

2020

Audit Quality Unit

Report on 2019 quality assurance review of EY

March 2020

Mission

To contribute to Ireland having a strong regulatory environment in which to do business by supervising and promoting high quality financial reporting, auditing and effective regulation of the accounting profession in the public interest.

About IAASA

The Irish Auditing and Accounting Supervisory Authority ('IAASA' or 'the Authority') is designated as the competent authority¹ in Ireland responsible for quality assurance reviews of statutory auditors and audit firms that carry out statutory audits of public-interest entities (audits of PIEs).

The Authority accepts no liability and disclaims all responsibility for the consequences of anyone acting or refraining from acting in reliance on the information contained in this report or for any decision based on it.

Guide to reports on quality assurance reviews

The Authority has published a guide to assist readers in understanding reports on quality assurance reviews of audit firms. The guide sets out what users can expect from the quality assurance review reports and explains how the quality assurance review process drives the form and content of these reports and can be accessed [here](#).

¹ Audit reform legislation requires the designation of a competent authority in each member state. Audit reform legislation comprises EU Regulation 537/2014 and Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 [OJ No. L 157, 9.6.2006, p.87] on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC, as amended by Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 [OJ No. L 158, 27.5.2014, p.196] amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts. The Directive is transposed into Irish law in the Companies Act 2014.

1. Introduction

Overview of EY (the Firm) and the outcome of the quality assurance review

The Firm



5
Offices in Dublin, Cork, Limerick, Galway and Waterford



123
Audits of public-interest entities in 2019



28
Audit partners



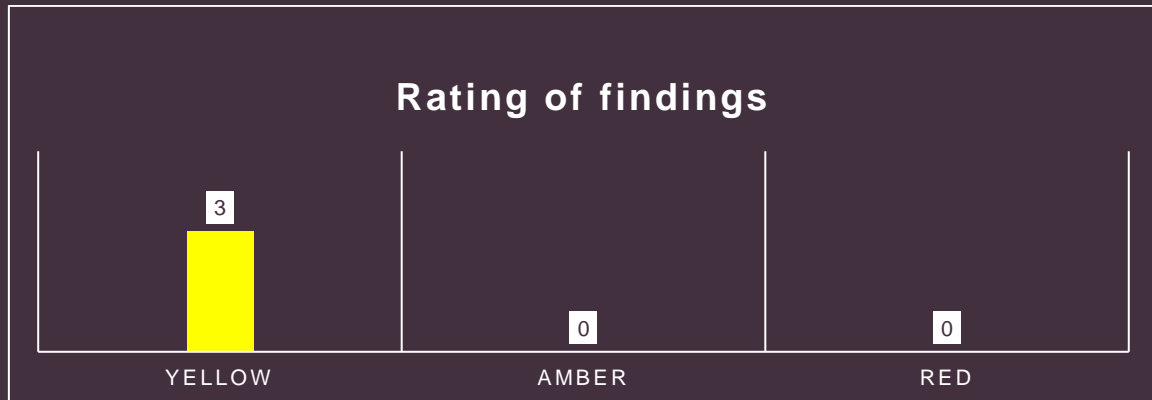
23.9%
Market share based on audit fees associated with public-interest entities in 2019



