**Chapter 2**

**The Public Accounting Profession and Audit Quality**

**Audit Challenge**

2-1

How does industry specialization help firms conduct a high quality audit?

One of the key factors in performing a quality audit is the auditors’ knowledge and understanding of the client’s business and industry. Firms that specialize in particular industries can build up a stock of knowledge on the industry, its business and accounting practices, which would improve audit quality. Both large and small firms specialize in particular industries.

Why do large firms perform the majority of public company audits?

Large firms have the resources to perform large and complex audits. Regardless of the size of the public company, the filing and regulatory requirements, also add a degree of complexity. Large firms tend to have the economies of scale regarding the audit and accounting skills necessary to conduct public company audits. With the onset of CPAB and the increased litigation risk associated with public company audits, many small firms divested themselves of public company clients.

A key factor that contributes to audit quality is the review process. However, given their size, for smaller firms this can be a challenge. **What sort of processes can regional and small local firms put in place to ensure that consistent, high-quality work is performed?**

A good article to refer to regarding quality control at small firms is by Phil Cowperthwaite, One Size Doesn’t Fit All. CA Magazine. Available at:

http://www.camagazine.com/archives/print-edition/2012/may/regulars/camagazine64128.aspx

As this article highlights, for small firms (perhaps one partner and a few staff) it would be more effective if they simply follow quality control requirements at the engagement level; whereas for large firms it is more efficient to rely upon firm-wide quality controls. Regarding the review process, the minimum allowed per CSQC1 is at least one file for every engagement partner every three years. For many firms annual inspection is much more effective in achieving the goal of the requirements and reducing firm risk. As pointed out in the Auditing Action 2-2, the provincial association’s practice inspections are not a replacement for the file review process. Firms would need to have public accountants from other firms perform an external quality review as well as set up some sort of network whereby they can consult with each other.

**Concept Check Questions**

C2-1 *How do structures of small and large public accounting firms differ?*

Large international or national firms have more specialist functions and a greater variety of support resources. They also have the resources and skills to audit publicly listed organizations from many different industries. Smaller, local firms may have only one or two partners who serve local business (although some of these firms do specialize in particular industries).

C2-2 *How does the organizational hierarchy of public accounting firms contribute to audit quality?*

The organizational hierarchy ensures that less experienced or knowledgeable auditors are supervised and their work is reviewed – thus ensuring that the audit work meets GAAS and sufficient appropriate evidence has been gathered. However, this model only works if it encourages open debate and consultation (key factors which contribute to audit quality). The hierarchical nature may inhibit less experienced auditors from questioning the decisions of their superiors or even coming forward with questions or concerns.

C2-3 *How does CPA Canada and the provincial institutes contribute to the competence of   
the PA?*

Factors that contribute to a PA's competence are training, quality control standards, professional rules of conduct, regulatory agencies, and continuing research.

C2-4 *List the ways that the accounting profession promote effective financial statement audit engagements.*

They provide professional guidance and continuing professional education. They also conduct practice inspection.

C2-5 *Identify three organizations involved in standard setting for the PA profession.*

The CPA Canada, AASB, and IFAC are involved in setting standards.

C2-6 *Explain how the CPA Handbook is organized*

The CPA Handbook includes accounting standards and assurance standards. The majority of the assurance standards focus on the conduct of the financial statement audit; however the standards do include other assurance engagements related to both financial and non-financial information as well as other types of engagements performed by public accountants. Refer to Table 2-4 to see how assurance standards are organized.

C2-7 *What is the purpose of the financial statement audit?*

The purpose of a financial statement audit is to provide financial statement users with an opinion issued by the auditor on whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. That opinion enhances the users’ degree of confidence they can place in the information presented in the financial statements.

