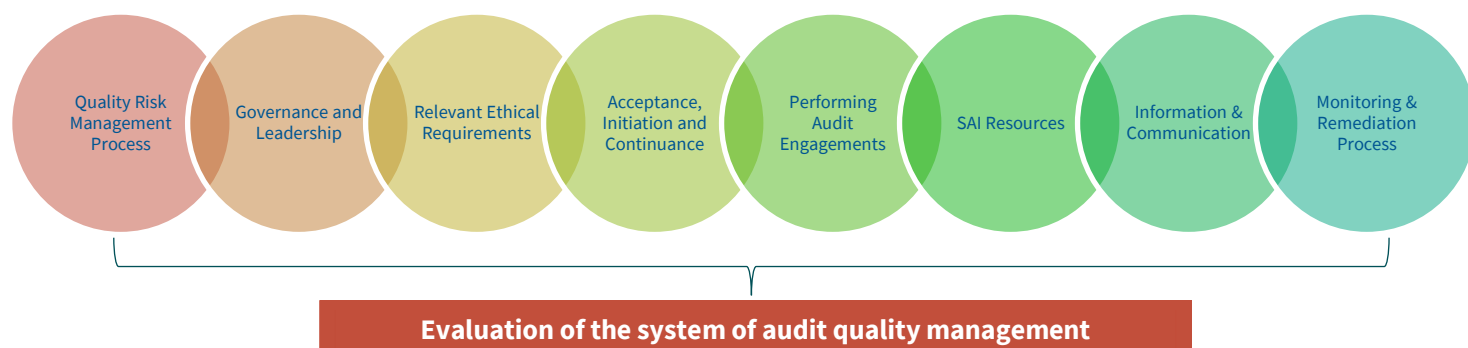


GUIDANCE 7: OVERVIEW OF THE EVALUATION



ISSAI 140 requires SAI to evaluate and conclude on the system of audit quality management. This responsibility rests with the individual with ultimate responsibility and accountability for the SoAQM (e.g. head of SAI). This individual may be assisted by other appropriate individual or group (e.g. those from the monitoring and remediation process; external experts). The Head of SAI considers the authority and the required level of knowledge about the SAI's quality management system as well as IFPP pronouncements in selecting such individual or group. Despite that other individuals may be involved, the responsibility over the evaluation process is retained by the individual with ultimate responsibility and accountability for the SoAQM.

The evaluation process is internal to the SAI, thus the results are only for the consumption of the SAI to further enhance the system of audit quality management, unless the legal and regulatory framework of the SAI requires the SAI to communicate the results of evaluation to external parties.

In performing the evaluation, the Head of SAI, or other qualified individual normally obtains information from the result of the SAI's monitoring process. Without the monitoring process, the evaluation will become burdensome to the Head of SAI or other qualified individual. Take note that similar with the monitoring process, the evaluation of the system covers all the components. Based on the evaluation, a conclusion is formed on whether the system of audit quality management provides reasonable assurance that its objectives are being achieved.

Frequency of evaluation

ISSAI 140 requires an annual evaluation of the system.

