

# Panel discussion: A true and fair value of the audit sector

By Olof Bik and Julia Wijnmaalen

*“It is an interesting time to work in auditing; it is difficult, but it feels great to be a part of this moment” (Agnes Koops, PwC).*

**INTRODUCTION** On Wednesday the 7th of June, four distinguished panelists took the stage on the first day of the FAR conference to discuss the need for change within the auditing profession. The discussion between the four members and the audience was chaired by Professor Robert Knechel of the University of Florida, academic member of the FAR Board, and member of the PCAOB Standing Advisory Committee. Five topics were discussed during the panel discussion:

1. What is the added value of an audit?
2. What is good auditing?
3. How should regulators approach the audit sector?
4. What are the challenges the profession faces and what does the future look like?
5. How to attract future talent?

These five discussion topics form the structure of this paper. The panel consisted of two audit practitioners, an investor and an academic. One of the practitioners, Agnes Koops, is a member of the PwC Assurance Board with a focus on human resources. Michael de Ridder was the second panelist. De Ridder is a member of the PwC Board, as well as of the FAR Board and speaks on behalf of the Dutch body of professional auditors. The third panelist was Martijn Bos. Bos is the Reporting and Audit policy advisor at Eumedion. Eumedion is a non-profit organization that represents institutional investors' interests in the field of corporate governance and sustainable performance. The next panelist was Professor Christopher Humphrey from the University of Manchester. The focus of his research field is international financial regulation, auditing practice and accounting education. Humphrey is also a member of the Institute of Chartered Accountants in England and Wales (ICAEW).

Professor Knechel starts the panel discussion with a reflection: “I have been working in audit education, practice and research for more than forty years and some of the issues that were being discussed over the years have not changed. In the eighties and halfway through the nineties this idea of firms and academics partnering up to do research was fairly usual. We lost that for a while. It is very nice that FAR has been able to resuscitate that relationship to help us understand auditing better. We have had at least ten years of regulation, we have been discussing about audit quality a lot longer and there have been many changes in the profession lately but we still have to do a lot more!”

## 1 What is the added value of an audit?

*“Why can't auditing be more about improving society instead of just assuring financial statements?” (Christopher Humphrey, University of Manchester).*

What is the added value of an audit? This question resonated throughout the conference. *“The expectation gap is crucial here”* says De Ridder. For example, there are general rules and standards for estimating materiality, but a part of it is professional judgment. The service that we deliver at this moment does not address all of our stakeholders' questions. Hence, there needs to be a dialogue between the profession and the users to understand what each of them expects and as to what audit quality actually is. This dialogue helps the audit profession to innovate and create new products that fit the wishes of the outside stakeholders better.

During the discussion, Bos was asked how the profession can create more added value for investors. He responds by giving the example that investors do not really understand the concept of materiality. Another issue is key-audit matters. Investors are interested in different key-audit matters than those that are currently included in the audit opinion. *“We sometimes observe that the audit professionals do not flag things that hook into material issues that are interesting to us as investors”*. For example, there are always several key-audit matters on goodwill; however, investors are interested in other matters like the quality of internal control.

*“Most of the added value of an audit is in the non-financial information area” (Martijn Bos, Eumedion).*

Next Bos is asked whether it helps when audit firms monetize values, such as tailored materiality values. Bos replies that monetization is not the Holy Grail. Moreover, *“we investors are keen to put our own prices on stuff”*. According to Bos, most of the added value of an audit is in the non-financial information, like evaluation of internal control quality, integrated reporting, quality of the management team and risk estimations. *“I think that if you are the only audit firm that cannot provide that kind of information in an audit report, your life is limited”*. De Ridder responds that it is sometimes difficult for audit firms to provide that kind of information, because things like a management letter often contain confidential and sensitive information. *“And even if you made that letter public, you would not achieve”*

ve the right effects. So, how can we find that balance between what you can and cannot say outside?”

“There is much more out there in which we can fulfill a role in providing assurance” (Michael de Ridder, PwC).

