The future of audit quality: A multi-stakeholder perspective

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INTRODUCTION Audit quality. The FAR invited multiple stakeholders to share their views during the conference on 7 and 8 June 2017. This paper provides an integrated review of the topics discussed by the stakeholders in their presentations as well as the subsequent discussions with the audience. The discussions touched upon five main topics:
1) What are the multi-stakeholders’ perspectives on audit quality?
2) Is the profession on the right track of regaining public trust?
3) What is the role of external supervision and regulation in regaining public trust?
4) What should the next steps be for the auditing profession?
5) What is the role of scientific research therein?

THE STAKEHOLDERS The first stakeholder to share his views was Marco van der Vegte. Van der Vegte is a member of the FAR Board as well as of the Public Interest Commission of the Dutch Professional Body of Auditors (NBA), and he just resigned as Deloitte’s Assurance leader. The second stakeholder was Pieter-Paul Saasen, who spoke in his role as BDO’s Head of Audit. Furthermore, Saasen participated in the Working Group on the future of the auditing profession (2014) and is a member of the Public Interest Commission of the NBA. The third stakeholder was the current Minister of Finance of the Netherlands Jeroen Dijsselbloem. In his role as Minister he has been a driving force behind the reform programs in the auditing industry. The last stakeholder to take the floor was Gerben Everts. Everts represents another key driver for audit reforms in the Netherlands. He is a member of the AFM board, chairs the Monitoring Group, and he is active in several international boards, such as IOSCO and IFIAR.

Additional stakeholder views on the future of the auditing profession reference are given in the PANEL DISCUSSION paper also included in this MAB issue.

1 A multi-stakeholder perspective on audit quality
“The there is more to audit quality, than merely compliance to the standards” (Marco van der Vegte, Deloitte). According to the Public Interest Commission, there is more to audit quality, than merely compliance with the standards. As there are several stakeholders interested in the work of auditors, there are also different perspectives as to what audit quality actually is. The combination of different stakeholders and different perspectives might be a major cause of the so-called expectation gap. Van der Vegte states that the report of the Monitoring Commission Accountancy in October of 2016 also touches on the unclarity. He postulates “We need a common definition, one that is more than only a quantitative interpretation of audit quality. There is a need for a more qualitative approach to audit quality”. He continues by outlining the multi-stakeholder perspective definition of audit quality outlined in the Green paper issued by NBA at the FAR conference on 7 June 2017. Four perspectives should be taken into account when talking about audit quality:
• Public interest quality: acting in the public interest is more than just complying with the standards; it means that an auditor needs to be there when it matters and act on signals that are relevant to society at large.
• Value added quality: what is the value of the audit by an external auditor to an audited company? How can the auditor help companies and its boards to improve their operations? Auditors should share their knowledge and experience from, for example, working with different companies.
• Compliance quality: this aspect is about compliance with auditing standards and regulations set out by policymakers and the external regulator.
• Process quality: process quality touches upon how auditing is performed by audit teams and firms. How should we organize the engagement team? What processes do we have in place to accept the client? How do we ensure consistent quality?

Everts underlines the broad scope used in the Green Paper to describe audit quality. “It is very good to involve different angles, perspectives and discussions”. However, he also acknowledges that the regulator tends to have a slightly different perspective on audit quality. In PIE licensed audit firms, for example, audit quality is about serving the public interest and being compliant with audit standards. Other perspectives on audit quality are ‘nice to haves’.

Van der Vegte strongly believes that in order to restore integrity and trust in the profession there needs to be a common definition of audit quality that incorporates different perspectives to bridge the current expectation gap. Hence, he has called upon all stakeholders to provide input for the Green paper in order to get to that one definition that allows us to move forward in the sector.
“From a mid-tier perspective it feels as if you’re running a marathon with different starting points” (Pieter-Paul Saasen, BDO).

