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NBA Practice Note 1135
Disclosure of Audit Quality Factors
March 4, 2016

Koninklijke Nederlandse
Beroepsorganisatie
van Accountants

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NBA Practice Note 1135 – Disclosure of Audit Quality Factors

NBA Practice Note 1135:	Disclosure of Audit Quality Factors
Applicable for:	Audit firms with a Public Interest Entity licence
Subject:	Explanation of quality factors in transparent reports
Date:	March 4, 2016
Status:	NBA memo, not mandatory provision. When the text uses the word 'should' or any synonym, then it is understood to refer to a legal or other obligation.
Relevant regulations:	<ul style="list-style-type: none">• Audit Firms Supervision Decree, Article 30• Audit Firms Supervision Decree, Article 2b• Audit Firms Supervision Act, Article 12c, first paragraph, section d.• EU regulation Article 13

Disclosure of Audit Quality Factors

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1 Introduction

The auditor plays a relevant and important role in society. It is imperative that auditors provide an opinion based on their audit upon which the stakeholders can rely. However, the quality of the audit is difficult to assess by users of the financial statements and the auditor's report (the 'stakeholders'). Therefore it is important that the boards of audit firms obtain reasonable assurance about whether their audits are conducted in compliance with the applicable laws and regulations. Reasonable assurance can be obtained by establishing an adequate system of internal (quality) control.

Audit firms with a Public Interest Entity (PIE) licence must publicly disclose in their transparency reports their legal structure, governance structure, quality control system and a statement on the effectiveness of functioning. Clear reporting on objectives and results based on the measurable KPIs used by the audit firm and a number of quality factors determined by the sector as a whole can contribute to help stakeholders understand the degree to which an audit firm and the sector as a whole invest in quality, as well as the results of these investments. The NBA working group on the future of the accountancy profession has advocated for such a report.

By reporting on KPIs and quality factors, audit firms with a PIE licence can actively comply with the description of their quality control system stipulated by Audit Firm Supervisory Decree (after June 17, 2017: the EU regulation) for audit firms with a PIE licence and the relevant information regarding its investments in quality and the results of these investments. In so doing, the organization's policymakers/ management also state how they can guarantee that they are adequately complying with the duty of care as intended in the Audit Firm Supervisory Act. The relevant regulations are included in the Appendix to this practice note.

2 Relevance

This NBA practice note is applicable to all audit firms with a PIE licence.

3 Reporting on organization-specific audit quality factors

To achieve the quality ambition, an audit firm must have formulated a number of quantifiable objectives with regard to the investments (input) in quality, the embedding of quality within the process of conducting the audit (process) and the desired results (output).

In order to be able to measure its performance and evaluate its progress towards realizing its quality ambitions, and the objectives formulated based on these ambitions, the organization must have identified a number of quality factors that set the scope for the organization - the KPIs in terms of quality. The result of measuring and evaluating the quality factors is relevant for the stakeholders, who wish to understand the audit firm's investments and performance with regard to quality.

The quality factor report does not provide a full understanding of the audit firm's concept of quality. In addition to the realization of a specific quality factor, it is important that audit firms also explain their ambition, why this ambition is relevant to them, the difference between the ambition and the realization, and the resulting actions. Information about the realization is valuable, but without the explanation of how this realization fits within the context of the specific audit firm, it does not sufficiently help stakeholders to have a good picture of the organization's quality control system.

The report is easier for the stakeholders to understand if the following aspects are addressed:

- an explanation of how the quality factor contributes to the quality ambition;
- an explanation of how the quality factor is measured;
- the objective of the quality factor;
- the realization in relation to the objective and the developments over time.

4 Reporting on general audit quality factors

The NBA believes that several general quality factors are important to the stakeholders, regardless of the information upon which the audit firm monitors itself. It is therefore only natural that the audit firm shall report on these factors in the context of the requirements to provide a description of the quality control system in the Transparency Report. This will also provide insight into the quality of, and the investments in quality by, the sector as a whole.

It is possible that some audit firms may not manage their organization based on the general quality factors described in this practice note yet. It may be the case that an audit firm has no information pertaining to a specific factor. In that case, this will be explained in the report ("comply or explain") with an explanation how the organization monitors the underlying quality objectives, or else it must state that it does not gather information in order to monitor the realization of the objectives pertaining to this aspect. The NBA has the opinion that these explanatory notes are of valuable information for the stakeholder who wishes to have a good understanding of the audit firm's quality control system based on the information included in the transparency report.

