The Quality of the Audit Process in the Light of Professional Pronouncements of Standards' Setting Bodies

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1.1 Introduction:

The audit firms seek to gain new clients and to retain their existing ones in order to expand and increase the size of their share in the market. However, the aforementioned sought may often interfere with the quality of the audit process, once attached by absence of an efficient system for control the performance of the audit. The absence of system of audit quality control negatively influences client acceptance procedures, follow-up audit procedures, and stress on the efficiency and integrity of the audit staff, which ultimately affects the reputation of audit firms. In this sense, a number of professional bodies have initiated the issuance of some criteria to develop guidance on the concept and elements of the quality control system to be applied within the auditing firms to ensure the quality of the audit process. Meanwhile, Public Companies Accounting Oversight Board (PCAOB) issued the Quality Control (QC Section 20), which included a definition of the quality control system in the audit companies, explaining the various incentives. The Board also issued both the (QC Section 30) and the (QC Section 40) to provide information of the key elements of the quality control system, namely, "oversight" and "personnel management", and under the "Clarity Project", which started in 2004 with the aim of improving the quality of the audit by establishment of an objective for each auditing standard to reflect a principles-based approach to standard-setting and Quality control to make it easier to read, understand, and develop. In 2008, the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC) issued both the International Standard on Quality Control (ISQC 1) entitled "Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements" and International Standard on Auditing (ISA 220) entitled "Quality Control for an Audit of Financial Statements", and in November, 2010 (AICPA) has issued the Firm's System of Quality Control (SQCS 8). This step is taken by AICPA as part of an attempt to achieve convergence with International Auditing Standards (ISAs). At the same time, an attempt is made to reduce unnecessary differences with the standards issued by the (PCAOB).

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2.1 Concept of audit quality:

The quality of the audit process is a multidimensional concept and it is difficult to be simplified (Francis, 2011; HU, 2015), this may be attributed to differences in views regarding the quality of the audit process and its measurement indicators. In regard to users of financial statements, the quality of the audit process is related to the absence of significant misstatements in the financial stalemates, whereas for the external auditor, the quality of the audit process refers completion of the tasks required in audit program in a satisfactory manner. The audit firm assesses the quality of the audit process as documentation evidence in peer review process, the periodic examination by professional bodies, and in litigation risk cases. As for the regulatory bodies of the audit profession, the quality of the audit process is determined by the adherence with the standards in question. The following is compilation of different definitions of audit quality investigated within literature and professional bodies.

The quality audit is to be related to the auditor's report (Francis, 2011). Francis (2011), notes that the quality of the audit process is generally realized by the external auditor's issuance of an 'appropriate' audit report after verifying the client's compliance with generally accepted accounting standards (GAAP). However, (Francis, 2011) establishes a framework that proposes indicators that determine the quality of audit. Knechel, et al., (2013) state that the quality of the audit process is achieved by careful implementation of the well planned stages of the audit process through a group of well-trained auditors who have the incentive to improve the quality of the audit.

US Government Accountability Office (GAO, 2003) defines quality of the audit is as the performance of the audit process in accordance with the generally accepted auditing standards (GAAS) to provide reasonable assurance that the accompanying financial statements and notes to disclosure are prepared in accordance with generally accepted accounting standards (GAAP) and these statements are free from material misstatements, whether due to errors or fraud.

This definition assumes that as audit is performed in accordance with the requirements of the GAAS by a third party, reasonably knowledgeable external auditor, and some material misstatements have been identified. Three scenarios are suggested, first, appropriate adjustments, disclosures and any other changes have been made to the financial statements to prevent them from becoming misleading to users. Second, a non-standard the auditor opinion on the financial statements is proposed, and third, the auditor declined the client acceptance.

Financial Reports Council of UK (FRC, 2006), states that quality of the audit process depends on a set of key quality indicators that must be available for the audit to be of high quality and that from the Council's perspective the most appropriate approach to formulating a definition of audit quality is to identify these factors that indicate whether the steps of the audit process that have been applied are high quality determined and assess how auditors and audit team perform audit tasks and threats that may affect compliance with quality determinants and proposed precautions to violate noncompliance.

International Audit and Assurance Standards Board (IAASB, 2014), states that the quality of audit is achieved by relation to the auditor's opinion in the financial statements. As this opinion is based on an appropriate and sufficient evidence gathered by the audit team whose members are characterized by:

- Clearly demonstrate their commitment to ethical values and appropriate behaviors;
- Have sufficient knowledge, experience and time to perform the audit process;
- Implementing the audit process and quality control procedures accurately; and
- Interact appropriately with the diverse needs of different stakeholders.

3.1 Framework quality audit process issued by a number of professional organizations

Given the difficulty of reaching a consensus on a common concept of the quality of the audit process, several professional bodies organizing the audit profession formulated a framework on the quality of the audit process. Attempts to formulate the framework started in November 2006, UK's Financial Reporting Council (FRC) issued a framework entitled "Promoting Audit Quality" (FRC, 2006). Following extensive consultations to develop that framework, the (FRC) issued in February 2008 the "Audit Quality Framework" (FRC, 2008). The framework has identified five key elements that are the main drivers of the quality of the audit process. These elements are:

• A culture of commitment to quality adopted by the management of the audit firm;

• Personal qualities and skills of the partners and employees of the audit firm;

• The effectiveness of the audit process

• Usefulness and faithful representation of audit report; and

• Non-controllable elements that influence the quality of the audit process.

In February 2014, (IAASB) issued a framework for audit quality entitled "A Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality" (IAASB, 2014). This framework is a result of the absence of a uniform definition or concept of the quality of the audit process that has been widely accepted and recognized in different contexts. The quality of the audit process is the responsibility of the auditors, however, this quality can be achieved by a regulatory and environmental framework that support interaction among all parties participating in the cycle of preparing, auditing and publishing the financial statements.

