

Abu Dhabi Accountability Authority – Technical Papers

Audit Quality by ADAA’s Amna Huwail

December 2017

Background

An auditor did an audit of a corner shop: They reported “*It has four corners!*”! A bad joke maybe, but if our goal is a continuous improvement to audit quality, how can we measure the effectiveness of an audit, or “*audit quality*”?

For many things it is simple to measure quality. The effectiveness of a McLaren P1 LM can be measured by its time around the Nürburgring (6:43.2). In the world of big data we live in, statistics can be found for almost anything. This year’s winners in the Royal Statistical Society’s ‘Statistics of the Year’ awards were the number of US citizens killed on average in lawnmower accidents each year (69), and the proportion of land area in the UK that is densely built up (0.1 %).

For audits, quality is hard to measure and there is an element of subjectivity. For an external audit to fulfill its objective the users must have confidence that the auditor has worked to a suitable standard and that “a quality audit” has been performed. Audit output is only seen usually as an unqualified (clean) opinion, or if the entity is listed, key audit matters summarized by the auditor. Only regulators and the audit firm themselves (via hot and cold reviews) actually see an audit file and can assess the quality of the audit.

Recently more emphasis has been put on measuring audit quality, especially by regulators and this paper aims to give a brief overview of how audit quality can be measured. Approaches vary, for instance ADAA does not grade individual audit files, but gives a classification to each comment (red, yellow and gray, see [ADAA’s annual report](#) for further details).

Framework

The International Auditing and Assurance Standards Board (IAASB) acknowledged that the term “audit quality” is frequently used, but no one seems to agree what it means because opinions vary on the measurements of quality.

So in 2014 the IAASB published ‘A Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality’. It includes the factors that contribute to audit quality at the engagement, audit firm and national levels. The IAASB’s goals were to:

- Raise awareness of the key elements of audit quality.
- Encourage key stakeholders to explore ways to improve audit quality.
- Facilitate greater dialogue between key stakeholders on the topic.

The framework distinguishes the following elements:

Inputs

The values, ethics and attitudes of auditors which are influenced by the internal culture of the audit firm. The knowledge, skills and experience of auditors and the time allocated for them to complete the audit.

Inputs to audit quality will be influenced by the context in which an audit is performed. The auditees attitude for example.

Process

Quality audits involve auditors applying a rigorous audit process and quality control procedures that comply with laws, regulations and applicable standards. The quality attributes of the process factor are described for engagement, firm and national levels.

Outputs

Outputs include reports and information that are formally prepared and presented by one party to another, as well as outputs that arise from the auditing process that are generally not visible to those outside the audited organization. These may include improvements to the entity’s financial reporting practices and internal control over financial reporting, that may result from auditor findings.

The outputs from the audit are often determined by the context, including legislative requirements. While some stakeholders can influence the nature of the outputs, others have less influence. For some stakeholders, such as investors in listed companies, the auditor’s report is the primary output.

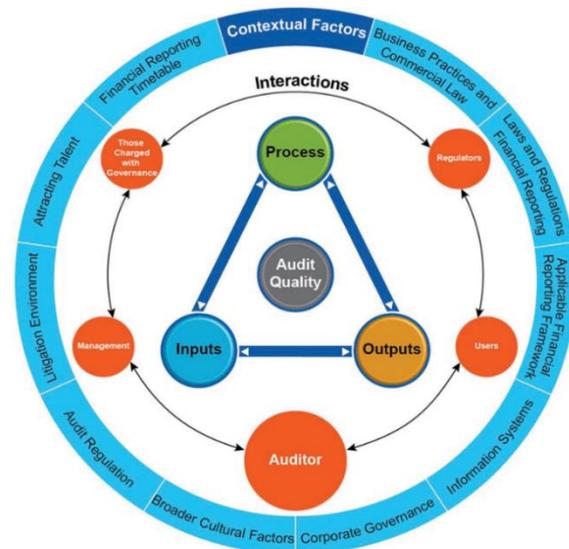
Key Interactions within the Financial Reporting Supply Chain

While each stakeholder in the chain plays an important role in supporting high-quality financial reporting, the way in which the stakeholders interact have a particular impact on audit quality. Interactions will be influenced by the context in which the audit is performed and allow a dynamic relationship to exist between inputs and outputs.

Contextual factors

There are a number of environmental – or contextual – factors, such as laws and regulations and corporate governance, which have the potential to impact the nature and quality of financial reporting and, directly or indirectly, audit quality. Where appropriate, auditors respond to these factors when determining how best to obtain sufficient appropriate audit evidence.

The IAASB depicts the **framework** as follows:





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The IAASB made some important points in their overview:

- Audit quality encompasses the key elements that create an environment which maximizes the likelihood that quality audits are performed on a consistent basis.
- A quality audit will likely be achieved by an audit team that: Exhibited appropriate values, ethics and attitudes; Was sufficiently knowledgeable, skilled, and experienced and had sufficient time allocated for the audit; Applied a rigorous audit process and quality control procedures that complied with applicable standards; Provided useful and timely reports; and interacted appropriately with relevant stakeholders.
- The responsibility for performing quality audits rests with auditors. However, audit quality is best achieved in an environment where there is support from, and appropriate interactions among, participants in the financial reporting supply chain.
- The Framework is aimed at raising awareness of the key elements of audit quality, thereby encouraging auditors, audit firms and other stakeholders to challenge themselves
- about whether there is more they can do to increase audit quality in their particular environments.
- The Framework is not a substitute for ISQC 1.
- The Framework is not sufficient by itself for the purpose of evaluating the quality of an individual audit. Consideration needs to be given to matters such as the nature, timing and extent of audit evidence obtained in a particular entity, the appropriateness of the relevant audit judgments made, and compliance with relevant standards.

So what are the measurements?

Now we have a framework, what next? In 2016 the Federation of European Accountants (FEE) published a paper setting out audit quality indicators (AQIs) developed by nine different organizations worldwide, including regulators, professional bodies and audit firms. AQIs are pointers that can be used to compare different audits, and different audit firms.

AQIs can be used by those charged with governance and audit committees in the audit selection processes. Audit firms can use AQIs to demonstrate their value.

Some of the findings by the FEE were that:

- AQI initiatives vary, some are rule based, some are based on principles.
- Information on firm level AQIs could be made public, but some indicators at the engagement level could be sensitive.
- Different approaches to formulating indicators: some quantitative, some qualitative.
- Most popular AQI is training hours per person, but does more popular mean better? Or are inputs easier to measure than outputs?

The FEE highlight the following AQIs from their research:

- Training hours per audit personnel.
- Internal engagement quality views (reviews).
- External inspections.
- Number of audit staff per audit partner.
- Years of experience.
- Partner workload.
- Industry expertise of audit personnel.
- Staff workload.
- Investment in development of audit methodology and tools.
- Staff turnover.
- Independence.
- Technical resources support.
- Staff satisfaction survey.
- External investigations.
- Tone at the top.

Conclusion

The annual reports issued by IFIAR and the consistency in the findings, demonstrate making improvements to audit quality is not easy, and requires continuous efforts from all stakeholders.

ADAA issued Rule No 1 in 2017 regarding the approach auditors take to audit internal controls. This could be a game changer for audit quality in Abu Dhabi, and we hope this paper is useful in the process of measuring your audit quality.



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