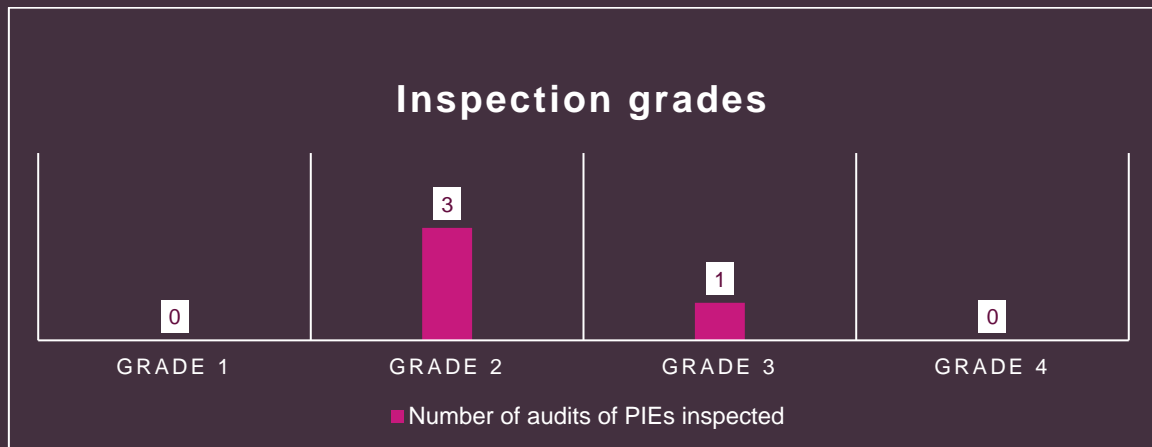
863
Personnel working in the audit function

The review

The Firm's system of quality control



Audits of PIEs



1.1. Contents of this report

This report documents the findings and recommendations from the Authority's quality assurance review of the Firm, which took place in 2019.

Where improvements are required in the design and/or implementation of the Firm's system of quality control, this report details those findings and sets out the Authority's recommendations for the Firm. This report also provides a summary of the four audits of PIEs inspected as part of the quality assurance review and discloses the grade that has been assigned to each of the audits inspected.

This report also sets out the Authority's conclusions on whether actions have been taken by the Firm to implement the recommendations made by the Authority in the first quality assurance review.

2. Quality assurance review explained

The purpose of a quality assurance review is to assess the effectiveness of the Firm's system of quality control. This involves an assessment of the design of the system of quality control, performance of compliance testing around the implementation of the Firm's processes and procedures, together with inspection of a sample of audits of PIEs. The quality assurance review is not designed to identify all weaknesses which may exist in the Firm's policies and procedures or in the implementation of those policies and procedures.

The assessment of the design of the Firm's system of quality control involves a review of the Firm's policies and procedures together with consideration of the impact of deficiencies identified, if any, on audit quality. Performance of compliance testing involves a review of evidence to corroborate the implementation of the Firm's policies and procedures.

The sample of audits of PIEs is selected on a risk basis, selecting audits which have particular complexities as well as ensuring that audits of varying sizes are selected. The sample is not a representative sample and therefore results cannot be extrapolated to make inferences about audits not inspected. An inspection of an audit involves review of the sufficiency and quality of audit evidence across a number of selected audit areas.

3. Scope of the quality assurance review of the Firm

The assessment of the Firm's system of quality control involves review of 13 areas over a three year period. The quality assurance review which took place in 2019 assessed the design of the system of quality control in the following areas:

- Tone at the top
- Partner and staff evaluation and compensation
- Engagement quality control
- Offshoring

For each of the four areas reviewed, the Authority assessed the Firm's policies and procedures and performed compliance testing.

Further to this, a sample of four audits of PIE were selected for inspection. The following areas were reviewed as part of each audit inspection:

- Audit planning
- Communications with the audit committee, or equivalent
- Completion areas

Certain additional areas were selected at the discretion of the Authority, taking into consideration specific risks pertaining to the audit as well as other areas of focus for the Authority.

4. Overall view on the Firm's audit quality

There were three minor deficiencies identified in relation to the effectiveness of the design or implementation of the Firm's system of quality control arising from this review.

Three audits of PIEs inspected were assigned a grade of 2 (limited improvements required). One audit of a PIE inspected was assigned a grade of 3 (improvements required).

For each finding, the Authority follows up to ensure the recommendation is implemented within twelve months. Where the recommendation is not satisfactorily implemented, the Authority refers the matter to its enforcement team.

Further details on the results of the quality assurance review are set out in section 5. A description of ratings and grades is set out in the Appendix.

