Accountancy Board

Quality Assurance

ANNUAL REPORT 2015

Quality Assurance Oversight Committee

April 2016

MINISTRY FOR FINANCE
Maison Demandols, South Street, VALLETTA, MALTA

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Chairman's Statement

I am pleased to present you with the ninth annual report which provides an in-depth insight into the activities and findings identified by the Quality Assurance Unit ('QAU') through monitoring visits carried out during the year under review.

2015 has seen the transposition of the Single Accounting Directive which is intended to harmonise accounting standards across the EU and to facilitate accounting and reporting requirements for small and micro entities. The accounting reporting framework for small and medium sized companies falling within the scope of this Directive was revamped. This, apart from being in line with the view taken by the EU to think small first, also relieves smaller entities from arduous, often over the top, reporting frameworks. SMEs dominate the Maltese economy in the same way they do in the EU and most other countries and economic regions. Out of the total registered companies in Malta, some 98% can be classified as SMEs and over 90% thereof as micro-entities employing less than 10 persons. Notwithstanding this, SMEs provide around 60% of private sector employment in Malta and are the backbone of our commercial and social infrastructure and major engine of growth [1].

Though the impact of the financial crisis was limited here in Malta, the biggest challenge for the financial sector in the coming years within the European Economic Area is to create a business culture of fairness and security and thus increase confidence in the financial sector. After the financial crisis, it became essential to restore investors' confidence in audits. As a result of the radical changes to the regulatory framework of our profession brought about by new EU directives and regulations, 2015 was indeed a very challenging year for the Accountancy Board. During April 2014 the Council of the European Union issued a new legislative package amending the Statutory Audit Directive and a new Audit Regulation. With these new rules, the European Commission has created a framework to restore investor's confidence in audits, safeguarding auditor's independence, promote better governance and transparency in financial reporting.

[1] Government Press release no 1960.

PURPOSE & SCOPE

The Quality Assurance Oversight Committee's objective is set out in Section 4 of Directive 4 of the Accountancy Profession Act (Cap 281), which states:

"The objective of this Directive is to ensure that all firms maintain the highest possible professional standards."

Successive governments and the EU required companies to have an external independent audit. Audit exists to provide stakeholders with confidence in the trustworthiness of the company's financial statements. Thus auditors must ensure that audit quality is maintained at all times. The Accountancy Board through the Quality Assurance Unit (QAU) monitors and enforces compliance with auditing standards. With the expectations gap on auditor reporting widening, the need for audit practices to have robust systems of internal quality controls and adequate risk management procedures are today more pronounced than ever before.

The new EU Audit Directive establishes specific requirements concerning the statutory audit of annual and consolidated financial statements. The Audit Regulation establishes further specific requirements regarding the statutory audit of public interest entities (PIEs). The carrying out of high quality audits enhances the degree of public confidence in the annual financial statements of PIEs, contributing to the orderly functioning of the market. This EU Directive requires transposition into local legislation to be in place by 17 June 2016 and will apply to financial years starting on or after that date.

The Audit Directive Transposition working group set up under the auspices of the Accountancy Board has sought views from a number of stakeholders on the implementation of the Audit Directive and Audit Regulation in Malta. The transposition working group included representatives of the Accountancy Board, the Malta Institute of Accountants, the Malta Financial Services Authority, the University of Malta, the Ministry for the Economy, Investment and Small Business and the Ministry for Finance. This working group met regularly during 2015 to consider and advise the Accountancy Board on the options available to Malta within the Audit Directive for the different sizes of audit practices as well as regulations attributed to public interest entities, taking into account the specific conditions and needs of the Maltese economy. The new EU Directive and Regulations governing European audit policy will undoubtedly give rise to further changes in audit quality methodologies.

The accountancy profession in Malta has trebled in size over the last three decades and is one of the largest professions in Malta. Following the initial transposition of the EU Statutory Audit Directive when Public Oversight and Quality Assurance were introduced in 2006, Malta has been monitoring the audit profession not only to safeguard the public interest but also to ensure that audit quality standards and ethical requirements applied by all statutory auditors and firms are in line with regulation. The Accountancy Board upholds the safeguarding of the public interest as its primary objective, which objective is shared by other European audit regulators and investor groups alike.

By the end of 2015, in respect to non-PIE auditors, the QAU had almost fully concluded its second cycle of monitoring visits. In the case of PIE auditors, the QAU finished the third cycle of visits. The regular and periodic monitoring of all local statutory auditors and firms is a means of ensuring that audit quality is maintained.

2016 marks the tenth anniversary of the audit quality assurance function. As for the future, undoubtedly 2016 will pose another challenging and exciting year for the accounting and audit profession in Malta, as indeed in all other EU member states.

Finally, I would like to take this opportunity to thank the members of the Quality Assurance Oversight Committee and the Quality Assurance Reviewers at the QAU for their work and support. I would also like to thank Mr Marcel Coppini (former Head of Quality Assurance Unit and Secretary to the QAOC) who has now retired and Ms Heather Briers (Member of the QAOC since its inception) who has resigned from her post. Their contribution towards raising standards in the audit profession is to be acknowledged and recognised.

Mr. Charles Rapa FCCA, FIA, CPA, MBA (Brunel/Henley), MIM

Accountancy Board Chairman

31 March 2016

Quality Assurance Oversight Committee (QAOC)

Section 1 – Committee structure and meetings

The supervision of the system of quality assurance is delegated by the Accountancy Board to the Quality Assurance Oversight Committee ('QAOC'). The QAOC is the policy-making body and regulator of the quality assurance function in Malta. Its primary function is to oversee, support and appraise the work of the QAU and follow up action by statutory auditors and firms in response to the QAU's visit recommendations. It also provides a formal communication link between the QAU, the Accountancy Board and statutory auditors and firms.

The QAOC will as from May 2016, be replaced by a committee of members from the Accountancy Board. This follows a the change in the composition of the Accountancy Board which, in line with the new Audit Directive is composed solely of voting non-practitioners.

As at year end, the QAOC was composed of the following committee members:

MR PETER BALDACCHINO CHAIRMAN	MR ALFRED LUPI MEMBER	MR GUIDO MIZZI MEMBER
		
M.Phil (Lough), FCCA, FIA, CPA, CSA.	FCCA, BSc Econ, FIA, CPA	FCCA, FIA, CPA

MR PETER PARIS MEMBER	MS KAREN SULTANA SECRETARY
	
FIA, CPA	B.Accty (Hons), CPA MIA

From 1 January to 12 February 2015, Mr Charles Rapa acted as Chairman of the QAOC who was replaced subsequent to his resignation by Mr Peter Baldacchino.

Ms Heather Briers, who was involved in the QAOC since its inception, also resigned from her position as QAOC member with effect from 31 October 2015.

On 24 April 2015, Mr Marcel Coppini resigned from the post of Secretary of the QAOC and Ms Karen Sultana was appointed in his stead on the same date.

During 2015, the Committee met on four separate occasions to discuss the visit findings carried out by the QAU and to report back to statutory auditors and firms. These meetings were held during April, July, October and December 2015.

The term of appointment for all QAOC members elapsed on 31 December 2015.

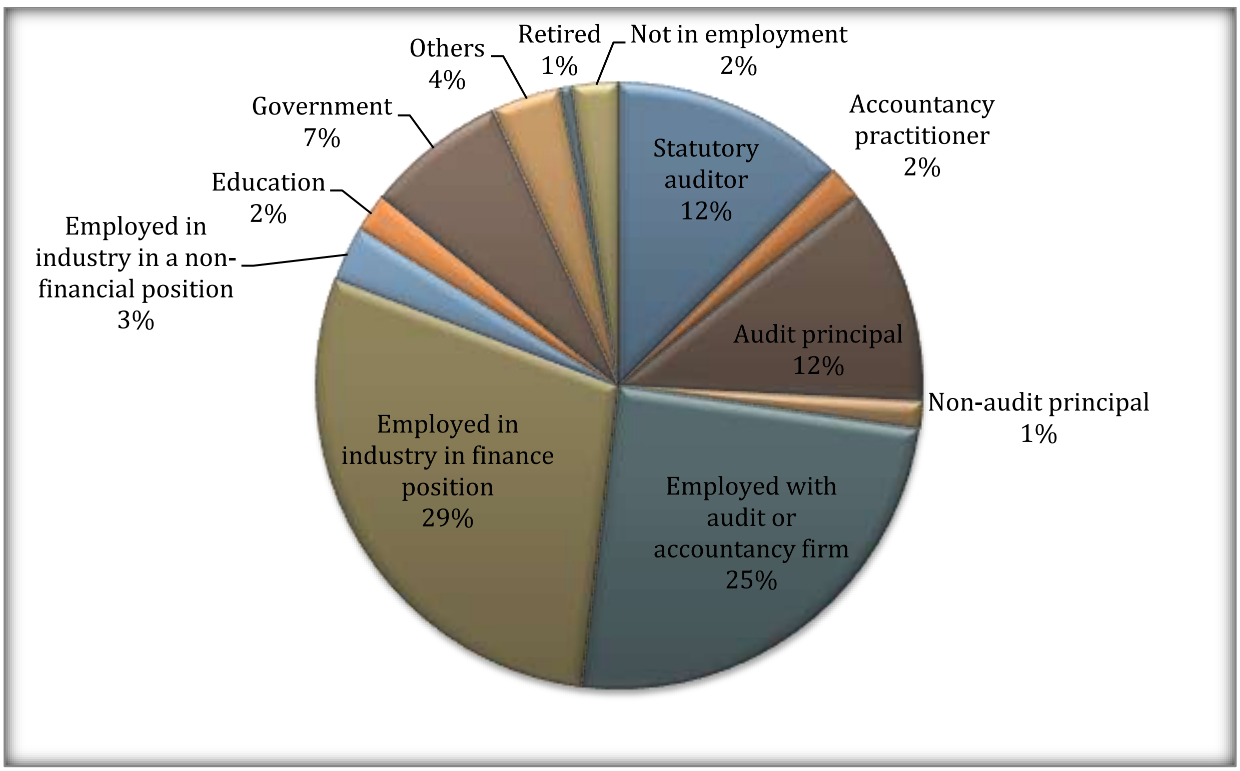
Section 2 – Overview of Quality Assurance Inspection Visits

Section 2.1 – Profile of the profession & audit practices

During the year, there was a marginal increase of 4% of registered warrant holders and there were in total, 2,311 (2014: 2,222) warrant holders registered with the Accountancy Board.

