

Transparency of Firms that Audit Public Companies

Final Report



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Statement on Transparency of Firms that Audit Public Companies

I. Introduction

The International Organization of Securities Commissions (IOSCO) objectives of securities regulation include protecting investors and ensuring that markets are fair, efficient and transparent. One avenue IOSCO has pursued to address these issues is to consider the role of audit firms, and in particular the practices employed by audit firms to be transparent in their own reporting to investors and other stakeholders about the firm itself, notably, with respect to firm governance and elements of their system of quality control for their financial statement audits (“audit firm transparency reporting” or merely “transparency reporting”). IOSCO recognizes that audit firm transparency reporting is a fairly recent practice that continues to evolve, as evidenced by its work in this area which has preceded developing this Statement.

Transparency reporting can foster internal introspection and discipline within audit firms and may encourage audit firms to sharpen their focus on audit quality, which would also be of benefit to investors and other stakeholders. In addition, in comparing audit firms competing for an audit engagement, audit firm transparency reporting can aid those responsible for selecting a public company’s auditor in their decision making process by providing information on a firm’s audit quality.

II. IOSCO’s Work on Audit Firm Transparency Reporting

In June 2007, IOSCO sponsored a Roundtable on the Quality of Public Company Audits from a Regulatory Perspective (Roundtable).¹ The Roundtable explored many aspects of the auditing of public companies in the global financial markets. One area of discussion involved whether audit firms should provide more information to the public on their governance structure and internal operations, including quality control systems, and whether such reporting might contribute in some way to enhanced audit quality. Since the time of the Roundtable, IOSCO has proceeded to study this area by:

- Issuing a public Consultation Paper and analyzing the twenty-one comment letters received, including five from audit firms, and publishing an associated comment letter summary;²

¹ Information regarding the proceedings, including video archives and a transcript, is available at http://www.iosco.org/media_room/?subsection=audiovisual.

² The comment letter summary is available at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD337.pdf>.

- Obtaining input from several audit oversight bodies, from persons involved with preparing financial statements of public companies, and from members of boards of directors and audit committees of publicly listed companies; and
- Conducting research on current audit firm reporting practices and related regulatory reporting requirements within certain IOSCO member jurisdictions.

IOSCO noted that one of the overarching points from various stakeholders was the need for some level of transparency about audit firms, though views on the nature and extent of such transparency reporting varied. Some stakeholders thought it was sufficient and appropriate for audit firms to provide transparency reports only to auditor oversight authorities/regulators whereas others were of the view that audit committees or investors should have access to this information to factor into their respective decision making.

Further, some market participants, such as investors and audit committees, have questioned whether the content of current transparency reports could be perceived as providing biased or marketing information rather than unbiased substantive content that contributes to enhancing transparency about matters that may affect audit quality.

Notwithstanding this range of views, IOSCO has observed an increased volume of audit firm transparency reporting in the last few years, including voluntary reporting of information. Further, some jurisdictions—such as Australia, the European Union and Japan, among others—currently do have legal and regulatory requirements with respect to audit firm transparency reporting, whereas others, such as the United States, collect transparency type information through other regulatory processes.

III. The Results of IOSCO's Work on Audit Firm Transparency Reporting

IOSCO recognizes that the overall reputation of an audit firm is one element that investors may consider in their decision making process. As audit firm transparency reports contribute to the reputation of the audit firm, we believe these reports can influence an investor's decision making and, as such, how these reports are presented is important.

In light of what IOSCO has learned and consistent with the IOSCO objectives of securities regulation, IOSCO believes that an audit firm transparency report could be considered of high quality if the information in the report includes, among other matters,³ reporting on the following elements:

1. The audit firm's legal and governance structure;
2. The audit firm's measures to foster audit quality;
3. The audit firm's internal indicators of audit quality; and
4. The audit firm's indicators of audit quality as generated by the work of external bodies.