5. Results of the quality assurance review

Overview of areas reviewed

Tone at the top

The purpose of testing in this area is to ensure that the senior leadership of the Firm communicates effectively that audit quality is of significant importance in the Firm. In order to assess this, the Authority interviews those holding key leadership positions in the Firm and reviews communications issued in relation to audit quality and strategy in general. This testing also includes a review of audit tender documentation and an assessment of whether the communications made at the audit tender phase are consistent with the audit work that is subsequently performed.

The Authority noted that audit quality was consistently communicated as being of vital importance. The Firm seeks to foster a culture of consultation and encourages open dialog within the audit function. Further, the Firm was cooperative and all information requested during the review was provided.

The Authority has no findings or recommendations in this area arising from the 2019 review.

Partner and staff evaluation and compensation

The testing in this area involves understanding the policies and procedures around the evaluation and compensation of partners and staff and assessing compliance with these policies and procedures by selecting samples of appraisals for both partners and staff and reviewing these against changes in compensation in order to ensure that audit quality is reflected in compensation.

The Authority noted that the processes and procedures in place for partner performance evaluation, and the approval of compensation were extensive. Documentation was provided to the Authority to evidence these processes and procedures, including how audit quality was considered as part of the partner appraisal and remuneration process. The Authority has no findings or recommendations in the area of partner evaluation and compensation. The Authority identified an issue regarding the evaluation of audit staff.

Full details of this finding and recommendation are contained below. (Finding 1)

Engagement quality control

The testing in this area seeks to understand the policies regarding the Firm's engagement quality control (EQC) reviews, which form part of the Firm's overall quality programme. The testing involves selecting a sample of engagements to review for compliance with those policies.

The Firm has a policy in place relating to EQC reviews, whereby a second partner performs an independent review of an audit in advance of the audit engagement partner signing the auditor's report, with the aim of ensuring that the engagement has been carried out to a high level of quality.

The Authority selected a sample of ten audit engagements for testing in this area. For each of the ten engagements, there was evidence of the EQC review being completed in accordance with the Firm's own policy. For each of the ten audit engagements selected for testing, there was evidence of the EQC reviewer being involved throughout the audit, from the planning stage through to the completion stage. The Authority identified an issue regarding the Firm's policies for certain special purpose vehicles (SPVs).

Full details of this finding and recommendation are contained below. (Finding 2)

Offshoring

The Firm engages offshored teams from a member firm to assist in specified audit procedures and audit support services. The testing in this area seeks to understand the policies regarding the Firm's use of offshoring as part of the audit engagement team.

In addition to reviewing the policies in place regarding the Firm's offshoring of audit work, the Authority tested compliance with independence and training policies for a sample of ten offshored staff. For a sample of five audit engagements, the Authority reviewed the interaction with the offshore engagement team to understand the extent of their participation in the audit, their level of knowledge of the audit client, the communication between the Irish team and the offshore engagement team, and the extent of the review procedures performed by the Irish team.

The Authority identified an issue regarding the implementation of the Firm's policies in this area.

Full details of this finding and recommendation are contained below. (Finding 3)

