is expressed in IFIAR's Core Principles for Independent Audit Regulation and in IFAC's SMO1. These good practices include the following.

- **The frequency of inspection of audit firms**. SMO1 requires a maximum review frequency of six years. Auditors doing PIE audits should be reviewed every three years or less.
- **Cycle or risk-based selection**. SMO1 notes that the selection of audit firms to visit can be cycle-based or risk-based, or ideally a combination of both.
- **Audit inspection procedures and methodologies**. These should cover firm-wide procedures including compliance with ISQC1 and audit file reviews in relation to ISAs etc.
- **Methodologies in use**. These should check compliance with requirements of international standards on auditing (ISAs), ISQC1 and the relevant codes of ethics for auditors.
- **Transparent and fair procedures**. The visit findings should be discussed with the audit firm and appropriate remedial actions agreed where appropriate.
- **Transparent and appropriate reporting**. This should cover inspection findings, both privately to the relevant QA Board and publicly where appropriate.
- **Sanctions and remedial actions**. An appropriate set of procedures must be in place, specifying the actions required for serious or repeated non-compliance.
- **Innovative policies and procedures** should be investigated to see if they can reduce costs, and/or increase efficiency, effectiveness and coverage of QA for audit. For example, PAOs in Australia and New Zealand use technology to reduce the cost of practice reviews and to survey large firm personnel to better understand matters impacting audit quality.

Operational capacity

International good practice in this area feeds into the costs and funding model that is included in Annex 4. Characteristics of good practice for operational capacity in QA for audit should include the following.

- **A dedicated inspection unit if possible**. This is more effective and independent than peer review.
- **A head of inspection with considerable experience and authority**. The senior figure will be respected in the audit market and should ideally have experience as a partner or director in an international firm or regulator.
- **Reviewers with expertise in audit**. The inspection unit should have two or more staff and all reviewers should have the skills to perform the QA inspections of audits and experience at manager level or above, ideally in an international audit network firm or equivalent.
- **Sustainable funding**. The inspection unit should be adequately funded and resourced, including with appropriate support functions.
- **Innovative approaches** should be investigated to maximise the impact of limited operational capacity; the use of technology can improve effectiveness.

Stage 4: implementing the system

Stage 4 in developing a QA system for audit involves establishing the system of QA for audit, guided by the roadmap produced in **stage 3**. Successful and timely implementation requires good in-country leadership and good project management.

Progress can also be assisted by an international development partner experienced in project implementation of QA for audit in other countries. This partner can give good practice guidance, hand over policies, processes and templates that can be tailored and provide mentoring.

Active engagement with key stakeholders is essential to secure their support. Key stakeholders include the relevant government ministry, PAO(s) and any regulators likely to assist or overlap during or after the implementation.

This section highlights the practical issues and decisions that frequently arise when implementing the roadmap and potential solutions.

Legislation and regulations

The responsibility for enacting legislation requires the support of the government and parliament. The government will need to agree policy recommendations and draft any required legislation. Assistance should be provided by PAOs, regulators and perhaps external sources capable of providing the required policy advice or funding. Questions that policymakers should consider in designing the legislation are included in Annex 1.

Policymakers will usually seek to refer to comparative legislation from other countries as a guide. Links to examples of such legislation from the EU and a number of countries worldwide are given in Annex 1.

The process of drafting legislation to facilitate QA for audit can be a long and difficult process, particularly when different interests are involved in the political process. Inviting stakeholders to workshops or reviews during the drafting process will help to minimise delays later.

As the legislation moves towards enactment, it will be necessary to agree sub-legislative acts or regulations. These can take various forms, including sub-legislation that remains the responsibility of the government, or through delegation of regulations by the government to those responsible (eg, audit regulators, PAOs, securities or banking regulators). Again, it is important that such regulations are developed with as wide a range of input from interested parties as possible so that the regulations are effective.

A number of examples of such sub-legislative regulations from countries worldwide are included in Annex 1.

Institutional governance

A key factor in designing the primary and sub-legislation and regulations is how to set up the institutional governance arrangements for QA for audit. Again, policymakers may seek to draw on examples from comparative countries worldwide. Links to details of the institutional governance arrangements for QA for audit in a number of countries are given in Annex 1.

One of the main elements of institutional governance is the establishment and operation of a QA board (or committee). If there is more than one body responsible for QA for audit, there should be an equivalent board/committee in each body with an overarching board/committee in the lead regulator. Setting these up and their structure should reflect the following.

- **An effective appointments process**, preferably by a separate nominations body.
- **Independence of the board**, by inclusion of members from different organisations and non-accountant members. Good practice is that the majority of members are not in public practice.
- **Appropriate powers in the board**, to approve or remove audit licences, impose conditions and restrictions on auditors or to refer cases to an investigation and disciplinary process etc.
- **Oversight responsibility** that involves not just monitoring visits to audit firms but also with a regular (possibly annual) review of the operations of the QA review unit.
- **Interaction with legislators and other regulators**, especially on matters related to audit quality.

Policies and procedures

As with the above sections, organisation(s) responsible for QA for audit will often seek to draw on established policies and procedures from comparative countries when developing and designing their own policies and procedures for QA for audit. Links to many of the globally-available resources in this area are given in Annex 1. They may also seek assistance from external sources such as through twinning with fellow regulators and PAOs and through consultancy advice and training.

Key resources on policies and procedures for QA for audit include:

- IFAC's SMO1;
- IFIAR's Core Principles;
- The European Audit Inspection Group's (EAIG) audit inspection methodologies;
- commercially-available audit practice manuals; and
- country-specific policies and procedures.

Operational capacity

A system of QA for audit will not be effective without the right operational capacity. A method for calculating the cost and operational resources required for the selected system of QA for audit is set out in Annex 4. There are practical challenges to address to ensure effective operations.