Humphrey takes the added value of an audit even further: “If we take a multi-stakeholder approach, does it not follow that an audit is for a better society? For example, in my country the audit profession took a neutral stance on the Brexit discussion. Why didn’t they venture into the political arena? Why can’t an audit be more about improving society instead of just assuring financial statements? I think that if we take the stance that an audit is just an audit, it could lead to a very stale discussion, and that is not going to sustain the profession in the future. Particularly since what you are auditing is losing credibility in itself”. De Ridder agrees with Humphrey: “We provide assurance and assurance has a value in society. There is much more out there in which we can fulfill a role in providing assurance. However, there are people out there who say you cannot even do your financial statements audits properly yet, so do not bother to provide assurance on other things”. Humphrey responds by saying: “I cannot stand the phrase: an audit is an audit. That is the most anti-innovative phrase you can imagine. It is not only about assurance, but also about advising and commenting. I worry about that split; you cannot do those other things anymore”. Again De Ridder adds that the sector needs to look for that balance. He states that a good example of this balance is the sector management letters that were published by the Netherlands Institute of Chartered Accountants. However, De Ridder is also aware of day-to-day reality: “Yes, we can do more, but we are also very focused on our clients”.

## 2 What is good auditing?

“Audit quality is implicitly observed by us. It is circumstantial evidence” (Martijn Bos, Eumedion).

Even in an extended audit rapport it is impossible to see how the audit firm conducted the audit and therefore it is difficult to assess audit quality. Bos is asked how institutional investors perceive audit quality. “Audit quality is implicitly observed by us. It is circumstantial evidence. Audit quality is a perception” says Bos. “We can read the report from the regulator, but the audit quality itself is below the surface”. The investor’s perception is influenced by incidents and how auditors present themselves in the public arena. For example: how does the profession respond to the regulator’s report? According to Bos, the profession needs to become more transparent and show how they put the public’s interests before the interests of the firms themselves and their clients. “That is evidence of change”, says Bos. He is also astonished that, as far as he knows, only PwC has a global investor liaison. “We are probably one of your more important stakeholders, so shouldn’t you talk to us all the time?”

Continuing along the lines of the issue of transparency, the next question is raised: “Long-form reporting has

existed forever yet, to my knowledge, no US organization uses it. Why?” It is De Ridder who responds: “There is probably some reluctance to be transparent because litigating is everywhere. The more you write down the more you expose the firm”. According to De Ridder, it is a balancing act between transparency, managing the risks of the firm and meeting the needs of the stakeholders.

“We have to be careful that we do not start to believe more in the standards than in the quality of practice” (Christopher Humphrey, University of Manchester).

Humphrey adds to the discussion that although everyone talks about the role of audit quality in building trust in society, he just wants to see good auditing. Auditors need to feel free to audit well and more standardization is a barrier that will kill the specificity in reporting. “We have to be careful that we do not start to believe more in the standards than in the quality of audit practice”.

“Why does it only happen when there is a rule? And there will be more rules. More rules will be detrimental to our profession” says De Ridder. A good auditor needs to know all the rules, as well as understand, for example, the board room dynamics and the value creation process of a firm. “I am convinced that in the end, our product is a very human product because the board wants to trust the person or team that does the audit”. So, how tangible is audit quality? “You can have an audit approach and technology, but in the end you have to make it understandable, personal and be convincing. The human element. To me, that is a very important element of audit quality. I am sure that the people who buy our services take that into account as well as the fact that you have professional expertise and experience”.

## 3 How should regulators approach the audit sector?

“The 2014 AFM report really hit us. We thought we were doing well” (Agnes Koops, PwC).

Knechel opens the topic of regulation by noticing that regulators around the world have been “a bit critical, so to say”. He asks the panelist: “what does the sector need to improve itself and how do they want the regulators to approach them in these times of change?” Koops shares honestly: “The 2014 AFM report really hit us. We thought we were doing well but we understood from the report that we had to do better”. She states that she feels that everyone within PwC is intrinsically motivated to really improve the quality of audits and, as an organization, they embraced many measures and started working on their culture and behavior. “We are making progress, but it takes time”. The first point Koops makes about the role of the regulator is that the reports helped the sector. However, the drawback of the reports is the pressure they cause. Koops describes an atmosphere of fear. “We are trying to learn from our mistakes, but sometimes the tone of our regulator makes you feel really bad”. She advo-

cates a change in the regulator's tone of voice in order to decrease the current amount of fear.

