

# THE CAPABILITY AND COMPETENCY REQUIREMENTS OF AUDITORS IN TODAY'S COMPLEX GLOBAL BUSINESS ENVIRONMENT

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ICAS 





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# CONTENTS

|  |     |
|--|-----|
| Foreword .....   | 1   |
| Acknowledgements .....                                 | 3   |
| Executive summary .....                                | 5   |
| <br>   |     |
| 1. Introduction and background .....                   | 19  |
| 2. Research approach .....                             | 25  |
| 3. Structure of research findings .....                | 31  |
| 4. Expectations on current versus future roles .....   | 33  |
| 5. Current capability requirements .....               | 61  |
| 6. Future capability requirements .....                | 93  |
| 7. Impact on recruitment models .....                  | 99  |
| 8. Impact on training and development programmes ..... | 111 |
| 9. Proposed strategy .....                             | 119 |
| <br>   |     |
| References .....                                       | 129 |
| About the authors .....                                | 133 |



# FOREWORD

In 2013 ICAS and the UK Financial Reporting Council (FRC) commissioned two international teams of researchers to investigate what mix of attributes, competencies, professional skills and qualities need to be combined in an audit team in order for it to perform a high quality public interest audit in a modern and complex global business environment.

This team from the University of Pretoria, Robert Gordon University, The University of Adelaide and the University of South Africa explore the views of key audit stakeholders from three countries – Australia, South Africa and the UK – to address this crucial question.

The research is based on interviews that focused on six of the most significant public companies, each from a different industry, from each jurisdiction. For each of the six companies from each jurisdiction the relevant Audit Engagement Partner and non-auditor experts who participate in the audit team, the Chief Financial Officer, the Audit Committee Chair and the Chief Audit Executive (internal auditor) were contacted to enlist their support in being interviewed. Individuals in each of the three countries who have some oversight, public policy or educative role with regard to audit were also interviewed. In the end, a total of 84 interviews were conducted.

The report's findings are structured around five key sub-questions which cover: expectations on auditors' current versus future roles; current capability requirements; future capability requirements, impact on recruitment models; and impact on training and development programmes. Based on these findings the researchers conclude with a proposed strategy to ensure that auditors of today and tomorrow have the necessary capabilities and associated competencies to deliver high quality public interest audits.

This strategy is broad and covers both the audit report and its scope, as well as individual and collective responsibilities. The recommendations include: a need for a constructive debate about the future of audit; an increasing need in audit teams for people with more diverse backgrounds; that specialists should be recruited and then trained in audit to become an effective part of the audit team; that competency maps and frameworks and CPD offerings should be adapted for the development of data interrogation and analytical skills, broad business acumen and forensic skills; that there should be more focus on the development of mid-career professionals;

and that – with the exception of financial services – specialising too early can sacrifice breadth of experience.

ICAS and the FRC welcome the opportunity of collaborating with the researchers on this important global issue. As the researchers state: knowing what capabilities and competencies auditors will need in an uncertain future is difficult, but if we do not start that debate now how will the profession keep pace with changing expectations and evolve to meet the needs of stakeholders and society? This research has been overseen by a Steering Committee, chaired by Richard Fleck, and the Committee will publish its own report based on the findings of the two research reports and the collective knowledge and experience of the members of the Committee.

The FRC and the Research Committee of ICAS have been pleased to support this project. The views expressed do not necessarily represent those of ICAS or the FRC itself, but we hope that the results will lead to a constructive debate on the future of audit and the skills and competencies which will be required in order to meet that vision.

Allister Wilson  
Convener of ICAS Research Committee  
March 2016

Stephen Hadrill  
FRC Chief Executive  
March 2016



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Finally, the Research Committee and researchers are grateful for the financial support of Scottish Accountancy Trust for Education and Research (SATER), now known as The ICAS Foundation (Charity registered in Scotland SC034836) and the UK Financial Reporting Council. Without this support, the research would not have been possible.



# EXECUTIVE SUMMARY

Various factors have changed the business environment in which today's auditors operate. This has resulted in a worldwide challenge to align the capabilities (technical knowledge, skills, values, ethics and attitudes) of auditors to the requirements of this new environment. Questions have subsequently been raised as to whether auditors have adequately responded to this challenge and it is within this context that this collaborative investigation into the current and future capability requirements of auditors performing complex financial statement audits was conducted. This study represents the first part of a constructive debate on auditors' capabilities to ideally position the audit profession in the 21st century and should therefore not be considered as an end in itself, but as a foundation to foster further deliberations.

A qualitative research methodology was followed which entailed 84 interviews with relevant stakeholders in three countries: Australia, South Africa and the United Kingdom (UK). The sample was restricted to audits conducted by the Big 4 auditing firms for some of their largest listed company clients in the aforementioned countries. Therefore the views of the interviewees (auditors, corporate managers and members of corporate audit committees), directly involved in the audit process are representing the higher end of the audit landscape. As such the study does not directly capture the perspectives of non-Big 4 auditing firms or smaller corporate clients. In addition, stakeholders who have some oversight, public policy or educative role in audit also participated in the study.

The study adds to the current debate on the impact of a changed business environment on auditors by proposing a strategy to ensure auditors of today and tomorrow, individually and collectively as a team, have the necessary capabilities to perform high quality public interest audits. As a basis for informing this strategy, the key findings that emerged from the research are presented in accordance with the study's five research questions:

## **Question 1 - How do expectations about auditors' current versus future role and responsibilities differ?**

There was no dissent regarding the need for a statutory audit and although general satisfaction was expressed about auditors' current capabilities and subsequent performance, the statutory audit in its current form was judged as being too

static. The latter was apparent from the reservations expressed on the value-adding ability of auditors in the public interest. Auditors were criticised for their inability to provide guidance to management about improvements to their business and insights based on industry and cross-industry trends which could promote improvements within businesses. In addition, the expectation gap was perceived to be still evolving and while the ongoing and proposed revisions regarding the content and format of the audit report were viewed as a step to narrow the gap, these were not regarded as being comprehensive enough. Indeed, much of the recent public criticism that has been levelled at auditors was ascribed to the continuing expectation gap and this is clearly an area that still requires to be addressed.

An attempt by regulators to drive up 'audit quality' has resulted in a highly regulated audit environment. Auditors were of the opinion that their response was compliance behaviour, as their firms became more risk averse. The outcome of this compliance driven behaviour has been two parallel audits, namely compliance and assurance driven audits, with the former focussing on ticking the right boxes and the latter aimed to express an opinion. Some chairpersons of audit committees also recognised the notion of the occurrence of two parallel audits. The practice of compliance-driven auditing has elicited much criticism. However, this increasing regulation, which has now also extended to compulsory retendering, and debates over mandatory rotation, was generally not regarded in a positive light for enhancing audit quality. This is an area that will require consideration.

There is no doubt that the environment within which business operates is constantly changing. This change engenders challenge, both in terms of the current capabilities of the audit team and also whether the scope of the current audit is still fit for purpose. A proper constructive debate on the future of an audit was called for, including all role-players (institutional investors, regulators, auditee companies and auditors) to assess the scope of future audits and forthcoming capability needs. Such a debate has started to emerge, for example, within the European Union, the Public Company Accounting Oversight Board (PCAOB) and the International Auditing and Assurance Standards Board (IAASB).

In terms of the current capabilities, the increasing complexity and globalisation of business, combined with the increasing complexity of financial reporting standards and the opportunities/risks afforded by information technology developments, demands increasing specialisation within the audit team. This specialisation comes at a cost, which provides further challenges as there is a perception that auditors' breadth of experience is compromised, that auditors overly rely on their technical

divisions, that there is a lack of integration of the specialists within audit teams and that the use of specialists has a subsequent impact on the audit fee. Concerns were raised about the audit being regarded as a commodity and hence the audit fee was constantly under pressure. Until the audit is seen to 'add value' this perception is unlikely to change.