In presenting these matters, IOSCO believes that an audit firm transparency report should provide information that is:

- (a) clear, useful and presented in sufficient detail to be meaningful to the different groups of likely users of the report;
- (b) fact-based and not potentially misleading;
- (c) unbiased and not oriented toward marketing or selling services;
- (d) concise, specific to the firm and avoids the use of boilerplate language;
- (e) timely, accurate and complete;
- (f) balanced in communicating the audit firm's output measures of audit quality in addition to any input measures;⁴ and
- (g) sufficient in terms of explaining the limitations of the indicators of audit quality, including that the indicators may not be comparable across audit firms.⁵

³ IOSCO's views about the information to be contained in an audit firm transparency report do not affect the ability of a jurisdiction, securities regulator and/or audit oversight regulator to develop and implement its own requirements.

⁴ Input and output measures were further discussed in the IOSCO Consultation Paper "Transparency of Firms that Audit Public Companies", available at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD302.pdf>.

⁵ For example, presenting total training hours may not communicate differences in the type, relevance or timing of training; additionally, the nature and scope of internal quality reviews may differ among firms, which can lead to differing results.

IOSCO believes that if audit firm transparency reports are published, then they should be made available at a minimum annually and be of sufficient timeliness after the audit firm's fiscal year-end to be useful to investors. These reports should be published in a manner that is visible and easily accessible to investors, regulators and other stakeholders.

IOSCO continues to see progress in audit firm transparency reporting. IOSCO encourages audit firms to explore ways to stimulate continued improvements in reporting on their practices, policies and results to investors and other stakeholders. In an effort to contribute to continued progress, IOSCO has prepared the accompanying Guide as a frame of reference for audit firms in preparing transparency reports, subject to jurisdictional requirements.

Guide for Audit Firm Transparency Reporting

I. Introduction

This Guide accompanies the IOSCO Statement on Transparency of Firms that Audit Public Companies, dated November 2015 (the Statement). This Guide is intended to serve as a frame of reference that could promote good practice and contribute to high quality audit firm transparency reports. This Guide should be read in the context of the Statement.

For ease of reference, this Guide is organized around the elements of content and delivery contained in the Statement.⁶ The Statement also addresses the presentation of the information to be provided; for ease of reference this text is repeated below.

II. Presentation of Information

As expressed in the Statement, IOSCO believes that an audit firm transparency report should provide information that is:

- (a) clear, useful and presented in sufficient detail to be meaningful to the different groups of likely users of the report;
- (b) fact-based and not potentially misleading;
- (c) unbiased and not oriented toward marketing or selling services;
- (d) concise, specific to the firm and avoids the use of boilerplate language;
- (e) timely, accurate and complete;
- (f) balanced in communicating the audit firm's output measures of audit quality in addition to any input measures; and
- (g) sufficient in terms of explaining the limitations of the indicators of audit quality, including that the indicators may not be comparable across audit firms.*

* For example, presenting total training hours may not communicate differences in the type, relevance or timing of training; additionally, the nature and scope of internal quality reviews may differ among firms, which can lead to differing results.

⁶ As described in the Statement, the elements of content are information about (i) the audit firm's legal and governance structure; (ii) its measures to foster audit quality; (iii) its internal indicators of audit quality; and (iv) its indicators of audit quality as generated by the work of external bodies. The elements of delivery are that if audit firm transparency reports are published, then they should be made available at a minimum annually and be of sufficient timeliness after the audit firm's fiscal year-end to be useful to investors. These reports should be published in a manner that is visible and easily accessible to investors, regulators and other stakeholders.

III. Content and Delivery of Information

1. Information About The Audit Firm's Legal and Governance Structure

- (a) Information about the audit firm including a description of the audit firm's legal, ownership and governance structures, and disclosure of any affiliated firms and other entities owned or in which the firm has a significant beneficial interest.
- (b) If a firm belongs to a network, a description of the network, the degree to which the network sets policy and monitors compliance therewith, and structural arrangements in the network including the respective responsibilities of the network and the audit firms.