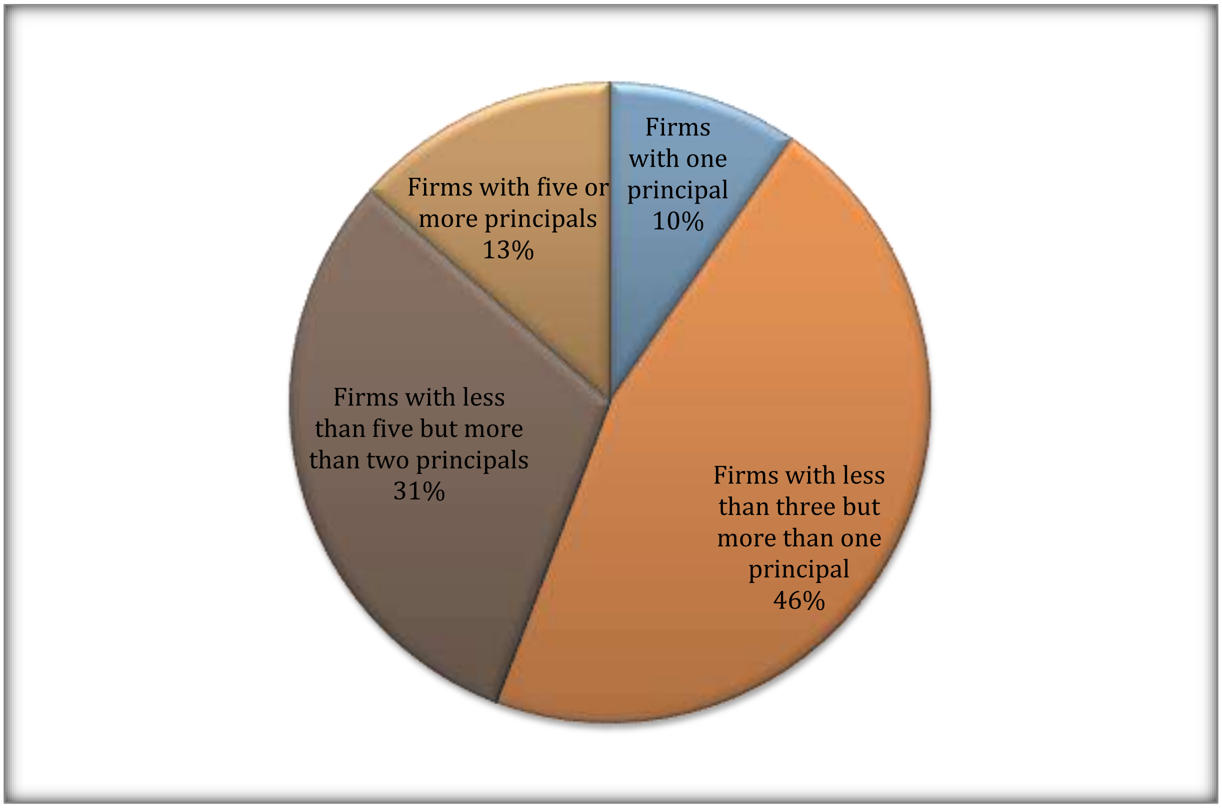
The total number of practising certificate holders at 31 December 2015 increased by 49 to 1,276 (2014: 1,227). Based on declarations made in the Annual Returns covering the year end 2015, there were a total of 170 statutory auditors providing statutory audit services. This represents 13% of the total registered practising certificate holders. Of these 78 operate on a full-time basis, while 92 provide audit services on a part-time basis. The number of statutory auditors working on a full-time basis and those working on a part-time basis in 2015 remained the same as the previous year.

The following chart depicts the sectors practising certificate holders are involved in:



In addition, up till year end, there were 66 statutory audit firms registered with the Accountancy Board, of which 6 were newly registered and 1 de-registered during 2015. Most of the statutory audit firms are composed of two principals as shown in the chart below:

Statutory audit firm composition



All public interest entities are shared amongst 10 statutory audit firms. Furthermore, 60% of all audits are carried out by statutory audit firms whilst the remaining 40% are carried out by statutory auditors.

Profile of statutory auditors and firms

	Total number of statutory auditors and firms
PIE statutory audit firms	10
Non – PIE statutory audit firms	56
Full – time statutory auditors	78
Part – time statutory auditors	92

Section 2.2 – Quality assurance visits

The obligation of statutory auditors and firms carrying out statutory audit services to undergo quality assurance visits emanates from Directive 4 issued in terms of the Accountancy Profession Act (Cap 281) and of the Accountancy Profession Regulations.

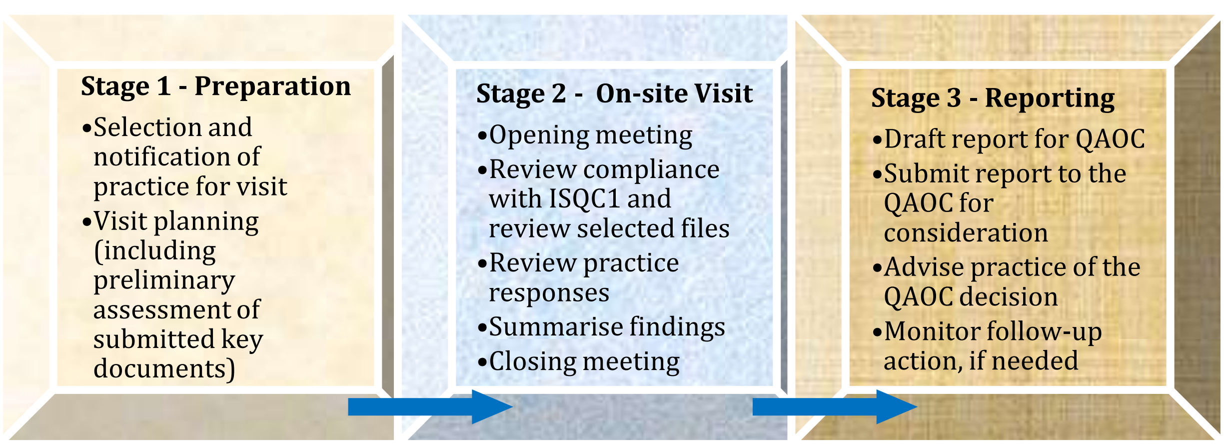
The main objective of the Directive dealing with Quality Assurance is to ensure that all statutory auditors and firms maintain the highest level of professional standards.

Section 12 of Directive 4 of the Accountancy Profession Act states that: “The QAOC shall, in its absolute discretion, determine the selection of firms in respect of which to conduct the quality assurance process including the conduct of periodic review visits, as well as the methods to be adopted in the conduct of the said process and visits and in the review of the detailed returns.”

All statutory auditors and firms providing audit services are subject to periodic monitoring visits to assess practice compliance with International Standards of Auditing, local legislation and directives issued by the Accountancy Board, with the approval of the Minister for Finance, in exercise of powers conferred by the Accountancy Profession Act. The QAU is committed to carry out monitoring visits to practices providing audit services to the public adopting a risk-based approach. This risk-based methodology is manifested throughout the visit review process from planning to completion and is of particular importance when the reviewer is selecting audit files for detailed review.

The Inspection Methodology

The practice monitoring process can be divided into three stages as follows:-



During 2015 the QAU was composed of 5 persons – the Head of the Quality Assurance Unit and 4 quality assurance reviewers. In early 2016, Mr Marcel Coppini retired from the post of Head of the QAU. The Ministry for Finance is in the process of recruiting a person to head the Unit. The QAU has also the support of a full time administrative person who was appointed during February 2016.