*"I sometimes feel that our regulator is a bit over the top"* (Michael de Ridder, PwC).

De Ridder supports Koops' observations. *"I sometimes feel that our regulator is a bit over the top"*. De Ridder compares the attitude of the Dutch regulator with the attitude of the PCAOB. *"The PCAOB has a different tone of voice, a wider view, takes more aspects into consideration, is subtler and is more professional and constructive"*. He applauds the "Dash Board" report issued by the regulator which records changes in the sector. According to De Ridder, this report is very helpful to the sector.

However, Humphrey feels that the regulator does not take the opportunity to balance good and bad news. *"IFIAR's findings always talk about things that went wrong or when there was non-compliance. Opportunities of making good quality audits visible are missed"*. He is also astonished about the contrast between the atmosphere in the many policy-makers and regulators' think-tanks and quotes a member of a think-tank: *"the floors are on fire. We are that radical at the moment"*. This in contrast with the atmosphere in practice where people have grown accustomed to having the regulator watching over their shoulder. Moreover, there are clear differences between regulators around the world in terms of how they approach the problems. *"It would be great to see which regulative attitude is most effective"*.

*"We just want regulators to be effective"* (Martijn Bos, Eumediton).

Bos: *"We just want regulators to be effective"*. He adds that he is aware that the regulations can become counterproductive. For instance, investors already notice more 'cluttering of information' in the annual report. Information that is demanded by the regulator.

Bos is asked about his concept of corporate governance in light of integrated reporting and decreasing audit fees. The attendee notes that he has *"never seen the investor stand up during a selection process of a new auditor and say to the audit committee: 'do not focus on price but on quality'"*. Bos replies: *"Eumediton goes into dialogue with more than 40 companies each year and when we do, we ask questions about the audit fee. Did you select on price?"* Investors worry about the audit quality when they see low audit fees. *"There should be sufficient room for an auditor to dig in if problems arise"*. Koops adds that she would feel supported if investors asked the question: *"Is the choice based on quality or on price?"*

Tapping into the discussion about audit fees, Humphrey adds that he feels audit firms should open up about the commercial side of the audit business, both external (in term of the market) as well as internal (status of the auditor in the firm). He has heard rumors that the firms cannot cover the costs of the audit with the audit business itself and that the firms' audit sections are cross-funded by other firm activities.

#### 4 What challenges does the profession face and what does the future look like?

*"What difference did you make as an auditor?"* (Martijn Bos, Eumediton).

De Ridder points to the expectation gap as the main challenge for the profession. *"I think there are two pretty tough elements out there: continuity and fraud. What do we do with these two aspects as auditors, what is our responsibility and what is the firm's responsibility? It has to do with managing expectations"*. Another challenge he recognizes is the link between the auditor's added value and digitalization. *"How do we embrace digitalization and technology in making our products timelier and accurate, while at the same time proving the statement that in ten years time there will be hardly any need for auditors' opinions?"*

*"I think the major challenge for the audit profession is explaining its added value to stakeholders, like investors and the public"* says Bos. *"What difference did you make as an auditor?"* Bos poses that to the audit profession; the client is a distant anonymous figure. Therefore, the sector needs to communicate more about their added value because otherwise, stakeholders have no way of perceiving the added value.

Humphrey: *"A mix of complexities constraints the intellectual space around which practice can be developed, considered, researched and debated"*. The challenge today lies in numerous complexities, such as: can I say this, or not, and to whom? Do I have to worry about legal and liability issues? Another challenge Humphrey identifies is the invisibility of audit quality. *"We use proxies for audit quality and have always assumed that we knew what audit quality was, but it is a big debating point"*.