The framework includes a set of factors that contribute to the quality of the audit process. These factors are divided into input, outputs, interactions, contextual, and special considerations at different levels of performance of audit process, audit firm, and national levels. The framework also is subject to a due process that provides an ample opportunity for all stakeholders' groups for discussion and dialogue between the stakeholders and the board as well as between the various stakeholders themselves on the subject of the quality of the audit process and emphasizing the role of regulatory and environmental factors in influencing the quality of the audit process. In addition, the due process provides an opportunity to identifying the factors that may have an impact on the nature and quality of the reports and therefore will, directly or indirectly, affect the quality of the audit process. The main elements of the framework can be illustrated by the following summary:

1. Input factors that include the following drivers:
    - o Values, Ethics and attitudes
    - o Knowledge, experience and time
    - o Audit process and quality control procedures

These drivers attached to nine guidelines at the levels mentioned above, i.e. performance of audit process, audit firm, and national levels.

2. Output factors that include a set of reports which can be divided according to the levels contained in the framework into two levels:
    - o Reports at the level of performance of the audit process of the client; and
    - o Reports at the level of the audit firm and the national level.

These types of reports are issued by external auditor, audit firm, Auditee, and professional bodies.

3. Interactions among different stakeholders in the financial reporting system
   Interactions refer to the relationships that affect the quality of the audit process that include external auditors, auditee and regulators basically personnel who charged with governance, users and regulators.

4. Organizational and environmental factors

The most important regulatory and environmental factors that are likely to affect the nature and quality of the financial reporting system of the auditee, therefore, they will directly or indirectly affect the quality of the audit, the framework mentions the following seven drivers:

- Business practices and commercial law
- Laws and legislations related to the preparation of financial reports
- Corporate governance
- Information Systems

- Scheduling of financial reporting
- The prevailing culture in society
- The conceptual framework for financial reporting

5. Special Considerations

   The quality of the audit requires a rigorous application of all the steps of the audit process and the quality control procedures carried out in accordance with the issued standards and the applicable legislative and regulatory laws. However, considerations should be attributed to the size and type of audit firm.

4.1 Quality indicators of the audit process

At the beginning of 2013, the Audit Quality Indicators (AQI) project became one of the most important priorities of the (PCAOB). The objective of the project was to identify a set of quantitative measures to assess the quality of the audit process. The project resulted in the issuance of the Audit Quality Indicators by the board in July 2015, which includes 28 Audit Quality Indicators divided into three main categories. These indicators can be summarized as follows (PCAOB, 2013, p. 13):

1. Audit Professionals that include three indicators and twelve attributes as follows:
   a) Availability
      - Staffing Leverage
      - Partner Workload
      - Manager and Staff Workload
      - Technical Accounting and Auditing Resources
      - Persons with Specialized Skill and Knowledge

   b) Competence
      - Experience of Audit Personnel
      - Industry Expertise of Audit Personnel
      - Turnover of Audit Personnel
      - Amount of Audit Work Centralized at Service Centers
      - Training Hours per Audit Professional

   c) Focus
      - Audit Hours and Risk Areas
      - Allocation of Audit Hours to Phases of the Audit

2. Audit Process that include five indicators and eight attributes as follows:
    a) Tone at the Top and Leadership
        - Results of Independent Survey of Firm Personnel
    b) Incentives
        - Quality Ratings and Compensation
        - Audit Fees, Effort, and Client Risk
    c) Independence
        - Compliance with Independence Requirements
    d) Infrastructure
        - Investment in Infrastructure Supporting Quality Auditing
    e) Monitoring and Remediation
        - Audit Firms' Internal Quality Review Results
        - PCAOB Inspection Results
        - Technical Competency Testing
3. Audit Results that include five indicators and eight attributes as follows:
    a) Financial Statements
        - Frequency and Impact of Financial Statement Restatements for Errors
        - Fraud and other Financial Reporting Misconduct
        - Inferring Audit Quality from Measures of Financial Reporting Quality
    b) Internal Control
        - Timely Reporting of Internal Control Weaknesses
    c) Going Concern
        - Timely Reporting of Going Concern Issues
    d) Communications between Auditors and Audit Committee
        - Results of Independent Surveys of Audit Committee Members
    e) Enforcement and Litigation
        - Trends in PCAOB and SEC Enforcement Proceedings
        - Trends in Private Litigation

(PCAOB) provide guidelines of proposed calculations of the above indicators at the level of the performance of audit process and audit firm attached by description of the objective and reason of selection for each one.

5.1The quality control system

The quality control system for audit firms is the basis for the company's ability to deliver high quality services (Nagy, 2014). Public confidence in the quality of service provided by auditing is the reason beyond expectation of a high level of professional conduct by audit firm (Arens et al. 2017). Many audit professional bodies develop standards for quality control in order to develop guidelines for audit firms in designing their own quality control systems and to clarify the elements of these systems, to determine the components and factors that must be taken into consideration when applied, and to ensure quality services are provided.

In January 2008, (IAASB) issued the International Standard on Quality Control (Revised), entitled "Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements" (IQCS 1). In the same vein, (ISA 220) entitled "Quality Control for an Audit of Financial Statements" is issued as part of (The clarity Project), which started in 2004 to improve audit quality by reflecting the principles-based approach in setting auditing standards to make these standards more clearly and better, in terms of understanding and application.[3]

In November 2010, the Audit Standards Board (ASB) of the (AICPA) issued the revised quality control standard (SQCS no 8), entitled "A Firm's System of Quality Control" that supersedes (SQCS no 7). The Standard has been reformulated by the (ASB) in light of the clarity project to better reflect the use of the Principals-based approach (AICPA, 2011) that provides a room for the project originated with the ASB plan to converge U.S. GAAS with the ISAs and align its agenda with the IAASB. (AICPA, 2011).