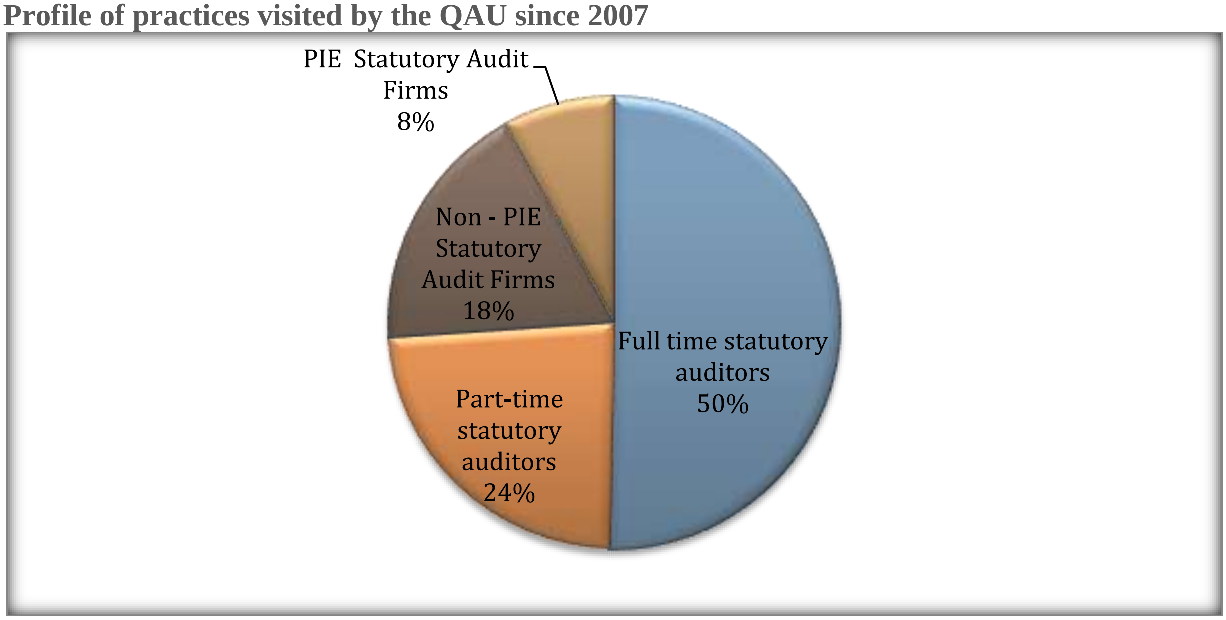
Since the first year of operations in 2007, the QAU carried out a total of 327 quality assurance visits. . The number of visits carried out by the QAU for each cycle since 2007 is illustrated in the diagram below:

Number of statutory auditors and firms visited since 2007 by the QAU

	Cycle 1	Cycle 2	Cycle 3	Total
PIE Statutory Audit Firms	11	9	11	31
Non-PIE Statutory Audit Firms	28	32	-	60
Statutory Auditors	131	105	-	236
Total	170	146	11	327

The number of visits closed down by the QAOC during 2015 attributed to visits carried out by the QAU inspectors during the same year amounted to 38. Furthermore 12 reports pertaining to visits carried out in 2014 were discussed and approved in 2015. The main findings identified are included in Section 2.5 of this report.

Profile of practices visited by the QAU since 2007

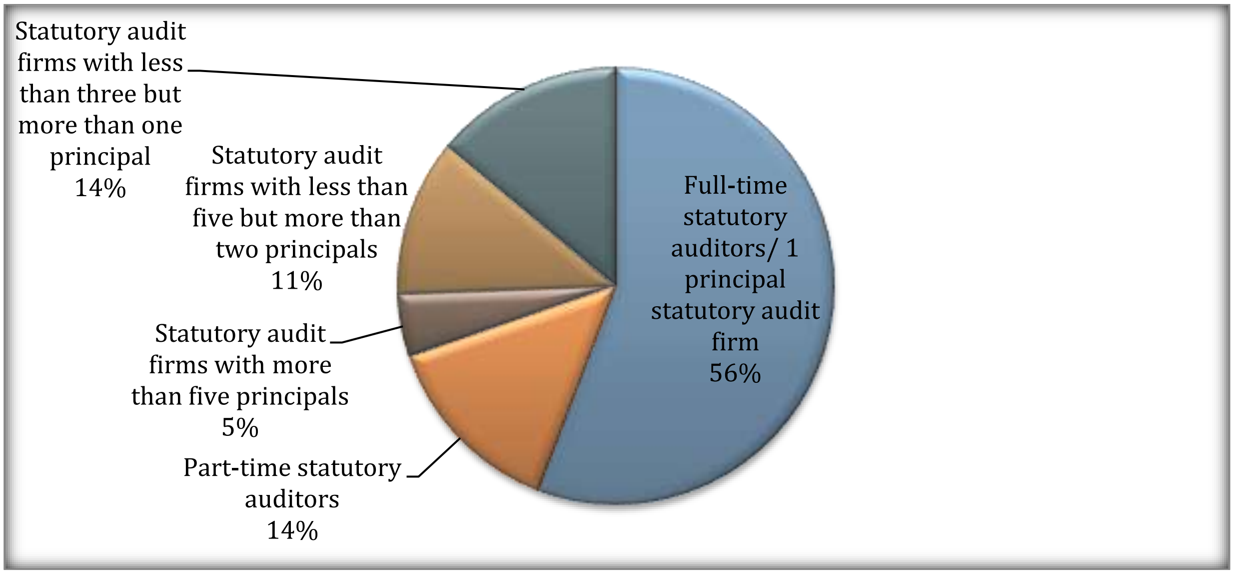


During the four QAOC meetings held in 2015, the Committee has reviewed and closed down 50 visits (including those pertaining to 2014), bringing the total visits reviewed by the QAOC to 321.

Section 2.3 – Review of visits conducted in 2015

Throughout 2015, the QAU carried out a total of 44 (2014:39) visits. The QAU also reviewed 4 statutory audit firms carrying out audits of public interest entities (of which one was a Big 4 firm) for which more time was dedicated to these visits. The following analysis depicts the composition of audit practices reviewed during 2015 by the QAU:

Analysis of audit practices monitored by the QAU in 2015



Whole practice/firm review

On all cyclical visits carried out, whole practice/firm procedures are reviewed. Such review would include a review of ISCQ 1 documentation, letterheads, professional indemnity insurance, CPE compliance and audit compliance reviews as well as cold file reviews. During the latter part of 2015, the Unit adopted the Common Audit Inspection Methodology ('CAIM') on its visits to PIE statutory auditors and firms. CAIM is an inspection programme introduced by the European Audit Inspection Group (EAIG) to ensure an effective and consistent inspection approach across Europe. CAIM will be used on all visits to PIE statutory auditors and firms going forward. By the year end, CAIM had been used fully on one PIE statutory audit firm.

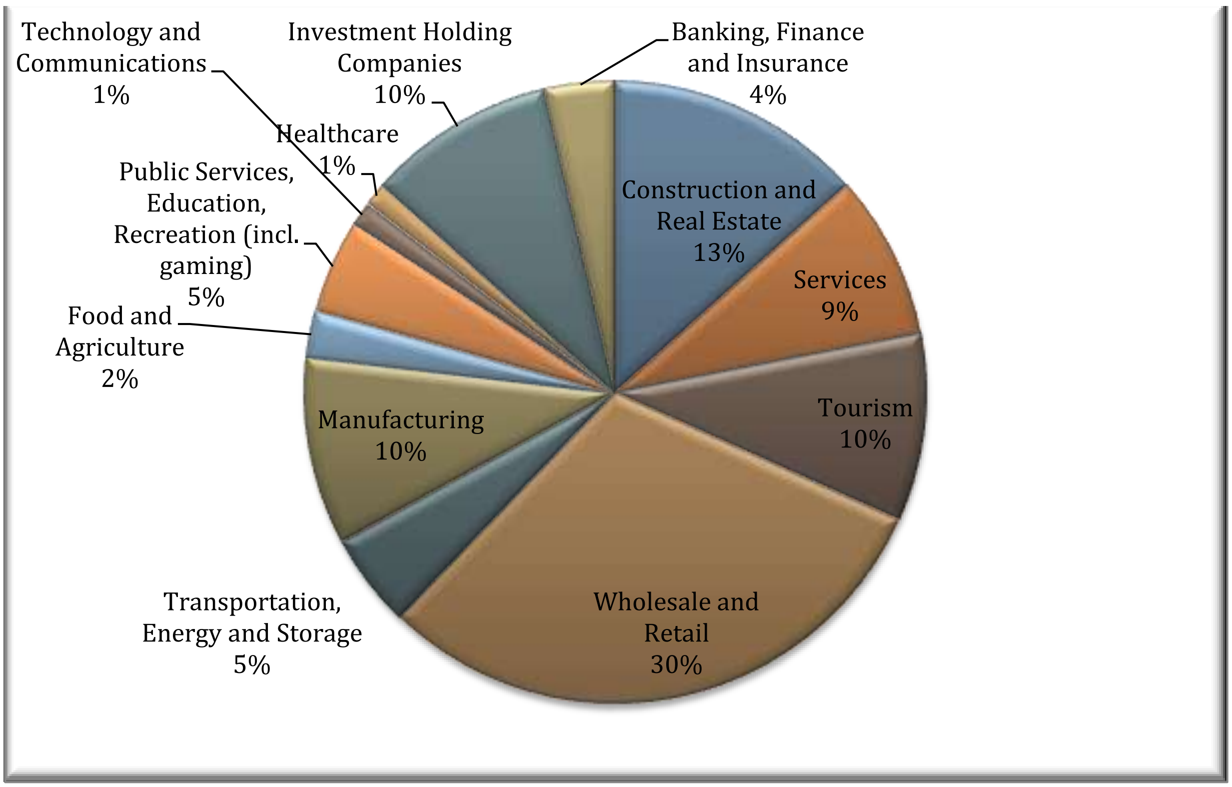
File selection

The preliminary file selection process is based on information provided by the statutory auditor or firm in the clients' list. File selection is risk-based and depends on risk factors such as whether or not a company is a PIE, audit qualifications, client size and engagement partner coverage.