C2-8 *What are the objectives of the financial statement auditor when performing the audit?*

Per CAS 200.11, the objectives of the financial statement audit are:

• Providing reasonable assurance that the financial statements are not materially misstated;

• Consideration of both potential fraud or error;

• Communicating whether the financial statements comply with an applicable financial reporting framework using the expression of an opinion;

• Reporting on the financial statements; and

• Communicating auditor findings in accordance with the CASs.

C2-9 *What are the three broad requirements of the financial statement auditor?*

The three broad requirements are:

Professional competence and due care

Comply with ethical and independence requirements

Maintain professional skepticism and exercise professional judgment

C2-10 *What are the different ways that quality control is established and enforced for public accounting firms in Canada?*

Professional rules of conduct and GAAS provide the framework for conducting an effective audit. GAAS includes specific guidance for quality control standards for the firm as well as for the individual engagements. The PA firm could have quality control monitored or enforced by members of its own firm, by the provincial CPA association, or by the CPAB for publicly listed clients.

C2-11 *Why is it important that PAs have high-quality financial statement audits?*

Poorly completed audits could result in incorrect audit opinions, resulting in increased audit costs or loss of confidence in the PA profession. The PA and PA firms could also be sued (increased legal liability).

**Review Questions**

**2-1** A small practitioner may work with a broad diversity of small clients, getting to know her customers well, perhaps doing detailed work such as tax planning. She would also be responsible for administrative, continuing education, quality control and marketing for the practice. A larger firm enables having different people doing the different tasks, such as marketing, administration, human resources, and support for quality assurance. There would also be an opportunity for working at diverse clients of different sizes.

**2-2** The major characteristics of PA firms that permit them to fulfill their social function competently and independently are:

1. *Organizational form* A PA firm exists as a separate entity to avoid an employer-employee relationship with its clients. The PA firm employs a professional staff of sufficient size to prevent one client from constituting a significant portion of total income and thereby endangering the firm's independence.
2. *Conduct* A PA firm employs a professional staff of sufficient size to provide a broad range of expertise, continuing education, and promotion of a professional independent attitude and competence.
3. *Peer review* This practice evaluates the performance of PA firms in an attempt to keep competence high.

**2-3** The answer to the first question will vary by province. For example, in Ontario, LLPs are permitted.

Differences between a partnership and an LLP: In a normal partnership, each partner normally could be liable to the full extent of his or her personal assets in the event of partnership lawsuits, and would share in profits based upon the partnership agreement. In a Limited Liability Partnership (LLP), one or more partners have limited liability (normally limited to the extent of their capital contribution), while one or more partners is designated as having unlimited liability. The LLP could also be structured so that all partners have limited liability, based upon the legislation where the LLP was established.

A firm would choose to organize as an LLP to protect the assets of its partners.

**2-4** The *CPA Canada Handbook* provides guidance in general circumstances to service the largest numbers of situations and users. Where there is no guidance in the *Handbook*, accountants rely on their professional judgment to fairly present the economic reality of the situation. Leaving the application open to judgment may result in general acceptance of a minimum level of auditing or accounting practice.

* The existence of standards is a means of transmitting wisdom and avoiding unintentional error due to ignorance.
* Standards may be a more efficient and desirable way of creating a body of knowledge about acceptable financial reporting frameworks or GAAS than expensive lawsuits and the development of case law.
* Compliance with a documented set of standards can provide a better defense against legal liability.
* If the Standards Boards did not develop standards, then other groups or agencies would.
* Standards instill confidence in the fairness and reliability of financial statements to users.
* On the other hand, market research suggests that too many standards are ineffective in assisting the operation of the market.
* Standard setting is expensive for the profession; the costs may exceed the benefits.
* Given the complexity of the economic reality that financial statements attempt to portray, no set of standards can be theoretically correct or deal appropriately with all situations.

