

# *The Macrotheme Review*

*A multidisciplinary journal of global macro trends*

---

---

## Audit quality, a review of the international and national legal framework

Elsa Tanushi

*Faculty of Economy, Unviversity of Tirana*

---

### Abstract

*The audit profession and its members are regulated by laws and regulations. Professional auditors should practice the profession in accordance with standards, regulations and legal requirements. This paper aims to present a detailed and comprehensive overview of the laws and bodies that discipline the concept of auditing quality in Albania and at the international level, specifically in the USA, where this concept was born and developed for the first time and in Europe. In this paper, the current legal framework and its development over the years will be evidenced. The review of the legal framework allows a fuller understanding of the importance that the concept of audit quality is taking internationally, with more dedicated laws, and nationally, with relevant changes in laws and regulations continuing on the basis of European framework.*

Keywords: laws and regulations, standard requirements, national and international bodies

### 1. Introduction

Audit professionals, who exercise their activity, whether as part of audit firms, whether as a free professional, should exercise it in accordance with standards, regulations and legal requirements. First, the standards, requirements and guidelines emphasize the importance of individual characteristics in the quality of audit performance. Standards such as ISQC<sup>1</sup> specifically discuss quality elements at the societal level. Standards present the requirements for the policies and procedures to be established within the audit firm to achieve quality services. These include ethical requirements for auditors, admission procedures and continuity of audit customer relationship, human resources, engagement performance, and quality monitoring. Second, regulators identify as another important quality element, the audit report. The report should be able to provide some indicators of the quality of audit performance. In addition, auditors should also be able to provide constructive remarks and suggestions for the company's management during the audit in areas where weaknesses are identified. Thus, the value of audit services involves the generation and growth of user confidence as well as audit services themselves can help improve the efficiency and effectiveness of the company's performance.

---

<sup>1</sup>International Standard on Quality Control, December 2009

## 2. International legal framework

First, it is appropriate to make a reflection of the way in which the profession of auditor is disciplined in the United States, since it is precisely here that this profession is born and developed mainly to further spread to the whole developed world.

In the US, the Securities Exchange Commission (SEC)<sup>2</sup> is the first oversight body we are considering, which seeks to find the help of investors and financial intermediaries to determine which information elements are important to them. There is a continuing relationship between the SEC and the investor community, aimed at improving the compulsory corporate communications system.

As far as the other supervisory body is concerned, it is the Public Private Enterprise Accounting Supervision Board (PCAOB), which arises in the context of the Sarbanes-Oxley-Act, July 2002. Following the blast of the technology bubble in the spring of 2000 and the crisis of the market after the terrorist events of September 2001, in the period from the end of 2001 to the beginning of 2002, the explosion of the Enron scandal occurred. It was made possible not only by the criminal behavior of a small number of people but also by the contextual conditions and in some cases it was favored by professional service companies (in particular the auditing company) which had allowed the company to produce systematically an information framework that represented non-existent situations. The main subject responsible for this circumstance was the audit firm A. Andersen, who during the crisis was also responsible for the destruction and alteration of documents and for numerous obstacles to justice. The scandal was such that the immediate consequence was the withdrawal of A. Andersen's license until it was forced to remain closed for several months. Following the Enron scandal, there is an accounting collapse (in the sense of showing the fact that the true conditions of the companies were much worse compared to what was stated in the official accounting information) of Global Crossing, Adelphia Communications, Tyco International, AOL Time Warner, Xeros, Qwest Communication, etc.

The common denominator of all scandals was the unfair representation of company conditions which was not sufficiently hampered by the rules and practices for drafting, reviewing and certifying accounting information. The public opinion response caused the political outturn to be the rapid processing of the Sarbanes-Oxley Act as a product of parliamentary hearings that followed the Enron scandal. For the purposes of this paper, we conclude that the Enron scandal lies in the lack of transparency and fair accounting treatment of related transactions and the presence of off-balance sheet items of suspicious content. The Sarbanes-Oxley Act, in addition to introducing numerous financial innovations in the financial market legislation with respect to the liability of issuing companies, deeply revised the issue of transparency in accounting information and tools to combat accounting fraud.

