Audit Quality: Beyond the technical perspective

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This article provides insights from the academic literature and the authors' research of early career auditors to draw out lessons for improving Audit Quality. We conclude with a call for greater focus on developing scrutiny and challenge among early career auditors, and for practical steps to be taken to 'operationalise' Audit Quality and auditor independence.

We hope this would join the discussions on the recent announcements in relation to the IAASB's new International Standards on Quality Management (ISQM) and the ICAEW's recent Audit Insights series.

What is Audit Quality?

As an important starting point, we note that there are several ways of thinking about what Audit Quality (hereinafter AQ) means in practice. A point emphasised recently by the FRC who found that Audit Committees struggle to distinguish between AQ and 'quality of service' (ICAEW, 2022).

One 'measure' suggested for AQ is the joint probably that an auditor will both *detect* an accounting misstatement and *report* the misstatement (De Angelo, 1981), a definition still used in many studies of AQ. However, as practitioners will know, the underlying processes and inputs to AQ can be harder to establish and aren't necessarily easily quantifiable. The IAASB (2014), for example, provide a useful discussion of the complexities that result from, in essence, the judgment inherent to both the accounting and auditing standards.

Academic studies into the underlying processes through which AQ emerges note that it depends upon:

- One's perspective as to what auditors are expected to deliver or the so called 'expectations gap' (Sikka et. al, 1998);
- The complex 'backstage' of audit practices and methodologies (Power, 2003);
- Auditor's relationships with clients (Guénin-Paracini et. al, 2015);
- Audit team dynamics (Amyar et al., 2019);
- Coaching and internal quality review (Seckler et. al, 2017);
- External quality review (Cohen et. al, 2020); and
- The cultural norms and discourses within the profession (Whittle et al., 2014).

An important theme across such studies is that besides learning via technical training, auditors also learn by experiencing what AQ looks and feels like in practice (De Vries et al., 2022). This happens via often difficult, emotional, and high-stakes encounters involving negotiation and compromise.

AQ in relation to the audit of financial statements, therefore, could be thought of as **a collective social project** through which auditors, regulators, professional bodies and many others seek to ensure that financial information is 'true and fair'. Recognising that this depends both on subjective judgments in relation to what ought to be reported and how auditors ought to go about verifying the accounting information.

Audit Quality as collective social project and the 'two-way' socialization process

Academic studies have highlighted how early career experiences within an audit firm, particularly big-4 firms, is an intensely formative process through which junior accountants learn how to present themselves as professionals (Anderson-Gough et. al, 2000) and learn the technical and cultural norms of audit practice (Guénin-Paraciniet al., 2014). They have also highlighted the 'emotional' aspects of auditing, which is often dominated by 'fear' (Guénin-Paraciniet al., 2014) and 'suffering' (De Vries et al., 2022) through the audit process before eventually achieving a sense of 'audit comfort'.

Such dynamics develop via a 'two-way' socialization process as junior auditors adapt themselves to their new environments, while the large accountancy firms similarly adapt themselves to the changing expectations of new recruits and early career accountants (Durocher et. Al, 2016).

At the team level, AQ could emerge through a complex balancing act involving junior auditors raising concerns and review processes (both formal and informal) identifying deviations (Seckler et. al, 2017). This contributes to successful firm wide implementation of AQ management, which is affected by the local audit team's ability to identify and resolve errors (Seckler et. al, 2017) and the local client relationship building (Guénin-Paracini et. Al, 2015)

Meanwhile, at the structural level, there is evidence across the UK, US, and elsewhere, that FRC and PCAOB style external quality review has driven change in audit practice over the past decade. The changes include excessive documentation and diminishing returns in terms of actual AQ (Cohen et. Al, 2020). We similarly noted in our data collection that firm-wide changes, resulting from FRC recommendations, filtering down into standardised working papers and revised audit methodologies.

This two-way dynamic can drive improvements in AQ, as local audit teams apply their professional judgment and build relationships with clients while firm wide quality control processes help ensure standardisation of best practice and thorough quality review.

However, the opposite is also true – there are both bottom-up and top-down pressures that drive 'Reducing Audit Quality Practices' (RAQPs) (see Seckler et al., 2017; and Amyar et al., 2019). Top-down pressures might include classic issues of firm or partner level independence, but more subtle issues include standardised methodologies producing a 'box-ticking' mentality (Cohen et. al, 2020) or commercial logics undermining professional scepticism at the level of the audit team (Guénin-Paracini et. Al, 2015; Canning et al., 2018; Broberg et. al, 2018; Dermarkar & Hazgui, 2022).