**2-5** The *CPA Canada Handbook* codifies as recommendations, the standards associated with several acceptable financial reporting frameworks (such as ASPE and IFRS), and generally accepted auditing standards (GAAS). In addition, the *Handbook* includes Accounting Guidelines and Assurance and Related Services Guidelines. The Guidelines are either interpretations of the recommendations, or a statement on a matter of concern. The *Handbook* is prepared by CPA Canada, which serves two main functions: 1) it is the umbrella organization to which all PAs belong, and 2) it has been given the authority by the *Canada Business Corporations Act* and the various provincial incorporating acts to set the accounting and auditing standards that must be followed by public accountants doing audits of companies chartered under one of the acts.

**2-6** The AASB is responsible for setting standards. It is supported by CPA Canada, who issues the CPA Assurance Handbook.

**2-7** In Canada, the AASB sets standards for both private and public companies. Canadian audit standards follow international standards. In the United States, sets standards for private companies (these standards are converged with international standards). The PCAOB sets standards for public companies and while they are similar to international standards they do not necessarily follow international standards. (Recall the auditors of American public companies provide an opinion on the effectiveness of internal controls as well as the financial statements.

**2-8** The CPAB provides quality assurance of the financial statement audit of public companies, by assessing the work of PAs conducting such audits. Firms who perform public company audits must register with the CPAB and be subject to quality control assessment by the CPAB.

**2-9** International Standards on Auditing (ISAs) are developed for broad use around the world, and are the basis for international GAAS. Member countries from around the world contribute to the development and assessment of standards. Firms who conduct an audit with local GAAS (such as Canadian GAAS) may not be in compliance with ISAs, since local standards often differ.

**2-10** *Generally accepted auditing standards* are general guidelines to aid auditors in fulfilling their professional responsibilities. These guidelines include standards concerned with adequate technical training and proficiency in auditing, due care, and an objective state of mind; examination standards including planning and supervision, understanding and evaluation of internal control, and the gathering of sufficient appropriate evidential matter; and standards of reporting including identification of the responsibilities of management and the responsibilities of the auditor with respect to the financial statements, the scope of the examination, and an opinion on the financial statements as to whether the financial statements present fairly the financial position, results of operations and changes in financial position in accordance with an appropriate financial reporting framework.

*Generally accepted accounting principles* are specific rules for accounting for transactions occurring in a business enterprise that relate to a particular financial reporting framework, such as ASPE or IFRS.

Examples may be any of the Accounting Recommendations (GAAP from an appropriate financial reporting framework) and Assurance Recommendations in Sections or in CASs (GAAS) of the *CPA Canada Handbook*.

**2-11** Competence and capabilities contribute to a PA’s qualifications to conduct a financial statement audit. PAs fulfill these responsibilities through their university education and the training that is involved in obtaining the CPA designation. Ongoing learning occurs through increased experience and consultation with peers and supervisors. PAs also continue to update their knowledge and skills through professional development.

**2-12** The objectives of the financial statement audit are:

• Providing reasonable assurance that the financial statements are not materially misstated;

• Consideration of both potential fraud or error;

• Communicating whether the financial statements comply with an applicable financial reporting framework using the expression of an opinion;

• Reporting on the financial statements; and

• Communicating auditor findings in accordance with the CASs.

**2-13** The PCAOB defines audit quality as meeting investors’ needs for reliable and independent audits – this definition emphasizes that the auditors’ key role is protecting the public interest and serving financial statement users’ needs. According to the CPAB, the four key areas that have a significant impact on audit quality are the competence of the right audit team, the support provided to the audit teams, the review process, and ensuring that accountability for audit quality is assigned to the appropriate individuals.

**2-14** Quality controls are established by individual public accounting firms to help ensure that their firm meets its professional responsibilities to clients. Quality controls are the procedures used by a public accounting firm that help it meet generally accepted auditing standards consistently on every engagement. Quality controls are therefore established for the entire public accounting firm as opposed to individual engagements.

**2-15** A practice inspection is a review, by practice inspectors employed by the provincial institute or *ordre*, of a public accounting firm’s compliance with its quality control procedure system for auditing and accounting engagements and its compliance with the *CPA Canada Handbook*. Practice inspection is mandatory in those provinces that have instituted it.

