

THE CRUX OF THE MATTER

COMPASS FOR
AUDIT QUALITY

Royal Netherlands
Institute of Chartered
Accountants

NBA

PUBLIC INTEREST
STEERING COMMITTEE

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PUBLIC INTEREST STEERING COMMITTEE

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CONTENTS

	INTRO.....	4
1	QUESTIONS ABOUT QUALITY.....	6
2	FOUR PRINCIPLES OF QUALITY.....	11
3	WHEN IT MATTERS.....	14
4	PREREQUISITES FOR QUALITY.....	16



INTRO

Accountants enable people to make well informed decisions. They do this by expressing their opinion about the fairness of information, thus providing greater certainty about the performance and (financial) health of organisations. This certainty is an important catalyst for the functioning of financial markets.

Accountants do their job because they are enthusiastic and proud of its importance.

And they bear great responsibility to achieve high quality when doing so. The importance of doing so has been clearly demonstrated in recent years by several discussions concerning the quality of their work. In the meantime, the ensuing debate has resulted in various initiatives. They involve initiatives like the Audit Change Agenda, the common root cause analysis, the NBA Renewal Agenda and debates and papers about structural models, fraud and continuity. Each of these initiatives is explicitly aimed at offering quality; an objective shared by this document.


The Public Interest Steering Committee published its green paper on audit quality in June 2017. Results of the debate and open consultation that followed the paper form the basis for this white paper about audit quality.

Read more about the initiatives referred to in it at www.nba.nl/veranderagenda.

Guidance about interpreting the term 'audit quality' is crucial for stakeholders so they know what they can and should expect. In reality, they have a variety of interests, which can both reinforce or contradict each other. Professional accountants also want this insight at the forefront of their minds, so they can meet such expectations and have a standard towards which they should aspire.

Accountants are actually not surprised about the need for this guidance. After all, complying with standards is part of a professional accountant's daily routine. Furthermore, audits are about evaluating against a norm.

The most basic norm for any accountant is represented by the fundamental principles of integrity, objectivity, professionalism, expertise, due care and confidentiality. The 'norm' for audit quality supplements these principles, which means it is important for it to be as transparent as possible. That is the objective of this document. To answer the question: when is audit quality sufficient and who determines this?



ACCOUNTANTS DO THEIR
JOB BECAUSE THEY ARE
ENTHUSIASTIC AND PROUD
OF ITS IMPORTANCE.



PROFESSIONAL OATH

'I am aware that as a professional accountant I am bound to act in the public interest.

I will exercise my job with an attitude of professional skepticism. When exercising my profession as a professional accountant I am guided by fundamental principles of integrity, objectivity, professional competence and due care and confidentiality.

I will comply with the laws and regulations applicable to my profession. My professionalism implies that I will not execute any acts of which I know or ought to know that these could bring the accountancy profession into disrepute.

So help me God/I promise/I declare.'

1

QUESTIONS ABOUT QUALITY

QUALITY IS VERY SIMPLE

It is about meeting expectations. Or better still:
about exceeding these expectations.

In this sense, quality is a very simple term,
also for accountants.

Nonetheless, it is not quite so simple in practice.
Because whose expectations are we talking about?
Do we know what they are?
Are these expectations realistic?



DIFFERING PERSPECTIVES

It is not possible to provide an unambiguous answer to these questions, particularly when it comes to (public) accountants. In fact, expectations are formed from a variety of perspectives. Sometimes they overlap each other, while at other times they differ. And sometimes they even conflict.

This is because different stakeholders – society, clients, the firm, professional bodies, regulatory bodies, etc. – adopt different perspectives.

In order to meet the need for quality in this complicated field, we must first ask ourselves the ‘why’ question. Why should we want to deliver quality? And for whom should we want to do it?

But other questions also need to be answered. What does the client want and how can accountants meet this need? And importantly for accountants: how is the concerned service regulated?

The ‘why’ question determines everything. The answer to the ‘why’ question also explains why every accountant does their very best to deliver excellent work. This is what inspires and motivates them. It is what makes the profession so attractive. And it adds meaning to the work of accountants.

When they defend their opinions during the moments that matter, or when they help clients, to close the gap in trust between organisations and their stakeholders. So the “why” question is automatically something that encourages them to do their very best each and every day.