When reporting on general quality factors, it is also important that the audit firms explain their ambition, why this ambition is relevant to them, the difference between the ambition and the realization, how the firm evaluates the difference and the resulting actions. In order to provide stakeholders with a good picture of the audit firm's conception of quality and its quality control system, it is important that the organization provide information regarding its investments (input) in quality, the embedding of quality within the process of conducting the audit (process) and the desired results (output).

4.1. Input

For an audit firm, significant investments in quality are investments in people, time available for audit engagements, technology and methodology. Investments in technology and methodology are generally done on an international level as part of the international networks within the network to which the Dutch organization contributes. It is important that audit firms provide insight into the investments that they make in these areas, whether or not as part of a network. Audit firms are expected to at least consider the following:

- The leverage on the audit engagements by expressing the number of partner/director hours as a percentage of the total number of hours;
- The number of hours per FTE (full-time equivalent) spent on audit engagements, respectively on other engagements in total and by function;
- The investments in technology and methodology for the benefit of the audit conducted by the audit firm, whether independently or through its contribution to the development as part of a network. The investments must be identified as a percentage of the audit revenue on an annual basis;
- The average number of hours spent on training and education per employee (internal and external training);
- The turnover of employees, with insight into the relevant characteristics the organization uses to monitor employee turnover, such as turnover per function level, years of experience or by differentiating between key talents and other employees;
- Results of employee satisfaction surveys on aspects related to coaching and audit quality.

4.2. Process

In the process of conducting an audit, an audit firm builds in safeguards to secure the quality of the audits conducted. In order to provide insight into the quality control system, it is important that the audit firm provides insight into the most important measures and the manner in which it monitors the execution of these measures. This concerns, for example the audit process as conducted by the audit team, the involvement of specialists and the degree to which quality review and consultation take place. For certain aspects the audit firm is expected to monitor its performance based on KPIs, or to provide stakeholders with insight into the execution of these measures by means of a quality factor report. Audit firms are expected to at least consider the following:

- The number of FTEs or hours spent on supporting the audit (Technical support positions, Compliance and Independence). This can be expressed as a percentage of the total number of FTEs or audit hours;

- The number of consultations in the field of accounting and auditing as a percentage of the number of audit engagements;
- The number of Engagement quality control reviews (EQCRs) and other quality reviews prior to the issuance of the auditor's report as a percentage of the statutory audits, with the mandatory and voluntary EQCRs disclosed separately;
- The number of hours spent on EQCRs and other quality reviews prior to the issuance of the auditor's report as a percentage of the total number of hours spent on audit engagements where i a quality review was performed, with the mandatory and voluntary EQCRs disclosed separately;
- The percentage of hours spent by IT specialists and other specialists on audit engagements (the specialists covered by Standard 620 disclosed separately), for PIE and non-PIE organizations.

4.3. Output

It is important that audit firms also provide insight into the effects of the measures taken within the quality control system. In addition to information about the input and process, it is therefore also important that the audit firm provide insight into the results of these aspects. Audit firms are expected to at least consider the following:

- The number of internal and external quality reviews conducted after the issuance of the auditor's report, as a percentage of the total number of issued auditor's reports, and the outcome of these quality reviews;
- The number of internally reported violations of independence rules, as a percentage of the total number of employees;
- The number of fundamental errors corrected, whereby the financial statements in which the errors were made were audited by the organization, as a percentage of the number of issued auditor's reports.

5 Development of quality concept

The quality factors listed in paragraph 4 combined, provide an indication of the firm's concept of quality, its investments in quality (input and process) and the results of these investments (output). The impact of each individual factor has not yet been determined scientifically, but the NBA is convinced that the attention paid to and the investments in these factors provide a positive contribution to quality.

International organizations, such as the IAASB and the PCAOB are also working on providing insight into the quality of reporting on quality factors. The use of the factors in the Netherlands, the discussion about these factors and new scientific research will eventually lead to new insights as well. The NBA therefore expects that it will update the quality factors as new information becomes available.

6 Scope and effective date

This practice note is applicable to all audit firms with a PIE licence . This NBA practice note does not contain new regulations. The NBA expects that audit firms with a PIE licence will report on the factors listed in this practice note in their transparency reports for the accounting years beginning on or after December 15, 2015, but early adoption is encouraged . Early adoption may also partially be based on the information already available.