Once a preliminary selection of files is made, this is to be communicated to the statutory auditor or firm normally on the first day of the visit. In this way, the compliance principal can ensure that the relevant principals are made available during the course of the visit to reply to any queries raised by the QAU. However, the statutory auditor/firm is made aware that this initial file selection list may be further increased on an ad hoc basis during the course of the visit, based on the findings identified.

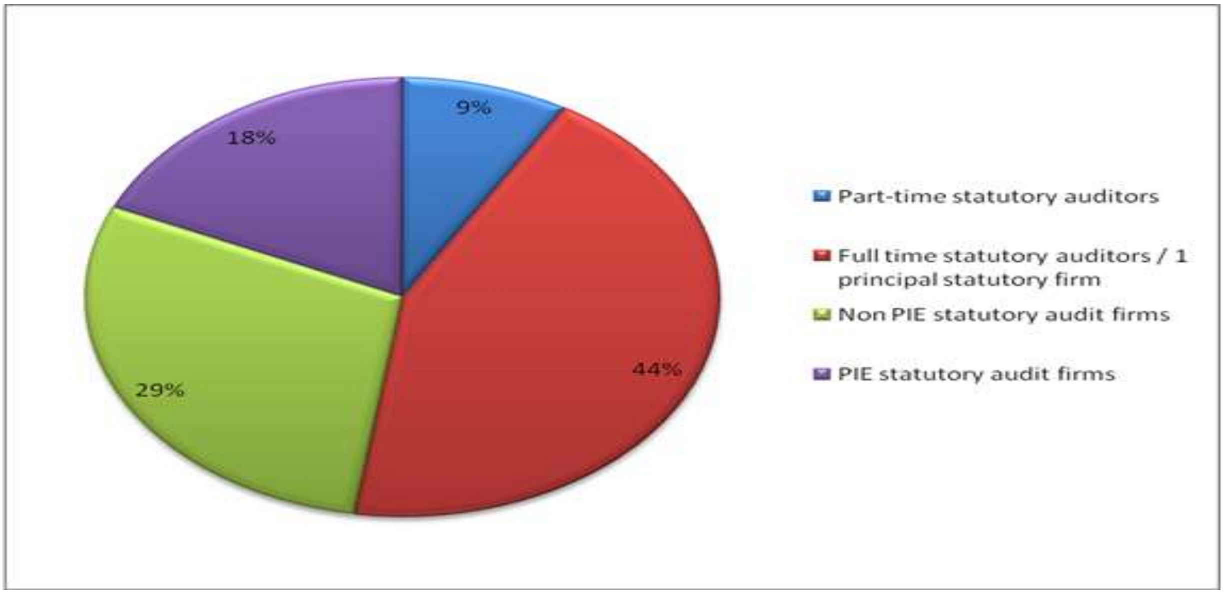
The analysis of audit files selected by industry during the inspection visits carried out in 2015 is shown below:

Audit files analysed by industry sector reviewed by the QAU in 2015



During 2015, the QAU reviewed a total of 85 audit files, of which 3 audit files were related to audits of public interest entities during 2015. The following chart shows the overall distribution the audit files reviewed in 2015:

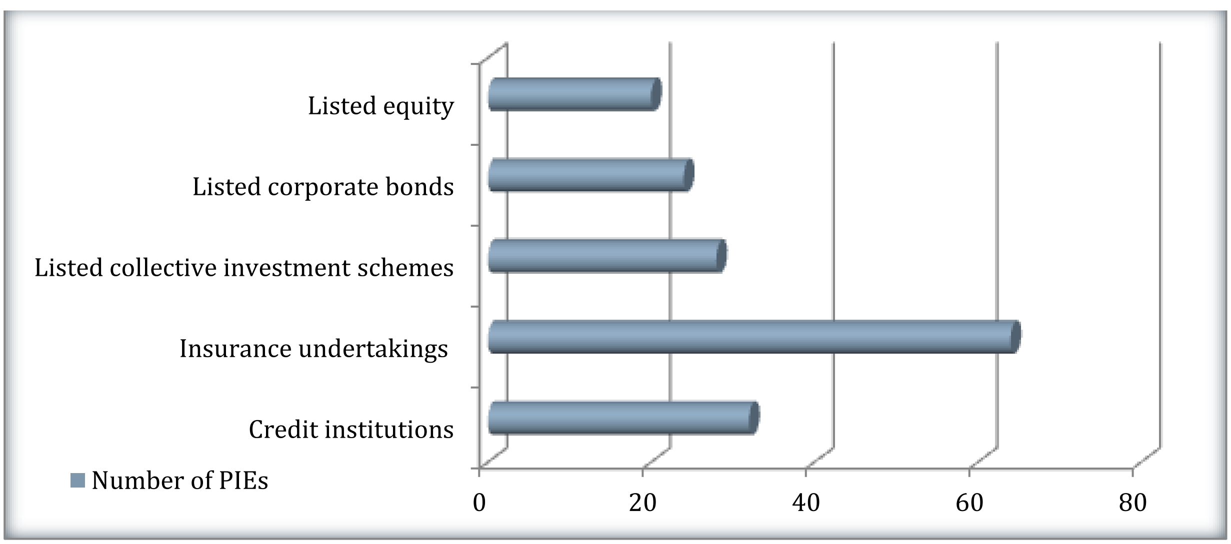
Distribution of audit files reviewed by the QAU in 2015



Public interest entities are entities whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC, a credit institution as defined in point 1 of Article 1 of Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions, an insurance undertaking within the meaning of Article 2(1) of Directive 91/674/EEC and such other entities as may be prescribed by the Board.

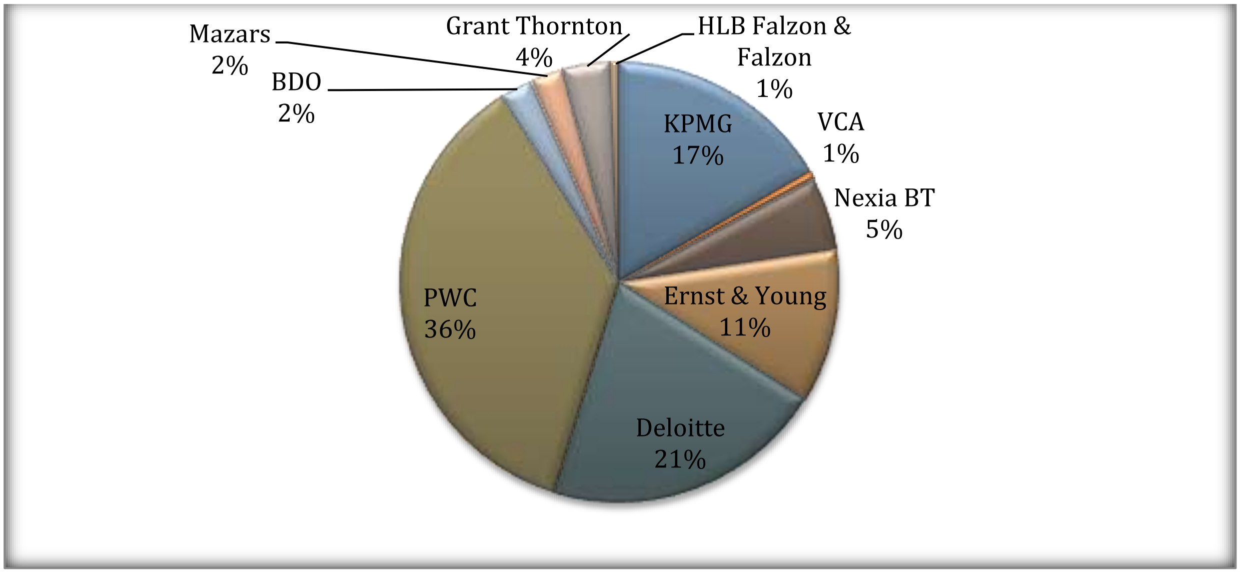
An illustrative segmentation of all types of entities which are deemed to be of a public interest is noted below:

Segmentation of Public Interest Entities



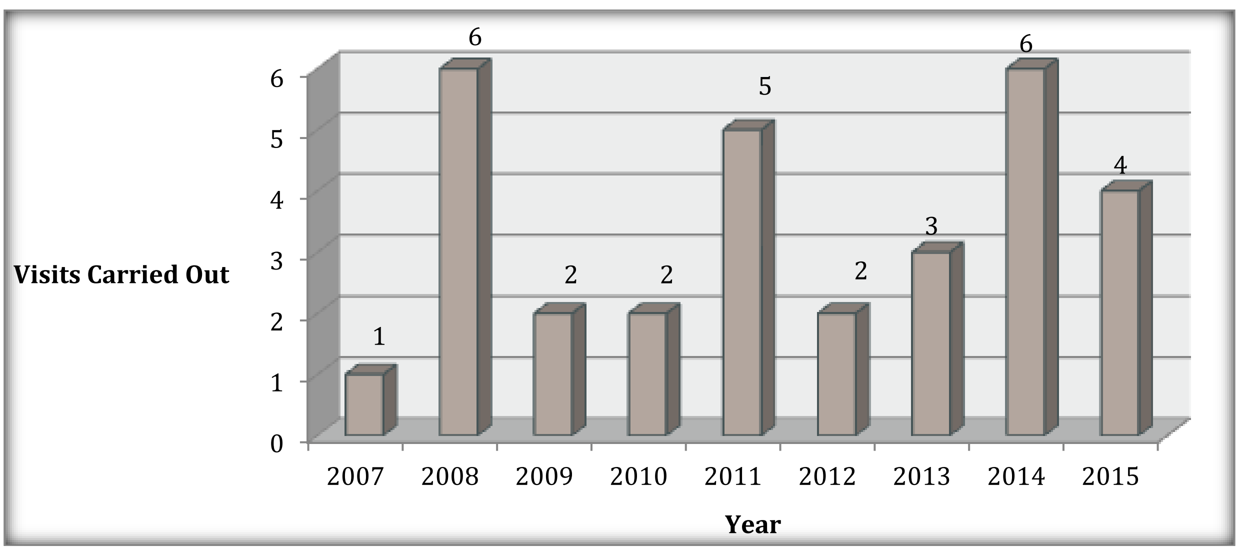
86% of the audits of all PIEs are conducted by the Big 4 internal network statutory audit firms. The audits of the remaining 14% are carried out by other mid tier statutory audit firms, all of which other than two, form part of an international network.