In the same vein, (PCAOB) has promulgated three detailed quality control standards, namely Standard (QC 20), "System of Quality Control for CPA's Firm's Accounting and Auditing Practice", (QC 30), "Monitoring a CPA Firm's Accounting and Auditing Practice", and (QC 40): "The Personnel Management Element of a Firm's

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[3] http://www.iaasb.org/clarity-center

System of Quality Control-Competencies Required by a Practitioner-in-Charge of an Attest Engagement".[4]

In Egypt, in 2008, the standards of auditing, limited inspection engagements and other assurance services were issued. These standards replaced the superseded Egyptian auditing standards issued in September 2000. The new Egyptian standards of auditing include the Egyptian Auditing Standard (No. 220), "Quality Control on Historical Financial Information audit". Most quality control standards issued by various professional organizations have enforced audit firms to establish and maintain a quality control system.

The concept of quality control system

(QC 20) promulgated by (PCAOB) defines the quality control system as the process by which reasonable assurance is provided to the audit firm that the personnel within the firm are in comply with applicable professional standards and the quality control standards established by the firm(QC Section 20 B: 02). (ISQC 1) issued by (IAASB), (SQCS NO 8) issued by (AICPA), and Egyptian Audit Standard (220) focus the same areas as these bodies define the quality control system as a system that consists of a set of policies and procedures that are designed by the auditing firm to provide reasonable assurance that auditing firm and its personnel comply with professional standards and applicable legal and legislative requirements; and reports issued by the audit firm or the responsible partner are appropriate for the circumstances of engagement.

Reviewing the aforementioned definitions of the quality control standards promulgated by the profession setting standards bodies, it is noted that there is high level of consensus of (AICPA) and (IAASB) definitions of the quality of audit. (AICPA) adopted a plan to bring audit criteria closer together by making the US (GAAS) more consistent with the International Auditing Standards (ISA). profession setting standards bodies agreed upon that the objective of Quality control system is to enhance development of policies, procedures and application controls to provide reasonable assurance about each auditor's compliance with the quality standards established by those bodies and the adequacy of audit reports issued by the audit firm to the circumstances and results of the audit engagement.

[4] http://pcaobus.org/Standards/QC/Pages/default.aspx

Elements of quality control system

Professional setting standards bodies propose a framework of quality control standards to be considered in design of the quality control system within the audit firm. The (PCAOB) has set five elements for quality control, as defined by the (QC 20), including:

- Independence, Integrity, and Objectivity;
- Personnel management;
- Acceptance and Continuance of Clients and Engagements;
- Engagement Performance; and
- Monitoring.

Through this framework quality control elements are linked to each other. For example, maintaining integrity, objectivity and independence requires constant evaluation of client relationships. Similarly, the personnel management component includes standards related to professional development, recruitment, promotion and the distribution of personnel in the audit firm on the various audit engagements and tasks that affect the efficiency of applying the policies and procedures established to achieve the objectives of the "engagement performance" component of the quality control system. In the same vein, the quality control procedures and policies of the "monitoring" component have been developed to provide the audit firm with reasonable assurance that the policies and procedures associated with each quality control component have been properly designed and effectively implemented (QC Section 20; B7). On the other hand, in the light of the "Project of Clarity and Convergence", the (AICPA) and the (IFAC) agreed to define elements of the quality control system on six key elements as contained in both (IQCS 1) and (SQCS 8), the aforementioned standards state that the quality control system of the audit firms should establish and maintain the policies and procedures that achieve each of the following elements:

I. Leadership responsibilities for quality within the firm.
II. Relevant ethical requirements.
III. Acceptance and continuance of client relationships and specific engagements.
IV. Human resources.
V. Engagement performance.
VI. Monitoring.

In the following is a review for the quality control system developed by the most influential setting standards body in US environment, i.e. (AICPA).

Quality Control Standards promulgated by the American Institute of Certified Public Accountants (AICPA)

In 1979, (AICPA) promulgated the Quality Control Standard No. 1 (SQCS 1) entitled "System of Quality Control for A CPA firm" Which includes a number of requirements that enforced audit firm to develop quality control policies and procedures on accounting and auditing practices. In addition, the standard has set nine elements of the quality control system. Over the past years, several amendments to the elements of (SQCS 1) have been introduced and new versions of Quality Control Standards have been issued. In 1996 Quality Control Standard No. 2 (SQCS 2) entitled "System of Quality Control for a CPA Firm's Accounting and Auditing Practice", the Standard has replaced the nine elements in (SQCS 1) with five elements while preserving the essence of some aspects related to the elements of the preceding standard. The (SQCS 2) has added quality control requirements for engagement performance carried out and are subject to "Attestation Standards".

In 2004, following the establishment of the (PACOB), the Audit Standards Board (ASB) developed a plan to bridge the gap between auditing standards within US (GAAS) and those within International Auditing Standards (ISA). As a result, the Board has re-drafted the (SASs) and (SQCS) as part of the "Clarity Project" that aims to make audit standards easier to read, comprehend, and implement (AICPA, 2011). In October 2007, Quality Control Standard No. 7 was issued (SQCS 7) entitled "Firm Quality Control System". The standard has provided guidance and requirements consistent with the international audit standards, as well as providing more detailed guidance than the preceding standard and adding other documentation requirements (Schmutte & Thieling, 2010).

In November 2010, the (ASB) promulgated a redrafted Quality Control Standard No. 8 (SQCS 8) entitled "A Firm's System of Quality Control", which supersedes the preceding standard (SQCS 7). (SQCS 8) has been redrafted by the (ASB) to reflect more clearly the use of the principle-based approach in the formulation of the Audit standards (AICPA, 2011). As with many of the standards that have been reformulated, (SQCS 8) did not result in a significant change in the requirements of (SQCS 7), however, the standard has to cancel redundant requirements and some explanatory material in (SQCS 7). It should be noted that (SQCS 8) is more consistent with International Standard on Quality Control (ISQC 1) and International Standard on Auditing (ISA 220)[5].