As highlighted previously, early implementation can be aimed at all auditors or restricted initially to PIE audits, which will reduce the number of visits required. This allows for a parallel process of capacity strengthening of audit firms through ISA and ISQC1 training, and for information to be captured on the audit market, including the size (partners, staff, locations) and type of audit clients (PIE and non-PIE).

Once a decision on the method of financing the QA for audit unit (*Stage 2: Developing the vision*), work is needed to develop and implement the method for collection of the funds required to finance the QA for audit unit (who pays, how payment is made).

Recruiting the right staff for the QA for audit unit is essential, including the right level of support staff to ensure audit reviewers can focus on the key technical skills of audit review. An appropriate and structured recruitment process will include:

- job specifications for head of unit, reviewers and admin staff;
- salaries that attract the right quality of staff;
- contracts of employment; and
- interviews.

Once staff are recruited, they need to be trained in the skills required to carry out QA for audit monitoring reviews and in the procedures to be used to carry out the work, including:

- soft skills – for example interview techniques, managing and resolving conflict;
- technical training in monitoring ISA (including ISQC1) and accounting standards compliance; and
- practical mentoring (in-country with external audit quality review experts and/ or accompanying experienced reviewers in other countries on their visits).

The administration for visits is also important. The information on the audit firms should be accurate and up to date and the scheduling of visits should be in accordance with the selected visit cycle. To do this it is necessary to:

- develop a return to be completed by audit firms annually to obtain current information on their activities;
- develop and implement a scheduling process; and
- develop a questionnaire to be completed by audit firms on the scheduling of a visit.

Annex 1: useful tools

Legislation and regulations

Questions to consider in designing enabling legislation include

Independent from the profession or not?

International good practice has now settled on QA for audit that is as independent of the audit profession itself as is practical. This is a relatively new development as professions such as accountants and auditors have traditionally been self-regulating; in the past the professions, and to some degree the public, thought it sufficient that audit professionals would be quality assured by their peers through the development of and adherence to professional standards.

Successions of high profile financial and corporate scandals have caused the public, regulators and governments to no longer accept this level of assurance and most leading economies, including all EU member states, US and Japan, have now legislated for QA for audit that is to some degree independent from the profession. However, each country must assess and decide the degree of independence that is appropriate as the costs of QA increase with the degree of independence.

Who should do QA?

In most countries there is shared regulation – the PAO or bodies of auditors perform some or all QA and there is some degree of independence in the governance arrangements and/or in inspection of PIE auditors. For low capacity countries, the PAO is often the only organisation that has the resource and expertise to do the QA.

What powers should the QA organisation have?

International good practice links the QA to the power to restrict the ability of the auditor to perform audits – the organisation performing QA should have the power to place conditions on and ultimately remove the auditor's registration.

Who should do complementary functions?

International good practice suggests that many of the complementary functions such as audit registration, audit qualification, complaints and disciplinary arrangements should be performed by the PAO, but should be subject to oversight by a body independent of the profession. In high capacity countries some of the functions are performed by the oversight body itself, particularly for PIE auditors.

How involved should the government and relevant regulators (such as banking and securities) be?

It is now international good practice for regulators to seek to cooperate and coordinate their regulation where possible, and audit regulation is included in this. As a result many systems seek to involve the regulators and other independent relevant organisations in the governance of QA for audit, or involve them formally in some other way.

What should the primary legislation cover vs secondary legislation and regulations?

International good practice and experience suggests that the primary legislation should cover the powers that the system of QA for audit needs in order to be established and function effectively. However, much of the detail of the system should be left to either sub-legislation, regulations or policies and procedures as these can be more easily changed to adapt to changes in the environment in the country concerned.

Good examples of legislation enabling and regulating QA for audit include:

- The EU Statutory Audit Directive (for all auditors) and Regulation (specific to PIE auditors). This EU level legislation is applicable to all 27 EU member states. Articles 29-32 of the Directive, and Articles 23-25 and particularly Article 26 of the Regulation, are specific to QA for audit. Links to the legislation are:
  - Directive: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0056&from=EN
  - Regulation: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0537&from=EN

- Examples of national legislation include:
  - Singapore audit legislation – *The Companies Act* sets out requirements for company audit, see: http://statutes.agc.gov.sg/aol/download/0/0/pdf/binaryFile/pdfFile.pdf?CompId:579244a5-83c6-46cc-8563-e01eee5ff6a8 and the *Accounting and Corporate Regulatory Authority (ACRA) Act* sets out the powers and responsibilities of the audit oversight authority, Accounting and Corporate Regulatory Authority (ACRA) http://statutes.agc.gov.sg/aol/download/0/0/pdf/binaryFile/pdfFile.pdf?CompId:5a0ebdbc-d49b-41df-bcfe-19999c7d537c
  - Australian audit legislation – *The Corporations Act 2001* (https://www.legislation.gov.au/Details/C2016C00368) includes provisions relating to financial reporting and audit by Australian companies, *The Australian Securities and Investments Commission (ASIC) Act 2001* (https://www.legislation.gov.au/Details/C2016C00725) gives ASIC authority for audit regulation within its general authority and powers as a securities regulator.

Institutional governance

Good practice examples of institutional governance arrangements for QA for audit include:

- Singapore: Singapore has an audit regulator, ACRA, and a PAO for auditors, the Institute of Singapore Chartered Accountants (ISCA). The institutional governance arrangements are described on the IFIAR member profile here: https://www.ifiar.org/IFIAR/media/Documents/General/About%20Us/2016_Member_Profile_Singapore.pdf
- Australia: Australia's QA for audit is overseen by ASIC, the securities regulator. Its institutional governance arrangements can be seen here: https://www.ifiar.org/IFIAR/media/Documents/General/About%20Us/2016_Member_Profile_Australia.pdf. A number of PAOs in Australia also perform QA for audit (for non-PIE audits).
- UK: The UK's Financial Reporting Council (FRC) oversees the QA for audit in the UK and performs QA for PIE audits. The FRC's institutional governance arrangements can be seen here: https://www.ifiar.org/IFIAR/media/Documents/General/About%20Us/2016_Member_Profile_United-Kingdom.pdf . A number of UK PAOs share the regulation and perform QA for non-PIE audits.
- US: In the US, the the Public Company Accounting Oversight Board (PCAOB) performs QA for audit for auditors of listed companies (most PIEs). Its governance arrangements can be seen here: https://www.ifiar.org/IFIAR/media/Documents/General/About%20Us/2016_Member_Profile_United-States.pdf . The PAO, the American Institute of Certified Public Accountants, is responsible for all other audits.