Moving to the future, in addition to the audit 'adding value' by providing wider assurance on business models and processes and being more forward-looking, predictive and warning of corporate collapses, several other areas were highlighted that are likely to demand change. However, the need for the audit process to be far more forward-looking and predictive in nature, requires changes in current liability and regulation profiles as these were perceived to be factors hindering change. Whilst many of the areas highlighted were simply extensions of the current challenges discussed above, such as the increased complexities within a global environment, some pertinent new areas were raised. For example, the opportunities offered by increasingly sophisticated technology could result in real-time auditing and the movement away from problematic statistical sampling to data analytics. Changes such as these will have profound implications for the capability requirements and composition of audit teams in the future.

## **Question 2 - What are the capabilities needed by auditors (individually and collectively) to perform their current role and meet their current responsibilities?**

Auditors are expected to demonstrate a wide range of capabilities and there was a general consensus that the Big 4 firms have access to the requisite capabilities within their global networks. Whilst it is recognised that auditors can never have the same insight as those involved in a business on a daily basis, a deep understanding of the industry in which the client operates, the client's business and business processes are regarded as key. Such understanding, developed over time, facilitates appropriate risk-focussed audit procedures. Although it was acknowledged that auditors have a good appreciation of risk (which was ascribed to improved risk articulation by boards and audit committees), disquieting views were raised about the depth of risk understanding reflected in audit approaches. Auditors were criticised for not considering the interconnectedness and interrelationships within businesses during their risk identification and assessment processes.

Assigning the most appropriately competent and experienced engagement partner who is actively engaged on an audit is pivotal to audit quality. Industry, multinational and across industry experience are relevant. Project management, communication and negotiating and conflict resolution skills, as well as the ability to apply professional scepticism and to challenge and stand up to management are critical for engagement partners on large complex audits. In general engagement partners were perceived to meet expectations, albeit with some reservations. For example, criticism was levelled at their ability to cross-fertilise knowledge gained from working within other industries, to spend time on pertinent matters and to demonstrate the required level of professional scepticism. The engagement partner should make use of experts where appropriate but should remain in charge of the audit through decision making and the exercise of professional judgement. Succession planning, especially for those with the capability and presence to be able to robustly challenge management, and retention strategies were highlighted as areas of concern and these should be prioritised to ensure that current engagement partners are supported to remain in the profession and more junior partners are given the appropriate development opportunities to enhance their capabilities. This was especially apparent in South Africa where social transformation pressures resulted in premature retirements and promotions.

Junior audit staff were subject to some criticism which was ascribed to poor communication skills and compliance driven practices resulting in rote learning and a lack of exposure to the commercial world of the client. Inappropriate supervision subsequently compromised their development of professional scepticism.

Without a balanced, cohesive and compatible audit team of the right size and structure, with requisite industry and client business experience and an appropriate mix of capabilities across all the relevant technical areas, a high quality audit of a complex client is not possible. Careful assignment of audit work to team members, appropriate supervision and appropriate use of experts are equally important. Team composition elicited some criticism. These include their collectiveness (functioning as a whole as opposed to in silos), the distinction between expertise and depth of experience of team members, the seamless functioning of global teams, full integration of team members because they are operating in disparate streams which become fragmented, stability of teams and the historic pyramid structure of audit teams. These factors need to be considered when putting together a team to balance capability and cultural cohesion with economic efficiency. Cohesion within audit teams is particularly relevant when the utilisation of experts or specialists is concerned. Although the use of experts on audit teams is considered to improve

audit quality, several challenges exist. There can be mixed loyalties and tension when experts act as consultants to their own clients but subsequently have to balance that with their audit support function. The use of audit firm in-house experts was supported for ensuring a consistency of approach and an adherence to confidentiality undertakings, with the counter-argument that audit quality could be compromised by not considering the superior knowledge of outside experts. The direct involvement of such experts in clients' audits was questioned and the impact of accommodating contradicting experts' views during an audit process was highlighted as a concern. Timely involvement of appropriate experts as part of a cohesive audit team is costly and, if not properly managed, may not have the desired positive impact on the audit outcome due to misunderstanding of their role and contribution to the audit and inappropriate interpretation of their findings.

### **Question 3 - How should the capabilities needed by auditors (individually and collectively) change to meet expectations of their role and responsibilities in future?**

An augmented capability set for auditors was identified which, if ultimately developed, could change the traditional nature of an auditor. Skills include:

- marketing skills and relationship building skills to compete in a retendering environment;
- enhanced problem solving skills;
- data analytical skills to analyse and interpret big data;
- business acumen skills in line with broader business qualifications;
- in-depth industry knowledge;
- negotiation and relationship building skills to interact with various assurance providers;
- project management skills to manage audits in a globally regulated environment; and
- forensic skills to unpick businesses.

However, it is recognised that the augmentation of current capability within an audit team to address all of these areas is unlikely to be achieved within the 'traditional' audit team. Moving forward, it is envisaged that the composition of audit teams will change in order to meet the challenges of the future audit environment. More of the 'mundane' work will either be 'off-shored' or replaced with more sophisticated

IT system interrogations and data analytics. The increasing complexities of both business and regulatory frameworks, combined with the requirement to provide wider assurance will result in an increasing need for individuals with more diverse backgrounds. Thus, it is envisaged that auditor teams in the future will all have core specialist skills but these specialisms will be different. Some individuals will have a core accounting and audit specialism and wrapped around this will be a general industry and business knowledge, with an understanding of other specialist areas such as valuations, data analytics, etc. Other individuals will be, for example, industry experts or data analytic experts and wrapped round this core competence will be general audit knowledge. Thus, instead of audit firms training auditors to become specialists, firms will also be training specialists to become auditors.

## **Question 4 - How should recruitment models used in practice be adapted to ensure that those auditors that are recruited meet the current and future capability needs of audit teams?**

Attracting quality people to the profession, and providing them with appropriate training, will remain of paramount importance in the future. With the exception of the financial services industry, which is complex and diverse and subject to onerous regulations, audit trainees should be exposed to a wide range of industries before specialising. Concern was expressed about the practice of early career specialisation because it holds negative value-adding consequences for individuals' subsequent contribution to audit, as it sacrifices breadth of experience for a narrow focus. This was also raised as a reason for firms struggling to retain staff in their audit divisions. A suggestion was made to include industry-related traineeships in the audit profession's training model. By the time individuals reach managerial levels, industry specialisation was considered to be appropriate.

The increasing use of experts was also mentioned in relation to the recruitment model as if the structure of audit teams change, as advocated in Question 3 above, then the recruitment practices will have to change accordingly. The engagement of experts within audit teams drew out a debate regarding the potential impact an audit-only firm structure would have on overall audit quality. Arguments against audit-only firms include the fact that non-audit exposure enhances the development of a sufficient breadth of experience. Restricting audit to audit-only firms also has implications for embedding specialists into audit teams as there may be insufficient work to offer them a full-time role. Such additional capacity within firms may aid retendering as firm and industry knowledge could be gleaned through



consultancy activities, staff could be retained by providing various career-enhancing opportunities and development and training of staff could be enhanced by exposing them to a wider range of the firm's services. Some minority counter-arguments were, however, also expressed. Situating experts in firms' consultancy/advisory divisions were perceived to have a negative impact on the capabilities of the audit practice; consultancy/advisory divisions have fundamentally changed the culture, operational and financial business models of firms and could even compromise quality audits if firms employ such expertise for consulting rather than in the audit function. Moreover, the use of experts from consultancy/advisory divisions could be detrimental to the morale of the audit side of firms because such experts join firms at high levels and reach partner levels without progressing through the lower ranks.

In addition, several recruitment and retention challenges were highlighted. Concern was expressed about both the quality and diversity of graduates attracted to the audit profession. The reason for this was ascribed to the negative perceptions about the profession; articulated as risky, over-regulated, offering poor work/life balance, possibly boring and with onerous entry and complex update requirements. Retention of quality staff at all levels was also identified as problematic as attrition of professional staff, to the consultancy arms within the Big 4 or to audit clients or other organisations outside of the Big 4, regularly occurs which causes continuity challenges to the audit team and succession planning for engagement partners. Given Australia's unique geography and South Africa's challenges as a developing country with a new democracy, the attraction of following a career path elsewhere in the world also remains a challenge in these countries. Indeed, competent engagement partners and experts were deemed to be in short supply, despite a high demand.