The accountancy profession is a regulated profession. The requirements of society have been incorporated into laws and professional standards, and are expressed in the quality control policy and the quality control systems of accountants organisations. In this case, the perspective centres on the **public interest**. This is not an abstract term. The term ‘public interest’ actually relates to real people with specific needs: shareholders, pensioners, employees, suppliers, investors, etc., each of whom want their securities, pensions, wages and investments to be safeguarded. They want to be able to trust the information they receive about them. When these needs are specified, this actually increases the accompanying professional pride and drive for quality: it serves as a tangible reminder that a lot is at stake. It is a powerful incentive that appeals to the professional pride of accountants to always aim for the highest standards and, if necessary, to not shy away from difficult discussions.

In addition, certain stakeholders also have extra needs. For instance, clients select particular accountants because they expect them to offer better quality than the competition: more efficient, more proactive and more communicative. Audit firms implement quality control policies for the work they carry out, and use this as a basis for their audit approach and the accompanying processes, tools and measures included in their quality control systems. This offers **added value** to clients and society alike. In fact, because clients are improving internal controls within their processes, this has helped to reduce the likelihood of incorrect information being supplied to users.

PUBLIC INTEREST

Society has given accountants a mandate and expects them to live up to it in an appropriate manner. The requirements that society has set for accountants organisations and their accountants are reflected in the Audit Firms Supervision Act (Wta), the VGBA and Auditing standards.

However, meeting society's expectations clearly requires more than just evaluating the fairness of annual reporting. For example, it also means punctually identifying important topics when it comes to issues like organisation continuity, fraud, corruption, corporate governance and transparency about the main operating risks.

Our professional standards are able to offer an answer to the 'how' questions. These standards represent over 100 years' experience of and insight into auditing financial and non-financial annual reports and honouring a comprehensive public mandate. Professional standards are thus more a set of rules that require formal compliance. They explicitly stimulate active compliance based on a professional and critical mindset, as well as professional judgement. Once again, this serves as one of the main drivers of professional pride.

The supervisory body has been given a legal mandate to assess whether accountants comply with these requirements. However, professional accountants are primarily responsible for determining how they meet the requirements in question.

EU REGULATION*, CONSIDERATION (1)

'The public importance of statutory audits means many people and institutions trust the quality of the work carried out by these statutory auditors or audit firms. [...] Statutory auditors therefore fulfil a particularly important public role.'

ADDED VALUE

Clients want accountants to, for example, meet deadlines, possess knowledge about their organisations and specific circumstances, organise their work in an efficient and cost-effective manner, identify problems on time, offer insights and avoid surprises. Or in other words: clients want a 'painless audit', which requires faultless cooperation between client and accountant. Added value is created when accountants share their findings and insights, but also when they provide recommendations concerning internal control and relevant signals concerning current risks like cyber security, integrated reporting, electronic income flows and responsible fiscal policy.

Audit firms implement quality control systems, which are used to define the expectations of individual accountants and teams. From this perspective, quality will benefit from adequate process management and effective prioritisation. As demonstrated by the common root cause analysis (see paragraph 4), important components include sufficient partner involvement, effective risk analysis (use of resource wherever necessary) and use of smart technology during data analysis.

* EU regulation: regulation (EU) no. 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities (PbEU 2014, L 158).

ON THE LIMIT OF EXPECTATIONS: WHAT IS ALLOWED AND WHAT ISN'T

Accounting activities result in expectations among users. Some of these expectations are justified, others are not. And this creates a gap in expectations.

Limperc's (1932) theory of inspired confidence is thus still valid: it states that accountants must perform their activities in a trustworthy manner and not create more expectations than justified on the basis of the concerned activities.