Share of market of PIE Audits



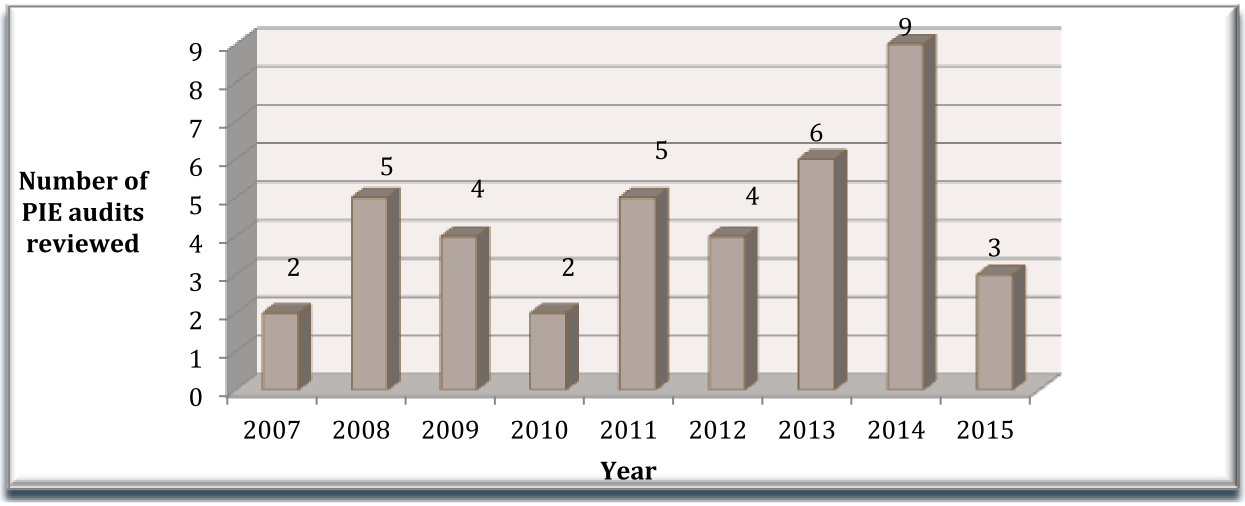
During 2015, there were 10 statutory audit firms auditing PIEs of which 4 statutory audit firms were subjected to a QAU visit, including one follow-up visit. The number of QAU visits to PIE statutory audit firms visited on an annual basis is shown below:

QAU visits carried out to PIE Statutory Audit Firms



During the year under review, the QAU reviewed 3 audit engagement files of public interest entities as can be seen below.

PIE Audit files reviewed by the QAU since inception



As from 2007, 31 visits to PIE statutory auditors and firms having being carried out, of which 4 were carried out by the QAU in 2015. Visits to PIE auditors accounted for 10% of all QAU visits carried out since 2007. Since the QAU's inception, it reviewed a total of 40 statutory audits of public interest entities which account for 7.5% of the total number of files reviewed to date.

Section 2.4 – 2015 inspection reports overview

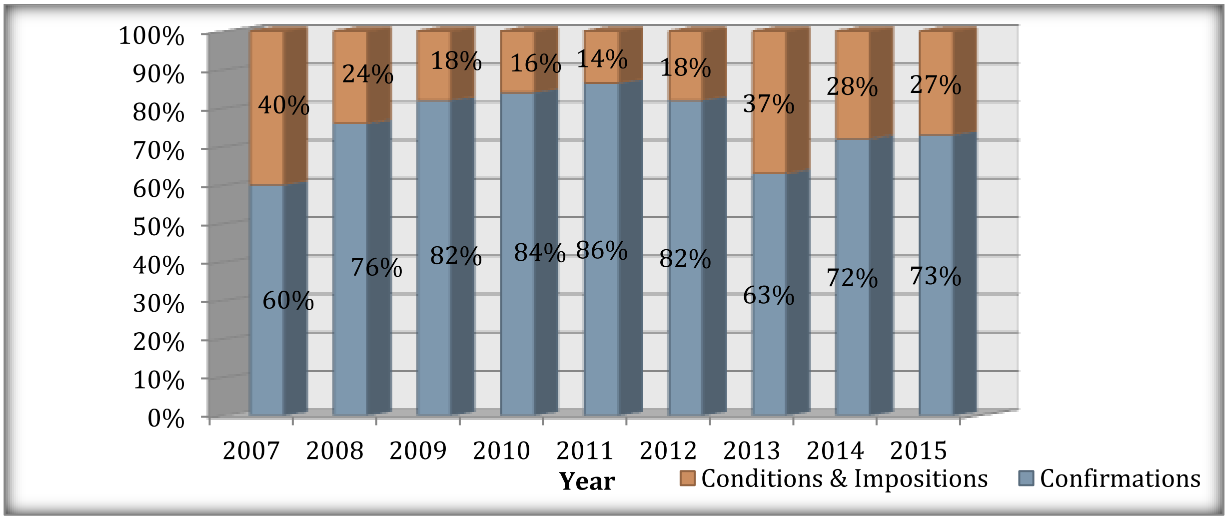
At the final stage of the QAU visit, a summary document of the findings identified during the course of the visit is prepared by the QAU reviewer. The statutory auditor or firm is given fourteen days to respond to this document, which is known as the Closing Meeting Notes. On receipt of the statutory auditor's or firm's responses to this document, a report is prepared for the consideration of the QAOC based on the findings identified during the QAU visit and responses received from the statutory auditor or firm in the Closing Meeting Notes.

As in past years, these reports are then categorized for internal purposes into ratings which are determined by the instances and magnitude of non-compliance with the relevant regulations, the level of commitment and ability of the statutory firm/auditor to correct the problems identified and the regulatory action, if any, which the QAOC considers should be applied. In its closing down letter to statutory auditors and firms, the QAOC communicates the sanctions, impositions or any other corrective action, which the QAOC deems appropriate.

The QAU is presently well in its second cycle for non-PIE statutory auditors and firms, and closed the third cycle for PIE statutory auditors and firms. Again the type and gravity of the findings noted during the reviews were fairly consistent with that of prior year. By the end of the year, the QAOC had asked statutory auditor/firms on 73% (2014: 72%) of visits for confirmations only of future compliance with breaches identified.

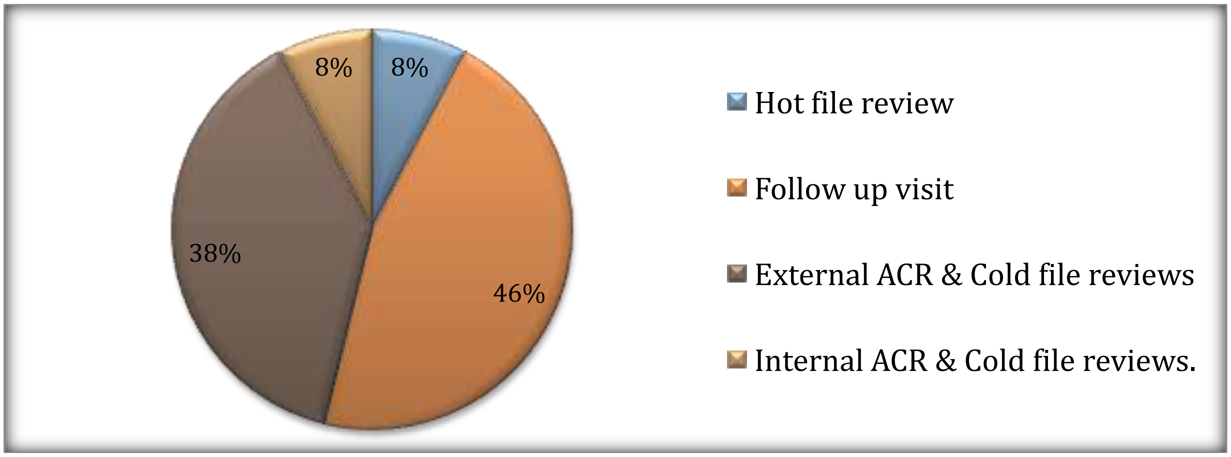
Conditions including impositions such as follow-up visits, hot file restrictions, internal and external audit compliance reviews and external cold file reviews were sanctioned on 27% of statutory auditors/firms visited in 2015 when compared to 28% in 2014. An analysis of the courses of action taken by the QAOC since 2007 is illustrated in the diagram below:-

Analysis of courses of action taken since 2007



Conditions address the reasons for the non-compliance, provide protection to the statutory firm's/auditor's clients and provide a means whereby QAOC can monitor that the statutory firm/auditor has carried out its undertakings. During 2015, the sanctions imposed on poorly performing audit practices can be analysed as follows:

Analysis of sanctions imposed by the QAOC in 2015



The number of conditions and impositions imposed since 2007 amounted to 55 and these can be analysed as follows:

Analysis of sanctions issued by the QAOC since 2007

	Follow-up visits	External ACRs & cold file reviews	Hot file restrictions
PIE Statutory Audit Firms	3	0	1
Non-PIE Statutory Audit Firms	4	8	0
Full-time Statutory Auditors	6	15	5
Part-time Statutory Auditors	4	6	3
Total	**17**	**29**	**9**

On average, 17% of the inspections visits carried out to date were subject to one form of sanction or another. Of this, 1% relates to statutory auditors and firms of PIEs which is equivalent to 13% of the total PIE inspection visits carried out to date.