Policies and procedures

The following are resources that the organisation(s) responsible for QA for audit can draw on when developing and designing policies and procedures for QA for audit.

- IFIAR Core Principles: https://www.ifiar.org/IFIAR/media/Documents/General/Final-Core-Principles.pdf
- IFAC's SMO 1: http://www.ifac.org/publications-resources/statements-membership-obligations-smos-1-7-revised
- Audit inspection methodologies: The European Audit Inspection Group (EAIG), which comprises most of the EU independent audit inspection units, has published for public use their Common Audit Inspection Methodology for both firm-wide inspections and for audit file inspections. The methodology is available here: http://www.eaigweb.org/projects.php

Operational capacity

Examples of the operational capacity of leading international QA systems for audit include:

	Sri Lanka	Singapore	UK	Thailand
GDP ($m)[6]	81	292	2,858	395
Number of auditor entities in scope	70	689 audit firms (in listed and non-listed companies segments) and 1,076 public accountants	N/A	25 firms, 180 auditors
Number of audits reviewed each year	100	Approx. 100–140 public accountants (in listed and non-listed companies segments) – covering approx. 160–230 engagements	126	12–14 audit firms 40–70 audit partners Approx. 100 engagements
Organisation	SLAASMB	ACRA	FRC (PIE audits only)	SEC
Budget ($000)	682	Non-disclosure due to confidentiality	6,383	Approx. 1,000
Attributes of Head of Unit	Chartered accountant with 12 years' experience	At least 12 years of audit experience (including managerial experience) with Big Four firms	Former staff of National Audit Office	CPAs Audit practice with Big Four firm
Number of staff: inspectors	12	Listed companies: 10 inspectors (including Head of Inspection) Non-listed companies: 6 inspectors	Approx. 25	13 inspectors 3 managers
Number of staff: support	9	1	Approx. 3	1

6 All GDP data acquired via the *International Monetary Fund economic outlook database* for the 2015 year-end.

Annex 2: case study – example country

The following case study is based on a country with a small public interest audit market with no audit exemption. It is an example of successful completion of implementing an effective system of QA for audit.

Legislation and regulations

Diagnostics	Roadmap	Implementation
Legislation had been drafted which would establish the PAO as regulator of the accountancy profession and responsible for the conduct of examinations. It set out: • the requirements for the PAO's governance structure; • qualification requirements for practice; and • provisions for investigation and discipline. Its shortfalls were that it did not provide for: • any public oversight; • licensing of auditors other than through the general practicing certificate; and • audit quality monitoring.	Discussions between PAO and government to agree amendments in legislation to align with proposed regulatory structure.	Legislation redrafted to accommodate suggestions for improvement.

Institutional governance

Diagnostics	Roadmap	Implementation
The PAO had draft bye laws and associated regulations but these had never been finalised and implemented.	Identify good governance examples in other countries with similar but more mature QA review processes. Draft and implement bye laws and associated regulations tailored from those identified as a good model.	PAO bye laws updated to provide a framework to accommodate audit regulation. A set of audit regulations put in place to govern the conduct of audit firms and provide a set of rules for measuring audit quality and for the monitoring, inspection and regulation thereof. A QA Board, including stakeholder representation, set up to license audit firms and consider reports of QA inspections.

Policies and procedures

Diagnostics	Roadmap	Implementation
As there was no QA function there were no policies and procedures.	Develop a QA manual setting out the policies and procedures to be adopted in the QA inspection process. Provide training for the QA review team and desk based training to the QA Board. Provide training for audit firms on the expectations and implications of the QA process.	Draft the policy and procedures. Deliver both detailed desk based and pilot visit training on the above to the QA inspection team and high level desk based training to the QA Board. Set up a register of all licensed auditors. Implement an annual reporting mechanism to obtain information from each audit firm on its activities. Run seminars for audit firms on ISQC1, audit quality and the QA inspection system. Carry out initial assessment visits to audit firms to: • establish what policies and procedures they had established to comply with ISQC1; and • gain more information on the quality of the audit firms. Once the cycle of initial assessment visits had been completed start a cycle of full audit monitoring visits.

Operational capacity

Diagnostics	Roadmap	Implementation
There was no QA function within the PAO.	Perform calculation to determine the level of staffing for a PAO QA unit. Carry out a detailed costing of the QA review function including the cost of the inspection unit and associated regulatory costs. Agree how the QA regime is going to be funded. Write person specifications for QA inspection team, interview and appoint staff.	Develop functions for regulatory action, complaint handling, investigation and discipline. Identify and appoint a QA Board with appropriate stakeholder representation. Recruit suitably qualified head of QA unit and inspection staff. Provide training through a combination of visit to a country with a mature QA regime and in-country training on good practice for QA. Set scale fee levels for audit firm licences based on the size of the firm and its audit clients with the objective of fully covering anticipated costs.

Stakeholder consensus

Diagnostics	Roadmap	Implementation
Principal stakeholders identified as auditor general, banking and insurance regulators, capital markets authority, revenue & customs authority, representatives of major international firms and SMPs. Although there was some scrutiny of financial statements there was no QA framework.	Round-table for all stakeholders to outline possible changes and stimulate discussion across stakeholders. Individual discussions held with each stakeholder to help build sustainable relationships and establish clear lines of regular communication.	Establish procedures for information sharing between stakeholders and PAO. Ensure stakeholders represented on QA review board.