The most important decision in this regard was the establishment of PCAOB, the Public Company Accounting Supervision Board, with the task of supervising the activities of audit companies for companies with widely distributed titles in the public, making it essentially auditor of audit firms. The establishment of PCAOB constitutes a radical change in the previous system of self-regulation of accounting and auditing professions. The creation of PCAOB, like all SOA legislation, was a consequence of Enron and WorldCom events, and as such aimed to rebuild public confidence in financial markets by ensuring the integrity of audit firms. From a legal point of view, PCAOB is created by law and is an almost governmental body. Funding of PCAOB activity is accomplished

through the collection of contributions from listed companies and independent auditors. PCAOB consists of five members who work full time and remain in office for five years, renewable only once; two members must be (or have been) Certified Public Accountants. The President may also have not exercised the audit activity in the year preceding his appointment. PCAOB is subject to SEC supervision, and in fact the regulatory activity of PCAOB is subject to approval and revision by it. The SEC also has some responsibilities and other competencies to the PCAOB: it appoints the president and four other members and approves the annual budget and rules before they are approved. Audit firms, to offer their services to listed companies, should register at PCAOB. Article 104 of SOA requires PCAOB to implement a continuous audit program on audit firms. In these inspections, PCAOB assesses the compliance of audit societies' behavior with SOA, with PCAOB and SEC rules, as well as with professional standards. SOA requires PCAOB to conduct annual audits on audit firms that produce audit reports for more than 100 issuing firms, PCAOB should also produce a written report for each inspection performed and this report is communicated to the SEC. The object of the inspections is the audit duties performed by the audit firm; the adequacy of the quality control system in the audit companies and the manner of keeping the documentation and all other controls considered appropriate. PCAOB has the power to impose sanctions, which are subject to revision by the SEC. PCAOB also has investigative and disciplinary powers: it may investigate any act or omission by a registered audit firm or a related person that may have violated any provision or regulation of SOA. Also, PCAOB may require proofs or documents (including audit documents) from any registered firm for its audits and may take disciplinary action in the event of a lack of co-operation. PCAOB is the entity responsible for defining standards for auditing and accounting certification. Prior to the establishment of PCAOB, the accounting professions operated on a self-regulation system based on which standards of behavior were established, but this system was ineffective and criticized several times. It is important to first analyze quality control in the United States - which represents the context in which the audit was born and continues to grow. In the United States, where accounting auditing has been established since the beginning of the twentieth century as a function of public interest, the extension of quality control is more rooted than in European countries, but not necessarily better; it suffices to think that most of the biggest financial scandals are verified exactly there. Perhaps even with regard to what was just affirmed, AICPA, the American Institute of Certified Public Accountants, to ensure a high quality of services provided by its members, has developed a major self-regulation activity that includes defining the requirements of admissibility in the institute, technical and behavioral principles, in order to verify compliance with the rules issued and the enforcement of sanctions in case of violations. In the United States, the quality control system of an audit firm is divided into process controls, or human resources, and in product or engagement controls. The first includes the proper procedures to ensure an appropriate level of quality: the human components, that is, the personal and technical characteristics of the person performing the audit work. The second category, ie product controls, includes client / job acceptance procedures, which provide an accurate analysis of the risks of a new professional relationship, referred to as business characteristics, as well as the integrity of the management of the client company. The overall audit risk in this case is given by the combination of three components:

- the risk of operational continuity of the client;
- image risk to the auditor, which is the threat that may arise for the audit firm by associating its name with that of the audit client;

- the risk of the audit, or the possibility for the auditor not to disclose any errors or irregularities even after the completion of all the procedures envisaged.

Audit firms have an organizational pyramid structure in which each subject should limit its control over the hierarchically in a positively-positioned position. This system is the clear expression of the self-regulation approach that characterizes American reality, where it is the profession that undertakes to ensure quality in the interest of public service.

Of course, there are advantages and disadvantages, but the role of the Security Exchange Commission (SEC) should not be forgotten as a body designed to ensure the transparency and protection of the American financial market. It recognizes, encourages and supports the many initiatives developed by AICPA and carries out a supervisory activity on the work of various operating bodies within it, and verifies compliance with audit principles and independence. Therefore, an intensive agreement has been established between AICPA and SEC, a cooperation based on a continuing debate on the most critical issues related to the quality of the audit. Regarding the Old Continent, starting from the 1996 Green Book, there have been many legal interventions in the field of accounting by various European bodies, including the recommendation issued by the European Commission on May 16, 2002, which states correctly that rules regarding the independence of legal auditors in EU Member States must comply with the fundamental principles of: objectivity, integrity and independence.

