

# What practitioners and academics want to know about audit quality

Jan Bouwens

What do we know about audit quality? An intriguing question for which society seems to have a ready-made answer, while to the audit industry is much less clear about what it takes to get there. Society would seem to impose a zero-mistake tolerance on the audit industry. Surely society does not want to pay the price that would take audit quality to a level where quality is irreproachable. For that matter, it is not even clear that auditees who pay a premium fee get better quality. For instance, while industry specialization tends to have a positive effect on audit fees (Numan & Willekens, 2012a), competitive pressure may inflict a negative effect on quality. Numan and Willekens (2012b) report a negative impact on audit quality delivered by an auditor who faces competitive pressure from competitors who resemble the focal auditor in its range of activities. These results seem to suggest that society varies the price it is willing to pay for an audit. To the extent that audit fee is associated with the quality of the audit, it would appear that audit quality is not uniform across audit engagements. If that is the case how should we interpret the expectations of society with regard to audit quality? What determines audit quality? When is audit quality (in) sufficient? However, before we can even begin to answer that question we first need to agree on what exactly is audit quality. Is it possible to measure audit quality?

During its first conference, the Foundation for Auditing Research<sup>1</sup> (FAR) takes issue with exactly this topic: “What do we know about audit quality?” At the conference academics as well as practitioners gave their take on what makes audits good. This issue of MAB elaborates on these topics and gives the floor to the discussants of the papers that Jere Francis, Marleen Willekens, Suraj Srinivasan and Robert Knechel presented at the FAR conference, May 9 and 10, 2016. Liesbeth Bruynseels, Christine Nolder, Jeroen van Raak, and Joost van Buuren discussed their papers during the conference. An exciting feature of the FAR conference was the contribution of auditors from practice, an auditee, as well as the audit oversight body. They took the floor in the panel, as presenters in front of the class room or as an interested auditor present in the class room.

This MAB issue opens with a paper by Liesbeth Bruynseels and Herman van Breuk that presents a discussion of the presentation Jere Francis gave. Jere's discussion at the conference focused on his study (Francis, Pinnuck, and Watanabe, 2014) that reveals that auditors have a particular style of auditing leading to the observation that (1) two companies in the same industry and year indeed have more comparable earnings when they are audited by the same Big 4 firm, and (2) that companies audited by the same Big 4 auditor will have more comparable earnings than companies audited by the same Non-Big 4 auditor. The first finding is according to Bruynseels and Van Breuk's discussion at odds with the idea that firms differ and that therefore similarities in their financial statements should not be observed. Francis, Pinnuck and Watanabe (2014) attribute the second observation to the fact that Big 4 auditors have more resources to standardize their audits. However, in their discussion Liesbeth Bruynseels and Herman van Breuk, propose that auditees may select auditors with particular styles.

Marleen Willekens presented her working paper co-authored with Ann Gaeremynck and Robert Knechel (Gaeremynck, Willekens & Knechel, 2016). She took issue with the (efficient) production of audits. What is efficient in this regard? This is by no means a straightforward question to ask unless one assumes that quality is fixed. While we know that assumption is not fulfilled in reality answering what is efficient pertains to two important dimensions: efficient at the micro-economic level and at the societal level. Willekens examines audit efficiency from the micro-economic level. The paper demonstrates that partner tenure is positively affecting audit efficiency. Interestingly it appears that the work clients execute in preparation of the audit work has a negative relation with efficiency. One wonders how and whether this finding extends to how well the auditee has organized its internal controls. After all, the auditor can more or less depend on these internal controls in designing its audit conditional on how well the controls operate. Willekens et al. (2016) have also examined that question and find that “no efficiencies are realized by relying on internal controls”. Christine Nolder and Sytse Duiverman discuss in this issue the pa-