*"We have to become more IT savvy"* (Agnes Koops, PwC).

*"If you look further ahead, audit work will become more interesting. Data analytics will deal with the 'easy' work and you as an auditor only have to pay attention to the interesting things that stand out in the annual report"* Koops expects. She stipulates further that the profession has changed a lot in the last decade. *"Before, you joined a firm, worked in a team and went together to clients. Now the auditor is more of a project manager who outsources work"*. In the future, the human recourse regarding planning of an audit will change drastically. Koops theorizes that large uniform teams will be replaced by small diverse teams that consist of people with different backgrounds, like data analytics or project management. One of the attendees asked what type of education prepares students best for the profession. According to Koops, automation is the next step. *"We have to become more 'IT savvy'"*. We should educate students about the usage of data analytics and other forms of automation in an audit. Additionally, more attention should be paid to behavioral components, because what distinguishes us from data analytics is that we are human. *"We have to bring the human factor to the client"*.

To a question about his vision on the future behavior

of auditors, De Ridder answers that auditors need to be conscious of the broader role they have in society. He sees it as his job to *“make my (his) people more aware of this responsibility, and make this responsibility carry a heavier weight in their day-to-day decisions while doing an audit”*. It is only possible to achieve this awareness if the tone at the top is right and there is a program that supports this attitude. For example, the firm’s educational programs now discuss the broader picture of auditing and how to translate this into day-to-day business? *“I hope that the tone-at-the-top helps employees when they need to have that difficult conversation with a client”*. However, how can you measure changes in behavior effectively? That is difficult. De Ridder also explains that having a purpose and values is also discussed with clients. According to De Ridder, a signal of whether it is helpful to have this conversation is: *“how many audit proposals did we actually win whilst being the most expensive proposal?”* Koops adds: *“Our purpose is building trust in society. Our profession matters. The purpose and values help us to do the right thing. I think our people are very proud that we do things differently now”*. An example is that if an assignment needs more time, they ask for it, which makes people feel more empowered to increase audit quality. Moreover, she says, the culture is shifting from being internally focused to what is happening around us. *“We could do even better, because sometimes we forget when we are busy with our clients”*.

A last thought on the future of auditing comes from Professor Humphrey: *“Earlier Agnes said ‘the job of the audit is to enhance trust in society’. If the audit sector is successful we will need less auditing, as auditing is there because we do not trust each other. So, in a sense auditing has a strange future because good auditing then eliminates audits. You could argue that the equilibrium for the audit is the expectations gap”*.

## 5 How to attract future talent?

*“I want to train thought leaders!”* (Christopher Humphrey, University of Manchester).

When Knechel raised the question as to how he could convince a smart student to go into the auditing profession, Humphrey replies he asks three questions:

1. Do you have a passion for it?
2. Do you think you can be a leader?
3. Do you think you can drive the profession forward in a new way of thinking?

*“I want to train thought leaders!”* Humphrey notices that the majority of his students drifted into auditing. *“Many of my students do not have a passion for accounting”*. Reading a recent FRC study amongst various audit firms in different countries, Humphrey got the following signals: *“We no longer attract the best students, and when we do, we spend the next few years beating the brightness out of them. Recruitment is really an issue”*. This is very worrisome according to Humphrey. He suggests that universities can also assist in changing the students’ attitudes. *“Look at how we name our subject: financial accounting 1, 2, 3. That is hardly exciting!”*

*“We have to make sure that our profession remains attractive for the talented”* (Agnes Koops, PwC).

It is, however, not only about attracting talent to the firms but also about retaining talent. *“We have to make sure that our profession remains attractive for the talented”*. Koops worries that the increased emphasis on standardization of the profession might lead to an audit to becoming *“just a checklist we need to complete, which does not inspire and challenge new talent to step in. Auditing for a better society does”*. ■

Olof Bik is Associate-Professor at Nyenrode Business University and a member of the management board of the Foundation for Auditing Research. Julia Wijnmaalen is a researcher and editor at the Foundation for Auditing Research.