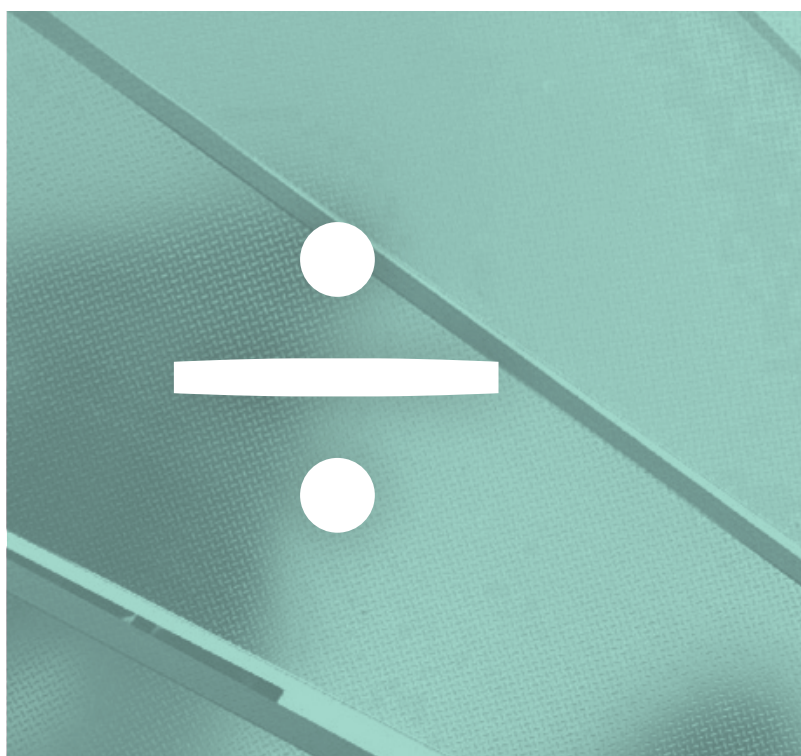
In some cases, accountants do not perform their activities as they should. On these occasions, the public's expectations are justified, and accountants are falling short in their responsibilities. This can be seen as a gap in performance.

However, society sometimes expects accountants to do more than they are able. For example, provide certainty that a positive auditor's report eliminates the likelihood of fraud or corruption and ensures the continuity of the company. It is not reasonable to expect accountants to bridge this gap. These limitations are also expressed in the standards. However, this never relieves accountants of their duty to act accordingly when they encounter signs of fraud and discontinuity.

Things are not quite so black and white when it comes to expectations accountants could meet, but for which standards are not (yet) available.

In this case, accountants have no laws or norms to serve as a compass for their activities. This, for instance, could involve judgements about how a company is being managed, proper corporate governance and transparency about the main (business) risks. Firms can live up to such needs by formulating an additional engagement, where a role is played by the accountant as well as other experts. Quality will thus mainly be an issue of offering sufficient added value to specific users.

However, the absence of such norms in laws and regulations does not mean they are not in the public interest; on the contrary. 'Public interest' is not a static concept, although this also applies to accompanying quality requirements, including the professional standards in which they are expressed.



Standards developed over the years always result in new activity. Factors such as new technology or social change have an impact on expectations and cause standards to evolve. In this sense, quality is about being involved in continuous dialogue with stakeholders about what is allowed and what isn't, and to adapt standards accordingly. The sector can work with its members and affiliated firms to improve audit-related and other standards, which includes increasing understanding about the standards in question. This will make the sector more proactive, which is another aspect of quality.

2

FOUR PRINCIPLES OF QUALITY

This document aims to answer the question of when audit quality is achieved. But what is audit quality? Can we use the previous chapters to arrive at a comprehensive and conclusive definition?

No, and such a definition would also be undesirable. Such a comprehensive and conclusive definition would actually do injustice to several essential characteristics of the accountancy profession:

- Accountants use the circumstances they face to determine what they must do to deliver quality; they do this with passion and pride, have courage to expose certain matters and are trained to make a professional judgement. This requires a certain amount of leeway, rather than a specific definition. Accountants must have the freedom to display their expertise without being guided by strict instructions relating to quality.
- In essence, accountants almost always operate in grey zones where there is an absence of clear visions; they must dare to start a dialogue if this is not the case, and present well-founded arguments about why a particular stance has been taken. A rigid definition is not compatible with this approach.
- And last but not least: interpretations of quality can differ and even contradict each other. That is why situation-specific considerations must be left to the professional judgement of accountants.

In other words, an exhaustive definition of quality would actually be an assault on the professionalism of accountants and could have an adverse effect.