Practice inspection can be beneficial to the profession and to individual firms. By helping firms meet quality control standards, the profession gains if inspections result in practitioners doing higher quality audits. A firm having a practice inspection can also gain if it improves the firm’s practices and thereby enhances its reputation and effectiveness, and reduces the likelihood of lawsuits. Of course, practice inspections are costly. There is always a trade off between cost and benefits. A PA firm also gives up some independence of activities when it is reviewed by the practice inspectors. The consensus is that practice inspection has been successful in increasing the quality of public practice.

**Multiple Choice Questions**

**2-16** (1)

**2-17** a. (2) b. (3)

**2-18** a. (1) b. (2) c. (3)

**Discussion Problems**

**2-19**

**a.** The main objective of an audit of financial statements is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion in a written report on whether the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework.

* + - 1. No. In an audit of the financial statements, the auditor performs audit procedures to obtain reasonable assurance about whether the financial statements contain material misstatements. While a high level of assurance, reasonable assurance is less than a guarantee―  
         which implies absolute (100%) assurance. In an audit, the auditor issues an opinion on whether the financial statements are presented fairly, but the auditor is not guaranteeing that the financial statements are accurate with certainty.
      2. No. Fraud is a broad legal concept that describes any intentional deceit meant to deprive another person or party of their property or rights. The auditor does not take responsibility for detecting all types of fraud, given many types of fraud do not impact the financial statements. Instead, the auditor performs auditing procedures to obtain reasonable assurance that the financial statements do not contain material misstatements, whether due to fraud or error. Thus, the auditor is concerned with detecting fraud that leads to a material misstatement. The auditor is not responsible for detecting fraud that does not lead to a material misstatement.
      3. Each entity faces a number of risks unique to the nature of its business and industry. The types of operations, the extent of regulation, how the organization obtains capital to fund its business model, and the nature of accounts in the financial statements, among other factors, each trigger different types of risks that could lead to material misstatements. In addition, there are unique accounting standards for certain industries that impact how transactions, accounts, and disclosures are reported in financial statements. Thus, a thorough understanding of the client’s business is critical to assessing the risk of material misstatements in the financial statements when planning the audit.
      4. The auditor is responsible for obtaining sufficient appropriate audit evidence about whether the financial statements are free of material misstatements. In addition to understanding whether the amounts reported in the financial statements are mathematically accurate, the auditor obtains other types of information to determine that the amounts reported represent valid transactions and accounts and that all valid transactions and accounts are included in those statements. Evidence is also gathered to determine that the entity has the rights to assets and has the obligation to repay liabilities reflected in those financial statements and whether the correct disclosures are included in the financial statements as required by accounting standards.

**2-20**

a. Engagement performance: provides access to current standards and material to answer technical queries

1. General human resource policies and Engagement performance: The partner and manager provide adequate supervision for field work, while continuity helps ensure efficiency and knowledge of business.
2. Engagement performance: Electronic signatures (passwords) help maintain authorized access, while the electronic prevention of archiving helps ensure that all documentation is completed.
3. Engagement performance: Staff feedback and queries help ensure that all views are considered and encourages staff at all levels to bring forward unusual items for discussion while approvals ensure that adequate professional judgment has been used in the development and execution of audit steps.
4. General ethical requirements and Independence: Ensures compliance with independence rules.
5. Engagement quality control review: Ensures that adequate quality control review is completed by those not involved in the engagement.
6. Client acceptance or continuance: Only clients that fit the risk profile of the firm are accepted as continuing clients.
7. General human resource policies: Only competent, high quality individuals are promoted to partner.
8. General human resource policies: Engagement deficiencies are identified and remedied; all staff receive necessary continuing education.

**2-21** Note the following supplemental information:

The comments in the problem do summarize the beliefs of some practitioners about quality control and practice inspection. The arguments against quality control and practice inspection are stated in the comments and can be summarized as five basic arguments.