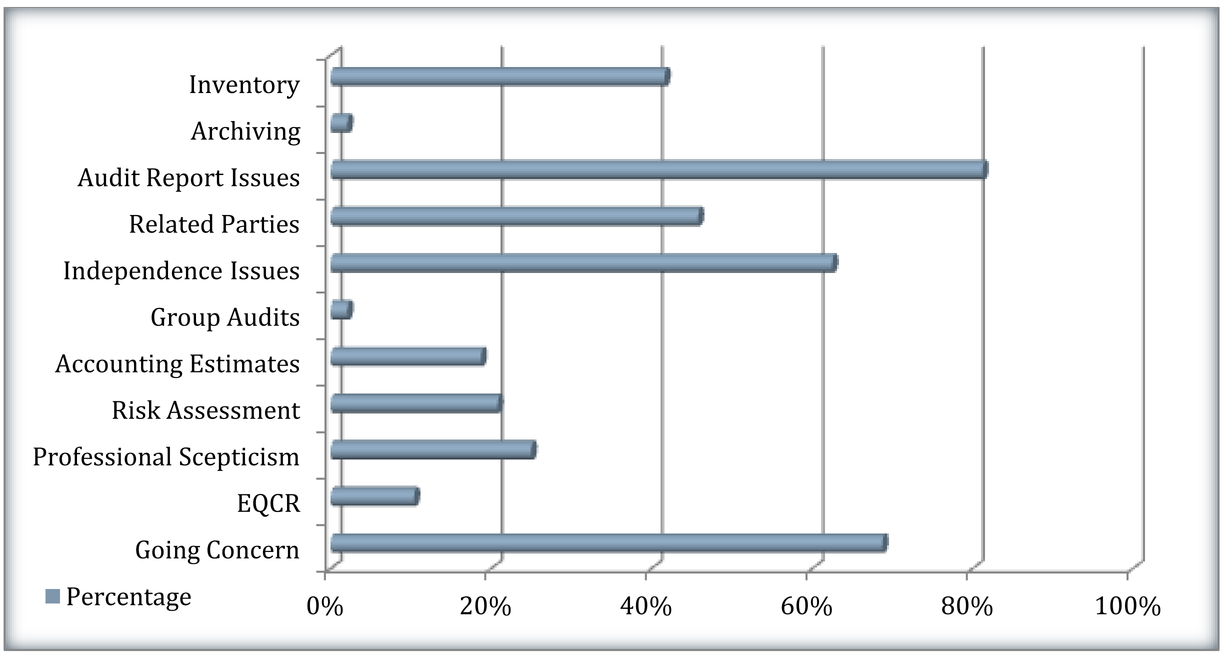
Section 2.5 – Key observations from 2015 inspection findings

This section summarizes the areas in which the most common weaknesses were noted and which require improvement based on the findings identified during the quality assurance visits carried out throughout 2015.

Due to the size, structure and the very nature of small, medium and micro entities our visit findings on these type of entities tend to be more basic and fundamental than those findings normally found in the audits of the larger entities, some of which may or may not be public interest entities.

A summary of the main findings emanating from all files reviewed are presented below:

Analysis of audit findings of files reviewed by the QAOC in 2015



At year end, reports pertaining to seven inspection visits (including one PIE statutory auditor firm) carried out by the QAU during quarter 4 of 2015 were not yet approved by the QAOC at the time of presentation of this report. Thus findings identified during these visits have not been included in this report.

Findings identified during 2015 predominantly fell into three broad categories – Audit Engagement File Findings, Whole Practice Matters and Auditor Reporting issues, and have been segregated between non-PIE and PIE statutory auditors and firms.

Section 2.5.1 - Audit files findings noted on visits to "Non-PIE" audit practices

ISA 210 – Agreeing the terms of audit engagements

The most commonly identified pitfall during QA visits in relation to agreeing the terms of engagements was that the terms of engagement did not include identification of the applicable financial reporting framework for the preparation of the financial statements.

Another issue noted on a small number of visits was that the statutory auditor commenced the audit in spite of the pre-conditions of the audit not being satisfied, particularly where management impose a limitation of scope on the statutory auditor due to not carrying out the annual inventory count.

ISA 220 - Quality control for an audit of financial statements

Work papers on a number of files reviewed did not show evidence of the preparer and sign-off dates within audit working papers and date and sign-off of the engagement partner review. Dates of preparation should also be found when the audit is carried out by a statutory auditor with no audit staff who is involved on the engagement as otherwise there would be no track record on file of the dates of completion of audit work.

ISA 230 – Audit documentation

Documentation and evidence issues remained of concern as in previous years on a number of QA visits. Some small practices perceive and have identified to QAU reviewers that given their knowledge of their clients, it is unnecessary to document details of the client's background and audit work including risk assessment procedures carried out. Practices also often blame time pressure constraints to explain failures in audit documentation.

However, the type of relationship a statutory auditor has with a client and time pressures does not justify the overriding of ISA 230 requirements. The golden rule to audit documentation is that documentation must be sufficient to enable an experienced (third) statutory auditor to understand the audit procedures performed, the audit evidence obtained and any significant judgment applied.

ISA 240 – The auditor's responsibility relating to fraud in an audit of financial statements, ISA 250 – Consideration of laws & regulations in an audit of financial statements, ISA 560 – Subsequent events.

There were a number of practices who have not adequately addressed the following: fraud risk assessment, subsequent event review and an evaluation of laws and regulations that affect the company.

Furthermore, there are a number of practices that continue to fail to carry out some of the procedures required by ISA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", e.g. no presumption of risk of material misstatement due to fraud in revenue recognition, testing of journal entries and review of accounting estimates for management biases.

In addition, a number of cases were identified where there was failure to carry out fraud discussions within the engagement team.

ISA 260 – Communication with those charged with governance

It was noted that, in a number of instances, significant findings from the audit were not formally communicated with those charged with governance. In many cases the practice stated that significant findings were communicated verbally, however no minutes were kept on file evidencing this discussion and the responses received. In some instances, where the statutory auditor included an audit report modification, no documentation was found on file of the statutory auditor's communication in relation to the matter raised with those charged with governance.

ISA 300 – Planning an audit of financial statements

Planning is a crucial part of the audit, yet some issues identified during QAU visits were a result of lack of proper planning that addressed the company's risk and failure to understand the company and its environment. The major pitfall noted on visits, was that in many cases planning was standardised for all similar clients rather than assessing the risks of the company and its environment so audit procedures are designed accordingly. In the majority of the cases this may have led to extensive substantive testing that was very time consuming. The audit strategy at planning stage is meant to indicate the scope of the work highlighting high risk areas and identify the resources to be allocated to specific high risk areas in terms of experienced staff or hours and timing of work. A good audit plan helps audit teams to identify these key risk areas at an early stage so that audit work can be focused on these more risky areas.

ISA 320 – Materiality in planning and performing an audit

The calculation of materiality was another area which required improvement. Of particular concern was the fact that lack of documentation was identified in respect of the benchmark used to calculate the materiality levels to support the professional judgment applied in determining materiality. Performance materiality was also not determined on some audit engagements.

ISA 500 – Audit evidence

Findings often raise questions about the sufficiency and appropriateness of audit evidence. The reliability of information used as audit evidence is influenced by its source and nature and the circumstances under which it was obtained. In carrying out audit tests, many smaller practices still relied solely on documents generated by the client without giving due consideration to their reliability. Typical examples were (a) checking sales invoices/ service billings in transaction and cut-off tests; and (b) relying on ageing reports to assess recoverability of receivables and appropriateness of inventory provision.

Furthermore, confirmations and written representations provided by company directors may not be reliable forms of evidence. Typical examples were: (a) confirmations from the company's directors on the inventory balance at year end without attending the physical inventory count or performing any alternative procedures; and (b) confirmations pertaining to the cash balance at year end without carrying out cash count procedures.