This does not detract from the importance of understanding the concept of 'quality'. In our view, it is better to have the concept of quality at the front of your mind than to formulate a definition for quality. As a result, this document aims to reinforce this understanding, so individual accountants can form an attitude aimed at achieving the highest possible quality.

Certain principles are needed if we are to focus on the concept of quality instead of a rigid definition. Accountants must be able to use these principles to determine what quality actually entails and to determine, for each specific situation, whether sufficient quality has been achieved. In this case, the following principles are needed:

PRINCIPLE 1

Serving the public interest should be prioritised above other perspectives towards quality

The aim of audits is to determine the faithfulness of a company's reporting so annual reports become informative documents that can be helpful to users. The public interest must always be central to accountants, also in cases where it may conflict with other viewpoints. Serving the public interest is thus about more than just compiling an audit file where all requirements in applicable standards have been met. It goes much further than that and is actually expressed in the 'courage' of accountants when having to weigh up differing interests.



FOUR PRINCIPLES OF QUALITY



PRINCIPLE 2

Professional standards: not because it is necessary, but because it matters

Accountants must be familiar with standards and be able to implement them. But complying with standards is not an objective in its own right. Standards are not obligatory additions to auditing activities and all accompanying professional judgements, but actually indicate what these activities should entail. So compliance with standards is not a must for achieving quality, but confirms it has been achieved. To summarise: not because it is necessary, but because it matters. Either way, this means individual accountants must be familiar with standards and know how to implement them when performing their activities.

3

PRINCIPLE 3

Accountants must make a well-founded judgement that ensures a reasonable level of certainty

When performing auditing activities, accountants use their professional judgement to effectively respond to the client's situation and the material risks which are important to the audit carried out for the client in question. This means accountants use the knowledge they gather, as well as the quality control systems of their firms, to decide which aspects deserve extra attention and which deserve less attention. Audits are a human undertaking, which means accountants may make different considerations and choices when performing them.

PRINCIPLE 4

Accountants must believe in their approach and not be afraid to discuss it

Audit quality is realised by a profession that is characterised by (terms like) professional judgement and fair presentation. Therefore, a black and white discussion about whether or not quality has been achieved cannot take place. This is exactly why it is important for accountants to make individual considerations. This is also something clearly supported by the content of applicable standards.

Standards offer accountants the freedom they need to modify their auditing activities to suit specific circumstances. Moreover: they offer the opportunity to adopt a different (substantiated) approach and thus rely on their professionalism. In this case, individual accountants have an explicit responsibility to defend this decision and to not be afraid to debate it.

This dialogue is also important when it comes to the profession as a whole:

- Firstly, in order to use stakeholder dialogue and input from sector analyses to determine which standards must be developed or modified to continue safeguarding the quality of the profession.
- Secondly, to allow the sector to reduce the gap between the expectations of the profession and society by improving understanding for, and knowledge about, accountants using publications, round table meetings and regular stakeholder management.




3

WHEN IT MATTERS

All this clearly shows that quality is primarily a question of believing in your principles and effectively implementing them in different situations. It is therefore unavoidable that moments will be encountered when things get tough in a figurative sense. In such moments, achieving quality will not be a question of completing check-lists, but about independently applying the principles.

These moments, where different interests collide with each other, are actually the decisive moments within the accountancy profession. Because these are the moments when accountants must consider everything correctly based on their professional understanding; with a neutral and inquisitive attitude and based on thorough knowledge of the situation at hand. This also applies if stakeholders wholeheartedly disagree with choices or have little understanding for them. These are actually the moments when accountants must dare to have a robust dialogue, while maintaining an open mindset. Because that is their obligation. And a gem cannot be polished without friction.

BECAUSE THAT IS THEIR
OBLIGATION. AND A GEM
CANNOT BE POLISHED
WITHOUT FRICTION.



THESE DIFFICULT AND DECISIVE MOMENTS ARE ENCOUNTERED MORE OFTEN THAN MANY PEOPLE THINK.