Annex 3: QA models clarified

Each of the different models of QA for audit has its own benefits and disadvantages. The table below describes each model and also sets out the perceived advantages and disadvantages.

Internal QA only

Individual audit firms carry out their own QA with no involvement from either an independent oversight body or the PAO. This would meet the requirements of ISQC1 on monitoring provided the inspection was carried out by those not involved in the audit engagements they were reviewing.

Advantages	Disadvantages
• The only advantage in adopting this system is that there is little cost and implementation would meet little or no resistance from audit firms.	• As the process is completely internal it would not meet the good practice objectives of transparency and accountability. It is inherently not independent and there is no mechanism to investigate and discipline where there is poor performance. • Poor performance would only be identified through self-reporting, whistleblowing or when an audit failure reached the public domain. • This approach would not improve standards unless current standards within the audit firms were already high and there was a willingness in the firms to use this process as an effective QA tool. • This would be difficult for single partner firms to implement as they would need to find a reviewer not involved in the audit engagements they were reviewing.

Peer review

QA is carried out by another audit firm but as with internal QA with no involvement from either an independent oversight body or the PAO.

Advantages	Disadvantages
• This option draws on the skills and experience of members. It shares information across the profession and can be a good option for improving audit quality in an already developed and mature audit market. • This option would also address the problem of single partner firms not being able to meet the ISQC1 objective of review by a reviewer not involved in the audit engagements they were reviewing.	• This option has the same disadvantages as the second and third points noted in internal QA above. Although it is not internal there is still no mechanism to investigate and discipline where there is poor performance. • Additionally there may also be independence issues if, for example, the reviewing audit firm has some connection with or dependency on the audit firm it is reviewing. • Firms may also be resistant to the introduction of this process as they will not want to reveal commercial information to the peer reviewer who will be a competitor.

PAO framework and oversight of peer review

As with peer review but the PAO has a framework for oversight of the firms that carry it out. It may include approval of firms who are allowed to carry out peer reviews and an investigation and disciplinary process where poor performance is identified.

Advantages	Disadvantages
• As for peer review alone, this option draws on the skills and experience of members. It shares information across the profession and can be a good option for improving audit quality in an already developed and mature audit market. • This option gives the PAO an element of control over the quality of the peer review process and the potential to put in place investigation and disciplinary processes where poor quality audit work is identified.	• Although this option has some oversight built in there is likely to be a perception of a lack of separation of public interest and self-interest and therefore there is a risk of insufficient credibility. • Also, as above, firms may be resistant to the introduction of this process as they will not want to reveal commercial information to the peer reviewer who will be a competitor.

Inspection by PAO team (own employees)

The PAO carries out its usual professional body functions and also assumes all the audit regulatory functions. A governing board and QA committee have increased external representation to provide a public oversight element. Review staff are employees of the PAO.

Advantages	Disadvantages
• This option has the advantage of being cost effective in that there is no separate regulatory body or public oversight body and therefore no duplication of responsibilities and functions. • PAOs have the knowledge of the profession and the markets in which they operate to help them design and implement good QA. • With a single QA inspection team of the right calibre this should provide consistent QA reviews and with a single board/committee considering reports this should provide consistent outcomes.	• There is likely to be a perception of a lack of separation of public interest and self-interest and therefore there is a risk of insufficient credibility.

Inspection by PAO team (subcontracted to independent reviewers)

The PAO carries out its usual professional body functions and also assumes all the audit regulatory functions. A governing board and QA committee have increased external representation to provide a public oversight element. The PAO subcontracts the review work to an independent organisation or uses independent individuals as reviewers.

Advantages	Disadvantages
• This option has the same advantage as the one above. • This option has the advantage in smaller audit markets of not incurring full-time employment costs for the PAO, with subcontractors only needed for the visits to be carried out each year. • This option also has a potential advantage in bringing in external expertise of audit regulation from another country/regulator's perspective.	• There is still likely to be a perception of a lack of separation of public interest and self-interest and therefore there is a risk of insufficient credibility. • There is a challenge in making sure that subcontractors are fully aware of the audit regulation framework, especially if they are external to the country.

Independent oversight of PAO inspection

Self-regulation with public oversight and accountability would typically involve some form of oversight being carried out by an independent agency. While the independent agency assumes responsibility for regulation it may still delegate functions, including licensing of auditors and QA, to the PAOs.

A public oversight body is established with the responsibility for delegating and overseeing the licensing and monitoring of auditors. The board of the public oversight body would include public representation and the public oversight body would oversee the activities of the PAOs with particular emphasis on public interest entities (PIEs). The PAOs retain responsibility for licensing and carrying out the QA function of all auditors (auditors of PIEs as well as auditors of non-PIEs). The PAOs also retain responsibility for the professional qualification, setting accounting, auditing and ethical standards and investigating complaints and enforcing sanctions for violations.

Advantages	Disadvantages
• This option has the advantage of being cost effective in that the public oversight body delegates most of its functions to the PAOs while retaining a public oversight function. As a consequence there is little duplication and overlap of responsibilities and functions. • The option also offers flexibility in that the public oversight body could bring some of the functions (for example; licensing of auditors of PIEs and QA of auditors of PIEs) in house at a later date if circumstances dictated that it was appropriate to do so.	• This option would need to have boundaries of responsibility clearly drawn out to ensure there was neither duplication nor omission of responsibilities.

Oversight body and PAO

This is similar to independent oversight of PAO inspection but some of the functions may be delegated to the PAOs; for example licensing of auditors of non-public interest entities and QA of auditors of non-public interest entities.