per Marleen Willekens presented and pay specific attention how future research can build on the work of Gaeremynck, Willekens and Knechel (2016) to enhance our knowledge of efficiency. Among other recommendations they advise future researchers to pursue a research agenda that takes issue with office levels factors to enhance our understanding of what are the underlying forces that determine efficiency. Suraj Srinivasan presented a paper on audit quality co-authored with Shiva Rajgopal and Xin Zheng (Srinivasan, Rajgopal & Zheng, 2016). The central topic of their paper is to examine how well empirical audit quality measures stand validity and reliability tests. Their paper provides a rather bleak picture of how well the existing measures stand the tests. Jeroen van Raak and Ulrike Thürheimer propose that the way ahead is using data researchers collect from the audit firms, rather than using data that is publicly made available. They present in their paper some important examples of how this can be accomplished. Their paper will help future researchers in their endeavors to capture the phenomenon of audit quality.

Robert Knechel presented his paper co-authored with Carlin Dowling and Robin Moroney (Knechel, Dowling & Moroney, 2016) at the conference where he asked: Does tougher enforcement by regulators entail higher quality? Knechel argues that clear limits exist as to the extent that enforcements can help improve audit quality. Joost van Buuren and Annie Wong examine these limits in their discussion. They suggest that the authors further examine how cooperation between regulators and audit may affect audit quality. In a panel consisting of Deloitte partner and Head of Audit Marco van der Vegte, AFM director Barbara Majoor, Non-executive director Jan Nooitgedagt and researcher Marleen Willekens it is discussed what each of these stakeholder believe what it takes to enhance the meaning of the audit function. Philip Wallage summarizes this discussion. Marco van der Vegte focuses in his discussion on the importance of extending our knowledge of the audit process, i.e., opening the “black box” of the audit. By studying how the attention of audit work is distributed over the processes and the care with which the processes are accomplished we can extend our knowledge of whether and how the structure of the auditing processes affects the use of information. Barbara Majoor focused her attention on the organization cultural dimension. She argues there is much to learn about how culture is related to audit quality. Culture may pertain to auditor and auditee. Jan Nooitgedagt calls for innovation in the profession. He has yet to see how automation is going to affect the audit function. Marleen Willekens believes that we need to learn much more about input-output models to understand what determines the quality of the audit. In fact the call of

Marleen comes very close to the call of Marco van der Vegte where he referred to the audit process. The panel is also asked to comment on the role of audit committees. It appears that audit committee members often have no accounting/financial background. This comes at a cost!

During the conference the auditing industry took the floor to elaborate on what it expects to learn from research and how it sees their own role in strengthening the bridge between practice and science. To this end the industry was represented by Egbert Eeftink (KPMG), Michael de Ridder (PwC), and Marco van der Vegte (Deloitte). Olof Bik provides a summary of the ideas they put forward. Michael de Ridder argued that there can be no doubt, the audit industry has to change. While the sector has its own ideas of what steps to take, it would be important to know what measures (do) not work and why. For instance what does it mean if auditors get more involved with non-executive directors and untie their relation with managing directors?

Marco van der Vegte believes that the communication on what an audit and its quality entails should be studied so as to provide auditors guidance to meet the expectations of financial statement users. Egbert Eeftink believes that auditing research could fill the gap between disciplines. Research can help to identify areas that auditors may want to emphasize.

This special issue closes with a remarkable observation made by Willem Buijink. He states that the profession is not so much in trouble, but that stakeholders seem to *feel* that audit is in trouble. That said, Buijink does believe that auditing has a great future ahead and that the profession would benefit a lot if we extend our knowledge of auditing!

As the work by Numan and Willekens (2012a and b) suggests users and producers of audited statements alike may have alternating opinions of what is good audit quality. The discussion that we had at 9 and 10 May 2016 at Nyenrode University has confirmed this idea. In fact during the conference it became clear that a third group has alternating opinions as well: the academics. That said all of the participants agree that we can extend our knowledge significantly if academics and the audit industry join forces in examining audit practices. This issue of MAB demonstrates the large array of opportunities lying ahead of us. ■

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## Notes

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■ See: <http://foundationforauditingresearch.org/>

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