



Enhancing Audit Quality

2018 highlights and progress



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Contents

2 Introduction

4 2018 Enhancing Audit Quality areas of focus

5 Peer Review

6 Risk assessment

7 Documentation

7 Single audits

8 Auditing in the Future

9 Other activities

10 2019 Enhancing Audit Quality areas of focus

Introduction

Audits play a crucial role in the activities of business owners, investors and customers. And they're even more important in today's increasingly complex business environment. Businesses rely on audited information for decision-making, so the CPA profession is committed to performing high-quality audits. The American Institute of CPAs (AICPA) launched the Enhancing Audit Quality (EAQ) initiative in 2014 to align all AICPA assurance-related activities and support firms as they work to improve the quality of their audits.

Our approach

To help firms improve audit quality, we take a data-driven approach. First, we gather audit data from the AICPA Peer Review Program and other sources. Then, we analyze that data to identify common quality issues. We then help firms improve in those areas by revising standards and guides, developing education and resources and emphasizing them in Peer Review.





2018 Enhancing Audit Quality areas of focus

Through EAQ's data-driven approach to quality enhancement, the AICPA identified several key areas to focus on in 2018.

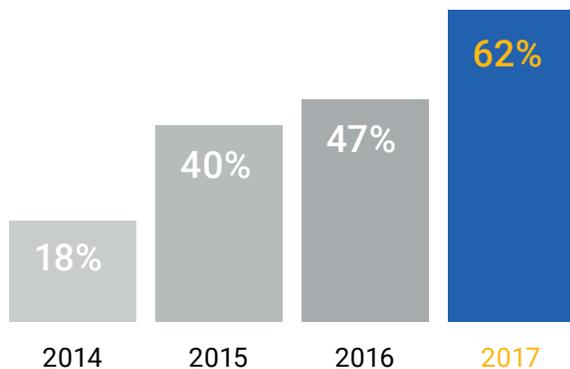
Peer Review

The Peer Review Program is integral to achieving the profession's audit quality goals. Nearly all firms that perform audit engagements are required to undergo a peer review, which puts peer reviewers in a unique position to drive quality enhancement.

Because of the important role peer reviewers play in helping firms identify their quality issues, we've launched new training requirements, communications efforts and oversight programs to help them perform their best. These efforts are working. In 2017, peer reviewers detected 62% of non-conforming engagements — up from 18% in 2014. There still is room for improvement, but this is a substantial move in the right direction.

Figure 1: Percentage of non-conforming engagements detected by peer reviewers

Reviewers improved.



Identifying non-conforming engagements in Peer Review is important because when Peer Review finds problems, firms get the needed remediation. For example, when a firm gets a non-pass peer review report and they are required to undergo pre-issuance review, their subsequent peer review report rating improves 90% of the time.

Figure 2: Progress through remediation

77%
improvement after CPE

86%
improvement after third-party review of engagements or quality control documents

90%
improvement after pre-issuance review of firm engagements

Firms that fail to remediate after their second consecutive non-pass peer review can be terminated from the Peer Review Program. Significantly, this means firms may have one chance to improve their quality.

A key component of an effective Peer Review Program is the peer reviewer pool. While the peer-reviewer pool has a sufficient number of subject-matter experts, additional team captains and review captains are needed in select states. The Peer Review team is actively recruiting new team captains and review captains where needed.

Risk assessment

Identifying, assessing and responding to risks of material misstatement are at the core of every audit. However, a recent survey of peer reviewers found over half of 400 audits they reviewed were non-conforming because of non-compliance with the risk assessment standard.

The AICPA Peer Review team analyzed risk assessment matters for further consideration (MFCs) forms and identified a primary issue: Many auditors, especially those working with small- and medium-sized entities, believe they can perform sufficient substantive procedures to support the audit opinion regardless of whether the client's risks were properly considered.

We've taken numerous steps to educate members about proper risk assessment. These efforts include the development of a [free risk assessment toolkit](#) featuring an internal inspection aid, a risk assessment infographic illustrating common issues, FAQs and a staff training workshop presentation. We published blog posts and a *Journal of Accountancy* [article](#) and developed a risk assessment webcast that has been converted into an [online course](#) with case studies addressing common problem areas.

We are also working with the International Auditing and Assurance Standards Board (IAASB) as it revises ISA 315, *Identifying and Assessing the Risks of Material Misstatement*, to keep up with the changing business environment, improve identification and assessment of risks of material misstatement and stress the importance of exercising professional skepticism throughout the risk assessment process. These changes may ultimately lead to revised risk assessment standards in the U.S.