Advantages	Disadvantages
• Like independent oversight of PAO inspection, this option also has the advantage of a high level of public oversight and division of duties between the functions of the oversight body and PAO(s).	• This is likely to be expensive due to some overlap and duplication of responsibilities and functions between the oversight body and PAO(s). This will particularly be the case, if the licensing and QA functions for auditors of public interest entities and auditors of non-public interest entities are divided between the oversight body and PAO(s).

Oversight body does all inspection

Under external regulation, the government regulates the profession, either through a government agency or through an independent agency that has been created and delegated regulatory powers by the government. A regulatory body is established with the responsibility for licensing auditors and performing the QA function. The regulatory body may also be responsible for setting accounting, auditing and ethical standards and investigating complaints and enforcing sanctions for violations. A board (or equivalent) of the regulatory body would include public representation and the regulatory body would employ staff to carry out the licensing and QA functions.

Advantages	Disadvantages
• This option has the advantage of a high level of public oversight and division of duties between the functions of the oversight body and PAO(s)	• This is likely to be expensive due to some overlap and duplication of workload and functions between the oversight body regulatory and PAO(s).

Annex 4: QA system cost calculator

The following method can be used to roughly calculate the cost of an inspection unit-type of system of QA for audit in any specific country, based on the inputs desired by the country. Once the cost of an 'ideal' system is estimated, it can be compared against the amount of funding that is estimated to be available in the same country. If the costs exceed the funding, then the assumptions can be varied or other ways to raise extra funding investigated.

Stage 1 – calculate how many QA inspection visit days to auditors required per year

International good practice suggests an inspection of each auditor that audits PIEs once every three years and all other auditors every six years.

The number of days needed to carry out an inspection will depend both on the size of the audit firm and the number and type of audit clients it has. A sole practitioner with one office and no PIE audits would typically take 2 days on-site plus 1 day off-site (planning and completion time). Each additional partner will typically add 1 day and each additional office will also add 1 day. Inspections of large auditors of PIE entities will typically take 7 days (5 on-site and 2 off-site). Inspections of the large international audit firms will typically take 14 days (10 on-site and 4 off-site). Actual timings used will depend on getting information on the size and nature of audit firms in each country.

Once this information has been gathered a grid should be constructed showing how much reviewer resource is needed.

In a very simple example, assuming each PIE auditor visit takes an average 7 days and a non-PIE auditor visit 3 days, then the number of visit days can be estimated as:

$$\text{Number of visit days} = \frac{\text{Number of PIE auditors} \times 7}{3} + \frac{\text{Number of non-PIE auditors} \times 3}{6}$$

So in this case, if there are 30 audit firms that audit PIEs and a further 600 audit firms, the number of QA inspection visit days would be 70+300 = 370 per year.

Stage 2 – calculate the number of reviewers needed

Work out how many working days are available for inspection each year for a reviewer. A typical assumption would be between 150–200 days to allow for administration, training, holiday, sickness etc. Using in our example 150 days, then the number of visit days (370) divided by 150 days per reviewer gives an estimate of the number of reviewers needed. (Or full-time equivalent (FTE) reviewers – two reviewers working 50% part time is equivalent to one FTE reviewer).

In this example, about two and a half FTE reviewers would be needed.

Where less than two FTE reviewers are indicated, international good practice would suggest having at least two part-time reviewers so that when one leaves there is some continuity.

Stage 3 – calculate the costs of the reviewers and other costs

International good practice suggests that reviewers need to be of sufficiently high calibre and probably have worked at manager level with an international firm (or equivalent) and have gained experience across different sectors of industry. Next estimate the salary of such a reviewer and multiply that by the number of FTE reviewers to give the total salary costs of reviewers. After this add other reviewer costs such as estimated travel, phone and computer equipment, subsistence expenses, location costs (if any).

The next major cost to estimate is the salary cost of a head of unit. International good practice suggests that the head of unit should be at partner or director level at an audit firm, ideally an international firm.

An audit quality review unit of one to two FTE reviewers may not necessarily need a full-time head of unit – it should be possible for an experienced person to fulfil this role in two or three days per week. The cost of such a head of unit in the country context should be estimated.

The salary of an administration assistant, expenses of volunteer committee members and any additional costs of investigation and discipline also need to be estimated.

Stage 4 – Calculate the overall costs total and check that it is reasonable

Adding together all the costs calculated in the previous stage provides an overall budget. The budget should be reviewed in total to check it appears reasonable. If not, then the assumptions will need to be revisited.

Stage 5 – Calculate the potential funding available

International good practice suggests that the two most common sources of funding for QA for audit are from audit firms themselves and/or from direct government funding. The funding that is likely to be available or realistic from a charge or levy on audit firms will depend on the size of the audit revenues that audit firms receive.

Based on international comparisons and norms, a levy on audit revenues to fund a QA scheme is generally less than 3–4% of audit income. This varies from country to country and depends on the system chosen for QA for audit. The key is to obtain adequate funding while retaining the support of both firms and regulators for the chosen system. Government funding can be theoretically any amount but will often be limited. However, the estimated costs of the minimum for international good practice QA for audit derived at stage 4 above should be the starting point for discussions with the relevant government department.

Stage 6 – Compare costs to funding

At this stage the estimated costs from stage 4 should be compared against the the funding available from stage 5. Where there is a projected shortfall that cannot be made up by increasing funding in some way, then some of the assumptions made in stages 1–3 need to be revisited.

Options, which vary from international best practice but which may be realistic as good practice especially in low-income countries, include the following.

- Reducing the frequency of visits, say to once every five years for PIE auditors and 10 years for non-PIE auditors
- Reducing the number of days for each visit; however, the assumptions of 14 days for an international firm, 7 days for a PIE auditor visit and 3 days for each non-PIE auditor visit are close to minimums, based on experience.