Procedures in Evaluating the System of Audit Quality Management

- 1 Accumulate all the relevant deficiencies.** The SAI accumulates all relevant deficiencies identified in the monitoring process and in any other assessment efforts in the SAI. The description of the deficiencies is listed in the suggested template.
- 2 Evaluate the severity and pervasiveness of the deficiencies at the individual level.** The SAI considers how the deficiencies affect the achievement of one or more quality objectives in assessing the severity. On the other hand, assessment of pervasiveness requires the SAI to understand the extent of the effect of the deficiencies. The SAI ticks the appropriate checkbox in the suggested template for the individual evaluation. The SAI may utilize some information from the assessment of severity and pervasiveness of deficiencies
- 3 Determine whether remedial actions are provided to address the deficiency.** Monitoring function often provides recommendations to address the deficiencies noted. Ineffective remedial actions or non-provision of remedial action suggests the need for improvement in the monitoring process. The SAI ticks the appropriate checkbox in the suggested template (i.e. with effective remedial action, remedial action is not effective, remedial action is not provided). When effective remedial actions are provided, such needs to be documented in the template.
- 4 Assess whether the effects of the deficiencies are corrected, if any.** The evaluation also considers the effects of the deficiencies. Some of the remedial actions mentioned above may take time to be implemented, thus, at the time of evaluation, some of these effects may not have been addressed for which the SAI needs to re-evaluate if additional actions are needed. During the period of evaluation, it is possible that the effect of the deficiencies may not have been manifesting yet. The corrective measures, if any, need to be documented in the template.
- 5 Evaluate the severity and pervasiveness of the deficiencies at the aggregate level.** It is possible that individually, the effect of deficiencies is not severe and/or pervasive but when aggregated with other deficiencies, the effect is severe and/or pervasive in the system of audit quality management as a whole. The monitoring and remediation process normally provides information on the severity and pervasiveness of deficiencies.
- 6 Conclude on the result of evaluation and identify further actions needed.** When the evaluation at the individual and aggregate level is that deficiencies are NOT severe AND pervasive, the first type of conclusion is selected. There may be instances that further action is still necessary if there are uncorrected effects of the identified deficiencies, though their implication to the system of audit quality management is not significant. When the effect of the deficiencies is severe but NOT pervasive, the second type of conclusion is selected. When the effect is BOTH severe and pervasive, the third type of conclusion is selected. For the second and third type of conclusions, further actions are mandatory which may need modification of the policies and procedures, and provision of remedial actions and/or correction of the effects of deficiencies. The SAI needs to undertake measures to expedite the implementation of the ongoing remedial actions, if any, or extend the coverage of its monitoring function to ensure that sufficient information will be obtained in the succeeding evaluation period. Take note that limited coverage of the monitoring may indicate deficiencies especially when the SAI policy clearly specifies the wide coverage of the function.

As mentioned, the evaluation procedures could reflect the following considerations:



Severity and pervasiveness of the identified deficiencies in the system of audit quality management. Severity refers to the significance or magnitude/gravity of the deficiencies, while pervasiveness refers to the extent of the effect of the deficiencies. The monitoring and remediation process provides sufficient information for this purpose.

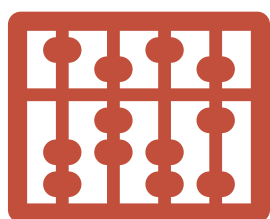


Existence and/or effectiveness of remedial actions to address the deficiencies. Monitoring provides not only the identified deficiencies, but also the remedial actions to address the deficiency and its impact, and the cause of the deficiencies. The evaluation should consider whether the remedial actions of the monitoring are sufficient to address the deficiencies, which will reflect on the assessment of the monitoring component.



Correction of the effect of the identified deficiencies. Some of the monitoring recommendations mentioned above may have already been implemented to correct the effect of deficiencies. Take note that effective system of audit quality management also addresses present issues (current effect) caused by the deficiencies.

Based on the evaluation, the SAI provides conclusion as to whether the system of audit quality management provides the SAI with reasonable assurance that its objectives are being achieved. The conclusion may take one of the following forms. Additional guidance and example are provided in the succeeding pages.



Types of Conclusions on the System of Audit Quality Management

1

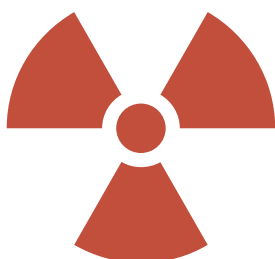
The system of audit quality management provides the SAI with reasonable assurance that the objectives of the system are being achieved.

2

Except for matters related to identified deficiencies that have a severe but not pervasive effect, the system of audit quality management provides the SAI with reasonable assurance that the objectives of the system are being achieved.

3

The system of audit quality management does NOT provide the SAI with reasonable assurance that the objectives of the system are being achieved.



The existence of deficiencies suggests that component or group of components of the system does not operate as intended or is not designed appropriately. Non-achievement of one or more quality objectives is indicative of deficiencies in the system. For instance, the SAI may observe that the deficiencies could have not existed had the risk assessment component identified the apparent threats before such materialized into deficiency. Thus, the SAI may need to revisit its policies and procedures in the risk assessment component to identify the need for enhancement.