2. Information About The Audit Firm's Measures to Foster Audit Quality

- (a) A description of how the firm establishes, evaluates and monitors compliance with auditing standards.
- (b) Insight with respect to the initiatives the firm has implemented to encourage a culture of professional skepticism and a tone at the top that promotes audit quality.
- (c) A discussion of how the firm manages the assignment of partners and staff to engagement teams based on, for example, workload, technical competence, and the years of audit experience of its partners and staff (possibly including metrics for partners and staff in auditing particular industries).
- (d) A description of the firm's risk management process to identify, measure, and mitigate material risks.
- (e) A discussion of how the firm holds partners accountable for audit quality, including how performance on audit quality was assessed and the extent to which this affects remuneration.

3. Information About The Audit Firm's Internal Indicators of Audit Quality⁷

- (a) Insight, for example via a qualitative statement, about significant areas for improvement from the results of the audit firm's internal monitoring of its implementation of regulatory and other requirements in areas such as professional continuing education, acceptance and continuance of clients and engagements, auditor independence of the audit firm and its staff and system of quality control, and the corresponding remedial actions.

⁷ Disclosure of this information depends on confidentiality legislation and other regulatory frameworks or requirements.

- (b) Input measures including statistical metrics aimed at providing information on the personnel and availability of resources to support the level of audit services in the firm. Examples of these metrics include:
 - i. Proportion of revenues from non-audit services to audit and to non-audit clients; and
 - ii. Indicator(s) of the years of experience of partners and staff.
- (c) Output measures and results of applying those measures, presented on a comparable basis from year to year. These should be accompanied by a thorough description of the methodologies used to develop these measures of audit quality. For the purposes of comparability, if the firm has replaced a measure with another measure in its transparency reports, present both the previous measure and replacement measure in the current year report.
- (d) Any other measures of audit quality.

Note: Disclose a true depiction of results as generated by the monitoring work of the audit firm. These results should not be presented so as to give a more favorable picture than reported by quality control reviewers or audit oversight regulators, whether by way of the selective reporting of results or other means.

4. Information About The Audit Firm's Indicators of Audit Quality as Generated by the Work of External Bodies⁸

- (a) Inspection results of audit oversight bodies. Inspection results reported on by audit oversight regulators should be included in the audit firm's transparency report. The firm should disclose, subject to confidentiality legislation and other regulatory frameworks or requirements:
 - i. The scope and results from audit oversight inspections, including main or general deficiencies and other findings without identifying names and other confidential information about individual audits.
 - ii. The name of the audit oversight body reporting on observed deficiencies.
 - iii. The corresponding remedial actions by the audit firm.

⁸ Disclosure of this information depends on confidentiality legislation and other regulatory frameworks or requirements. Firms should evaluate the law applicable to such information and determine whether the firm is precluded by law from disclosing this information or whether the firm should, even if not precluded by law from disclosing, obtain consent of audit oversight regulators and other external bodies, where relevant, to any reporting of inspection results in the firm's report.

- (b) Compliance results from external bodies including peer reviews. A statement about the audit firm's compliance results and significant findings with respect to regulatory frameworks and other requirements related to professional continuing education, quality control and auditor independence.

Note: The inspection and compliance results presented should provide a true depiction of results. These results should not be presented so as to give a more favorable picture than reported by quality control reviewers or audit oversight regulators, whether by way of the selective reporting of results or other means.

5. Frequency of Reporting

It would be to the benefit of investors and audit committees if the audit firm's transparency report was made available at a minimum annually and be of sufficient timeliness after the audit firm's fiscal year-end to be useful to investors. Also with respect to timing matters, it would be beneficial to indicate the report date of the audit firm's most recent audit oversight body inspection report.

6. Circulation of Transparency Reports

It would be to the benefit of investors if the audit firm's transparency report was made visible and easily accessible to the public on the firm's website.⁹ The audit firm should also consider providing its transparency report to audit committees of publicly listed companies audited by the firm in order to promote greater awareness of the firm's governance and audit quality indicators.¹⁰

⁹ Audit firm transparency reports could be presented on the regulator's website if the regulator makes these reports available.

¹⁰ The audit firm may be required by local law or regulation to provide its audit firm transparency report to its public authority or a stock exchange.