Saasen identifies a dedicated movement towards an increased audit quality environment that was initiated by the profession itself. “Improving audit quality can be considered a journey and we, as a profession, are not there yet. We need time to change because changing an industry, a profession, a firm requires a lot of time”. However, all audit firms in the Netherlands were told to comply with the same 53 measures proposed by the Working Group for the future of the auditing profession (2014). “From a mid-tier perspective it feels as if you’re running a marathon with different starting points”. There are many differences between the audit firms; for example, differences in resources, client base and culture. So, it is impossible for all firms to achieve the same level at the same moment in time. Moreover, what is the audit quality level that we need to achieve? The definition of audit quality is very different for a controller at Unilever NV compared to someone who owns a family business. In the latter example, the auditor is considered to act as a trusted advisor to that family, and not so much for the interest of the public or investors. However, this family business auditor needs to comply with the same standards as an auditor of a large international trading company. Yet the contexts and goals of any audit differ significantly. Saasen therefore suggests that the sector should consider the example of the SME auditing standards developed in Scandinavian countries, as it prevents auditors getting caught in the middle between auditing standards and delivering a qualitative audit tailored to the client and circumstances. There, auditors do not have a “one size fits all” mentality.

2 Is the profession on the right track of regaining public trust?

“To me, accountability stands for independence […], reliability and accuracy” says Dijsselbloem. However, the current situation is that both the seal of approval and the added value of the work an auditor is questioned and doubted by the public. The challenge faced by the profession is to increase audit quality and restore trust in audit firms and auditors. Dijsselbloem acknowledges the progress the sector has made; however, he is also aware that the sector still has a long way to go. For him, an indicator of progress was an article in the Financieele Dagblad in 2016 in which several corporate executives complained that the relationship between them and their auditor had become a lot more complicated since the new regulations came in force. “I thought this was great news! It signals that difficult conversations are taking place”.

“Where are we on our journey to improve audit quality?” asks Everts. According to both the AFM and the Monitoring Committee Accountancy, progress on strengthening quality controls, beefing up internal oversight and achieving a cultural change, has been slow. A lot more work needs to be done to restore trust and ensure that the public interest are being upheld. Nonetheless, Everts is feeling quite positive because “the ground work has been done, the foundation is in place and it is now up to the sector to convince the audience they can deliver their promise”.

“If we have to take so many measures, are we doing the right things? Are we in the heart of the matter?” Dijsselbloem ponders out loud. At the end of last year, the Monitoring Commission on Accountancy evaluated the effectiveness of the 53 measures and concluded that the measurements are not going to solve structural problems. The Commission identified several issues that still need to be addressed in order to improve audit quality, such as the impact of the business model on audit firm culture, balance between private and public interests and one definition of ‘audit quality’. These issues are also marked as the root-causes of audit failures. Dijsselbloem: “I think that the heart of the matter lies in the business model – it is the customer that pays and therefore stays. How can you ensure standards of integrity and quality and withstand pressure from the customer?” Everts also taps into the last statement by saying: “The current funding structure hinders professionals to act in the public interest. Can you really be independent when you are paid directly by the company whose accounts you are checking?” He feels that the sector itself should put forward suggestions to improve the business model, test them diligently and then implement the changes.

“I fear a situation of shared irresponsibility” (Pieter-Paul Saasen, BDO).

Saasen proposes that it is time to reflect on the 53 measures. He asks: “Is the profession on the right track?” He sees the profession moving towards a compliance driven sector in which everyone just follows the standards instead of applying professional judgment and taking responsibility for what actually needs to be done. Professionals seem to hide behind rules and regulations as they fear the consequences of a condemning file inspection and the enforcement consequences. Saasen fears it creates a situation of “shared irresponsibility” because professionals no longer rely on their professional judgment and none of them, therefore, want to take individual responsibility. “Professional judgement is the foundation of our profession; it requires softer factors such as professional experiences, client relationship and situational factors”. Professor Humphrey shares Saasen’s views and states: “Auditing is in danger of becoming a check-list function instead of a professional function”. As a regulator, Everts hopes that future competition between audit firms is based on quality instead of variables such as fees. “Compliance must be considered in context. Professional judgement must be compiled with as well. Key inspection findings therefore rightfully focus on lack of professional judgement and not on minor check-list omissions - as some would
like the public to believe”. And, ideally, the firms should not be informed by the AFM about the lack of audit quality. No, firms themselves should inform the AFM about the lack of audit quality and should communicate as to which mitigating actions have been taken.