In this sense, the following sections will emphasis the discussion of elements of (SQCS 8) that entitled "A Firm's System of Quality Control"

Leadership responsibilities for quality within the firm

The audit firm develops policies and procedures, represent the tone of top management, aimed at improving the internal culture to raise awareness that quality is an essential element in the engagement performance and encourage subordinate to comply with quality requirements. These policies and procedures require the Company's CEO (or its equivalent) or the Partners Council (or its equivalent) to take final responsibility for the quality control system of the auditing firm. (ISQC 1; P18; QC Section 10; P19).

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[5] http://cpafirmsupport.blogspot.com.eg/2010/11/sqcs-no-8-replaces-sqcs-no-7.html

Relevant ethical requirements

The audit firm should establish policies and procedures that provide reasonable assurance that the audit firm and staff comply with ethical and behavioral requirements (ISQC 1; P20; QC Section 10; P21). This element of the quality control system in both the International Quality Control Standard (IQCS 1) and the US Standard (SQCS 8) of the American Institute of Certified Public Accountants (AICPA) corresponds to the element of "independence, integrity and objectivity" in the Standard Quality Control issued by the (PCAOB) (QC Section 20). Independence has been defined by (AICPA) and (PCAOB) and related explanations that contain some illustrative examples that violate independence, impartiality, and objectivity. The independence includes impartiality and commitment to fairness in forming the professional opinion not only for management and owners, but also for other users of audit reports. Integrity requires individuals to have honesty and sincerity within the scope of client confidentiality, and the services provided by the audit firm should not be subject to personal gains and benefits. Objectivity is the state of mind and quality that provides value to the services of the auditing firm. The principle of objectivity imposes a commitment that the audit services are impartial, unbiased and free of conflict of interest (QC Section 20: P1).

Acceptance and continuance of client relationships and specific engagements

The audit firm should establish procedures and policies for acceptance of functions and continuity with clients and certain specific audit engagement to provide reasonable assurance that the audit firm will accept the engagement and maintain relationships with clients only when specific requirements are attained within audit firm (ISQC 1; P26; QC Section 10; P27) as follow:

1. Competence that enables audit firm to perform audit tasks and have the time and resources that enhance the performance of these tasks;
2. compliance with laws, regulations, and ethical and behavioral requirements; and
3. Integrity of the client and ensure that no evidence that may lead to the conclusion that the integrity of client is impaired.

Regarding the later issue, i.e. integrity of the client, (QC Section 20) of the (PCAOB) state that audit firm should establish and maintain the policies and procedures that enable the firm to make appropriate decision regarding acceptance or continuation with the client or accepting certain audit tasks specified for the client. Such policies and procedures should provide reasonable assurance that the probability of contracting with a client lacking integrity is very low. Furthermore the establishment of such policies does not imply that the audit firm ensures the integrity and credibility of the client, nor does it mean that the audit firm has a compliance obligation concerning other person or organization with respect to acceptance, decline or continuation with clients. However, in accordance with the conservatism principle, the auditing firm should be selective in determining its relations with the clients and the professional services it will provide (QC section 20; p14).

Human Resources

The audit firm should establish and maintain the policies and procedures that are designed to provide reasonable assurance that the company has sufficient number of personnel who have the competencies, capabilities, and commitment to the principles and ethical code of conduct necessary to achieve the following (ISQC 1; P29; QC Section 10; P31):

a. Performance of audit duties in accordance with professional, regulatory and legal standards.
b. Issuance of reports that are appropriate to the circumstances and results of the audit process by audit firm or the responsible partners.

Detailed requirements for the "Human resources" element, in Standard No. 40 (QC 40) entitled "The Personnel Management Element of a Firm's System of Quality Control-Competencies Required by a Practitioner-in-Charge of an Attest Engagement", have been developed for the management of individuals in the quality control system of the audit firm focusing competencies required for the practitioners responsible for audit contracts.

Engagement performance.

Audit firm should develop policies and procedures designed to provide reasonable assurance that engagement performance conducted in accordance with laws, regulations, and professional standards, and to provide reasonable assurance that the reports issued by the auditor are relevant to the circumstances. Such policies and procedures should include the following (ISQC 1: P32; QC Section 10; P35):

- Material issues related to quality enhancement within engagement performance;
- Supervisory responsibilities; and
- Responsibilities of limited scope inspection, i.e. periodic review.

Monitoring

The audit firm should establish and maintain policies and procedures to provide reasonable assurance that the policies and procedures related to the quality control system are adequate, sufficient, and effective. This process must (ISQC 1; P48; QC Section 10; P52):

- Include a continuous evaluation of the quality control system of the auditing firm, which requires periodic review, i.e. inspection, of at least one of the completed commitments of each responsible partner.
- Require that the responsibility for the monitoring and follow-up process be assigned to the partner, partners or equivalent with appropriate and adequate experience and have the authority in the audit firm to undertake this responsibility.
- Requires that persons responsible for the engagement performance of the client or pre-issuance review do not participate in inspections of the performance of these tasks, to keep independence intact.

With regard to element of monitoring, (PCAOB) has developed detailed guidelines on how to apply this element of quality control system by promulgating (QC Section 30) entitled "Monitoring a CPA Firm's Accounting and Auditing Practice".