## **Question 5 - How should training and development programmes for auditors be changed to align them with current and future capability needs of auditors?**

Audit firms make huge investments in training and development of staff and there was general feeling that this is appropriately targeted at the capabilities highlighted as required by the participants in Chapter 5. In general, favourable views were expressed on firms' training models but some dissenting views were also raised. Traditional training models were perceived to lag behind audit practices. In the light that the revised *Professional competence for engagement partners responsible for audits of financial statements* (IES 8) does not provide guidance on the development

of mid-career professionals, firms' emphasis on the development of mid-career professionals was questioned. Training was perceived to lack breadth as business exposure was compartmentalised and limiting because it was done from an auditing perspective with little emphasis on social matters. This resulted in a consentaneous way of thinking. Firms were challenged to adopt a changed mindset to allow for a less cost driven approach when it comes to training.

If some of the predicted audit scope changes take place, there will be a need to adapt training and development programmes in line with the changed capability requirements, which may require some additional specialist qualifications to be undertaken. The different types of training were discussed and the importance of experiential training and coaching were highlighted, although it was suggested that coaching and mentoring of more junior audit staff was not sufficiently embraced within audit teams. In addition, whilst formal training appeared to be mostly concerned with the regulatory and technical aspects of the audit, it was suggested that more could be done to expose technical auditing staff to industry, commerce and non-audit work to further develop their capabilities, utilising individuals with actual experience of the industry to deliver some of this training.

## Proposed strategy

The aim of this study was to propose a strategy that will ensure that the auditors of today and tomorrow, both individually and collectively as audit teams, have the necessary capabilities and associated competencies to deliver high quality public interest audits. However, it is difficult to evaluate the current and future capabilities of auditors without first considering the context within which audit teams deliver their opinion. The strategy therefore needs to be placed within context and this in turn has led to wider recommendations that extend to both the scope of the audit and the audit report itself.

## Audit report and scope

### *Regulators and professional bodies*

- There is a requirement to be more pro-active in articulating in a public forum the roles and responsibilities of auditors to narrow the still evolving expectation gap. More needs to be done to increase the public profile of the profession by focusing on its need for the proper functioning of capital markets, alluding to the capabilities of auditors, promoting realistic expectations for the audit of today within its materiality constraints and thereby resisting mere commodity

perceptions or the notion of the profession as the ‘whipping boy’.

- The expanded UK audit report should be disseminated as best practice and subsequently adopted on a more global basis. It is noted that the IAASB has recently introduced revisions to international auditing standards that are consistent with the UK changes (IAASB, 2015).
- Consideration needs to be given to the appropriateness of the current regulatory regime to evaluate whether the perceived current checklist approach is in fact in the best interests of audit quality.

#### *Regulators, professional bodies, audit firms and global business*

- There is a need to work together in a cohesive manner to have a constructive debate about the future of audit. Whilst this debate needs to be led by the regulators, without such action audit changes may be imposed which are neither welcome nor likely to improve audit quality. A combined consultation document on the future scope of an audit could be issued by regulators from the three countries in this study, namely Australia, the UK and South Africa to allow audit stakeholders in the three countries to debate the subject and give feedback on suggestions.

#### *Firms*

- Firms should ensure capability needs are met by their business models taking into account the following future expectations:
  - increased competition due to higher levels of rotation and retendering;
  - increased risk complexities and globalisation of business;
  - increased complexity of financial reporting standards;
  - embedding the application of technology and data analytics in audits;
  - adding value by providing wider assurance on client’s business models and risks;
  - being more forward-looking, predictive and warning of corporate collapses; and
  - improved audit efficiencies requiring more reliance on other assurance providers.

Consideration needs to be given to firms’ audit methodologies, adapting them to promote fully integrated audits and discourage parallel audits, thus capitalising on the training and development opportunities offered by integrating more junior staff on the assurance aspects of the audit in addition to the regulatory aspects.

Irrespective of any fundamental changes to the current scope of audit which may or may not come about following the debate recommended above, this research identifies some areas of concern that are worthy of both consideration and action in order to improve auditor capabilities thereby driving audit quality.

## Individual capabilities

### *Regulators*

- The narrow focus of the revised *Professional competence for engagement partners responsible for audits of financial statements* (IES 8), to simply consider the particular role of an engagement partner needs some further thought as appropriate guidance needs to be provided for mid-career professionals. This could include a standard on competence levels expected from managers of audit engagements.

### *Professional bodies*

- Competency frameworks should be adapted for the development of data interrogation and analytic skills, broad business acumen (emphasising a deep understanding of business risks) and forensic skills.
- CPD offerings of professional bodies should provide the above mentioned skills which should be presented from a business perspective.
- Education and training models of professional bodies should, as some already do, include hybrid training options, allowing trainees in public practice to undergo industry-related training periods.

### *Firms*

- Firms should revise the competency maps for individuals to include the augmented capabilities identified in this study (data interrogation and analytics, broad business acumen, project management, team dynamics, forensic skills and relationship building and marketing skills) and they should align their training and development programmes accordingly.
- Firms should offer programmes directed towards the development of mid-career professionals with a view to exploring their potential to develop into engagement partners. Firms should offer programmes directed towards the development of professional scepticism as an attribute for junior staff members and audit simulations could be used to teach them this skill.

### *Educators*

- Educators should expand their syllabi in accordance with competency framework adaptations.
- Educators should change their teaching methods to foster learning of broad business acumen skills by introducing real-life business case studies and by including practical courses on data interrogation and analytics.

## **Collective capabilities**

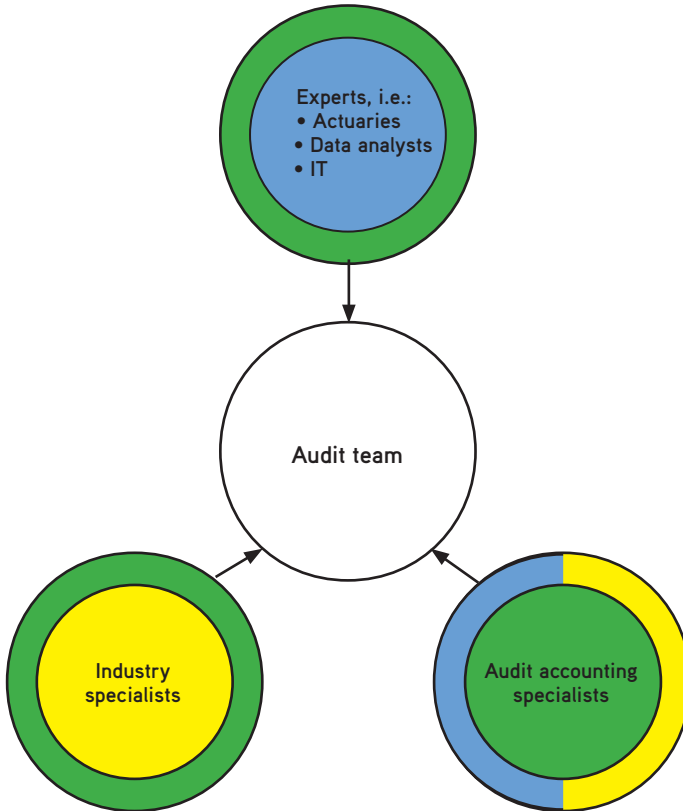
### *Audit firms*

- The requirement for collective capabilities within more multidisciplinary teams will involve recruiting and training graduates who will specialise in accounting and auditing but who will, with the exception of those graduates who are involved in the delivery of financial services audits, gain exposure across a range of global audit clients. The complexity of financial services demands specialism from an early stage and thus it would appear appropriate to recruit directly into this service line.
- Graduates should be recruited and trained within specialist capabilities such as IT, valuation, actuarial work, business consultancy and then subsequently develop their audit capability. The IT capability, in particular, within audit teams will be fundamental as the potential offered by technology to dispense with a statistical sampling approach and adopt full population audits using data analytics must surely be readily embraced.
- Lateral hires will need to be made, bringing more senior people with direct industry experience or key specialist capabilities into the audit team.
- It is therefore proposed that there are three types of individuals who make up an audit team, some of whom will be recruited as school leavers or at the graduate level and others will be hired in laterally. These three categories of individuals will have different core capabilities and wrapped round these core capabilities will be different complementary capabilities which will enhance their core specialism to that of an effective audit team member. The three types are as follows:
  - those with a core specialism in accounting and audit who receive appropriate industry training and some exposure to the different specialism of relevance to the particular audit client;
  - those with a core industry specialism who receive appropriate training in audit

to make their contribution to the audit team more effective; and

- those with specific core specialisms required by the particular audit assignment who receive appropriate training in audit to make their contribution to the audit team more effective.