Findings and recommendations on the Firm's system of quality control

Area	Significance rating	Background	Issue	Recommendation
Tone at the top	N/A	The Authority has no findings or recommendations in this area arising from the 2019 review.		
1. Partner and staff evaluation and compensation – staff appraisals	● Yellow	<p>Legislation requires audit firms to have remuneration policies that provide sufficient performance incentives to secure audit quality.</p> <p>Staff are assigned a performance outcome on a periodic basis throughout the year. The “performance outcome” is based on feedback, training attendance, quality results and other factors and is finalised in meetings of the appraiser group.</p> <p>The Authority selected a sample of ten audit staff and reviewed the documentation supporting their performance outcome.</p>	<p>The continuous feedbacks on staff performance were not sufficiently detailed to determine how audit quality was assessed. There was insufficient evidence retained from meetings of the appraiser group to demonstrate the degree to which audit quality was taken into account.</p>	<p>The Authority recommends that the Firm retains sufficient evidence to demonstrate how audit quality is assessed for audit staff and how this assessment impacts the performance outcome assigned.</p>
2. Engagement quality control – application of EQC procedures	● Yellow	<p>International Standard on Quality Control (ISQC) 1 requires audit firms to establish policies and procedures that require the EQC review to include: discussion of significant matters with the engagement partner; review of the financial statements; and review of selected engagement documentation relating to significant judgements.</p> <p>The Firm's policies set out that where there are certain related SPV entities (not regulated by the Central Bank of Ireland or equivalent authority that have issued debt instruments which are listed on a stock exchange but are not actively traded) with common features, a "house approach" can be applied. Under the house approach, an EQC reviewer reviews all planning, audit strategy, summary review and consultation documents that are prepared for the group of engagements. The EQC reviewer reviews the financial statements for a sample of engagements within the group, reviewing a minimum of one set of financial statements annually.</p>	<p>The Firm's policies fail to require all EQC reviews of audits of PIEs to include a review of the financial statements.</p> <p>For two audit engagements in the sample of ten reviewed, there was insufficient evidence of the extent of the EQC review of key audit workpapers and judgements made or the conclusions reached by the EQC reviewer. There was also no evidence that the EQC reviewer had reviewed the audit work papers supporting the key audit matter for one of these two engagements.</p>	<p>The Authority recommends that the EQC policy is updated to require an EQC review of the financial statements for all audits of PIEs.</p> <p>The Authority further recommends that the Firm amends its EQC policy to ensure that audit files evidence EQC review procedures that are specific to each audit.</p>

Area	Significance rating	Background	Issue	Recommendation
3. Offshoring – Communications and independence	● Yellow	<p>The Firm employs offshored teams to assist in the delivery of specific audit procedures on some audits. The Firm's policies require local teams to communicate with, supervise, review, and assess engagement performance of offshored teams as they do with members of the local team.</p> <p>The Firm's guidance sets out that where there is significant offshored involvement in an audit engagement and the offshored personnel are not in attendance at the planning meeting, there should be a separate communication of information that is relevant to the role that offshored team at the planning stage. This communication should be evidenced on the file.</p> <p>The Firm's policy also requires that offshore assurance professionals are subject to the same engagement specific independence confirmation requirements, regardless of their location.</p>	<p>In a sample of five audits that used offshored staff, four of these audits did not include sufficient evidence of communication of information that is relevant to the role of the offshored team at the planning stage.</p> <p>For three of five audits sampled, some offshored hours were completed by staff who were not identified as members of the engagement team and there was no evidence of their independence assessment on the audit file.</p>	<p>The Authority recommends that the audit file evidences communications between the local team and off-shored teams at the planning stage of the audit.</p> <p>The audit file should also evidence, where applicable, how offshored staff, performing work on an audit file, but not listed as part of the engagement team have been monitored and their independence assessed.</p>

Summary of audits of PIEs inspected

	Grade assigned	Summary of inspection
Audit one	2	In addition to audit planning, communications with the audit committee, or equivalent, and completion areas, this review assessed the audit work in relation to accounting estimates and journal entries. Audit work was generally of a good standard with some limited improvements required.
Audit two	2	In addition to audit planning, communications with the audit committee, or equivalent, and completion areas, this review assessed the audit work in relation to accounting estimates, revenue recognition and journal entries. Audit work was generally of a good standard with some limited improvements required.
Audit three	2	In addition to audit planning, communications with the audit committee, or equivalent, and completion areas, this review assessed the audit work in relation to accounting estimates and journal entries. Audit work was generally of a good standard with some limited improvements required.
Audit four	3	In addition to audit planning, communications with the audit committee, or equivalent, and completion areas, this review assessed the audit work in relation to accounting estimates, deferred tax, going concern and journal entries. Improvements are required to the audit going forward.