ISA 501 – Audit evidence – specific considerations for selected items

The statutory auditor's inability to attend the year-end inventory count is one qualification which featured frequently on QAU files reviewed during the year. There were also a number of instances where the year-end inventory count was not attended by the statutory auditor or firm, and this was not because there was a limitation of scope imposed by management, nor because it was impractical to carry out the physical count. It was noted that the statutory auditor/firm, in these circumstances, chose not to attend the client's stock take due to time restraints or staff limitations. Unless it is impracticable to do so, the statutory auditor/firm is required to attend the inventory count, perform test counts and evaluate and observe management's count procedures. Resorting to modifying the audit report, unless it is impracticable to attend the inventory count which is specifically described by ISA 501 – Audit evidence – Specific considerations for selected items is not permitted.

Where a scope limitation is truly imposed by a client, practices should also consider the other audit procedures required by ISA 501 and not simply issue a qualified audit opinion.

ISA 520 – Analytical procedures

In some instances, it was noted that analytical procedures were not carried out. However in the majority of breaches identified it was noted that no explanations for material fluctuations were documented to identify the potential risk areas. This was of particular concern at the planning stage. This is a clear indication that analytical reviews are not being used to help identify risk areas.

ISA 550 – Related parties

From the audit files reviewed, it was noted that, in a number of instances, the audit engagement team did not adequately identify and document related parties as part of the statutory auditor's understanding of the entity being audited. This may have led to related party transactions not being identified during the course of the audit and inappropriate disclosures being made in the financial statements. Thus more effort is required in this regard.

ISA 570 – Going concern

Going concern continues to be an area where the QAU, in a number of instances, has had different views from statutory auditor and firms in respect to the use of the going concern emphasis of matter paragraph found in a number of audit reports issued. ISA 570 clearly sets out guidance in its application material as to how and when such emphasis of matter should be used and this goes far beyond than just exercising professional judgement. An emphasis of matter paragraph should only be used when the statutory auditor/firm concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists. The statutory auditor/firm is then required to ensure appropriate disclosure is found in the financial statements being audited.

During the planning stage, as part of the statutory auditor/firm's understanding of the entity, the statutory auditor/firm should consider if the going concern assumption is appropriate or whether there are events or conditions and related business risks which may cast significant doubt on the entity's ability to continue as a going concern. As in prior years, although some statutory auditors and firms have invariably stated that the material uncertainty considerations had been addressed at planning, fieldwork and reporting stage, this was either inappropriately documented or not documented at all.

Although management is responsible to assess its ability to continue as a going concern, it is the statutory auditor/firm's responsibility to obtain sufficient appropriate audit evidence about the appropriateness of management's assertion of the going concern assumption and to conclude whether there existed a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern at the time of signing of the audit report. The emphasis here is on the words "material" and "significant". When either or both do not prevail, the statutory auditor or firm should issue a clean auditor's report. In a significant number of files reviewed during the QA visits it was noted that the statutory auditor/firm included an emphasis of matter paragraph in the auditor report although the documentation within the audit file suggested that a "material" or "significant" uncertainty in respect to going concern did not exist.

In determining whether or not to use an emphasis of matter paragraph, it is vital that the statutory auditor/firm assesses whether or not there is a material uncertainty. It was noted that in a number of instances an emphasis of matter paragraph was included in the auditors' report, even when, it was clearly documented in the audit file itself that no material uncertainty existed.

However once the statutory auditor/firm identifies that the going concern assumption is appropriate but a material uncertainty exists, the statutory auditor/firm, before including an emphasis of matter paragraph in the auditor's report, is required to ensure that the financial statements include adequate disclosure such that they:

(a) Adequately describe the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and

(b) Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business.

During the course of a number of visits carried out during the year, it was noted that although an emphasis of matter paragraph was being included in the audit report, adequate disclosure was not found in the financial statements. In this regard, the statutory auditors and firms failed to modify the auditor's report for inadequate disclosure made in the financial statements. Statutory auditors and firms are reminded that in such cases, ISA 570 requires the statutory auditor/firm to express a qualified or adverse opinion as appropriate and is required to state in the auditor's report that there is a material uncertainty that may cast significant doubt about the entity's ability to continue as a going concern.

Although the QA reviewers are conscious of the fact that this is an area of professional judgement and that the statutory auditor/firm would have an in-depth understanding of their audit client, the audit files in a number of instances did not contain sufficient documentation to support the audit opinion given.

Section 2.5.2 - Whole practice matters noted during visits of "Non-PIE" audit practices

ISQC 1 - Quality control for firms that perform audits and reviews of financial statements, and other assurance and related services engagements

Most statutory auditors and firms have adapted to the requirement to maintain documented quality control policies and procedures and the results for the current year indicate this trend is continuing. However, practice reviews continue to find that many smaller practices still do not have quality control policies and procedures to the extent required by ISQC 1. Deficiencies include:

a) Quality control policies and procedures did not cover all of the six elements of quality control set out in ISQC 1; and
b) The quality control policies and procedures had not been tailored to suit the practice's own circumstances, which resulted in inconsistencies between policies and procedures set out in the quality control manual and those which are applied in practice.

Commonly, statutory auditors and firms need to refine their quality control systems by improving aspects of their documentation. ISQC 1 applies to practices of all sizes. However, the level of sophistication and complexity of quality controls necessary to meet the requirements of ISQC 1 will be far less for smaller practices than bigger ones with a higher risk client base. Each statutory auditor and firm should establish quality control policies and procedures that address all the elements required by ISQC 1 and that are suitable for its size and operating characteristics. Statutory auditors and firms should appreciate that having appropriate policies and procedures in place will enhance quality of audit work.

Directive 2 – Code of ethics

Independence issues were raised on a few of the statutory auditors and firms we visited. These ethical issues related primarily to close business relationships, familiarity threats and self-review threats.

Section 2.5.3 - Audit report issues noted on our visits to Non-PIE audit entities practices

During quality assurance visits carried out throughout 2015, the large part of weaknesses identified in respect to audit reports reviewed, were a result of statutory auditors and firms using outdated wording in the audit report and inappropriate headings or omission of headings. In the QAU's view such weakness should be relatively easy to address and statutory auditors and firms are encouraged to refer to the illustrative audit reports found in ISA 700 (Forming an opinion and reporting on financial statements), ISA705 (Modifications to the opinion in the independent auditor's report) and ISA 570 (Going concern).

Section 2.5.4 – Audit file findings noted on the visits of audit firms carrying out PIE audits

The following PIE statutory audit firm inspection findings emanate from QAOC reports approved during 2015 and thus these findings pertain to 3 network statutory audit firms (of which 2 are Big 4 statutory audit firms) and 2 other mid tier statutory audit firms which are not associated with an international network. The findings identified relate to both audit files of PIE and non-PIE entities.

ISA 220 – Quality control for an audit of financial statements

On two particular audit engagements within the same PIE statutory audit firm, there were no audit work papers addressing client continuance procedures.

In respect to another statutory audit firm visited, it was noted that the engagement partner did not ensure that timely sign-offs were made in the audit file at both planning and completion stages of the audit. Such sign-offs were made subsequent to the audit report date.

On another particular audit file it was noted that the manager's sign-offs were dated four months after the audit report date. As a result, this audit file was not archived within sixty days from the audit report date.

In the case of one regulated entity, although the audit underwent an EQCR review, no documentation was found of this review on file. Furthermore, on another file, based on the criteria found in the statutory audit firm's ISQC 1 manual, an EQCR should have been carried out, however no EQCR was in fact carried out by the statutory audit firm.

ISA 230 – Audit documentation

A number of documentation issues were noted at the audit fieldwork stage. Some of the findings noted on the audit files reviewed were:

- No documentation was found on how the firm obtained audit comfort on the recoverability of debtors;
- The professional judgment used to assess the reasonableness of valuation from an expert was not documented; and
- There was no documentation as to how the statutory audit firm dispelled doubts on any possible management bias by an architect appointed by the client.

ISA 250 – Consideration of laws and regulations in an audit of financial statements

On a PIE audit, the engagement team did not carry out procedures to ensure that the fund was in compliance with the requirements of the Investment Services Regulation.

During the visit to another statutory audit firm, it was noted that on one of the files reviewed although some laws and regulations pertaining to the entity were identified, there were others which had not been specified.

ISA 260 – Communication with those charged with governance

Weaknesses in respect to communication with those charged with governance were noted on two quality assurance visits to PIE statutory audit firms. On one file, it was noted that the management letter did not include as a management letter point that the company did not obtain a land valuation for a number of years. On another audit file, the statutory audit firm did not include within the management letter reference to the audit report modification being proposed.

ISA 500 – Audit evidence

A number of evidence issues were noted at the audit fieldwork stage. On two audits of non-PIEs, no detailed substantive testing was carried out in relation to revenue to determine that this balance was not materially misstated.

ISA 501 – Audit evidence – specific considerations for selected items

On two files pertaining to two statutory audit firms, even though the inventory balance was material at year end, the inventory count was not attended by a representative of the statutory audit firm.

ISA 520 – Analytical procedures

On two audit files of two different non-PIE entities, there were no explanations documented of the variances resulting from preliminary analytical procedures.

ISA 530 – Audit sampling

On two non-PIE audit files audited by the same PIE statutory audit firm audit sampling methodologies were not documented.

ISA 550 – Related parties

In respect to a number of audit files pertaining to one PIE statutory audit firm, it was noted that a completed list of related parties were not documented on file.