6.1 Quality Control Standards for Small and Medium-sized Enterprises

Considering the reasonable assurance concept and cost-benefit factor, (IFAC) assumes commitment to assisting small and medium-sized enterprises to implement auditing standards. In November 2011, Small and Medium Enterprises Committee (SMP) issued "Guide to Using ISAs in the Audits of Small- and Medium-Sized Entities" that is designed to help small- and medium-sized enterprises understand and apply effectively the International Auditing Standard (ISA220) that was first published in 2007 and developed in conjunction to the Canadian Institute of Chartered Accountants in the light of the "Clarity" project"[6]. In August 2011, the Committee also issued the third edition of the Manual for Quality Control in Small and Medium Enterprises entitled "Guide to Quality Control for Use by Small- and Medium-sized Practices" as a 'risk-based approach' manual to implement (ISQC1) to assist practitioners in understanding and applying the standard when establishing and maintaining a quality control system[7].

7.1 (PCAOB) Inspection (Periodic review)

to improve the quality of the audit process and reestablish investor confidence in integrity and the quality of the financial report of companies, especially after the financial collapse of a number of major international companies, notably Enron and Worldcom, Sarbanes Oxley Act (SOX) create (PCAOB) that enforce public audit firm to conduct a periodic review (inspection) to assess their compliance with the rules of Sarbanes Oxley Act, The Securities and Exchange Commission (SEC), and the Professional Standards (SOX Section 104a). This became a fundamental shift in the history of accounting and auditing profession as review of auditing profession reformed from being a self-controlled profession under the peer review program under the supervision of the (AICPA), which lasted about 50 years until the Sarbanes Oxley Act of 2002, to be a profession subject to independent external inspection by the (PCAOB) (Abbott et al., 2013)

According to the rules of the (PCAOB), this examination is carried out on an annual basis for the big auditing firms (which issue reports reviewing the financial statements of more than 100 clients). However, this inspection conducted on a three years basis for smaller audit firms (which issue reports reviewing the financial statements of 100 clients or less). The later periodic review called "Triennial

[6] https://www.ifac.org/publications-resources/guide-using-international-standards-auditing-audits-small-and-medium-sized-en

[7] https://www.ifac.org/publications-resources/guide-quality-control-small-and-medium-sized-practices-third-edition-0

Inspection". The periodic inspection by the (PCAOB) shall be conducted of registered audit firms to investigate

- The procedures for performing the audit process for a sample of clients of the audit firm; and
- The efficiency of the control system on the quality of the audit process applied within the audit firm. In order to verify the shortcomings in the performance of the audit process, i.e. engagement performance, on the one hand, and the weaknesses of the quality control system of the audit process, on the other hand (PCAOB, 2010).

First: Engagement Review

Through the periodic examination of the audit firms, (PCAOB) examine certain special procedures of a sample of engagements that conducted during the former year. The (PCAOB) adopts a risk-based approach to the selection of engagements or procedures under review, based on an assessment by the team of the 'risk of material misstatements' and the risks associated with the nature of the client's activity and the industry to which it belongs in defining the inspection's sample units to include operations and specifically high risk areas of high risk audit (PCAOB, 2012). The review process starts with the meeting of the review team and the audit team selected for the examination procedures. The documentation and related records and documents are then examined and analyzed to conclude how the audit was performed by focusing on some of areas of interests (Center For Audit Quality; CAQ, 2012), as follows:

- whether the company has followed the required procedures in accordance with auditing standards issued by the (PCAOB) of audit firm, i.e. registered public accounting firms that provide audits for publicly traded companies, in the United States;
- whether the audit firm has identified some circumstances where the financial statements of the client do not comply materially with the Generally Accepted Accounting Principles (GAAP);
- How the audit firm dealt with the amendments to the financial statements; and
- Whether there are indications of the independence violation of the audit firm in accordance with the requirements of both rules promulgated by (PCAOB) and the (SEC).

I case that examination raises questionable issues, those issues should be discussed with audit firm in a written form and audit firm should respond in detail to the areas of interests in a written form as well. After looking at the audit firm's responses, the examination team has the right to decide whether these responses answer the questions of inspection team or not. If the later incurred, the examination report shall be included as one of the shortcomings related to the engagement performance of the audit process.

Second: Quality Control Inspections

(PCAOB) examines the control system on the quality of the audit process by focusing on the performance of the system and its impact on the audit procedures performed by the firm. The examination process includes several components (PCAOB, 2012) as follows:

- Checking whether the audit firm's top management establishes, maintains, and encourages a culture of integrity, independence and quality of audit among the firm's personnel, i.e. Tone at The Top;
- Checking the extent of compliance with the policies and procedures to assess the risks associated with the client's acceptance and continuity of this relationship, if any, and whether audit procedures reflect the magnitude of these risks;
- Inspection of the control procedures on the performance of the related audit firm; and
- Examining how the company is internally responding to the indicators of weakness and their impact on the performance of the audit process.

Third: Inspection Report

The inspection process is completed by publishing a report to be released on the web site the (PCAOB). This report contains introduction to describe the process of examination followed by the three sections. The first section is to present the information of the inspected audit firm, e.g. company name and address. A presentation of the deficiencies related to the procedures of the performance of the audit is highlighted as well. The second section is to present the criticisms of the control system on the quality applied within audit firm and this section is not disclosed unless the audit firm cannot take remedy actions to alleviate these weaknesses within 12 months from the date of the report; the aforementioned delay of disclosure is an incentive for audit firm to resolve these areas of weaknesses. Finally, the report presents response and the audit firm's comments on the findings of the Board (PCAOB, 2004). Although the comment on the results of the examination is optional, a large proportion of the audit companies (about 86%), including the big audit firms, comment on the results of the examination, which provides an opportunity for these firms to present their views on the results of the examination (Hermanson et al. 2007). Responses of audit firm range from those who admit to the results of the examination and those who deny these results and the latter group represents a small proportion of the respondents (Robertson et al., 2014).