Depending on the practices of the SAI, the monitoring function may already provide information about the root causes of the deficiencies and thus, the evaluation will focus on validating and addressing such causes. The concepts of monitoring in the Playbook are designed to support the evaluation of the system of audit quality management. The assessor uses significant professional judgment in performing the evaluation.

Tool 14: Evaluation of SoAQM

For this purpose, the SAI may use the suggested template in the Playbook.

*Example of an identified deficiency that may be considered **severe** but **not pervasive***

The SAI identifies a deficiency in a smaller regional office of the SAI. The identified deficiency relates to non-compliance with many SAI policies or procedures. The SAI determines that the culture in the regional office, particularly the actions and behaviour of leadership in the regional office, which were overly focused on administrative priorities, has contributed to the root cause of the identified deficiency. The SAI determines that the effect of the identified deficiency is:

- Severe, because it relates to the culture of the regional office and overall compliance with firm policies or procedures; and
- Not pervasive, because it is limited to the smaller regional office.

*Example of an identified deficiency that may be considered **severe and pervasive***

The SAI identifies a deficiency in a regional office, which is the largest office of the SAI and provides financial, operational and technical support for the entire region. The identified deficiency relates to non-compliance with many SAI policies or procedures. The SAI determines that the culture in the regional office, particularly the actions and behaviour of leadership in the regional office which were overly focused on administrative priorities, has contributed to the root cause of the identified deficiency. The SAI determines that the effect of the identified deficiency is:

- Severe, because it relates to the culture of the regional office and overall compliance with SAI policies or procedures; and

- Pervasive, because the regional office is the largest office and provides support to many other offices, and the non-compliance with SAI policies or procedures may have had a broader effect on the other offices.

These examples are adapted from ISQM 1 Application material A192 and A193.

Example:

SAI of Country X (see assumptions on the next page)

Deficiencies		Individual evaluation		Remedial Action	Correction of the effect of identified deficiencies
No.	Description	Severe	Pervasive		
1	Components: Monitoring Process The monitoring was not able to cover representative samples in the audit universe of the SAI covering the three audit streams and all government accounts. Thus, audit engagements with potential issues due to disagreements with the audited entities were not selected.	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	<input type="checkbox"/> With effective remedial action Specify: _____ <input type="checkbox"/> Remedial action is not effective <input checked="" type="checkbox"/> Not provided with remedial action	<input checked="" type="checkbox"/> Corrected Specify: <u>Consultation with other Audit Directors were made to re-evaluate and ensure correctness of the audit opinion</u> <input type="checkbox"/> Not corrected <input type="checkbox"/> No effect in the system
2	Components: Resources & Performing Individual Audits In the recent monitoring, it was found out that the Performance Audit Teams were experiencing challenges in interpreting and processing statistical data on subject matter that relates to poverty alleviation causing significant delays in the completion of the audit activities. The audit resorted to procurement of services from third party to facilitate completion of the audit. Upon further investigation, the SAI's Competency Framework does not consider the diversity of the competency needs for performance audit as the framework focused on financial and compliance audits.	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	<input checked="" type="checkbox"/> With effective remedial action Specify: <u>The monitoring function recommended the enhancement of the SAI's Competency Framework, and development of policy on engaging auditor's experts to ensure alignment with ISSAIs and SAI's mandate, and that auditor's responsibilities are not reduced by the work of the expert. These measures were already started in the SAI.</u> <input type="checkbox"/> Remedial action is not effective <input type="checkbox"/> Not provided with remedial action	<input checked="" type="checkbox"/> Corrected Specify: <u>Through the performance audit teams' consultation with the Audit Director, the SAI engaged the services of statistician to properly interpret the data.</u> <input type="checkbox"/> Not corrected <input type="checkbox"/> No effect in the system