This is demonstrated in Figure 1.



- Firms' future employment practices will need to emphasise the potential that the assurance environment holds for these three different types of auditors, therefore providing an environment that is attractive both for recruitment and retention.
- Specific training and development interventions, such as mentoring and coaching should be introduced for the development of potential engagement partners

for multinational clients in complex industries, thereby expanding the pool of engagement partners to lead such audits.

- Achieving compatibility and cohesion within such a diverse team will necessitate a cultural shift in attitude by the firms to accommodate this new structure. Partners will also need training in how to manage the inevitable change in team dynamics that are likely to result from this change.
- Firms' structures, operational and financial business models should be aligned with the suggested strategy. For example, firms will have to consider whether expert team members (those with specific core specialisms required by the particular audit assignment who receive appropriate training in audit) should be situated in their consultancy/advisory or assurance divisions and how that will impact upon the structuring of their internal groupings, their engagement team planning, as well their training and recruitment practices.

### *Professional bodies*

- Professional bodies could offer conversion programmes that would enable those individuals who have developed their 'specialism' outside of the audit and accountancy specialism route the opportunity to acquire the audit skills and competence that would make them suitable members of audit teams.

### *Regulators and professional bodies*

- Guidance should replace the auditing-is-only-done-by-auditors mentality with a more inclusive approach by providing requirements for a mutually supporting team of multidisciplinary specialists.
- Guidance and standards, in particular *ISA 220*, should be revised to include factors to consider for the composition of an appropriate audit team.
- Guidance and standards, in particular *ISA 620*, should be revised to provide clarity on experts' responses to assessed risks.
- Consideration needs to be given to the impact of this proposed strategy on current developments in the audit landscape to promote audit-only firms.





# 1. INTRODUCTION AND BACKGROUND

*While the concept of audit remains constant, the operational interpretation of the concept is an evolving one, dependent not only on changing ethical values but also on a societal value judgement as to those issues of accountability to which the audit process should be applied. (Flint, 1988, p.7)*

The relevance of Flint's view to the audit profession of today, more than 25 years later, is still evident. The question to be answered is: What is the operational interpretation of the auditing concept in 2015 and beyond? The answer lies in perceptions about and expectations regarding the current and foreseeable roles and responsibilities of auditors and whether auditors have the necessary capabilities and associated competencies to meet such expectations.

Society grants professional standing to those groups of occupations which contribute to the well-being of the broader society (Reynolds, 2000). Although professionals operate in a rapidly changing society and provide their services in terms of an explicit or implicit social contract (Carnegie & Napier 2010), their justification is based on the delivery of socially desirable ends to society (Flint, 1988). Many believe that from a functionalist perspective, institutions such as professions, are constantly being assessed to determine their legitimacy and relevance (O'Regan, 2001). This perspective suggests that the audit profession can only maintain its status and independence if it continuously demonstrates the benefits of its services to society. It is against this background that this research commissioned by The Institute of Chartered Accountants of Scotland (ICAS) and The UK Financial Reporting Council (FRC) was undertaken.

This report outlines the findings of research into the current and future capability requirements of auditors performing complex financial statement audits. Capabilities are defined by the International Accounting Education Standards Board (IAESB) as the 'professional knowledge; professional skills; and professional values, ethics, and attitudes required to demonstrate competence' and they are 'the attributes held by individuals that enable them to perform their roles' (IAESB, 2014c, p.22). Capability is distinguished from competence where the latter is the 'ability to perform a work role to a defined standard with reference to working environments' (IAESB, 2014c, p.23). To achieve the required level of competence for any particular task, the auditor must have developed the relevant capabilities.

The research was based on 84 interviews, conducted with relevant stakeholders in three countries: Australia, South Africa and the United Kingdom (UK). The implications of those findings are used to inform a proposed strategy for change and improvement in audit practice.

## The regulatory framework concerning competence

The current global regulatory framework that defines the capabilities that engagement partners require in order to perform their work competently is contained within *IES8: Professional competence for engagement partners responsible for audits of financial statements (revised)*. Guidance on how these capabilities are acquired is provided by ISQC1 (issued by the International Auditing and Assurance Standards Board (IAASB)) *Quality control for firms that perform audits and reviews of financial statements, and other assurance and related services engagements*. These capabilities are broadly acquired through a combination of activities, many of which are also the focus of international accounting education standards. Namely, professional education (IES 2, 3), continuing professional development and training (IES 7), work experience (IES 5) and coaching by more experienced members of the engagement team.

In addition, most countries have specific legislative requirements for audit professionals which in the case of Europe have derived from the European Union's (EU) Statutory audit directive which set out minimum education qualification requirements on entry to training, demands in respect of theoretical knowledge, length of practical training and assessment of professional competence. The UK has enacted the requirements of this directive through the Companies Act (CA) 2006 thus auditors must be 'appropriately qualified' (CA, 2006, s1209) and they must hold a 'recognised professional qualification' (CA, 2006, s1219). Once the requisite capability is developed, however, the IESBA Code requires that any professional knowledge and skill must be maintained at an appropriate level to ensure that the client receives competent professional services based on current developments in practice (IESBA Code, para 100.5c). Thus, continuing professional development, regulated by IES 7, is often a condition of continuing professional membership. In South Africa similar requirements are included in the Auditing Professional Act, No 26 of 2005, s37 and they are acknowledged in the Companies Act (No 71 of 2008, s1), whilst in Australia to be recognised as a registered company auditor you must meet the requirements of s1280 of the Corporations Act (2001). These requirements include satisfying the Australian Companies and Securities Commission (ASIC) that the individual has appropriately high levels

of relevant education and that they can meet a competency standard prescribed by ASIC. This standard includes membership of one of the three professional accounting bodies in Australia and those bodies require compliance with IESs.

Whilst much of the regulation centres around the individual auditor, it is the collective capability and competence of the audit team that defines audit quality and this responsibility lies with the engagement partner who needs to be satisfied that the engagement team, and any experts who are not part of the engagement team, collectively have the competence and capabilities to: (a) perform the audit engagement in accordance with professional standards and applicable legal and regulatory requirements; and (b) enable an auditor's report that is appropriate in the circumstances to be issued (ISA 220). If expertise in a field other than accounting or auditing is necessary in order to obtain sufficient audit evidence, then the auditor needs to determine whether to use the work of an expert (ISA 620). The engagement partner is therefore vital to audit quality, hence the reason for the recent refocus of IES8 to specifically address the competence of these particular individuals.

## The changing environment

Various factors such as globalisation, increased competition, rapid developments in information technology and communication facilitated by the internet have changed the business environment in which today's auditors operate (Chang and Hwang 2003; Howieson, 2003; Pan and Perera, 2012). This has resulted in a worldwide challenge to align the capabilities (technical knowledge, skills, values, ethics and attitudes) of professional accountants or auditors [IAESB, 2014a, *IES 3 (revised)*, para. A4] to the requirements of the changed business environment (Hancock *et al.*, 2009; Howieson *et al.*, 2014; Paisey and Paisey, 2010; Sin *et al.*, 2012).