Key recommendations arising from the inspection of audits of PIEs

This table sets out the key recommendations arising from the inspection of audits of PIEs. These are recommendations that were deemed by the Authority to be key to an individual inspection or which are recurring across inspections. Not all recommendations apply to all audits of PIEs inspected and, equally, not all recommendations issued are included in this table.

Accounting estimates	<p>The Authority recommends that the audit file evidences the procedures performed to identify and evaluate the significant assumptions used by management in determining accounting estimates. The Authority further recommends that the audit file should clearly demonstrate the evaluation of whether the judgements and decisions applied throughout the estimation process, even if they are individually reasonable, indicate a possible bias on the part of the entity's management.</p> <p>The Authority recommends that the audit file evidences sufficient procedures to verify the completeness and integrity of the data used by management's expert in determining an accounting estimate.</p>
Communications with those charged with governance	<p>The Authority recommends that adequate evidence is retained of communications with those charged with governance. Where communications are made orally, a record should be retained of items discussed, who they were discussed with and the dates the discussions occurred.</p> <p>The Authority recommends that the engagement team ensures that evidence of communications with those charged with governance, including all mandatory disclosures, is included on the audit file.</p>
Control activities relevant to the audit	<p>The Authority recommends that the engagement team evidences their procedures to understand all of the controls in place throughout end-to-end processes for significant risks.</p> <p>The Authority recommends that the engagement team consider if it is satisfied that inquiry alone was sufficient to confirm that the controls were operating effectively during the remaining period of the year after the interim period controls were tested.</p>
EQC review	<p>The Authority recommends that the engagement team ensures that there is evidence of EQC review before the signing of the auditor's report for all relevant audit workpapers.</p>
Going concern	<p>The Authority, recommends that, where applicable, the engagement team provide detailed evidence to support the risk classification of the going concern assumption.</p> <p>The Authority further recommends that, where applicable, the engagement team more clearly evidence how the team's detailed minutes from relevant meetings were considered as part of the audit work performed on the going concern assumption.</p>
Group audits	<p>The Authority recommends that, the engagement team consider the professional competence of component auditors, whose audit work they plan to use.</p> <p>The Authority recommends that, where applicable, the engagement team ensures that the audit file includes sufficient evidence of how the engagement team reviewed and evaluated the work performed by the component auditor.</p> <p>The Authority recommends that, where applicable, the engagement team includes sufficient evidence in the audit file and that they satisfy themselves that the component team have obtained reliable audit evidence and that information produced by the entity was sufficiently complete and accurate.</p> <p>The Authority recommends that, where applicable, the audit file sufficiently evidences the engagement team's assessment of the component team's challenge of the auditor's specialist's results.</p> <p>The Authority recommends that, where applicable, the audit file sufficiently evidences how the engagement team reviewed and evaluated the work performed by the component auditor's specialist and includes sufficient evidence to demonstrate that sufficient and appropriate evidence was obtained from the work performed by the component auditors assessing the work performed by their specialist</p>

Journal entry testing	<p>The Authority recommends that the engagement team retains evidence of the inquiries made in respect of inappropriate or unusual activity relating to the processing of journal entries.</p> <p>The Authority recommends the engagement team retain sufficient evidence of assessment of management's explanations for samples of journal entries tested.</p>
Key audit matters	<p>The Authority recommends that the audit file sufficiently evidences the rationale for including key audit matters in the auditor's report and that this is consistent throughout the audit file.</p>
Management's expert	<p>The Authority recommends that the audit file clearly demonstrates the engagement team's understanding of the work of management's expert, including evidence of the resolution of any issues identified by the engagement team in evaluating the work of that expert and evaluation of the appropriateness of that expert's work.</p>
Materiality	<p>The Authority recommends that, where applicable, the audit file evidences the engagement team's conclusions that the audit procedures performed were sufficiently precise to address the final planning materiality.</p>
Work of specialist	<p>The Authority recommends that, the audit file sufficiently evidences the communications between the engagement team and the specialist.</p> <p>The Authority further recommends that, where applicable, the audit file sufficiently evidences the audit procedures performed by the engagement team to review and challenge the results of the procedures performed by the specialist.</p>

6. Results of follow up procedures

The Firm provided a written submission to the Authority within twelve months of the date of the report on the first quality assurance review. The reports on the first quality assurance reviews were not published. The submission set out details of the actions taken by the Firm to implement the recommendations made by the Authority. The Authority has reviewed this submission and notes that all recommendations were implemented within twelve months of the date of the report.