...
...
Evaluation at the aggregate level:			<input checked="" type="checkbox"/> Severe		
			<input type="checkbox"/> Pervasive		
Conclusion:					
<input type="checkbox"/> The system of audit quality management provides the SAI with reasonable assurance that the objectives of the system are being achieved. <i>(Note: Actions are still needed to address the effect of uncorrected effect of deficiencies, if any)</i> Planned actions: _____					
<input checked="" type="checkbox"/> Except for matters related to identified deficiencies that have a severe but not pervasive effect, the system of audit quality management provides the SAI with reasonable assurance that the objectives of the system are being achieved. Planned actions: <u>Review and enhance the criteria of selection for review in the monitoring policy;</u> <u>Provide the necessary support to the working group responsible on the enhancement of Competency Framework, policy on the engagement of expert, and policy on the evaluation of misstatements to expedite the process.</u>					
<input type="checkbox"/> The system of audit quality management does NOT provide the SAI with reasonable assurance that the objectives of the system are being achieved. Planned actions: _____					

The first deficiency relates to the risk that materialized while the risk response is still ongoing (i.e., development of policy on evaluation of misstatements). Take note that the deficiency focused on the monitoring, and not on other component affected by the potential inappropriate opinion, since the risk assessment (see example in Quality Risk Management Process) has effectively identified the related risk and that response was already provided, although, the response is still on-going. The deficiency is considered severe since inappropriate selection of samples may result in deficiencies in the system of audit quality management that remain identified, although not considered pervasive since the selection only affects one component of the system. The monitoring itself was not able to identify the deficiency in the monitoring itself. As of the evaluation period, there is no remedial action yet, thus the planned actions of the Head of SAI or other qualified individual include the review of the selection criteria for monitoring and enhancement of the monitoring policy.

In the second example deficiency, the source of information of the Head of SAI or other qualified individual is the SAI's monitoring mechanism (see example in Monitoring & Remediation Process). The lack of emphasis of the SAI's competency requirements for performance audit is evaluated as severe considering that this affects the quality of audit work. The effect is not pervasive since only 10% of the audits is affected and not all performance audit engagements are affected. There are no further actions except for the support to the recommendations since such can sufficiently address the deficiency

In the assumption that there were no other deficiencies, the evaluation at the aggregate level showed that the deficiencies are severe but not pervasive given the limited components affected, and thus, the second conclusion was selected.

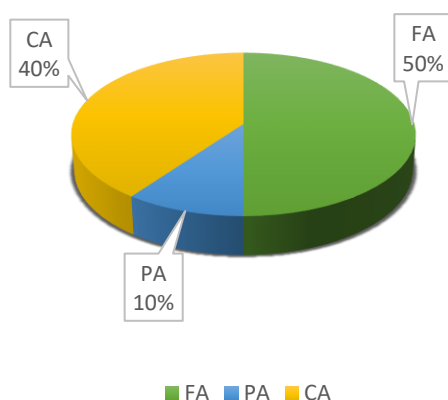
Conditions in SAI of Country X relating to the System of Audit Quality Management



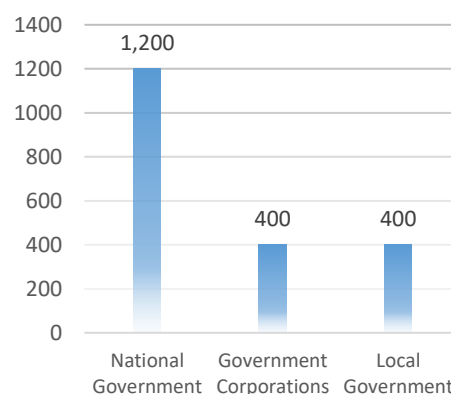
Assumptions Used in the Example

- The SAI of Country X has an established system based on the extant ISSAI 140. Upon revision of ISSAI 140, the SAI reviewed its policies and procedures to ensure that these are aligned with the changes of ISSAI 140.
- In the risk assessment process of the SAI, responses were already defined and being initiated, which affect the audit methodologies and tools. During the year, the SAI reviewed the audit manuals as part of the quality risk response.
- Based on the audit universe of the SAI, 1,000 (50%) represents financial audits, 800 (40%) represents compliance audits and 200 (10%) performance audits. The SAI has no mandate to perform other tasks other than the three audit streams. From these audits, 60% pertains to national government accounts, 20% pertains to government corporations and 20% pertains to local government accounts. Based on the legal audit deadline and considering that several national programmes are implemented by the local government, the audit of local government account was the last to be completed.