In addition, trust in the audit profession is currently under threat (Howieson, 2013) as the market and public is questioning the contemporary role and relevance of the audit function which failed to deal with the turbulent and uncertain times of the financial crisis (Lam, 2009; Humphrey *et al.*, 2011). The financial statement audit is therefore the subject of much reflection. For example, the European Commission published a Green Paper, *Audit Policy: Lessons from the Crisis*, in October 2010 (EC, 2010) seeking views from stakeholders and the broader public on a range of issues related to the statutory audit. ICAS also published a report, *The future of assurance* (ICAS, 2010) whereby ICAS challenged the traditional role of auditors by proposing a 'vision' that there should be more assurance on the front half of

the annual report which would promote more transparency and accountability in corporate reporting. The ICAS report acknowledged that courage would be required from the auditing profession to realise such a vision, as external auditors would have to step beyond their current practices by exercising greater professional judgement within a new audit framework that would be set in the context of assuring narrative information. Such a vision could only be realised if auditors have the requisite capabilities and competencies to enable them to act courageously and apply the fundamental ethical principles (IAESB 2014b, *IES 4 (revised)*, para. 11). In 2013, ICAS further outlined a model for applying its vision for a broader role for assurance by suggesting that an additional assurance opinion should be provided about whether the disclosures and assumptions made by an entity's management in the narrative section of the annual report were 'balanced and reasonable' (ICAS, 2013, p6). Whilst stakeholder feedback on this proposal was of the view that some form of assurance with regard to this type of information was inevitable (ICAS, 2014), a number of user and preparer respondents questioned 'whether auditors had the necessary skills and ability to undertake this type of work, recognising that greater expertise and reliance on subject experts and specialists might be required' (ICAS, 2014, p.6). Subsequently the UK FRC introduced a requirement for corporate boards to confirm that their annual reports are 'fair, balanced and understandable' (FBU) and for external auditors to report by exception on this confirmation.

ICAS's vision for a broader role for assurance forms part of a wider trend to make the audit report more meaningful and useful to financial statement users. In June 2013, the FRC started this initiative and issued a revised *ISA 700 The independent auditor's report on financial statements* which requires auditors to:

- provide an overview of the scope of the audit, showing how this addressed the risk and materiality considerations;
- describe the risks that had the greatest effect on (i) the overall audit strategy; (ii) the allocation of resources in the audit; (iii) directing the efforts of the engagement team; and
- provide an explanation of how they applied the concept of materiality in planning and performing the audit.

In April 2014, the Parliament and the Council of the European Union endorsed Directive 2014/56/EU and Regulation (EU) No 537/2014 as a package of reforms to establish a new Statutory Audit Framework. In particular, the new regulation

requires, *inter alia*, under section 2(c) of Article 10 that the audit report of public-interest entities includes:

- a description of the most significant assessed risks of material misstatement, including assessed risks of material misstatement due to fraud;
- a summary of the auditor's response to those risks; and
- where relevant, key observations arising with respect to those risks.

Section 2(d) requires the auditor's report to include an explanation as to what extent the statutory audit was considered capable of detecting irregularities, including fraud.

The IAASB in 2015 subsequently revised ISA 701, *Communicating key audit matters in the independent auditor's report*. Among the revisions to the auditor's report is the requirement that auditors will include a statement about 'key audit matters' which are defined as:

*Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance. (paragraph 8 of revised ISA 701)*

The IAASB believes the reporting of key audit matters will aid the users of financial statements to better understand the reporting entity and identify areas in which significant management judgement has been exercised. Similar to the IAASB's proposals, the US Public Company Accounting Oversight Board (PCAOB) is proposing potential changes to audit reports and in 2013 it issued Release No. 2013-005 and Docket 034, *Proposed auditing standards on the auditor's report and the auditor's responsibilities regarding other information and related amendments*. Potential changes to the audit report that are explored in those documents include the provision by the auditor of an 'auditors discussion and analysis' and information about 'critical audit matters' which would provide a narrative description of 'significant matters' such as items of audit risk and a discussion of the auditor's views on management's judgements and estimates in the financial statements. Other proposals by the PCAOB include the suggestion that the auditor might provide assurance on other information outside the financial statements.

Against the background of these international developments to redefine and broaden the scope of audit reporting, the aim of this research is therefore to explore the views of auditors and key audit stakeholders regarding the current and future capabilities of auditors with a view to proposing a strategy to ensure auditors of today and tomorrow, individually and collectively as a team, have the necessary capabilities to perform high quality public interest audits.

As a basis for informing this strategy, the research set out to answer five specific research questions, namely:

1. How do expectations about auditors' current versus future role and responsibilities differ?
2. What are the capabilities needed by auditors (individually and collectively) to perform their current role and meet their current responsibilities?
3. How should the capabilities needed by auditors (individually and collectively) change to meet expectations of their role and responsibilities in future (as per (1) and (2) above)?
4. How should recruitment models used in practice be adapted to ensure that those auditors that are recruited meet the current and future capability needs of audit teams (as per (2) and (3) above)?
5. How should training and development programmes for auditors be changed to align them with current and future capability needs of auditors (as per (2) and (3) above)?

In the light of globalisation with rapid growth in international markets, the increasing complexity of the business environment, the shortage of skills and resultant recruitment of newly qualified accountants across borders, the research questions are addressed by exploring viewpoints from three countries, Australia, South African and the UK. All three countries are members of the Commonwealth of Nations and share similar legal, financial and market systems. In addition, each of these countries has well established audit professions of high standing. As at May, 2013, their collective share of world share market capitalisation was 9.43% (the largest market, the United States, was 34.17% and the second largest, Japan, was 7.9%) (Seeking Alpha, 2013) and between them they are significant countries for complex industries, such as mining, oil and gas, insurance, and financial services. The next chapter of this report describes how data based on interviews conducted in these countries were gathered and analysed.

## 2. RESEARCH APPROACH

Given the complexity of the research questions, this study adopted a qualitative research method and employed semi-structured interviews to elicit relevant key themes and information. This approach facilitates a rich investigation of the research questions as the interviewers had the opportunity to ‘drill down’ into the experiences of each interviewee. Appropriate ethics approval was obtained before conducting any interviews.

### Interview participants

Financial statement audits of the largest listed public companies in complex industries are of interest to at least two broad groups of stakeholders – those who are directly involved in the audit process (auditors, corporate management, and the members of corporate audit committees) and those who have some oversight, public policy, or educative role with regard to audit (regulators, standard-setters, Big 4 audit firms (as training institutions), and professional accounting associations). Other interested stakeholders include the users of financial statements but, as users tend to have little direct experience of the audit process, they were not perceived to have sufficient insights into the conduct of audits for the purposes of this study. Consequently, the researchers identified potential participants in the following way:

- To enable an overview across a wide range of industries and to focus on the largest global companies, six of the most significant public companies, each from a different industry, were chosen from each jurisdiction.
- For each of the six companies from each jurisdiction the relevant audit engagement partner (EP), the chief financial officer (CFO) or equivalent, the Chair of these entities’ audit committees (CAC) or equivalent and the chief audit executive (CAE) were contacted to enlist their support in being interviewed.
- For each jurisdiction, the regulators, representatives of professional accounting associations, and the training and recruitment staff of Big 4 audit firms were also included.
- In addition, as interviews progressed and were analysed, it became apparent that it would be valuable to include the views of non-auditor experts (such as actuarial, environmental, information technology (IT), taxation, quantitative analysis and data analytic experts) who participate in audit teams.

In the UK the six companies were chosen from the top 20 companies determined by market capitalisation, in South Africa five companies were chosen from the JSE Top 40 index, while a listed South African managed mining company was also included, in Australia the companies were chosen from the top 100 by market capitalisation.

A pilot interview with an engagement partner of a Big 4 firm in South Africa was conducted in April 2013. The partner held an executive position at the firm, but was an engagement partner for various clients. Invitations for interview were accepted by a further 80 targeted participants. Based on suggestions made by some participants, the views of three additional engagement partners at a Big 4 firm in South Africa (specifically tasked with their firms’ audit methodology and structural changes) were obtained. For the purpose of this study, they are considered as snowball sampling participants. The total number of interviews conducted therefore was 84 (1+ 80 + 3) (refer to Table 2.1). Two of these participants presented their views as chairs of audit committees for two different global companies, while another participant commented on dual roles as an IT expert and as the head of the firm’s sustainability division. Thus, even though 84 participants were interviewed, these effectively represent perceptions about 87 (84 + 3) role perspectives. Information about the role and location of these participants is provided in Table 2.1, whilst Table 2.2 describes the sub-set of the participants that related to the representatives of corporations and their auditors.