Appendix: Relevant regulations

Regulations pertaining to Dutch organizations prior to June 17, 2016

Audit Firms Supervision Decree, Article 30

- 1 An audit firm which has carried out a statutory audit for a Public Interest Entity must draw up a report which includes at least the following information within three months of the completion of the financial year:
 - a a general description of its legal and organizational structure;
 - b if it is part of a network: a general description of the organizational structure of the network;
 - c a general description of its control structure;
 - d a general description of its quality control system and a statement by the persons responsible for day-to-day policy as to the efficacy of this system;
 - e the moment in time at which the quality control system was evaluated, in accordance with Article 22, second paragraph;
 - f whether the quality control system has been the subject of supervision by the Financial Markets Authority;
 - g a list of Public Interest Entities for which a statutory audit has been conducted during the applicable financial year;
 - h a statement confirming that internal supervision of compliance with the independence provisions has been conducted;
 - i a statement regarding the policy implemented by the audit firm regarding the structural maintenance of its employees' basic knowledge and keeping current with developments in the field;
 - j the total revenue of the units of the network located in the Netherlands, in which the revenue of the audit firm is divided among the revenue for statutory audits and for other services, and;
 - k information about the grounds for remuneration of the external auditors.
- 2 The audit firm must sign the report and immediately post it to its website. The audit firm must keep the report posted and accessible on the website for at least one year.

Obligations pertaining to foreign organizations prior to June 17, 2016

Audit Firms Supervision Decree, Article 2b

The transparency report referred to in section 12c, subsection d of the Act, contains information similar to the information mentioned in Article 30, first paragraph.

Audit Firms Supervision Act, Article 12c, first paragraph, section d.

must publish a transparency report on its website each year with certain information under general management measures.

Relevant regulations after June 17, 2016

EU regulation Article 13 Transparency report

- 1 A statutory auditor or an audit firm that carries out statutory audits of public-interest entities shall make public an annual transparency report at the latest four months after the end of each financial year. That transparency report shall be published on the website of the statutory auditor or the audit firm and shall remain available on that website for at least five years from the day of its publication on the website. If the statutory auditor is employed by an audit firm, the obligations under this Article shall be incumbent on the audit firm.

A statutory auditor or an audit firm shall be allowed to update its published annual transparency report. In such a case, the statutory auditor or the audit firm shall indicate that it is an updated version of the report and the original version of the report shall continue to remain available on the website.

Statutory auditors and audit firms shall communicate to the competent authorities that the transparency report has been published on the website of the statutory auditor or the audit firm or, as appropriate, that it has been updated.

- 2 The annual transparency report shall include at least the following:
- a a description of the legal structure and ownership of the audit firm;
 - b where the statutory auditor or the audit firm is a member of a network:
 - i a description of the network and the legal and structural arrangements in the network;
 - ii the name of each statutory auditor operating as a sole practitioner or audit firm that is a member of the network;
 - iii the countries in which each statutory auditor operating as a sole practitioner or audit firm that is a member of the network is qualified as a statutory auditor or has his, her or its registered office, central administration or principal place of business;
 - iv the total turnover achieved by the statutory auditors operating as sole practitioners and audit firms that are members of the network, resulting from the statutory audit of annual and consolidated financial statements;
 - c a description of the governance structure of the audit firm;
 - d a description of the internal quality control system of the statutory auditor or of the audit firm and a statement by the administrative or management body on the effectiveness of its functioning;
 - e an indication of when the last quality assurance review referred to in Article 26 was carried out;
 - f a list of public-interest entities for which the statutory auditor or the audit firm carried out statutory audits during the preceding financial year;
 - g a statement concerning the statutory auditor's or the audit firm's independence practices which also confirms that an internal review of independence compliance has been conducted;
 - h a statement on the policy followed by the statutory auditor or the audit firm concerning the continuing education of statutory auditors referred to in Article 13 of Directive 2006/43/EC;
 - i information concerning the basis for the partners' remuneration in audit firms;
 - j a description of the statutory auditor's or the audit firm's policy concerning the rotation of key audit partners and staff in accordance with Article 17(7);
 - k where not disclosed in its financial statements within the meaning of Article 4(2) of Directive 2013/34/EU, information about the total turnover of the statutory auditor or the audit firm, divided into the following categories:
 - i revenues from the statutory audit of annual and consolidated financial statements of public-interest entities and entities belonging to a group of undertakings whose parent undertaking is a public-interest entity;
 - ii revenues from the statutory audit of annual and consolidated financial statements of other entities;
 - iii revenues from permitted non-audit services to entities that are audited by the statutory auditor or the audit firm; and
 - iv revenues from non-audit services to other entities.

The statutory auditor or the audit firm may, in exceptional circumstances, decide not to disclose the information required in point (f) of the first subparagraph to the extent necessary to mitigate an imminent and significant threat to the personal security of any person. The statutory auditor or the audit firm shall be able to demonstrate to the competent authority the existence of such threat.

- 3 The transparency report shall be signed by the statutory auditor or the audit firm.

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