Types of Audit

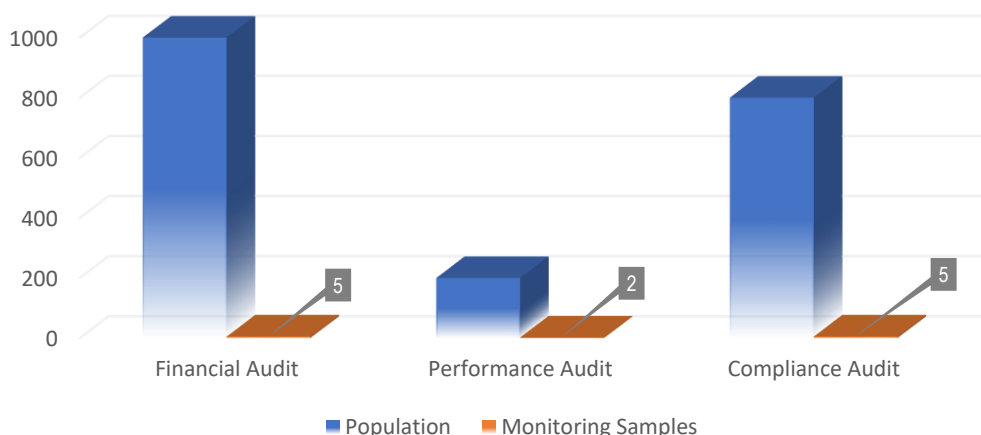


Government Accounts



- The SAI has 3,000 auditors who perform the total of 2,000 audit engagements covering three audit streams.
- SAI has existing policy in monitoring. The policy requires SAI to create an ad-hoc team yearly to conduct monitoring. The members of the team need to collectively possess the competency requirements including the experience and knowledge prescribed in the SAI's Monitoring Policy.
- In monitoring at the engagement level, five samples of financial audits (0.5% of the total FA), five samples of compliance audits (0.625% of the total CA) and two samples of performance audits (1% of the total PA) were selected randomly for inspection. There was no stratification made as to the type of government entities.

Monitoring Samples



- In the recent monitoring report, it was found out that the Performance Audit Teams were experiencing challenges in interpreting and processing statistical data on subject matter that relates to poverty alleviation causing significant delays in the completion of the audit activities. The audit resorted to procurement of services from third party to facilitate completion of the audit. Upon further investigation, the SAI's Competency Framework does not consider the diversity of the competency needs for performance audit as the framework focused on financial and compliance audits.
- There were no significant monitoring findings on Financial and Compliance audits, despite that the SAI has initially identified quality risk relating to evaluation of misstatements, and potential non-compliance of current practices with the new ISSAI requirements in the IFPP.
- There were complaints received by the SAI from one of the audited entities in the local government about their dissatisfaction with the expected audit opinion communicated to them by the audit team during the exit meeting. The audit report was not yet released due to disagreement. The management of this entity requested for a change in opinion considering that the audit findings, and the involved amounts are relatively similar with another local government account with different audit opinion issued, and that the management claimed that the audit team has different treatment on these findings as compared with another local government account.
- Upon checking, there was no monitoring sample selected from the local government account during the year and in the past 2 years. The concerned Audit Director re-evaluated the case with consultation from other Audit Directors, and noted that although the findings are similar and of the same amounts, the level of materiality in relation to the financial statements is significantly not comparable. Despite that the audit teams had different evaluation treatments on the misstatements, it turned out that the audit opinions on both audits in question were appropriate. The concerned audit team will hold a meeting with the management, together with the Audit Director to explain the issues.
- Based on the timetable on the quality risk management template, the related policy will be completed and adopted in about three to four months.