- Reducing the coverage, for instance to cover only PIE auditors at first, or to only perform firm-wide ISQC1 inspections and not file reviews at first. These should only be temporary measures.
- A 'hybrid model' which combines good practice inspection with another less-optimum system such as peer review for some auditors.
- Reducing the experience requirements, and thus the salary costs, for the reviewers and head of unit.
- Starting the monitoring process with initial assessment visits which focus on a firm's ISQC1 policies and procedures. Only when this initial visit cycle has been completed start the cycle of full monitoring visits which include audit file reviews. This would keep starting costs down and give more time to establish a sustainable long term funding solution.
- Getting firms to send information on ISQC1 procedures and compliance and a sample of audit files to the regulator which would eliminate travel costs and could potentially help with visit scheduling challenges.

Annex 5: ISQC1, requirements and considerations

We have referred at various points in this document to ISQC1 (the IAASB's International Standard on Quality Control 1 *Quality control for firms that perform audits and reviews of financial statements, and other assurance and related services engagements*). ISQC1 provides audit firms with a firm-wide framework for delivering audit quality.

ISQC1 sets out six key areas for firms to consider and each needs suitable and proportionate policies and procedures. These six key areas are considered individually below. Audit firms can get assistance from externally produced manuals but they have ultimate responsibility for the quality control policies and procedures they adopt. Firms should tailor the procedures to reflect their own circumstances.

1. Lead from the top giving consistent messages on the importance of quality control

The firm's leadership must assume responsibility for its system of quality control. The example a firm's leadership sets ('tone at the top') should significantly influence its internal culture.

There should be a consistent message on the importance of quality control and policies and procedures should recognise that quality is essential to performing audits. Firms should place particular emphasis on:

- commercial considerations never overriding the quality of performance;
- independence and professional scepticism;
- rewarding quality; and
- sufficient appropriate resources for the firm's quality control policies and procedures.

2. Act ethically in accordance with the relevant standards and pronouncements

Firms need reasonable assurance that they comply with the relevant ethical requirements. ISQC1 gives particular guidance on independence and the application material makes reference to the Code of Ethics for Professional Accountants issued by the IESBA and establishes ethical requirements for professional accountants. A member body of IFAC may not establish less stringent standards than those set out in the IESBA Code.

The general approach is to consider whether safeguards are available to address identified threats to compliance with the fundamental ethical principles. In many jurisdictions around the world, firms may also be required to comply with their own national legal or regulatory requirements relating to ethics.

Firms should ensure that audit partners and staff have training and guidance on ethical matters. They should be aware of who or what to consult if they are uncertain on a particular matter. Specifically, there should be a policy and procedure on what staff should do if they have an ethical issue to resolve. Larger firms are likely to pay specific attention to the requirements that are relevant for PIE audits and smaller firms might want to emphasise issues relevant to the audits of smaller entities.

3. Accept only those engagements where the firm is confident it can provide a service in compliance with requirements with particular emphasis on integrity and competencies

ISQC1 outlines the requirement for firms to have policies and procedures for the acceptance and continuance of client relationships and specific engagements. In summary, firms are required to document the following considerations when accepting or continuing audit engagements:

- the integrity of the client;
- the firm's competence to perform the engagement; and
- whether compliance with ethical requirements can be achieved.

ISQC1 indicates the type of factors to consider, for example the reputation of the client's management and owners. While there is a requirement to obtain appropriate information to support a firm's decision to accept or continue an audit appointment, the need to document arises where 'issues' are identified and the firm decides to accept or continue the appointment.

Firms may use a checklist to help with this and there are externally produced checklists available. However, firms must recognise that this is not a checklist driven decision and they must give issues proper consideration.

As part of the acceptance and continuance exercise, firms have to consider whether partners and staff have the competencies to perform the engagements.

4. Recruit, develop and support capable and competent staff giving due attention to the firm's human resources policies and procedures

ISQC1 requires firms to consider their human resources policies and procedures on issues such as recruitment, obtaining references, induction and career development, and assess the effectiveness of their performance evaluation and reward system. These are sensible procedures for firms that wish to motivate and develop their staff and partners.

Firms need policies and procedures to demonstrate:

- that there will be sufficient suitably qualified staff and partners with the competencies to cope with the number and complexity of audit assignments;
- that audit staff and partners will be trained and developed to ensure that they are sufficiently independent and approach audits with a mindset of professional scepticism;
- that the minimum standards required of audit staff and partners at the different levels of responsibility are in place within the firm, and that training arrangements are tailored to the needs of the firm and its clients; and
- that the means of maintaining and keeping staff and partners up to date with developments in audit regulation and practice is established and formalised as part of a commitment to ensuring staff and partners comply with Continuing Professional Development (CPD) requirements.

Firms should have suitable recruitment policies and should periodically evaluate capabilities and performance in an appropriate way.

The engagement partner and staff assigned to audits via the audit planning process should have the appropriate authority, experience and competencies necessary for that engagement.

5. Deliver quality audits that comply with law, regulations and standards, including consulting when needed and meeting requirements for engagement quality control review (EQCR)

Firms should establish procedures to enable audit engagements to be performed to the standards expected. Ordinarily, this will involve the use of manuals, checklists and other tools. In particular, it is important for firms to recognise when consultation is needed.

Firms and the engagement teams carrying out audits need to comply with all the requirements of ISAs, including the requirements relating to risk and fraud. Experience has highlighted a number of operational issues of relevance to audit firms looking to achieve a high quality of audit work, including the need for:

- timely audit planning;
- appropriate and timely use of technical specialists on accounting and auditing matters; and
- effective post audit reviews which are linked to appraisal processes and which inform the planning of the next year's audit.

Firms must establish policies and procedures to provide them with reasonable assurance that consultation takes place on difficult or contentious issues and is properly recorded and acted on. Small firms might consider obtaining external guidance in formalising consultation procedures. It is recommended that formal consultation relationships are established by all small firms so that these are in place when needed.