(1) Relative cost for smaller firms is excessively high.

(2) Smaller firms have less need for quality control because of greater partner involvement.

(3) It eliminates the major competitive advantage of smaller firms which is a simple and efficient organizational structure.

(4) Quality control standards are not needed because they have already been implemented by quality firms.

(5) Three other things already provide assurance of adequate quality: auditing standards, legal liability, and a competitive economic environment.

To support these comments it can be argued that the profession has functioned well with relatively little controversy and criticism. A major reason many practitioners choose the profession is the relative freedom to operate their professional practice as they see fit.

*Solution to text problem*

a. The arguments against these comments are primarily as follows:

* It will not be costly for most smaller firms to implement quality control requirements because the quality control standards required are not onerous unless the firm chooses to register with the CPAB and conduct public company audits
* There is no need to eliminate the simple organizational structure now enjoyed by many smaller public accounting firms.
* Certain critics of the public accounting profession have argued strongly against self-regulation of the profession. Many public accountants believe that only through self-regulation will it be possible to minimize government interference. Even if the elements of quality control enunciated by the text are in existence, the quality control and practice inspection requirements may be necessary to avoid government interference.
* For those firms that already have the necessary elements of quality control in their practice, the additional implementation costs should be minimal. Those lacking such elements will incur more cost, but presumably are lacking in certain elements needed for a high quality practice.
* Partner involvement on engagements does not necessarily ensure that all quality control requirements have been met. For some smaller firms, top partners may spend relatively little time on audits and therefore not be as knowledgeable about auditing as may be necessary.

b. There is no correct answer to this question. Different people reach different conclusions, depending on the weights put on each of the arguments stated in Part a, for and against quality controls and practice inspection. The authors believe that both quality control and practice inspection are worth the cost.

The post-Enron (and other accounting problems such as Nortel in Canada) have resulted in an increased emphasis on quality control and practice inspections.

**Professional Judgment Problems and Cases**

**2-22**

a. Rossi and Montgomery’s primary consideration is their professional competence to perform all of the audit work for filing with the OSC. In addition, if Rossi and Montgomery have performed bookkeeping services or certain consulting services for Mobile Home, they will not be independent under the independence requirements.

b. The filing with the OSC, in addition to normal audited financial statements, will require completion and registration with the OSC of specific forms by the client and by the auditor. The auditor needs to have an understanding of the requirements of these documents in addition to the completion of the audit. Additional documents must be filed by the client and the auditor within a specific time period after every quarter (usually 45 days) and after the year end (usually 90 days). These documents must adequately disclose the results of financial operations and any related party transactions.

The audit firm must be registered with the CPAB (Canadian Public Accountability Board), pay the appropriate fees, and be subject to quality control review from the CPAB.

c. Since the public accounting firm has not performed a public company audit in the past, the key issue would be regarding whether the auditors’ personal responsibilities is whether or not they would have the necessary competence and capabilities. It follows from this, if they do not have the necessary knowledge, they may not be able to exercise appropriate professional judgment. Regarding the performance requirements, it would cause to question whether the auditors would have the skills/knowledge to plan and supervise the audit appropriately.

d. Refer to Table 2-5 for the elements of Quality Control. One could argue that all the elements could apply to this situation; however, it would be necessary to provide an adequate explanation of how they would apply to this specific situation.

* Leadership Responsibilities – An appropriate tone at the top would not pressure practitioners to take on clients which it is beyond its capabilities;
* Human Resources – it would be necessary to ensure all the engagement team have adequate training regarding public company audits.
* Client Acceptance and Continuance – If the firm has appropriate client continuance procedures in place then it would be able to make an informed decision as to whether or not it can provide a quality audit
* Engagement Performance – The firm would need to ensure that its procedures encompass the requirements for public company audits.
* Monitoring – Public company audits should all have a practitioner with public company audit experience involved in the monitoring process.