The European Directive 2006/43 / EC, which refers to Isa<sup>3</sup> of Isqc1, presented a major innovation in the quality of auditing already present at an international level: quality control over the work done by auditors. The directive went beyond the concept of independence by introducing forecasts regarding quality control and defining the quality standards that subjects should definitely meet. The goal was to increase the credibility of the financial market review activity and respond to those who were asked: "Who controls the controller?"

These new rules for auditing and certifying accounting information were intended to improve the reliability of accounting information and the establishment of minimum standards for the certification of annual financial statements with the ultimate aim of strengthening confidence in capital markets.

The directive clarifies the obligations of the audit firm, defines the obligation of independence and ethics, it provides for the need for external quality certification and provides a public control over the professional audit. The main aspects of the directive are as follows: it requires auditing companies, which carry out statutory audits of companies accessing public savings, to draw up a detailed public report describing the audit firm and the network of relationships it has. Article 41 of the Directive provides that any entity in the public interest has an audit committee. The Member State shall determine whether audit committees should consist of non-executive members of the administrative body and / or members of the supervisory body of the audited entity and / or members appointed by the general meeting of shareholders of the audited entity.

Member States should ensure that any independent auditor is identified in a public electronic register and that the information in the register is kept up-to-date and in the register they must report information on the number of employed or linked auditors and the ownership structure and management structure of the audit firm. The Directive also requires auditing companies to undergo a quality control and certification system and be organized so that they remain independent and

---

<sup>3</sup> International standards on auditing

subject to public oversight. In order to guarantee better controls, Member States should organize effective systems of inspection and sanctions (civil, administrative or criminal) which have to be made known to the public. Member States should determine the authority competent for the approval, registration, quality certification, inspection and discipline of audit firms. Also, the authorities of different countries have to cooperate with one another and be organized in such a way as to prevent conflicts of interest and to preserve professional secrecy. The Directive requires auditing and certification companies to make public paying commissions to audit firms, divided between fees for audit services and those for other services. There is a principle of rotation of tasks under which Member States may choose whether to require that the main auditor engagement that conducts an audit in a company is changed every five years (internal rotation) or the audit company is changed every seven years (external rotation). The Directive does not prevent an audit firm from providing additional services to the audited company but strengthens protection in conflict of interest situations: auditors can not provide any additional service that could compromise their independence and make them involved in any way in management decisions. Unlike the US case there is no list of non-audit services that can not be provided. However, the audit firm should reflect the amount of fees for the audit and non-audit services that a particular entity has benefited. Public oversight of professional auditing has been strengthened, and in this regard, the directive requires Member States to organize a public oversight system. It is assumed that any audit firm performs the work in a certain way, thus achieving a final result that will not be homogeneous in terms of quality, therefore not comparable directly to that achieved by others. In this way, there is a need to have common standards for all audit firms, through which a minimum level of quality can be guaranteed, where these standards are a guideline that leaves the auditor free to apply in every specific case, his free and professional opinion, this refers not only to the ethical standards and professional, but also technical, as well as the rules for drafting the final audit report. In addition to the analysis that the auditor who acts as an independent, it is necessary to do the analysis of the audit firm, because it is true that some features are traceable to the natural person. It is also true that many others, those that relate to the organizational nature belong to a group of individuals who cooperate to achieve certain goals, ie an audit society. An auditor, who follows the dictates of the standard, makes his job this a certain minimum quality level. Consequently, to ensure the quality of the procedures and, consequently, the final product of the audit, the audit firm should have its own internal control system, and this need is felt so much that it is drafted by the IAASB, a standard of special international quality control (ISQC No. 1). This standard is intended to be a guide to the establishment of a quality control system, audit tasks, and more closely related services to an audit firm. In general, each company should establish a quality control system that ensures a reasonable assurance that the company itself and its staff perform their work in accordance with professional standards and legal requirements so that the reports they provide be appropriate for the circumstances. ISQC provisions n. 1, vary according to the characteristics of the audit societies themselves and on the basis of the national context in which they exercise their activity.

The Directive reviewed above was subsequently amended by the new Directive 2014/56 / EU. The new Audit Directive aims at improving the quality of the audit and includes measures to strengthen the independence of legal auditors, to make the audit report more informative and to strengthen audit oversight across the EU. The European Parliament and the Council of the European Union adopted in April 2014:

- Directive 2014/56 / EU ("Audit Directive") relating to statutory audits of annual and consolidated accounts;
- EU Regulation 537/2014 on requirements for legal audit of public interest entities.