The processes of consultation on individual issues should generally be separated from those of an EQCR. ISQC1 requires an EQCR for all audits of PIEs and other entities as appropriate (determined by the firm's own criteria). Sole practitioners, firms with only one individual qualified to act as an audit engagement partner, or other small firms may only need to carry out EQCRs in exceptional circumstances and may use suitably qualified and experienced external persons or other firms to carry out these reviews where they are needed. Firms taking this option need to ensure that they are satisfied that the external person has the necessary skills and experience.

An EQCR reviewer considers his/her independence, experience, and level of authority to deal with the issues arising, where possible at an early stage in the planning. He or she also considers the significant risks as identified in the audit planning documentation. Before the audit report is issued, the reviewer will need to be satisfied with the quality of the audit work and the key judgements and decisions made. The reviewer will also need to confirm that he/she is not aware of any unresolved matters that would cast doubt on the significant judgements that have been made. The audit report cannot be issued where there remain unresolved differences of opinion between the engagement partner and the reviewer.

For any departures from the requirements of ISAs, the audit documentation should indicate how and why the auditors have departed from the requirements and the alternative procedures performed to meet the objective of the audit.

Apart from records of audit tests performed, care should be given to documenting judgemental issues. Where significant or contentious issues are discussed with clients, it is helpful to ensure that copies of the relevant notes are forwarded to clients in order to establish accuracy and agreement.

6. Monitor and seek continuous improvement of the firm's system of quality control and carry out a periodic objective inspection of a selection of completed audit engagements

The monitoring section of ISQC1 covers a firm's overall review of policies and procedures and it is important for firms to do this on an ongoing basis – good practice would be to review what has been done annually. The firm's policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic review of a selection of completed engagements ie, 'cold file' reviews.

Determining who to use for the 'cold file' reviews might be a practical challenge for very small firms, and particularly sole practitioners and firms with only one individual qualified to act as an audit engagement partner, where there is likely to be no independent person within the firm suitably qualified to fulfil this role. Firms can benefit from reviews carried out by the appropriate external persons.

ISQC1 requires firms to communicate, at least annually, the results of the monitoring of its quality control system to engagement partners and other appropriate individuals within the firm. Clearly firms need to consider the urgency of any matters found in the review and the need to make appropriate changes and to communicate these as soon as possible. This requirement to communicate results may well be an item for review by an external monitoring team. It is important for firms to select an appropriate way of achieving compliance and to ensure the monitoring is carried out properly.

Documentation

For each of the above key areas there is the requirement to document the operation of the quality control system. The level of documentation needed will depend on the size of firm. It is intended to provide firms with the opportunity to examine their practices and find efficiencies and appropriate ways to manage the risks they face.

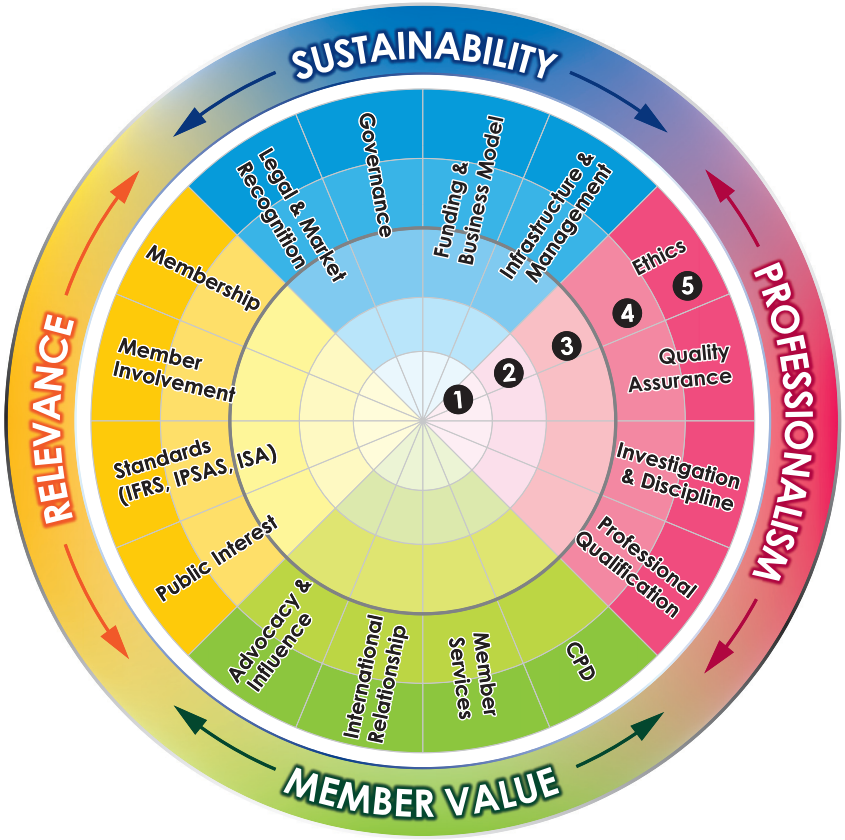
For small firms to comply with ISQC1 this could be done succinctly eg, using a single sheet of paper or making a single statement within an ISQC1 file.

Once a firm has developed its quality control policies and procedures, it is required to monitor compliance with those policies and procedures and to ensure that the relevant documentation is kept up to date, for example to reflect changes in the firm's procedures, personnel and audit and accountancy updates. Responsibility for doing this should be clearly assigned to a suitable person or persons within the firm.

ANNEX 6: CAPA maturity model and guidance series

The Maturity Model[7] is a support tool that allows professional accountancy organisations (PAOs) to take a systematic approach to their organisational development. The Maturity Model's open approach and user-friendly interface present a clear value proposition that is unique on the international PAO development stage.

The Maturity Model helps PAOs make and carry out their commitment to excellence, easily tracking their progress along the way. It provides a holistic, proven and easy-to-scale framework that PAOs can interpret within their own context. This flexibility allows PAOs to decide on their own purpose and pace of improvement efforts.