7. Purpose and limitations of this report

While the purpose of the quality assurance review is to assess the effectiveness of the Firm's system of quality control, the purpose of this report is to communicate any deficiencies identified through the quality assurance review and the recommendations arising.

This report is not intended to serve as a balanced scorecard or overall rating tool. Although this quality assurance review report may comment positively on certain items, this report is not designed to give a balanced analysis of all areas of the Firm.

Where an inspection of an audit of a PIE identifies an area where the Firm did not obtain sufficient audit evidence, this does not necessarily indicate that the audit opinion is inappropriate or that the financial statements are misstated. Furthermore, it would be inappropriate to infer that any issues identified in this quality assurance review report are replicated in audits which have not been inspected by the Authority.

Appendix – Detailed description of ratings and grades

Ratings

Findings arising in relation to the effectiveness of the design or implementation of a firm's system of quality control have their significance rated by way of a red-amber-yellow (RAY) system.

- **“Red”** indicates that a finding is a significant deficiency². Failure to implement a recommendation and/or remediation set out in a prior finding in relation to a firm's system of quality control, or, in relation to a matter arising from a PIE inspection is also likely to be assigned a red grading.
- **“Amber”** indicates that an improvement is required. This is a less than significant failure to:
 - meet the requirements of the ethical standards and international standard on quality control (Ireland) 1 (ISQC 1); or
 - apply a firm's processes or procedures.
- **“Yellow”** indicates that a finding is a minor deficiency. This is:
 - a minor failure in the application of a firm's procedures or processes; or
 - a low level deficiency that has the potential to develop into a significant or less than significant failure to meet the requirements of the ethical standards and ISQC 1.

Grades

Each of the audits of PIEs inspected as part of the quality assurance review is assigned a grade.

- 1 A **“1”** grade is a good audit with no concerns regarding the sufficiency and quality of audit evidence or the appropriateness of significant audit judgements in the areas reviewed. Any concerns are very limited in their implications (both individually and collectively).
- 2 A **“2”** grade is an audit with limited improvements required. There will be only limited concerns regarding the sufficiency or quality of audit evidence or the appropriateness of significant audit judgements in the areas reviewed. There may be some concerns but their implications (both individually and collectively) are limited.
- 3 A **“3”** grade is an audit with improvements required. There will be some concerns, assessed as less than significant³, regarding the sufficiency or quality of audit evidence or the appropriateness of significant audit judgements in the areas reviewed. There may be concerns, the implications of which (both individually and collectively) are less than significant.
- 4 A **“4”** grade is an audit with significant improvements required. There will be significant concerns regarding the sufficiency or quality of audit evidence or the appropriateness of significant audit judgements in the areas reviewed. There may also be concerns in other areas, the implications of which are individually or collectively significant.

2 A significant deficiency is a significant failure to meet the requirements of the ethical standards or ISQC 1; or, a pervasive failure to apply a firm's processes or procedures where there is more than a remote likelihood that the deficiency could affect the firm's independence or the quality of audits performed by the firm.

3 For audits of PIEs, four key factors will be considered in assessing “significance” of findings, these are as follows: the materiality of the area or matter concerned; the extent of any concerns regarding the sufficiency or quality of audit evidence (e.g. whether they relate to specific elements of the audit evidence only or are more pervasive to the overall sufficiency or quality of audit evidence in the areas concerned); whether appropriate professional scepticism appears to have been exercised in forming audit judgments; and the extent of any non-compliance with standards or the firm's methodology identified.



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