3 What is the role of external supervision and regulation in regaining public trust?

“Auditors need to demonstrate parrhesia – act and think independently under difficult circumstances” (Jeroen Dijsselbloem). “The stricter rules we have introduced now must help auditors to resist peer pressure; however, they cannot generate a real change. The real change in corporate culture needs to come from the inside”. In his speech, Everts refers to an article in the (Dutch Newspaper) NRC of 29th May 2017 based on research by Therese Grohnert (who is currently conducting research on behalf of the FAR) on learning within an audit setting. Grohnert’s work shows that more work needs to be done to create an environment within auditing firms in which colleagues can learn from one-another and learn from mistakes. Everts points to the absence of a learning climate in firms as a possible cause of audit failure. “The way the firms currently structure their work acts as a brake on quality improvement”. Firms work with large teams consisting mostly of juniors whose professional judgement has not matured yet, and he concludes there is no time for professional discussions due to efficiency demands. A large shift in mindset is necessary according to Everts and this has to do with the difference between theory and practice. That attitude needs to change. “Theory is practice. At least it should be. That is what new talent should be told!” Moreover, the regulatory focus is not merely on box-ticking. The AFM wants to bring about a dif- ferent approach in auditing so that it can serve the public interest better. “What I would really like to see is the work of auditors going beyond simply performing checks”. Hence, the AFM introduced many regulatory initiatives that strengthen governance, structure and the culture of the profession.

“The current method is what it is, but if the outcome implicates that you are underperforming, do something about it!” (Jeroen Dijsselbloem)

Willem Buijink of the FAR Board and the Open University asks both Dijsselbloem and Everts about the methodology behind AFM’s statement regarding the supposedly 45% deficient audits and how these findings relate to the 11,000 statutory audits conducted in the Netherlands. Does this mean that over 5,000 audits are deficient? He asks what is the AFM’s basis for such a statement. Dijsselbloem answers that a debate about the methodology is good as “methods can always be improved”. However, Dijsselbloem is reluctant about changing the method “because as soon as there is a critical outcome from a supervisor, we go back to the method and say ‘the method is wrong’. [...] My point of view is that the method used at this moment is what it is, but if the outcome implicates you are underperforming, do something about it! Is it possible to have a parallel debate about the method? Sure. But don’t postpone the difficult question to improve audit quality”. Everts responds by saying that “the 45% is not something we actively highlight to the audience, as if 45% of all audits are not according to standard procedures”. He explains that the AFM examines the operating effectiveness of the internal control environment of a firm. It selects files and runs them through auditing procedures, just like with every other audit. The AFM found weaknesses in the internal control environment in all the four Big firms. Subsequently, the AFM asks the firms how they select the riskier audits and how they evaluate them. The AFM then randomly selects files from the pile including those that received extra attention from internal control. Two alternative conclusions can be drawn from this: One, these files are higher risk, so it is of no surprise that you find audit weaknesses. Or two, you can argue that these files had already been recognized as being high risk, so you will probably not find weaknesses as these files have received special attention. “The overall conclusion is, independent of methodology used, that internal controls do not function effectively. Here, the regulator and the firms agree. We see positive development and potential for further improvements supported by good practices; investing in internal quality controls is the key vector for improving audit quality”.

4 What should the next steps be for the auditing profession?

“Let’s cooperate, let’s connect and let’s work on our shared goal of improving the governance, structure and culture within the audit sector: Thereby improving audit quality” (Gerben Everts, board member AFM).

The generally agreed upon view is that successful transformation of the auditing profession and sector can only take place if all stakeholders work together. A cooperation grounded in mutual respect, trust and open dialogue. Everts stresses that the AFM “is not a prosecution office focusing solely on fines for non-compliance”. According to him, audit quality can only improve if all stakeholders work together: the audit profession, the regulator and the academics. The regulator is not the enemy that designs regulation after regulation in an ivory tower. He says: “The audit firms and the AFM are fully aligned to the fact that inconsistent audit quality needs to be tackled and this journey goes way beyond a pure compliance exercise”.