> **A useful approach may well be to … use the 'PAO maturity model' … to ensure a comprehensive assessment is completed and that a properly tailored approach is taken to capacity development based on each PAO's local context.**

The World Bank – *Current Status of the Accounting and Auditing Profession in ASEAN* – publication (September 2014)

7 The *Maturity Model for the Development of Professional Accountancy Organisations* publication can be downloaded at www.capa.com.my

Key Success Areas (KSAs)

The Maturity Model comprises 16 KSAs across four broad characteristics, which are presented around the outside of the model as **sustainability**, **relevance**, **professionalism** and **member value**. Each of these KSAs is considered important; however, the emphasis may vary based on the organisation concerned. Quality Assurance (QA) is included as a key success area.

Characteristic	Key Success Areas	Description
SUSTAINABILITY	Legal & Market Recognition	An acknowledged reason to exist
	Governance	Oversight, direction and control arrangements
	Funding & Business Model	A strategy and plans for long-term viability
	Infrastructure & Management	Appropriate systems, processes and people
RELEVANCE	Membership	Criteria for admission and levels of membership
	Member Involvement	Member needs and views understood
	Standards*	International technical standards adopted and implemented
	Public Interest	Generates benefits for all society
PROFESSIONALISM	Ethics*	Established standards of conduct for professionals
	Quality Assurance*	Standards for delivering services to the public
	Investigation & Discipline*	Maintains standards of membership
	Professional Qualification*	Established required-competency benchmark
MEMBER VALUE	Continuing Professional Development*	Supports member competency
	Member Services	Responds to member needs; provides value
	International Relationships	Internationally connected and continually improving
	Advocacy & influence	Recognised voice on topics of relevance

*These KSAs link to IFAC's Statements of Membership Obligations (SMOs)

QA and the Maturity Model

Each KSA is accompanied by an attribute table[8] that assists PAOs in assessing their current level of maturity and considering their desired level for each KSA. The attribute table for quality assurance is below.

In the attribute tables, five levels of maturity are distinguished. As accountancy organisations mature, they typically pass through each of these development levels, which can be characterised by attributes representing:

1. Ad hoc or no practices
2. Informal practices
3. Good practices
4. Strong practices
5. Best practices

Organisations are encouraged to attain good practices as a minimum for all KSAs.

> **Achieving best practice for all KSAs may not always be an appropriate goal, given differing contextual or regulatory environments.**
>
> CAPA

Quality Assurance in the Maturity Model refers to 'establishing standards and systems to monitor the quality of services provided by members to the public'. The range of such services is very broad and quality assurance may be applied to all such services. However a primary focus is in respect to 'audit, review, other assurance, and related services' as required by SMO 1.

Accordingly, this guide focuses on audit services and is designed for any organisation looking to implement a robust system of quality assurance for audit that, at a minimum, demonstrates the attributes of good practice. Many leading PAOs have a long history and have evolved and developed over decades, learning and improving continuously. Younger, developing PAOs can take the lead from these more experienced PAOs, following in their footsteps; however, it can still take a number of years to design and implement a sound system of QA for audit and achieve the desired outcomes. The exact time frame will depend on the starting point, including a basic recognition and acceptance of QA as a fundamental need for a professional membership organisation. It will also depend on the level of available resources and any legal or regulatory considerations which affect the allocation of responsibilities for QA-related matters.

This guide provides the "why," "what" and "how" of QA for audit. It explains why a strong commitment to QA for audit is important; highlights the key components of a robust QA for audit system that complies with international requirements for good practice; and provides some tools and examples to assist with implementation.

This guide is primarily aimed at PAOs without established or mature QA for audit systems. It focuses on practical guidance to achieve the minimum requirements for a working system.

The terminology used throughout this guide reflects common usage by the global accountancy profession. The use of other terminology may be appropriate in differing contexts and cultures.

8 The attributes included in the attribute table on page 41 are not necessarily exhaustive and should be viewed as examples.

Quality Assurance (QA)[9] – Establishing standards and systems to monitor the quality of services provided by members to the public.

Aspect	1	2	3	4	5
Standards and guidance	None	Guidelines developed and issued	Minimum standards and requirements established at the levels of: • audit engagement • firm • body responsible for quality assurance review	Guidance to members Requirements in place across the full range of public accounting services	Regular review of standards and requirements Guidance to members regularly updated Advice structures in place, for example, helplines
Implementation and monitoring	None	No formal monitoring of compliance	QA programme based on periodic review cycle Necessary allocation of management resources	Dedicated management resources with necessary skills and competences Risk-based review cycle Transparent and documented policies and procedures	Regular review of QA programme to ensure compliance with external standards QA committee with balanced and independent representation Established cooperation with other oversight bodies or regulator
Reporting	None	None	Outcomes shared with members Outcomes used to inform development of guidance and CPD	Annual public reporting Outcomes embedded in CPD programmes Implementation of disciplinary procedures where there is non-compliance	Outcomes shared with and feedback sought from external stakeholders Mutual recognition programmes with other regulators
SMO compliance	Not active	Considering how to address the requirements of SMO 1	Has a defined plan to address the requirements of SMO 1	Executing and implementing the requirements of SMO 1	Ongoing commitment to continuous improvement in addressing requirements of SMO 1

9 SMO 1, Quality Assurance. Contains detailed requirements for the organisation and operation of quality assurance review systems.

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The Confederation of Asian and Pacific Accountants (CAPA) represents national professional accounting organisations operating in 23 jurisdictions including, Australia, New Zealand, Bangladesh, Canada, China, Fiji, France, India, Japan, Korea, DPR Korea, Mongolia, Nepal, Pakistan, Papua New Guinea, Philippines, Samara Region, Samoa, Solomon Islands, Sri Lanka, UK, USA and Vietnam.

CAPA's mission is to develop, coordinate and advance the accountancy profession in the region.

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