8.1 PCAOB inspection reports and auditing companies' characteristics

The relationship between the inspection report promulgated by (PCAOB) and the characteristics of auditing firms and the nature of their performance has been investigated in accounting and auditing literature. (Lenard et al., 2009) noted that the inspection report contained significant shortcomings (e.g. GAAP departures), which are positively correlated with the size of the audit firm, while negatively correlated with the relationship between the 'Audit Tenure' and the industrial specialization of the company. (Gramling et al., 2011) found that audit firms, whose inspection report contains some shortcomings, tend to issue a 'Going Concern Opinion' for financially distressed companies, especially in the post-test period compared to the previous one.

9.1 PCAOB Inspection Reports and Client and Stakeholder Responses

To investigate the responses of investors to the inspection reports, Robertson & Houston (2010) state that an investor who is aware of the results of the firm's inspection report is expected to be more reliable in the subsequent years of the report. In regard to the reactions of clients, the findings of previous studies are inconsistent about the reflection of the results disclosed in the report on the audit firm's clients. Wainberg et al., (2013) showed that the inspection reports contribute to mislead the clients when selecting the audit firm; as these reports indicate inefficiency of quality control system of client. Without an explanation of the number of audits reviewed, the statistical aspect of the inspection process in relation to the size of the sample and the basis for selecting its units has an influential role in interpreting a large part of the results obtained through the review process which is not reported in the inspection report. This is consistent with findings of (Daugherty et al., 2011), which proved that clients excluded audit firms whose examination report contained some shortcomings. The findings of Lennox & Pittman (2010) contradicted the aforementioned results, they showed that the number of clients of the auditing firm is not affected by the inspection report whether it includes positive or negative aspects. Abbott et al., (2013) rated the results of the first part of the inspection report to three levels in terms of cruelty, Clean, GAAS Deficient and GAAP Deficient, and analyzed the impact of these results on clients and find that the clients most likely to exclude audit firm that included their inspection report a (GAAP) Deficiencies. They also concluded that the inspection report and its results are a good indicator of the quality of the audit process.

10.1 Examples of the deficiencies of the quality control system of audit firms

Since the quality control system of audit firms is mainly to ensure the efficiency of the performance of the audit process, the deficiencies of this system adversely affect the confidence of investors in the quality of the audit process, in this sense, several studies investigate and analyze the most prominent of these shortcomings. By examining the criticisms of the quality control system that were included in (PCAOB)'s inspection reports of about 100 small audit firms for the period between 2005 and 2011, (Blankley et al ., 2014b) showed that 77% this criticism is due to the lack of performance of the audit process, specifically with regard to the professional technical competences, due professional care, professional skepticism, communication between the auditor, audit committee, and engagement quality control review, or the so-called concurring partner review.

Blankley et al., (2014b) continue to state that 10% of criticisms of the quality control system are due to the failure of this system to provide sufficient assurance that the audit firm adheres to the requirements of the independence issued by (PCAOB), and about 4% of these criticisms related to personnel management. Review of inspection reports reveals that auditors are involved in audit of financial statements for a large number of clients as well as the lack the professional competence of some members of the audit team. Several studies provide a summary of the most prominent examples of the criticisms included in (PCAOB)'s inspection reports of a number of small-size audit firms as reported by (e.g. Blankley et al., 2014a, Blankley et al., 2014b, Newman & Oliverio, 2010) as follows.

Element Quality control system	**Deficiency**
Professional competence, professional care, and professional doubt	• The failure of the internal control system to perform the necessary procedures to ensure professional efficiency, due care and professional skepticism by the auditor; • Audit procedures related to obtaining certain confirmations included in the inquiries of the management that have no evidence; • Lack of essential deficiencies in the tests of revenue recognition; • The failure of audit team to conduct the necessary tests to obtain sufficient evidence of the possibility of material misstatements in the financial statements, as in accordance with the requirements of the AU 316 "Consideration of Fraud in the Financial Audit Statement audit"; • The failure of audit team to obtain ' Management representation letter' detailed enough for the period covered by the audit process; • The format and content of the report issued by the auditor does not conform to the professional standards issued by (PCAOB) because it does not include a proper explanation of the accounting basis used or appropriate reference to former auditors; and • The auditor does not follow the procedures for auditing misstatements, errors and omissions, in the financial statements and the notes to disclosures prior to issuance.
Engagement Quality control Reviewer	• There is no evidence that the procedures carried out by the pre-issuance inspection process resulted in the discovery of any of the deficiencies noted by the (PCAOB) inspection team.
Contact the Audit Committee	• The quality control system implemented within the audit firm does not provide sufficient

	assurance that the firm would perform and document the required contact between the auditor and the audit Committee, including the 'independence confirmation' of the Auditor, as required by the (PCAOB standard " Independence Standards Board Standard No. 1, entitled "Independence Discussions with Audit Committees"
Independence	• Procedures for ensuring the independence of the auditing firm of the client are not in accordance with the requirements of (PCAOB) 3400 T (b)
Appropriate audit procedures	Auditor failure to perform appropriate procedures relating to: • Test operations of revenue and equity rights; • Test of debt classification and intangible asset valuation; and • Test of share-based payment processes.
Appropriate tests	• The quality control system did not provide sufficient assurance that the auditor has completed all appropriate tests to perform a special audit in relation to cash flow statement, doubtful debts allowance, and stock valuation and impairment losses of PPE.
Documentation	• Deficiency of documentation of the audit work so that it becomes clear that there is no evidence sufficient to support the auditor's opinion.