EXAMPLES:

- Accountants can be placed under pressure by their clients to, for example, meet deadlines. This means the interests of the client (speed) can collide with the interests of society (diligence). In this case, the interest of the public must have priority. The root cause analyses performed by firms showed that making an appropriate decision in such situations has a major impact on quality.
- Accountants can sometimes get caught between two stools when determining how much transparency is needed to defend the public interest. For instance, imagine that a bank is at risk of encountering difficulties. Premature openness about the situation by the accountant could result in a bank run and thus strike the final nail in the bank's coffin. Therefore, transparency is also accompanied by unforeseeable risks.
Nonetheless, accountants must be crystal clear about their findings behind the scenes, for example, towards non-executive directors and external supervisory bodies.
- Accountants can face demands or expectations that simply cannot be met. If this is the case, they must be absolutely clear and explain that such requests are impossible to live up to. Also when it comes to the media, it is important to avoid long-winded excuses and to simply and firmly identify limits and mention whether certain expectations are unrealistic.
- Accountants can also have discussions with supervisory bodies, for example, because they have specific questions about considerations within arguments accountants have presented. Such discussions can be encountered in professional occupations where quality is based on certain principles. Naturally, in such cases, it is not possible to convincingly explain and carefully substantiate the 'story of the audit' (the process of identifying risks and the response to these risks).

Accountants can actually prepare for many of the above mentioned situations. But they are sometimes encountered unexpectedly. And accountants can sometimes realise - afterwards - that they have not made the right choice or that they should have considered the situation differently. In all cases, it is essential to share experiences with peers and to evaluate them. Making errors is par for the course; not learning from these errors is unforgivable.

4

PREREQUISITES FOR QUALITY

The joint root cause analysis performed by the four largest audit firms has identified ten drivers for audit quality. Shortcomings in audit quality can be encountered if one or more of these prerequisites are not met.

Read more at www.nba.nl/veranderagenda

10 DRIVERS OF AUDIT QUALITY

- 1. The audit team must be stable** - there should be few changes in the audit team, or any changes should be dealt with adequately. The level of in-built flexibility should allow the team to respond to unforeseeable circumstances.
- 2. Portfolio size and composition must be appropriate** - the quantity, size and nature of engagements dealt with by each professional must reasonably match his or her availability, experience and specific (sector) knowledge. On a similar note, it is important for required changes and actions concerning size and composition to be heard and understood. In this case, the organisation must take appropriate follow-up actions.
- 3. The audit team must have a diverse composition and there must be sufficient interaction between members** - the audit team must be well balanced, people must be free to have their own opinions and individual behaviour within the team must contribute to quality.
- 4. Partners and senior team members must be highly committed** - partners and senior team members must actively share (client-specific) knowledge while the engagement is being executed, punctually review audit activities and provide intensive support and coaching to team members.



5. The audit team must possess (professional) knowledge about methodology, NV COS, reporting standards, the audited company as well as the sector

- team members must be capable of implementing knowledge, learning from past findings and referencing audit standards and other relevant guidance in order to make well substantiated choices.

6. Team members must have a critical professional mindset and critical judgement - people must not be too quick to come to the conclusion that enough certainty has been obtained ('tunnel vision').

Focus must be placed on performing enough activities to obtain a sufficient amount of suitable audit information. Activities must be aimed at avoiding complacency and blind spots in risk analyses. The audit approach, as well as performed activities, must be critically evaluated, also in relation to the previous year's audit. There must be professional discipline when performing and recording activities compatible with the accounting profession.

7. There must be adequate process management

- knowledge, expertise and use of process and project-based thinking must be safeguarded in the audit team so the audit can be carried out in an effective and efficient manner.

8. The audit team must maintain a robust dialogue at crucial moments

- team members must be sufficiently supported, and feel comfortable enough, to maintain robust dialogue at crucial moments within the audited organisation. Performing adequate activities is more important than meeting deadlines and commercial considerations. Adequate process and project management helps to make sure this robust dialogue takes place within the audited organisation in good time. Support from the organisation is also essential during moments that matter in such a process.

9. The audit team must be critical towards activities performed by specialists

- there must be a critical professional attitude towards the management, communication and reporting of deployed experts or other accountants.

10. The audited organisation must have a mature level of internal control

- adequate internal control and sufficient expertise concerning audit and reporting issues at the audited organisation helps to improve audit quality and punctually conclude audit activities. If organisations miss such maturity, this can serve as an obstacle to achieving high quality audits.

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