**2-23**

a. Given that auditing is a business, public accountants routinely have to balance commercialism and professionalism. If a firm places too much focus on commercialism, it may encourage auditors to focus more on developing business than on performing a quality audit. Some even claim that it may compromise auditor independence and auditors will be easily swayed by the client’s arguments. In the aftermath of the Enron and WorldCom collapses, there was much discussion around this theme – particularly in relation to the role of consulting services and how they had eroded the emphasis on professionalism. As one senior auditor in the American profession stated “Health skepticism had been replaced with concurrence.” (from Arthur R. Wyatt. 2004. Accounting Professionalism – They Just Don’t Get It! *Accounting Horizons*. 18(1): 45-53).

b. CPAB has expressed concern that because some view the annual audit as a commodity, firms may lower fees and, as a result, will attempt to maintain profit margins at the expense of audit quality. Some controls that CPAB has recommended that firms can put in place are:

* Develop an accountability culture which starts with the audit firm’s CEO (tone at the top) – this type of culture should support “doing the right thing.” In addition, individual auditors should have the authority to deal with quality issues that affect audit quality.
* Firms should have policies in place that ensure audit teams have sufficient time to complete a quality audit.
* Audit quality should be part of performance evaluations.

**2-24** *Violation:* Both Liu & Liu and Cheng have violated generally accepted auditing standards in the conduct of this engagement.

While it was appropriate for Liu & Liu to accept the engagement after not hearing from the predecessor auditors for one month, professional skepticism would require them to investigate why the predecessor auditor resigned unexpectedly during the fiscal year. In addition, the fact that the predecessor issued an unqualified opinion last year is not enough to establish the fairness of the opening balances. Normally, a successor auditor would review the working papers of the predecessor to ensure that necessary audit procedures were performed. Since the predecessor did not communicate with Liu & Liu, the new auditors must themselves perform appropriate audit procedures to verify the opening balances. This was not done.

In addition, Cheng appears to lack adequate knowledge and experience to audit the financial statements of a financial institution. While she performed the audit as instructed, her lack of experience implies that her professional judgment in designing appropriate procedures and evaluating evidence would be questionable. For example, there was no field work conducted to relate the client to the business environment or to gather knowledge of the business environment in addition to knowledge about the client.

Cheng and her firm did not seem to act with due care – particularly since credit unions regulated and would require the auditor to have specialized knowledge. For instance, the regulator relies upon the financial statements to assess whether Demonte meets the conditions of its deposit insurance appears. Cheng also appears to have not acted with appropriate skepticism and overly relied upon the CFO for explanations.

Due to the lack of experience and knowledge, Cheng’s work would require close supervision by a more experienced auditor, which would be difficult (or likely did not occur) since this is the firm’s first credit union client. Further, the engagement partner’s cursory review suggests he did not fulfill his responsibilities. The comments by the CFO also suggest that the entire audit was not performed with due care – the previous auditors spent more time and assigned more staff to the audit.

Although standards permit an auditor to understand the client’ business and controls but not rely upon them, in today’s highly automated banking environment, it is likely that the auditor could not effectively conduct the audit without relying upon some automated controls.

**RA 2-1: Audit Quality Blog**

1. **Audit Quality Blog -**  It is an e-communications tool to help keep stakeholders in financial reporting (auditors, regulators, preparers, audit committee members, and investors) up to date with the improvements to audit quality and to engage the various stakeholders. It does the following:

* Provides links to useful audit quality resources (from around the world)
* Shares relevant information from a wide variety of sources (business investment circles, accounting professionals, academics, standard setters, and regulators)
* Provides a discussion forum (the site is hosted by CPA Canada and participants can post to the discussion forum)

1. Instructors may select a link to a *Previous Post* that either relates to the material covered in this chapter (GAAS, quality control, audit quality, standards setters) or later chapters such as Chapters 3 and 4 (Legal Liability and Professional Judgment, and Ethics) or ones which focus on the audit process (Chapters 5, 6, or 7). This question can easily be scaled up or down to become a research assignment for the course.