Because of the pervasiveness of the issues in practice, Peer Review issued new guidance that specifically addresses risk assessment. Under that guidance, failure to comply with the risk assessment standards will result in a

non-conforming engagement and will require remedial action. However, because non-compliance with risk assessment requirements is a profession-wide issue and does not necessarily indicate a deficient system of quality control, a firm would still receive a pass peer review report unless another deficiency was present.

Risk assessment in numbers

Members are interested in learning about risk assessment. We're continuing to track the numbers to gauge members' increased interest in EAQ topics.

13,000+ page views of the AICPA risk assessment landing page

6,500+ clicks to the *Journal of Accountancy* article on risk assessment

4,000+ page views to risk assessment blog posts

900+ attended the risk assessment webcast

Documentation

One of the most common audit quality issues isn't related to a recently issued standard or a complex area of guidance — it's a lack of adequate audit documentation. The Peer Review Enhanced Oversight results revealed that 25% of engagements subject to review were materially non-conforming due to the auditor's failure to comply with the audit documentation standard. If sufficient appropriate audit evidence necessary to support the audit opinion was not appropriately documented, then the audit was not conducted in accordance with Generally Accepted Auditing Standards (GAAS), and the auditor would not have a basis to render an opinion. Put simply: If an auditor's work is not documented, the auditor has no basis for asserting that sufficient evidence to support his or her opinion has been obtained.

To help auditors, we've created a free documentation toolkit that can be found at aicpa.org/documentation. The toolkit contains resources such as sample working papers, a tool for evaluating a SOC®1 consideration, a dual-purpose testing practice aid and a PowerPoint slide deck firms can present to their staff. Resources from the toolkit were accessed more than 15,000 times between launch in mid-2017 and Dec. 31, 2018.

In 2018, we also offered AICPA ENGAGE and Employee Benefit Plans Conference attendees free access to our audit documentation webcast, which addressed the most common areas of non-conformity. Over 800 conference attendees took advantage of the offer, and a free, no-CPE archive of the webcast is available on aicpa.org/documentation.

Single Audits

Single audits are a highly specialized type of compliance audit performed on state and local governments and not-for-profit organizations that spend \$750,000 or more of federal assistance in a fiscal year. About 35,000 of these audits are performed annually.

In a recent study, we found the most common cause of non-compliance in these audits was a failure to properly evaluate internal control over compliance. The AICPA Governmental Audit Quality Center (GAQC) has been helping practitioners understand their responsibilities around internal control when performing single audits. Recent efforts have included collaboration with federal agencies to identify ways that federal guidance can help improve practice, a December 2018 web event about 500 practitioners attended and the development of a continued GAQC strategy for 2019. In addition to these efforts, the GAQC also held other web events to help educate about 5,800 attendees on other important aspects of performing single audits.

To support efforts in this area, the Peer Review Board approved the [AICPA's Single Audit Certificate](#) as a remedial action for reviewers and individuals within firms.

Auditing in the Future

We're also working to help members in emerging technologies and areas, so that firms can offer new services that are more effective and efficient. The AICPA's Assurance Services Executive Committee developed a [free audit data analytics mapping document](#) that maps traditional audit procedures to new audit data analytics techniques and illustrative examples. It outlines the tools and applications available today to help facilitate the automation of certain audit procedures.

To help CPAs understand how blockchain impacts the profession, we released a [white paper](#) developed in collaboration with CPA Canada, Deloitte and the University of Waterloo; wrote a series of blog posts that educate members on the topic; created a [Go Beyond Disruption podcast series](#); and launched online courses and a [Blockchain Fundamentals for Accounting and Finance Professionals certificate](#).

Our [System and Organization Controls \(SOC\)](#) webpage contains resources for members beginning to offer the SOC Suite of Services. CPAs can provide SOC services in connection with system-level controls of a service organization or entity-level controls of other organizations. We are committed to helping our members understand and comply with standards unique to SOC services. With practitioner guidance and tools, we're making sure CPAs have access to the resources they need to provide high-quality assurance services.