ISA 580 – Written representations

The representation letter found in a particular audit file of a non-PIE entity did not include a representation that the director had fulfilled (rather than acknowledged) its responsibility for the preparation and fair presentation of the financial statements.

ISA 600 - Special Considerations—Audits of group financial statements (including the work of component auditors)

On a PIE audit, while the statutory audit firm was the auditor of all components of the group, no documentation was found that materiality of the group was the same as that of the parent; all components were material to the group; risk assessment was done at the component level and was to be used as the group risk assessment and of the overall group strategy.

Section 2.5.5 – Whole firm matters noted on the visits of statutory audit firms carrying out PIE audits

ISQC 1 - Quality control for firms that perform audits and reviews of financial statements, and other assurance and related services engagements

In respect to one mid-tier statutory audit firm, it was noted that both ACRs and cold file reviews were not being carried out on an annual basis as recommended by the QAOC in guidance which it had issued.

Furthermore, it was noted, that although another statutory audit firm was carrying out an ACR this did not include a review of the statutory audit firm's system of quality control.

Directive 1 - CPE

It was noted, on one of the mid-tier statutory audit firms visited that CPE compliance was not adhered to by two of its staff members who are warrant holders.

Directive 2 – Code of ethics

Documentation of independence considerations, including consideration of provision of non-assurance services and long association for non-PIE audit entities, required improvement. In respect to one particular statutory audit firm, policies and procedures in relation to the provision of non-assurance services by the statutory audit firm or its connected undertakings were not documented in the statutory audit firm's policies and procedures manual.

In respect to one network statutory audit firm, it was noted that payroll services were being provided to a PIE audit client by the statutory audit firm.

Also, during the visit to one particular statutory audit firm, a close business relationship was identified. In this instance, an audit was carried out on a company owned by an individual who owned another company together with the engagement partner.

Section 2.5.6 – Audit report issues noted on the visits of statutory audit firms carrying out PIE audits

The ultimate controlling party was not disclosed in the financial statements for a professional investor fund. The auditors' report was not qualified in respect of such non-disclosure. The identity of the ultimate controlling beneficiary was also not disclosed in the auditor's report.

On a number of audit files of different PIE statutory audit firms, going concern considerations made by the statutory audit firm are still being raised by the QAU. Statutory audit firms have argued that they included an emphasis of matter paragraph on the basis of ISA 706, stating that the objectives of the emphasis of matter paragraph was to draw the attention of readers of the financial statements, to management's disclosures in regard to the entity's going concern capabilities, simply on the basis of its magnitude and importance. However, ISA 706, specifically caters for situations other than those pertaining to going concern situations, which latter circumstances are dealt with under ISA 570.

Section 3 – Summary of activities carried out by the Quality Assurance Unit during 2015

Section 3.1 – Team meetings

Two local team meetings were held by the Quality Assurance Unit during the year, in June and September 2015. The June meeting enabled the reviewers to discuss topical issues arising from visits. The meeting in September was chaired by the Chairman of the Quality Assurance Oversight Committee who updated the QAU members on the latest developments at Accountancy Board level.

Section 3.2 – Attendance and participation in meetings of the European Audit Inspection Group ('EAIG') and its sub-groups

Malta is a founder member of the EAIG and the QAU has participated very actively within this audit inspection group whose primary purpose is to create an awareness of important issues and promote cooperation and consistency amongst European audit regulators on Quality Assurance inspections.

The EAIG also had ongoing discussions with four of the largest audit networks in Europe. It has set up specific work groups for each of these networks at which meetings, findings emanating from inspections carried out across Europe are discussed. Malta participated in two of these sub-groups, namely PwC and Deloitte.

The work of these sub groups were discussed at EAIG plenary meetings. Top officials of the respective international network statutory audit firms were invited to attend plenary meetings set for this purpose. These meetings with the larger networks focused on a root cause analysis of the findings noted during inspections and the remedial action to be taken by the respective network statutory audit firms to address the findings noted. Malta participated in three meetings during 2015. These were held on 25 & 26 March in Budapest, 23 & 24 June in Warsaw and 27 & 28 October in Malta.

Section 3.3 – The Quality Assurance Unit ('QAU') host European Audit Inspection Group ('EAIG') plenary meeting in Malta

On the 27 and 28 October 2015, the Quality Assurance Unit hosted the 16th plenary meeting of the European Audit Inspection Group ('EAIG'). 57 delegates representing audit regulators from 29 European jurisdictions within the EU and the EEA attended this event. The plenary meeting was spread over two days.

The agenda of the plenary meeting included a mix of informative discussions amongst delegates representing audit regulators in other EU members' states and presentations by standard setters.

The meeting was addressed by Professor Edward Professor Scicluna, Minister for Finance, and was chaired by the German Auditor Oversight Commission ('AOC').

Representatives from the International Auditing and Assurance Standards Board ('IAASB') and the International Ethics Standards Board for Accountants ('IESBA') joined the meeting on the first day and updated the EAIG on their current work streams and on how comments raised by regulators have been taken into account in their processes.

Section 3.4 – Inclusion of PIE inspection findings in a European database on audit inspection findings

The European Audit Inspection Group ('EAIG') maintains a non-public database, which contains inspection findings in relation to the ten largest European statutory audit firm networks. The purpose of the database is to share inspection practices and findings amongst its members and facilitates discussions on topics related to audit inspections with standards setters. The scope of this dialogue is that of promoting audit quality. The database is used by the EAIG to identify common issues in relation to particular networks or the application of particular standards by statutory audit firms in practice. This contributes to the on-going dialogue of the EAIG with the audit networks and the audit standard setters.

Findings and whole firm matters pertaining to local PIE statutory audit firms inspected during 2015 were included within this database.

Section 3.5 – Implementation of the first phase of Common Audit Inspection Methodology ('CAIM') project.

An important milestone for the EAIG in the past two years was the Common Audit Inspection Methodology ('CAIM') project, which project, as its name suggests, seeks to harmonise inspection methodologies amongst all EU member states and EEA countries. In November 2014, the EAIG members adopted the first suite of common work programmes for the inspection of statutory audit firms' internal quality control procedures.

The first phase of the project, which is wholly ISQC 1 related, was launched towards the end of last year. This sought to synchronise ISQC1 methodologies being applied by European audit regulators to assess the propriety of the whole firm quality control procedures adopted by statutory audit firms auditing Public Interest Entities. Phase One of the CAIM project was fully implemented this year in the inspection of one of the Big Four statutory audit firms and partially implemented on the inspection of another PIE statutory audit firm.

The initiation of Phase Two of the CAIM project pertaining to the quality of audit files was launched at the Malta meeting. EAIG members will now develop common work programmes on selected areas of audit engagement reviews. These work programmes, which have been developed on the basis of the EU Directive on Statutory Audit and the International Standard for Quality Control, will contribute to the harmonization of the inspections of statutory audit firms across Europe.

Section 3.6 – Maintaining a close working relationship with the Malta Institute of Accountants

Over the years, the Malta Institute of Accountants ('MIA') and the Quality Assurance Unit ('QAU') have fostered a close working relation. Both members of the MIA and the QAU have participated in the Audit Directive Transposition working group which was set up under the auspices of the Accountancy Board.

This year the QAU contributed to the winter issue of the MIA journal – the Accountant. The article gave a brief insight of what had happened during the 16th plenary meeting of the European Audit Inspection Group ('EAIG') hosted in Malta.

The QAU was also represented on a number of MIA committees dealing with areas such as Continued Professional Education, Ethics, Accounting and Audit.

Section 4 – Outlook for 2016

The Quality Assurance Unit, through the support of the Accountancy Board, looks forward to the challenges ahead of it particularly in relation to:

- The appointment of Head of Quality Assurance Unit;
- The transposition of the changes brought about by the revised Statutory Audit Directive by 17 June 2016;
- The implementation of Phase 1 of the Common Audit Inspection Methodology ('CAIM') on the inspection visits of all PIE statutory audit firms;
- Assistance to the European Audit Inspection Group ('EAIG') in the development of Phase 2 of the CAIM project and its implementation on inspection visits of PIE statutory audit firms;
- Maintain and further develop the existing Quality Assurance Unit methodology based on developments emerging from the transposition of the Audit Directive; and
- Continuance of on-going co-operation with the MIA.

Acronyms used

AB - Accountancy Board

ACCA - Association of Chartered Certified Accountants (UK)

AuRC - Audit Regulatory Committee

BCBS - Basel Committee Banking Supervisors

CPE - Continued Professional Education

CAIM - Common Audit Inspection Methodology

EAIG - European Audit Inspections Group

ECG - European Contact Group

EEA - European Economic Area

EFAA - European Federation of Accountants and Auditors for SMEs

EGAOB - European Group of Audit Oversight Bodies

ESMA - European Securities and Markets Authority

FEE - Federation Experts Comptables Europeens

GAPSE - General Accounting Principles for Smaller Entities

IAASB - International Auditing and Accounting Standards Board

ICAEW - Institute of Chartered Accountants of England and Wales

IFAC - International Federation of Accountants

IFIAR - International Forum of Independent Audit Regulators

ISAs - International Standards on Auditing

ISQC 1 - International Standard on Quality Control

MIA - Malta Institute of Accountants

PIE - Public Interest Entity

QA - Quality Assurance

QAU - Quality Assurance Unit

QAOC - Quality Assurance Oversight Committee

SME - Small and Medium Entities

SMP - Small & Medium Practices

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