Everts has a very clear image as to what the sector’s next steps should be. “First the sector should take a humble approach. Do not constantly test the waters or pick a fight with the regulators or policy makers. Secondly, the sector, together with the regulator and the Monitoring Commission, has
to take the initiative to reflect on the 53 measures and propose a ‘Plan B’. Do not wait for Parliament to make decisions. You have to be assertive and pro-active as a sector’. Finally, he says there is a need for a firm-specific approach to strengthen audit quality. How is audit quality failure linked to the specific characteristics of individual firms? “These three things need to be attacked with speed and energy”, he concludes. As to new approaches in auditing, Everts invites practitioners to test regulation in the AFM innovation room. “Join the AFM to see what regulation works and what does not in a changing environment with blockchain, data analytics and new technologies becoming more mainstream. We cannot afford that standards and regulation would uphold developments which could very well be part of the solution vis-à-vis audit quality problems.”

“The sector should pressurize policy makers to uphold audit quality instead of the other way round” (Jeroen Dijsselbloem, minister of Finance).

Dijsselbloem confirms that a lot has already happened and that the public should not expect “the full Monty in the short term. However, half a Monty in the medium term would be very welcome”. He also points out that the auditing profession differs from other sectors in that many of the proposed reforms have to come from the sector itself and not from legislation or regulation. The auditors have taken the lead and initiative in the public debate. “You are not forced to change, but you understand that there is an issue and take action”. This initiative is a great asset in terms of credibility. The next steps could be to tell Parliament and the Minister “look you need to change legislation further to uphold our quality and integrity, you need to protect us and support us when we have difficult conversations with our clients. That would be my preferred approach because then, the sector can keep applying pressure to uphold audit quality on policy makers instead of the other way around”. Dijsselbloem proposes that if the sector really wants to regain trust, it should offer initiatives. And not the ministry nor the regulator. “I would be really delighted to see messages going from the sector to society to show openness to society”.

It is for these very same reasons that Pieter-Paul Saasen invites the audit firms, the professional body, audit regulators and audit educators to a learning environment and change dialogue. “I would kindly like to invite Dijsselbloem and Everts to join us as major parties involved in our journey. Maybe FAR would want to host this and provide a ‘safe haven’ for a learning environment for the profession to determine its next steps” he concludes.

5 The role of scientific research in regaining public trust

“The FAR needs to ‘science the hell out of the problem’” (Jeroen Dijsselbloem).

The FAR facilitates independent research based on empirical data from the audit firms in the Netherlands to identify the determinants and drivers of audit quality. The foundation aims to strengthen the learning curve of the industry, disseminate knowledge, inform regulators and policy makers, and ultimately restore trust in the sector. All four stakeholders independently mention the important role of the FAR. Yet, the stakeholders have different views about as to what exactly the FAR provides.

Van der Vegte states that the FAR is relevant because it facilitates the conversation between practitioners and academics. Saasen agrees and hopes that the foundation can act as a safe haven where the profession can learn and have an open dialogue with the stakeholders such as the regulator and policy makers. Additionally, Saasen sees the FAR could play an active role in helping the sector increase the level of audit quality by finding answers to the most pressing questions.

The regulator expects a more content related role for the FAR to assist the audit profession in its current journey. Everts mentions several research topics that he feels should receive attention. For example, research on audit quality indicators. What indicators lead to audit quality? Moreover, Everts calls for more innovative research. What are the current innovations and how can audit standards tap into these developments? Dijsselbloem quotes Matt Damon in the movie The Martian to describe how he perceives FAR’s role: “The FAR needs to ‘science the hell out of the problem’.” Dijsselbloem makes this remark to emphasize that more profound analyses are needed to address problems in the audit profession. These analyses will pin down more precisely where things have gone wrong and can be improved.

References