This 'socializing' experience, through which auditors learn their craft, therefore has the potential to both improve AQ or, alternatively, embed poor practice and audit failure.

What are the causes of audit failure at the audit team level?

Research suggests that it is the more judgmental areas of the file such as materiality assessments, accounting estimates, and earnings management that are susceptible to audit failure (Commerford et. Al, 2015; Bennett & Hatfield, 2017; Bucaro, 2019). Similarly, the FRC have for many years raised insufficient challenge of management assumptions, the audit of complex judgments and estimates, and professional scepticism as being areas where firms need to improve. A brief review of recent audit scandals in the UK, whether it be the accounting for revenue rebates at Tesco, Going Concern review at BHS, or long-term contracts at Carillion, would seem to drive home a similar message.

But feeding into this are operational issues faced by auditors every day, which can lead to errors being compounded year on year making them harder to report, or client relationships becoming establish become difficult to disrupt. Cipriano et al. (2017) for example cite the vast discrepancy between qualified audit reports and subsequent GAAP restatements leading to a 'system of compromise' in which auditors, seemingly routinely, allow misstatements to remain in the accounts.

Numerous studies identify workload pressures, deadlines, and poor work life balance as persistently driving down AQ (Lambert et. al, 2017; Bennett & Hatfield, 2017; Christensen et al, 2021; Khavis & Krishnan, 2021). Christensen et al (2021), for example, suggest a tipping point at around 60 hours per week, beyond which we see increasingly severe negative impacts on AQ. While Bennett & Hatfield (2017) find that auditors adjust materiality levels and scope out work when faced with tight deadlines.

Meanwhile other studies highlight getting the job done, alongside income generation, as the major drivers of promotion (Carter & Spence, 2014; Storm & Muhr, 2022). One particularly extensive qualitative study on two of the big-4 (Storm & Muhr, 2022) goes so far as to conclude that "what counts for getting ahead is visibly working a lot and generating income. Particularly toward higher positions, promotions appear to be decoupled from talent, skill, or potential".

This is not necessarily a comprehensive review of all of the causes of audit failure, but it is perhaps worth emphasising the important *operational* and the *day to day* pressures that impact on AQ, alongside the classic organisational solutions, which tend to focus on rotation, non-audit services, and market competition.

Operationalising Audit Quality?

Evidence in relation to efficacy of FRC and PCAOB style external quality review is somewhat mixed. Knechel & Jong Park (2022), for example, review 13 years of audit reports for EC listed clients to conclude that PCAOB are being influenced (they suggest subtly and informally) by political connections between the SEC and the audit industry, while Cohen et. al (2020) suggest that PCAOB reviews have driven excessive documentation and tend to achieve diminishing returns over time.

To address these points, some academic studies have attempted to outline alternative policy proposals, although such work is limited. Van Brenk et al. (2022), for example, suggest a quasi-governmental 'audit board' that would conduct the audits of public interest entities, while Lesage et al. (2016) suggest that European style state regulation might be more likely to punish failures in serving the public interest. An idea that seems to foreshadow the establishment of the ARGA in the UK.

Drawing on our own data, however, we believe there is a need to develop what Guénin-Paracini et. al (2015) refer to as 'operational', rather than 'organisational', independence, and for a shift in focus towards the day-to-day issues driving audit failure. Following our interviews with early career auditors, we suggest steps could be taken to empower auditors to make the right decisions and challenge their clients without fearing for the impact on their careers or generating unmanageable workloads.

In contributing to our study, early career auditors have repeated many of the themes summarised above. In particular, the detrimental effects of excessive workloads, driven in part by the growth in documentation and issues with recruitment and retention. These issues are not just making the audit industry a less attractive space to build a career, but were directly impacting upon operational independence and AQ.

There is a sense that in order to 'get ahead' auditors need to 'play the game'. In practice this meant fostering good client relations and even learning to effectively document away or scope out misstatements. We believe this potentially 'bakes in' reducing audit quality practices (RAQPs) and saw evidence that it was leading to some technically minded or values driven auditors leaving the practice.

Our suggestion, which we would like to further discuss with the profession, would therefore be that we ought to invest in steps to educate and empower junior auditors to spot RAQPs and develop their professional identity towards one of scrutiny and challenge. We think this likely most likely needs greater resource flexibility when audit issues are identified, a re-shaping of client expectations, and a re-coupling of AQ to performance management practices and career progression opportunities.

We look forward to any feedback on these ideas or any opportunities or challenges practitioners could foresee in practice.

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