**Table 2.1: Number of participants**

| Cohort of participants  | Code | Australia | South Africa   | UK             | Total          |
|---|------|-----------|----------------|----------------|----------------|
| Engagement partners   | EP   | 2         | 7              | 7              | 16             |
| Chairpersons of audit committees  | CAC  | 2         | 5 <sup>1</sup> | 3 <sup>1</sup> | 10             |
| Chief financial officers  | CFO  | 6         | 6              | 3              | 15             |
| Chief audit executives  | CAE  | -         | 5              | 4              | 9              |
| Recruitment & training (talent) partners                                  | TP   | 3         | 8              | 4              | 15             |
| Professional bodies (including education/training directors) & regulators | PB/R | 4         | 3              | 2              | 9              |
| Pilot & snowball sampling   |      | -         | 4              | -              | 4              |
| Experts   | EX   | -         | 6 <sup>2</sup> | -              | 6 <sup>2</sup> |
| <b>Total</b>  |      | <b>17</b> | <b>44</b>      | <b>23</b>      | <b>84</b>      |

**Notes:**

1. One UK and one South African chair of an audit committee participant served on two audit committees.
2. An IT expert participant at a Big 4 firm also had the role of head of the firm’s sustainability division.



Table 2.2: Participants directly involved in the audit process as classified by industry

| Type         | Energy   |          | Telecoms |          | Diversified (various industries) |          | Pharma   | Banking  |          | Insurance | Retail   |          | Mining   |          | Total           |
|--------------|----------|----------|----------|----------|----------------------------------|----------|----------|----------|----------|-----------|----------|----------|----------|----------|-----------------|
|              | UK       | A        | SA       | UK       | A                                | SA       | UK       | UK       | SA       | SA        | UK       | SA       | A        | SA       |                 |
| EP           | 2        | 1        | 1        | 1        | -                                | 1        | 1        | 1        | 2        | 1         | 2        | 1        | 1        | 1        | 16              |
| CFO          | -        | 2        | 1        | 1        | 3                                | 1        | 1        | 1        | 1        | 1         | -        | 1        | 1        | 1        | 15              |
| CAC          | 1        | 1        | 1        | 1        | 1                                | 1        | -        | 1        | 1        | 1         | 1        | 1        | -        | 1        | 12 <sup>1</sup> |
| CAE          | 1        | -        | 1        | 1        | -                                | 1        | -        | 1        | 1        | 1         | 1        | 1        | -        | -        | -               |
| <b>Total</b> | <b>4</b> | <b>4</b> | <b>4</b> | <b>4</b> | <b>4</b>                         | <b>4</b> | <b>2</b> | <b>4</b> | <b>5</b> | <b>4</b>  | <b>4</b> | <b>4</b> | <b>2</b> | <b>3</b> | <b>52</b>       |

**Notes:**

Key: EP = engagement partner, CFO = chief financial officer, CAC = chairperson of the audit committee, CAE = chief audit executive (head on the internal audit).

1. One UK and one South African chair of an audit committee participant served on two audit committees, but as views were obtained for both companies their participation are double counted. The total is therefore 12 and not 10 as reflected in Table 2.1.

Interviews were conducted in 2013 and 2014 and ranged in length from between 30 minutes to nearly two hours, with an average of approximately one hour. Interviews were recorded and professionally transcribed and all participants were provided with an opportunity to review their transcript and, if necessary, clarify or amend any of the comments they had made during their interview.

## Interview questions

Semi-structured interviews were conducted based upon questions developed by the research team. The construction of the questions was informed by an extensive review of relevant literature and from feedback received from the ICAS/FRC Project Steering Group. Draft versions of the questions were also pilot tested in an interview setting with a South African engagement partner. Feedback received on the basis of this pilot interview suggested that the questions were appropriate and relevant to the aims of the research project.

## Analysis

The transcribed interviews were manually analysed by one researcher with the assistance of the Atlas.ti qualitative data analysis software. The data analysis process involved the following activities:

- categorisation (identifying meaningful categories and themes);
- ‘unitising’ the data (attaching units of data to the appropriate category);
- recognising relationships and refining categories (revising initial categories and reorganising data according to these categories); and
- developing and testing propositions and conclusions that have been derived from the data.

The analysis conducted was then independently reviewed by the other members of the research team. Any differences regarding interpretation of the data were discussed and resolved collectively.

## Limitations

Any research project involves limitations. In the case of this particular project limitations include: the data were derived from the perceptions of individuals and were restricted to their own experiences:

- the sample is not representative as it is relatively small and restricted to audits

conducted on entities from amongst the largest publicly listed companies;

- the interviews were conducted within three countries only; and
- the analysis is subject to potential interpretative biases by the researchers.

The impact of these limitations has been controlled in part by a conscious effort to triangulate data by obtaining interviews, (conducted by the different researchers using agreed upon interview questions) across a range of industries and locations and, as described in the next chapter, by the high degree of commonality of themes and issues that were expressed by the interviewees. In addition, 84 interviews, representing 87 role perspectives, is a large sample for a qualitative study and the analysis of the data was independently reviewed and mediated across the research team members.



### 3. STRUCTURE OF RESEARCH FINDINGS

This study aims to develop a strategy to ensure that current and future auditors, both individually and collectively as a team, have the necessary capabilities to perform high quality public interest audits. In the words of a UK PB/R participant, 'this (project) is the start of a journey' to ideally position the audit profession in the 21st century, it provides a foundation for a constructive deliberation on auditors' capabilities. In an attempt to formulate such a strategy the research findings that emerged from the five research questions described in Chapter 1 are presented in the next five chapters. Firstly, in Chapter 4 the views of participants are used to explain the purpose of today's audit; thereafter factors stimulating change in the audit environment are identified, and then participants' expectations of the future role and responsibilities of auditors are discussed. These sections present a picture of what has historically been expected of auditors, why these expectations are changing and will continue to do so, and ultimately what the expectations of tomorrow's auditors are.

Views on the capability requirements for today's auditors and engagement partners (Chapter 5), and those relating to the future then follow (Chapter 6).

For quality audits undertaken for clients with complex business structures, capabilities are found in teams with expert members. Based on participants' views the factors to consider when putting together such audit teams are reported in Chapters 5 and 6 and the challenges experienced within such teams of expert members.

In addition, current and future challenges for firms with their recruitment of competent staff, in-house training and development programmes are identified in Chapters 7 and 8, respectively.

Quality in an audit remains a fundamental concept; it was expected by all CAC and CFO participants, and perceived by EP participants to be their 'license to operate' (Australian EP), and therefore could not be compromised. Although all EP and TP participants agreed that quality was not negotiable as 'we simply cannot afford quality to slip' (South African TP), a South African PB/R cautioned that mere compliance with standards does not necessarily result in a high quality audit; the 'shortcoming' was perceived to be the absence of a deep understanding of the industry and business.

Whilst the quality of an audit can be enhanced by stringent internal review processes being undertaken (either during the audit before sign-off or subsequently), or by inter-firm reviews and inspections by regulators, a UK CFO participant was of the view that the regulatory environment is challenging audit quality noting that 'I don't actually think that's helping improve audit quality; I think it's actually doing the opposite'. Some CAC participants referred to the connection between the quality of the audit (outcome) and that of the engagement partner and audit team (the 'tools'). This sentiment was echoed by a South African CAE who pointed out that 'you cannot have a quality audit unless you've got the right people' and a UK CFO who also connected audit quality to the 'calibre of the people' on the audit team. A South African TP explained the negative cascading effect of an engagement team member who did not have the necessary capabilities, and the potentially negative impact this has on the quality of the audit:

*A first year who is struggling, who doesn't have the necessary skills or competencies - it impacts on the rest of the team, because ... it's a snowball effect. ... Now someone else needs to coach ... [and a senior member of staff needs] to review [that work] in more detail, make sure what was documented is actually correct ... [which] could then impact on the quality of the work by diverting attention from the audit to training.*

The interviews generated a very large volume of data. To help simplify the presentation of this data, in the discussion that follows each theme is accompanied by a graphic that summarises which participant cohorts commented on the specific theme. Each participant cohort is denoted by a particular colour and is described using the abbreviations given in Table 2.1.