SOC for Cybersecurity is the most recent addition to the SOC Suite of Services. Cyberattacks are increasingly common, and CPAs can help businesses protect their vital information. Members have access to a wide array of resources on this topic, including the [cybersecurity risk management framework](#), [PCPS Exploring Cybersecurity Toolkit](#) and the [CGMA Cybersecurity Risk Management Tool](#). We also offer a plethora of learning opportunities, including three cybersecurity certificates. Our [cybersecurity resource center](#) received more than 32,000 page views in 2018, nearly double the traffic in 2017.

Combined, these efforts will help ensure our members have the tools needed to evolve their practices for the future.

Other activities

- The Financial Accounting Standards Board's (FASB) revenue recognition standard is effective for non-public entities for reporting periods beginning after Dec. 15, 2018. We are committed to helping our members prepare to implement this principles-based standard. We have developed numerous member-benefit resources, including a [learning and implementation plan](#) and an [audit committee primer](#). Our [A&A guide](#) features guidance to help 16 industries implement the standard. Throughout 2019, we will focus our efforts on auditing accounting estimates, including those required under the new revenue recognition standard.
- The FASB's leases standard is effective for non-public entities in 2020. Under the new standard, current off-balance sheet leasing activities will be required to be reflected on balance sheets. The main challenge companies face is being able to gather the data necessary to do the accounting. We've been educating members about the operational challenges of this standard and have been developing [resources to help members](#) with implementation.
- The AICPA's Auditing Standards Board (ASB) approved a suite of auditor reporting standards, including a new [standard](#) that provides requirements and guidance when an auditor is engaged to include a discussion of key audit matters in the auditor's report. The ASB believes these changes will increase the informational value and relevance of the auditor's report for users and, therefore, are in the public interest.
- The ASB also approved a [new standard](#) specific to audits of financial statements of employee benefit plans subject to the Employee Retirement Income Security Act of 1974 (ERISA). The standard includes new requirements for engagement acceptance, audit risk assessment and response, communications with those charged with governance, procedures for an ERISA section 103(a)(3)(C) audit, and considerations relating to the Form 5500. The auditor's report for these audits will provide better insight to auditors, plan administrators and the public regarding the scope of the responsibilities of management and the auditor.
- We've proposed [revisions](#) to the audit evidence standard, AU-C section 500, to address the evolving nature of business and audit services. These issues include the use of emerging technologies by both preparers and auditors, audit data analytics, the application of professional skepticism, the expanding use of external information sources as audit evidence and more broadly the accuracy, completeness and reliability of such audit evidence. Voting on the exposure draft is expected in May. If adopted, the standard is expected to be effective for audits of financial statements for periods ending on or after June 15, 2021.
- Valuation-related estimates have become a larger component of the balance sheet. To assist those performing valuations and protect the public interest, we've developed the Certified in Entity and Intangible Valuations™ (CEIV™) credential, which launched in 2017, and is launching the Certified in the Valuation of Financial Instruments™ (CVFI™) credential in 2019. The CEIV credential addresses entity and intangible asset valuations for financial reporting, and the CVFI credential focuses on fair value estimates for financial instruments.

We've working with the IAASB to revise the international quality control standards. The updated standards are being designed to:

- Be responsive to complex and changing environments
- Encourage a proactive quality management approach that acknowledges the role of external stakeholders to improve the firm's recognition of its public interest role
- Reinforce the need for robust two-way communication
- Strengthen the requirements related to internal and external monitoring

- The research projects supported by the [Assurance Research Advisory Group](#) (ARAG) provide valuable insight into the factors that affect the quality of private company assurance services. The AICPA has funded six research studies to date on risk assessment, group audit, tone at the top, data analytics, adoption of technology by small firms and blockchain. The first research team to complete their study on group audits has provided the ASB with insights into how qualitative and quantitative risk factors associated with component units are considered by auditors under various conditions.



2019 Enhancing
Audit Quality
areas of focus

Internal control

The most common cause of non-conformity with AU-C Section 315 is a failure to comply with requirements around internal control. In 2019, we will launch new education, tools, resources and communications addressing this topic.

Risk assessment

In 2019, we will continue developing resources and communicating about issues in this area.

Auditing accounting estimates

Failures relative to accounting estimates were the most common engagement-level deficiencies detected by practice monitoring programs worldwide. In 2019, we will develop tools to assist members in fair value measurement, current expected credit loss (CECL) model and revenue recognition.

Documentation

In 2019, we are continuing to communicate about the need for proper audit documentation.

SOC engagements

New SOC services have been introduced, and a new service, supply chain, will be released in 2019. Since these services are new, we will be dedicating resources toward educating practitioners on the associated requirements.



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