(compulsory application for the financial statements, referred to the activity after 17/6/2016). The Regulation presents a double reporting level for public interest entities: an extended review report and an additional report to the Internal Audit and Audit Committee. The audit report shall be drawn up in accordance with the provisions of Article 28 of Directive 2006/43 / EC, shall contain the following additional information: who or which body entrusted the audit task, the date of the assignment of this duty and its duration, including any renewal; an explanation of the manner in which appropriate review is conducted to detect irregularities, including fraud; a confirmation that the audit opinion is in accordance with the supplementary report to the internal audit and audit committee; a statement that no prohibited service was provided and that independence was not compromised.

Article. 26 (3) of Directive 2006/43 / EC identifies the Group of International Standards on Auditing which becomes mandatory for carrying out the statutory audit and consists of:

- International Auditing Standards (ISAs);
- International Standards on Quality Control (ISQC 1)

Other related principles issued by IFAC<sup>4</sup> through the IAASB, to the extent that these are relevant to the purposes of the statutory audit, allows Member States to impose additional review procedures or obligations but are no longer allowed to abolish some of the principles of the international review

As far as ISAs are concerned, the following will list those that directly discipline the concept of audit quality.

SNA 200, The general objectives of the independent auditor and the performance of an audit in accordance with international auditing standards, of December 2009, relate to the overall responsibilities of the independent auditor when carrying out an audit of the financial statements in accordance with the SNA .The purpose was to provide a reasonable assurance whether the financial statements as a whole are free of material misstatement, whether due to fraud or error, enabling the auditor to express an opinion as to whether the financial statements have been prepared in all material respects with the applicable financial reporting framework. SNA 220, Quality Control for Audit of Financial Statements, of December 2009, relates to the auditor's specific responsibilities with regard to quality control procedures. This ISA is based on the fact that the company is subject to IASC 1, which stipulates that the company has an obligation to establish and maintain a quality control system. The auditor's goal is to implement quality control procedures at the level of engagement that give the auditor a reasonable assurance. SNA 315, Identifying and Assessing the Risks of Material Misstatement by Understanding the Customer's Activity and its Environment of December 2009, which defines the requirements for identifying and assessing the risks of material errors through understanding the entity and its environment. Such an approach is very different from how some audits may have been carried out in the past in some countries.

The International Standards on Quality Control (ISQC) 1, dated December 2009, deals with a company's responsibilities with regard to its quality assurance system for audits and reviews of financial statements, and other security and service commitments connected. The purpose of a company is to establish and maintain a quality control system to provide reasonable assurance that:

---

<sup>4</sup> The International Federation of Accountants is the global organization for the accountancy profession

the company and its personnel are in accordance with professional standards, applicable legal and regulatory requirements; reports compiled by the company or engagement partners are appropriate considering the circumstances of the processing.

Even the existence of an undisclosed material error in the audited financial statements can not necessarily indicate a poor quality audit as audits are designed to provide reasonable, non-absolute assurance that the financial statements do not contain material misstatement. The difference between absolute and reasonable assurance is particularly important when errors are the result of fraud that is hidden through falsification, secrecy and deliberate misrepresentation. An audit model that is designed to provide reasonable assurance, rather than absolute, implies that there is the possibility of undisclosed material misstatements. After identifying material errors, which have not been detected by the audit, it can be difficult to determine whether they have not been detected as a result of the overall audit pattern or deficiencies in the quality of individual audit.

### 3. National legal framework

Finally, we will follow the case of Albania, where law 10091, dated 05.03.2009 "On legal audit, organization of the profession of Legal Auditor and approved accountant" as amended by Law 47/2016, regulates the legal audit of the financial statements annual, individual and consolidated. According to the Law, the exercise of the profession of statutory auditor in public practice can be done individually, as a partner / shareholder participating in the capital of an audit firm, or as an employee of another registered legal auditor. The law provides that accounting professionals exercising their activity as legal auditors are grouped into a single professional organization that directly regulates the organization of the profession of legal auditor and is organized as a legal person in accordance with the law and the statute of theirs. The professional organization of legal auditors is a professional body that groups legal auditors and audit firms that operate in the Republic of Albania. "The Institute of Authorized Accounting Experts", IEKA, is the name of this organization. In addition to the rules provided by law, the Statute of the Professional Organization of Legal Auditors establishes detailed rules on the organization, selection criteria or appointment, functioning and duties of its bodies, a statute approved by the Minister of Finance. The profession of Legal Auditor is supervised by the Public Oversight Board as a direct supervising all legal auditors and audit firms, as well as overseeing the activity of the Professional Organization of Legal Auditors (IEKA). By Law No. 10091, dated 05.03.2009, as amended, the Board, in the exercise of its supervisory functions, of quality and administrative assurance, is assisted by a support structure whose employees are directly involved in the quality assurance control. The purpose of the public oversight system of statutory auditors and audit firms is to increase the assurance that legal audits are carried out in a transparent, controlled and prudent environment and that they are always in the service of public interest. The current BMP was appointed by order of the Minister of Finance, No.27, dated 24.03.2017, "Order on the appointment and mandate of the chairman and members of the public oversight board".