For large audit firms, Church & Shefchik (2012) examine the inspection reports conducted for eight largest auditing firms in America that review the financial statements of more than 100 customers, including the Big Four audit firms (Ernst & Young, Deloitte & Touche, PricewaterhouseCoopers, KPMG), in addition to four other firms of the second class (BDO Seidman, Crowe Horwath, Grant Thornton, and McGladrey & Pullen) for the period from 2004 to 2009, Church & Shefchik (2012), point out that there are a number of criticisms of the system of control on the quality of these firms, but not disclosed any of them because it has been processed in a timely manner and, unlike the criticisms of the quality control system of small audit firms, which focused heavily on the performance of the process of audit, the criticisms of large audit firms focused on some other issues, including the procedures and policies of the internal inspection, evaluation and compensation of auditors, and accept and continue the relationship with the client.

11.1 Procedures to address the deficiencies of the quality control system

In order to assist audit firms in understanding and applying standards of quality control (SQCS 8) entitled "A Firm's System of Quality Control", (AICPA) has developed some non-binding procedures, which pointed to the possibility of avoiding the deficiencies of the control system on the quality of the audit process included in the inspection report promulgated by (PCAOB) and the following table shows some of these procedures:

Elements of the quality control system	The followed procedure
Leadership responsibilities for quality within the firm.	• Assignment of management responsibilities to ensure that any commercial considerations (such as audit fees) do not affect the quality of the audit process; and • Assignment of qualified and experienced professionals to manage the quality control system who have the ability to understand the system and to develop the policies necessary to implement it.
Relevant ethical requirements.	• Establish the procedures necessary to familiarize the personnel of the firm to meet the requirements of independence and this may be conducted through meetings, training courses and memoranda that show some concepts of integrity, objectivity and other ethical concepts; • The firm should obtain written confirmation from all personnel of the firm at least annually about commitment to policies and procedures to independence; and • Setting Policies and procedures to identify and assess any risks that threaten the independence and impartiality of personnel 'Familiarity Threats' which may result by the same individuals audited the financial statements of the same clients for long periods, and take the necessary actions to eliminate or minimize these risks.
Acceptance and continuance of client relationships and specific engagements.	• Conduct an assessment of the risks associated with any of the professional services provided by the audit firm in certain circumstances; • The audit firm should evaluate, what was possible to perform the audit process professionally and acceptance of audit processes that are available for the potential resources and professional competence required and evaluation at the end of each period or with the occurrence of certain events, whether it is appropriate to maintain the relationship with the client; • Setting procedures for the withdrawal of the audit firm from the audit performance of a client.
Human resources.	• Personnel should be recruited within the firm on the basis of knowledge, skills, and potentials to suit the circumstances and nature of the required engagement.

Engagement Quality control Review	• The company should follow the necessary procedures to ensure the availability of some characteristics by pre-issuance inspection; • The reviewer should not be selected by the audit team; • The reviewer should enjoy her/his professional career; • The reviewer should carry out her/his duties objectively with due professional care; • The reviewer should comply with the relevant independence requirements as set out in the (PCAOB) standards; and • The reviewer should not participate in any of the decisions or tasks of the audit team.

12.1 Periodic examination, (PCAOB) Inspection vs (AICPA) Peer Review

Auditing profession was characterized, during the (1970s) in the United States of America, as a self-regulated profession under 'peer review' program supervised by (AICPA); after the bankruptcy of a number of enterprises and the failure of some audit firms. Through this program, the registered audit firm is examined every three years by one of the other auditing firms. The examination process includes the evaluation of the quality control system in the auditing firms focus on Independence, Personnel Management, Client Acceptance, Engagement Performance, and Monitoring (Gunny & Zhang, 2013). The effectiveness and efficiency of this program are appraised. However, it was subjected to a lot of criticisms after that, especially in during the 'Enronity decade' and its next period of large financial scandals. Because of these scandals, the 'SOX Act' was passed and the (PCAOB) was created to set auditing standards for the public accounting firms that audit public-held companies. (PCAOB) replaces the peer review program which have become limited to private-held companies. One of the most prominent criticisms of the peer review programs is the 'Independence violation' of the examination process, since the examined auditing firm had the right to choose the audit firm that will conduct the peer review examination.

Daugherty & Pitman (2009) note that the 'peer review' program indicates that no negative results were reported for any large audit firm, since the examination committee infrequently issued a report containing an adverse or qualified opinion. While Houston & Stefaniak (2013) point out that the results of the examination sometimes are not objective or fair as contested audit firms may have an interest in reporting negative results for the examination process because of competition purposes. In the same vein, Nagy (2014) states that the scope of the examination process of the 'peer review' programs does not include examination of the procedures for the 'Litigation Audit Review'. Lennox & Pittman (2010) support the aforementioned views as they point out that within the peer review programs, there is no sanction on audit firm that show a low quality performance. Unlike peer review programs, the periodic review (inspection) of (PCAOB) is carried out by independent parties outside the profession who have the rights to review the procedures for the performance of the audit. The inspection reports also include more detailed items for the deficiencies of both the performance of the audit process and the quality control system, not limited to 'Evaluative Summary' as in peer review program (Nagy, 2014). Daugherty & Pitman (2009) note that the (PCAOB)'s inspection report is more transparent compared to the report issued by peer review programs. Furthermore, PCAOB has the authority to impose sanctions on audit firms that have not complied with any of the Board's rules, (SEC) rules, or professional standards.

In terms of the nature and timing of the inspection, (PCAOB)'s periodic review is carried out annually for large audit firms while conducted every three years for smaller audit firms while the inspection is conducted every three years under 'peer review' programs. In terms of the content of the inspection report and the timing of disclosure, the inspection report under peer review programs discloses deficiencies in the performance procedures of the audit and quality control system, while the (PCAOB)'s inspection report does not disclose the deficiencies of the control system quality when audit firm take remedy action within 12 months from the date of the report.