## 4. EXPECTATIONS ON CURRENT VERSUS FUTURE ROLES

*How do expectations about auditors' current versus future role and responsibilities differ?*

### Purpose of an audit

All participant cohorts agreed that there is still a need for a statutory audit to ensure the effective functioning of the capital markets even though, in the words of a UK PB/R participant, the audit concept was:

*... designed 150/160 years ago at a time when most people couldn't add up and in times of very simple businesses, [and] where the purpose was to ensure there was an independent account of the stewardship of the company.*

In general CAC participants from Australia and South Africa expressed their satisfaction with their auditors, with comments such as: 'meets standards' (South African CAC); 'I find it hard to criticise' (South African CAC); 'I really can't fault the approach of the auditors' (Australian CAC); 'it is a good strong profession' (Australian CAC) with a 'very strong ethical base' (Australian CAC auditors are very competent' (Australian and South African CAC); and 'we've been very well served by our auditors over time' (Australian CAC). Some UK CAC participants were more critical: 'I think the audit one year to ... [the] next is a pretty static thing'; 'the plan, scope and approach have not changed much'; and 'audit has not really moved on that much'. All CAC participants expressed some reservations, however, on the value adding ability of auditors. These reservations are highlighted in the remainder of the report.

In general CFO participants were satisfied with their auditors, with comments such as: 'on balance I'm very happy with the audit and the auditor' (UK CFO); 'frankly, most of the big firms these days are pretty good. Occasionally, they drop the ball, but they are mostly pretty good' (UK CFO); '[the auditors] delivered everything they said they were going to deliver' (Australian CFO); and 'overall we are comfortable with the audit firms' (South African CFO).

Some PB/R participants advocated that auditors' social responsibility input be increased, and an Australian PB/R participant challenged the profession to 'develop and enhance the role of audit that will help to really add value in the public interest'. A UK PB/R suggested the focus of an audit should change from 'mathematical compliance to addressing the real issues that make a difference to the accounts'. The participant perceived the 'real issues' to be an understanding of the governance and control systems, making judgements about impairments and valuations, making judgements about risks and 'above all else understanding the businesses that are incredibly complex'.

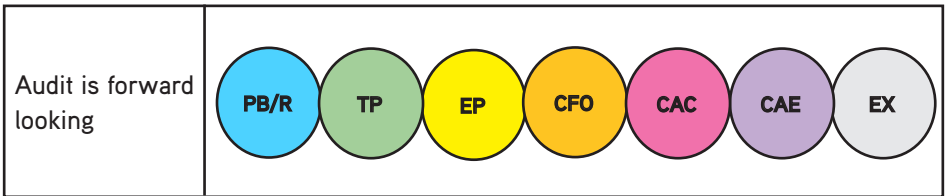
Participants from all cohorts acknowledged the criticism being levelled against the profession. However, the majority view was that this was misplaced as there was agreement that within the current regulatory framework, 'auditors did what they had to do'. Unsurprisingly there was a general consensus from the EP participants that the audit profession 'has not really got very much wrong' (UK EP) over the last decade, despite the frequently strident criticism. However, auditors were also defended by CFOs in this regard. One UK CFO articulated that even if the auditors had been deficient or incompetent in some way the [2008/9] financial crisis would still have happened. Another UK CFO asserted that the bad press the audit profession received after the financial crisis was 'a little bit harsh and not entirely supported by the facts', and that to a large extent the profession has let itself down by not resisting the 'whipping boy' role more vigorously. An Australian CFO was of the opinion that where company failures have occurred 'the audit generally is not the issue'; other factors such as the volatility of the industry or management's negligence, recklessness or incompetence had contributed to a more significant extent. The CFO then went on to say that 'when there's loss' there is a search for a scapegoat, 'and potentially [preferably] someone with deep pockets', which puts the auditors in the firing line.

## The expectation gap

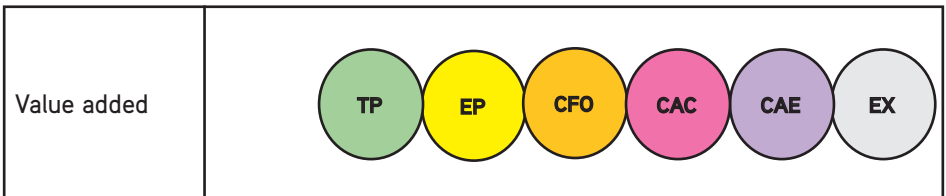
In general participants ascribed criticism of the audit profession to the still evolving expectation gap that exists between the formal roles and responsibilities of auditors (as defined in statute and regulation), and the general understanding of those duties being expressed by those outside the profession. A UK CFO expressed concern about the unrealistically broad scope of the expectations held by the general public for auditors, expectations which generally relate to the 'breadth of things that audit firms are asked to audit ... which may be individually laudable', but as a collective they become very onerous. An Australian CFO mentioned the need for management to be more realistic about their expectations of what the audit can do.



As a South African TP stated: ‘everyone wants the auditors to do everything, but no one wants to pay for it’. EP participants shared the view of a UK EP who intimated that there is ‘a live and unresolved tension ... regarding what this society wants an audit to be and what an audit is in law’. Several factors that contribute to this expectation gap were identified by the different cohorts of participants and these are now discussed in order of importance as determined by the number of cohort mentions.



There was recognition that the audit was backward rather than forward-looking but that the forward-looking expectation of investors could not be met if the auditing laws and regulations are not first changed, because the current nature of auditing is prescribed by statute. By ‘forward-looking’, participants were referring not only to narrative information in financial statements but also expected increases in other judgemental information, such as the use of estimates of fair values. All EP participants acknowledged that in order to meet this forward-looking expectation the responsibilities of auditors should be broadened. A UK CAC challenged the need for financial statement audits by noting that investors may rely more on narrative non-financial information for decision making: ‘what’s the point of incurring the cost of getting all this other [financial statement] information audited, ... [if it] doesn’t influence your investment decision?’

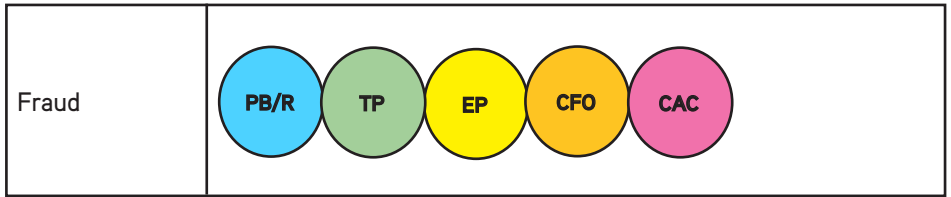


EP participants maintained that they, as auditors, do add value, although there was a recognition by one UK EP that there is a disconnect between such expectations and the reality regarding the roles of the finance function and the audit firm, which ‘probably [makes it] harder for the auditors to be seen to be adding value, and it can end up looking like [we fulfil] a more narrow role’.

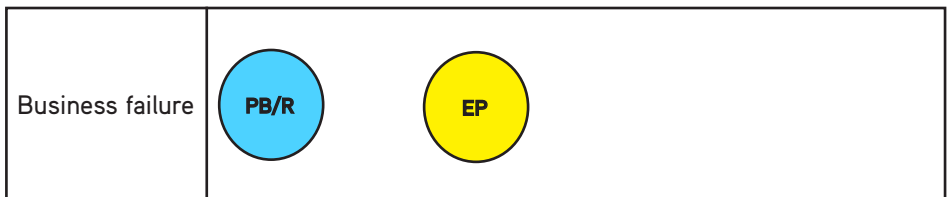
Some UK and South African CAC and CAE participants believed the profession 'still struggles a little bit around adding that extra bit of value' (UK CAC), referring to the expectation that auditors should provide helpful insights which have been benchmarked with trends observed amongst clients in similar industries or even across industries. However, these groups lamented that their auditors fail to 'tell me something I don't [already] know' (UK CAC), and were less inclined 'to contribute (within [the] bound[s] of sensible and appropriate professional behaviour) to the development of ideas in a constructive way' (UK CAE). Another UK CAC made the point that audit firms have the capabilities to assist the client to 'remediate problems' and that 'they [are] very good at helping us to clean up', but that this is not reflected in the audit process. The UK CAC went on to challenge the auditors to assist their clients by identifying matters that can go wrong so that preventive measures can be taken. Not all CAC participants were critical on this point however, as one CAC from Australia commented that the company's auditors 'have been pretty good' at that and another maintained that 'a lot of value' (South African CAC) came from an audit.