The statutory auditor or audit firm is subject to a quality control system for quality assurance, intended to provide security for the quality of audit work.

The quality assurance system includes two links:

- a) quality control, organized within the audit firm;
- b) quality control that is organized by the Public Oversight Board.

The Public Oversight Board may delegate the performance of quality control to audits of non-public entities to IEKA, the Institute of Authorized Accounting Experts, which is a professional association for 25 years, collects legal auditors that exercise the activity of in Albania. IEKA performs quality control through the Quality Control Committee, which aims to verify and provide sufficient certainty that the Legal Auditor and / or the affiliate partner and audit firm comply with the legal requirements and other internal rules of The Institute and that the organization of audit firms responds to the needs of practicing the profession. Quality Control is organized in such a way as to be independent of the Legal Auditors or engagement partners and audit firms that are audited.

Quality control within the firm / audit cabinet is guaranteed through the establishment of internal review rules for quality control engagement purposes, which are based on IASC1 and the relevant guidance elaborated by IEKA.

Quality Control organized by BMP / IEKA is a procedure for reviewing the professional activity of legal auditors (natural person and associates and audit companies) based on the requirements set out in the Audit Law, the IEKA Statute and in accordance with other requirements as explained in IASC1.

Quality control is performed on the basis of a risk analysis, at least once every three years, for statutory auditors and audit firms auditing public interest entities, and once every six years, for statutory auditors and audit firms that audit units other economic sectors. For legal auditors, with no more than five years of professional experience, this audit is carried out, at least once every two years, until the required experience is achieved.

#### **4. Conclusions**

Through this work was carried out a review of the national and international legal framework and its development in recent years, it can safely be asserted that the attention of the legislator and various international accounting bodies has increased considerably to the quality of audit topics. Originally in America, the 2002 Sarbanes Oxley Act, which was the result of inclusive financial scandals, and which focused a lot on the importance of a quality-conducted audit. In Europe, therefore, legal changes began to pursue a proper discipline of this aspect of the profession of auditor, and in 2016 with Directive 2006/43 / EC, a major innovation in audit quality was already present at a level international: quality control over work done by auditors. This Directive went beyond the concept of independence by introducing forecasts regarding quality control and defining the quality standards that auditing entities must meet. In Albania, the profession of auditor is disciplined by Law No. 10091 of 2009, and the quality of the activity is currently supervised by BMP. Starting in 2016, with amendments to the auditing law, oversight will be carried out by the Board through its special structures, not through IEKA, to underline that in Albania the quality of the audit is being devoted to the importance of equality in the context of legal changes at European level.

## References

[www.bmp.al](http://www.bmp.al)

[www.ieka.al](http://www.ieka.al)

[www.iaasb.org](http://www.iaasb.org)

[www.isa.org](http://www.isa.org)

[www.ifac.org](http://www.ifac.org)

[www.sec.gov](http://www.sec.gov)

Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006

Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC

The *Law* no. 10091, dated 05.03.2009 “On the Statutory. Audit and Organization of the Registered Chartered. Auditor and Approved Accountant”, changed by law 47/2016

Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014

Sarbanes–Oxley Act, 2002

ISA 200, “Overall Objectives of the Independent *Auditor* and the Conduct of an. *Audit* in ... responsibilities relating to fraud in an *audit* of financial statements.,December 2009

ISA 220, Quality Control for an Audit  
of Financial Statements, December 2009

ISA 315, IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT  
THROUGH UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT, December 2009

INTERNATIONAL STANDARD ON QUALITY CONTROL (isqc 1), December 2009

Order of the Minister of Finance, No. 27, dated 24.03.2017, "Order on the appointment and mandate of the chairman and members of the public oversight board".