(PCAOB)' periodic review, i.e. inspection, arose to address the deficiencies of peer review programs, however, the latter still has proponents. This support stem from considerations of the content of the peer review report. The observation indicate that the content of the peer review report is reflected in the shift of clients towards auditing firms whose report contains positive results and departing from audit firms whose report contains negative results. It was found that the information content of the reports issued under the peer review programs is stronger than that of (PCAOB). Bedard et al., (2010) found that audit firms that received negative results under peer review programs were more likely to lose a large number of its clients compared to the audit firms that are subject to periodic review by the (PCAOB). DeFond (2010) support the aforementioned point of view, DeFond (2010), found that the content of (PCAOB) inspection reports lacks the required information value for two main reasons. First, the (PCAOB) inspection reports do not contain the opinion of the Board on the quality of the audit firm (i.e. Modified, unmodified, and Adverse or disclaimer). Second, the (PCAOB) inspection reports do not disclose the deficiencies of the quality control system as opposed to the reports issued by (AICPA). Moreover, the (PCAOB) inspection process focuses on the procedures related to high risk as the risk of significant misstatement and especially in reviewing the financial statements of clients that has influence on 'Audit Failure Risk'. Accordingly, the information contained in the (PCAOB) report may not be useful to clients in the decision making process in relation to the selection of audit firms. In general, it can be stated that the shift of auditing profession from review and self-regulation under peer review programs to external review by (PCAOB), has created a kind of trade-off between independence and expertise. The inspection conducted by (PCAOB) is objective and impartial, however, the examiners lack the sufficient technical expertise, which is available to practitioners and professionals who have adopted the examination procedures under the peer review programs. Despite the fact that the examiners under the peer review programs have the appropriate experience, they lack independence and objectivity.

In an attempt to investigate the usefulness of the shift of the subordination of audit firms to independent oversight by the (PCAOB), Ragothaman (2012) studies the differences between the findings of the (PCAOB) inspection report and the contents of the report under the peer review programs adopted by (AICPA), to investigate deficiencies in the quality control system applied in the small audit firms. Ragothaman (2012) states that the deficiencies related to engagement performance and independence disclosed in the (PCAOB) inspection report are significantly greater than those reported by the (AICPA), which indicates that the quality control of inspection process through the (PCAOB) is more rigorous and strict compared to the examiners under the peer review program. In this sense, it may be an incentive for auditing firms to improve the quality of the audit process in preparation for the (PCAOB) inspection.

1.13 Periodic review and quality audit process

It is noted that the study of the relationship between the (PCAOB)'s periodic review, i.e. inspection, and the quality of the audit process is necessary to verify whether it is possible to check the quality of the audit process. The Board has successfully achieved its objectives towards improving the quality of the audit process (Ragothaman 2012). Several studies investigate this phenomenon, however, the findings are inconsistent. Carcello et al., (2011) show that periodic review by (PCAOB) has improved the quality of the audit process of the 'Big 4 Audit Firms' using the abnormal accruals as a proxy for audit quality. Carcello et al., (2011) find that level of 'client' abnormal accruals was reduced significantly following the first inspection of audit firms and additional decrease in abnormal accruals in the year following the second (PCAOB) periodic review.

Regarding the interpretation of the improvement of the quality of the audit process after the (PCAOB) periodic review, Carcello et al., (2011) point out three main factors: First: In case that the inspection report contains deficiencies, it is assumed that several modifications would be followed by audit firm including:

- Modification of the method and approach of the audit process;
- Modification of the nature and content of the training courses for the auditor in proportion to the required changes in the method and approach of the audit process;
- Modification of internal control system and control procedures applied within the audit firm.

Assumed that the deficiencies of the report are related to the quality control system, the audit firms have the incentive to make these amendments so that they can remedy the shortcomings in a timely manner so as not to be disclosed in the report. Second: inspected audit firms become more careful to detect the financial statements manipulation that use creative accounting. Third: Since the process of inspection is conducted periodically (annually or every three years), this represents a mechanism to oversee firms and provide them incentives to improve their performance in preparation for the next inspection.

Blankley et al., (2014a) tested the relationship between the compliance of small audit firms to the (PCAOB) inspection and the quality of the audit process, which was measured by audit fees and 'staffing structure', i.e. ratio of audit staff to clients. Blankley et al., (2014a) find that fees increased significantly after the first round of inspection, which supports the positive effect of the inspection process on the quality of the performance of the audit firm and that the high fees audit is directly linked to the efforts of the auditor and by turn related to the quality of the audit process. However, staffing structure disparities are related to lower quality audits following the inspection. Blankley et al., (2014a) note that 'small' audit firm that has inspection report with deficiencies made no effort for restructuring the internal staff and the work assigned to it. The aforementioned finding may rationalized by that small-size audit firm may respond to the deficiencies of the periodic review report by expanding the scope of auditor's performance and audit procedures, audit firm ignore the recruitment of new auditors and this in turn was reflected in an increase in audit fees.

Lamoreaux (2016), test the relationship between the periodic review of the procedures for foreign companies registered in the US stock market and the quality of the audit process. Lamoreaux (2016), concludes that the inspected audit work which characterized by high quality, using several quality of audit process including the going concern opinion', internal control weaknesses, and earnings management. The interpretation of this relationship may be emphasized in light of the commitment of auditing firms to provide documents and records for the audit work at the time of the audit. In addition to the nature of the rigorous sanctions that may be imposed by (PCAOB) in case of violating the efficiency of quality control system, this enforcement mechanism represents an incentive for these firms to improve their performance, since the issuance of an inspection report with deficiencies is negatively influence auditors and audit firms. It is clear from the above discussion that the process of inspection by the (PCAOB) in the United States, however criticized for lacks the professional experience, has authority and enforcement mechanism to investigate and discipline audit firms and individuals for deficiencies of quality control system and to impose sanctions on firms with low quality performance. In this sense, inspection report by (PCAOB) has become influential in improving the quality of the process of auditing in order to restore the confidence of investors.

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