**RA 2-2: CPAB and Audit Quality in Canada**

1. CPAB’s key stakeholders are:

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| **Stakeholder** | **Role in relation to audit quality** |
| Audit Firms | Audit firms are responsible for the execution of the audit and produce the audit report. Firms have in place quality control practices to ensure that audits are performed to high standards. |
| Audit Committees | Audit committees play a key role in audit quality through diligent oversight of the auditors’ work and independence. |
| Reporting Issuers | Reporting issuers are responsible for internal controls over financial reporting and the actual preparation of financial statements. The relationship between management, the audit committee, internal and external audit play a key role in audit quality. |
| Investors | Investors, form large institutional to individuals, represent one of the key users of financial statements. Investors can play a role in enhancing audit quality by encouraging audit committees to be more transparent with respect to their evaluation of the quality of the audit and the auditor. |
| Regulators | Regulators include securities regulators as well as similar oversight boards in other countries. By working together and sharing insights, findings, etc.. all can help improve audit quality. |

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| **Priority Area** | **Importance to Audit Quality** |
| Auditor Independence | As highlighted in the past two chapters (and throughout the book) auditor independence is fundamental to audit quality.  Regulators are considering options such as mandatory firm rotation as well as expanding rotation beyond the key audit partner. Other options are placing restrictions on non-audit services. |
| Audit Reporting | Users of the financial statement rely upon the audit report as to an indicator of the financial statements. However, many critics of the current audit report argue that given its standard format it is limited in its usefulness (other than its binary pass/fail indicator). Investors could benefit from greater insights provided by the auditor (this is discussed in more depth in the Audit Reporting Chapter) |
| Role of Audit Committee | The audit committee plays a key role in overseeing both management and the auditor (as well as managing disputes). CPAB has now developed a Audit Committee Reporting Protocol that requires the auditor to report CPAB finding to the audit committee. This is based upon the premise that greater transparency will allow everyone in the audit process to perform their roles more effectively. |

**RA 2-3: Audit Firm’s Transparency Reports**

This response is based upon which firm the students choose to analyze. Instructors may wish to modify the assignment to ask the students to compare and contrast the reports or assign different firms to the different groups in the class and have class discussion based upon similarities and differences among the firms.

The objectives of this research activity is:

* To encourage deeper thinking around what exactly is audit quality and how firms attempt to monitor and control it;
* To develop an understanding around the current issue of audit quality and how to measure it;
* To learn about different regulatory regimes and consider how different practices may improve audit quality.

Several regulators in Europe have mandated these reports with the expectation that greater transparency will reveal audit quality. The transparency reports tend to use the quality control framework to describe audit quality and to demonstrate the types of control procedures and processes. However, the firms do not use any objective measures of audit quality to demonstrating the effectiveness of the systems (the PCAOB provides some examples of measures).

These reports focus on the governance of the firms and tend to highlight that they have a code of conduct, carefully monitor independence, carefully screen potential clients, staff and partners are evaluated based upon audit performance, there are professional development requirements, policies regarding supervision and review, a standard audit methodology, audit partner remuneration is based solely on profits (no bonuses/incentives for selling services).

Some information which students may find interesting is the breakdown of revenue by major services, assurance, tax, and consulting, as well as details on partner remuneration.

The usefulness of the reports is debatable. Some may argue that the report provides key information regarding quality control processes, others would argue it is very general and vague. Academic research tends to conclude that the reports are not that useful in distinguishing the firms along the lines of audit quality. Whether Canada’s regulators should require firms to issue transparency reports is again open for debate. It seems that the regulator themselves has access to better information through their reviews but, based upon the current reports, it is not clear whether being more transparent to the investing public is achieving the regulators’ goal.