Whilst CFO participants highlighted that value added is directly related to the availability of quality people, they were somewhat critical about the value that auditors add: one Australian CFO stated that 'it's got to the point now where we no longer bother asking our auditors for insights and guidance', whilst another Australian CFO participant perceived it to be 'mistake' to think of auditors as part of a company's internal control environment. There was an expectation that auditors should review companies' strategies to identify 'new challenges that may emerge that maybe we haven't thought of' (South African CFO) or review transactions their company was entering into or financial instruments they were considering. In this regard two South African CFO participants commented that, given their accounting background, auditors could add value by advising management more effectively on how to structure these transactions to make sure that they accurately reflect the economic realities, thereby creating an opportunity for the auditors to act as a 'sounding board' to management. There was a belief, however, that auditors were constrained in this regard by their rules of independence and litigation fears, and this inability was further exacerbated by the audit firms' cost management and their aim to minimise fees. One Australian CFO highlighted the growing pressure to prevent audit firms from offering their audit clients non-audit services to be fundamentally changing the relationship between auditors and management, and this hampered value added opportunities for auditors. The CFO commented on the strictly applied rules that the CFO's company follow to allocate non-audit work to their auditors: 'we administer that ruthlessly ... and they [the auditors] hate it, and

not just for the revenue that they lose, but they hate the fact that they can't provide that full body of service'.

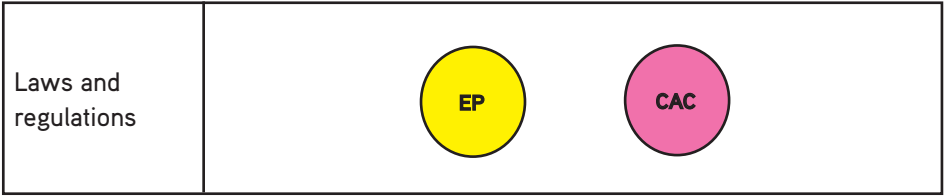


A South African TP participant expressed concern about stakeholders' expectation that auditors not only have to discover fraud, but they 'have to stop it as well'. Two South African CAC participants mentioned that because of the moral decay of society in general, and business in particular, auditors are now being expected to contribute to efforts to detect fraud. In their opinion 'this is one of the areas where [auditors] can certainly help in terms of reviewing areas where fraud is possible' (South African CAC).



A UK EP participant claimed that 'it's pretty difficult for an auditor to see a brewing problem in the business model that the board, and the executive management, and (in a regulated industry) the regulator have all missed'. The EP went on to explain:

*If you have a client who is ostensibly seen by market commentators as having a successful franchise, if you have a business strategy that the board has signed off on and that doesn't look wrong-headed, if you have a stock market valuation which is implying ... that there's value, if you've complied with all the regulation[s], and if there's no immediate storm cloud there which clearly has potential to create an environment which is going to cause the model to fail, I think it is genuinely hard, and I think [completely] unrealistic, to expect the auditor to be the one who's going to see it when everybody else doesn't.*



There was a perception that animosity towards auditors had increased through the negative effects of the financial crisis. These were fuelling stakeholders' expectation which was at variance with auditors' responsibilities in this regard:

*We don't go and test in-depth [for compliance with] laws and regulations; we look at the overall environment [to determine if there] are ... any issues coming out, ... [if] there [are] any issues that are non-compliant that we have to go into further, and [if there] are fines and penalties [to be] considered. (South African EP)*



The concept of materiality was also recognised as a contributor to the expectation gap, where those charged with governance of companies expected auditors to identify a misstatement which is 'never going to be considered material by them' (Australian CFO).

## Narrowing the expectation gap

A South African TP participant articulated the shortcomings of the concise audit report as follows:

*... our concise form of an audit report has served us well up until this point; but I think at this point it does more damage than not, because the reader of it does not actually understand what an audit is. And they don't understand the concepts of materiality. They don't understand ... [that] debates have taken place with those charged with governance, or the ... disagreements with management.*

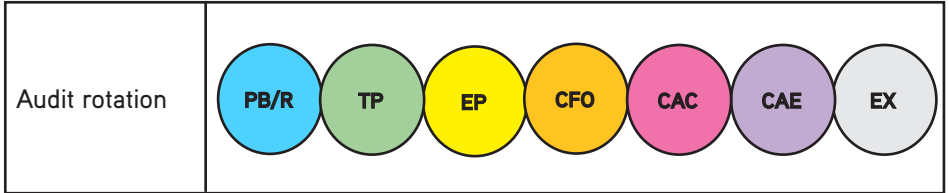
An Australian CFO was cautious about expanding the audit report, to report on a 'journey [rather] than an opinion [by disclosing] ... a full-on story about the risks and how they audit [them]'. This CFO maintained that it is the management's responsibility to report those risks to the market; and that publishing auditors' views in relation to this will 'sort of confuse the relationship ... and the [division of] responsibilities between management and the auditor', because it will 'become chaos in negotiating who's going to report on what'. The CFO further predicted that it will increase costs and questioned the value thereof.

However, the revised auditing standard issued by the FRC in June 2013 which requires auditors reporting on companies which apply the UK Corporate Governance Code to explain more about their work in their audit report was perceived by UK EP, TP and CAC participants to be a 'very good step' (UK TP) forward. By disclosing more information the expectation gap could be narrowed as it 'clarifies them [auditors' roles and responsibilities] in a much broader sense' (UK TP). Several participants, however, were of the opinion that the revised audit report had not gone far enough. A UK CAC believed it was now vital to enter into a much needed dialogue with investors. As the audit report still only covers 'the key risks, audit scope [and] audit materiality', another UK CAC perceived it to remain a somewhat limited document because auditors have still not 'moved to the centre stage': they are only 'coming out of the shadows in the mind of investors'. Nevertheless, in general UK CAC, TP and EP participants believed the new audit report format creates a platform for audit reform.

## Changing environment

Participants from all cohorts acknowledged that the environment within which business operates is rapidly changing, which necessitates a vigorous ability for corporations to adapt, which in turn requires auditors to change their audit practices. Two UK TP participants claimed that 'the goal posts are constantly shifting' and these changes 'require different skills, a different mental approach ... [The new audit environment] is about doing things differently, about constantly challenging' the status quo. A UK CAC called for a 'proper constructed debate on the future of audit', including all role players (institutional investors, regulators, auditee companies and auditors) to consider whether the scope of the current audit 'continues to be fit for purpose' and if not, to come up with recommendations as to what needs to change. The CAC claimed that at present this debate is not happening in a coherent way.

Several factors that are currently stimulating changes in the audit environment and which, therefore, have an impact on the capability requirements of auditors were identified by the different cohorts of participants. As it is highly likely that these factors will continue to drive change in the capability requirements for the foreseeable future, these will now be discussed in order of importance as determined by the number of cohort mentions.



Participants of all cohorts acknowledged that audit rotation could increase competition, create perceived independence and could counter ‘stale and complacent’ (South African TP) perspectives by bringing ‘new ideas and approaches’ (South African TP) to the fore.

*Partner rotation*

The general consensus reached by participants from all cohorts was in favour of partner rotation to counter a familiarity threat, with a period of at least five years recommended because it takes the partner at least three years to fully understand a complex business. Except for one UK CAC (‘I am far from convinced’ on the merits of partner rotation) all participants supported partner rotation, claiming that not only is independence maintained, but as two South African CAC participants argued ‘it does bring ... a fresh way of looking at things, or a different way, more questioning way’, and that the new engagement partner ‘brings other competencies to the table’. However, one South African CAE questioned the ‘fresh pair of eyes’ concept on the grounds that the incoming partner has usually been groomed for some time and will ‘want to lean toward’ what the predecessor partner has done. Indeed, participants of all cohorts were of the view that audit firms actively engaged in engagement partner succession planning in order to carry forward the accumulated knowledge of the client.

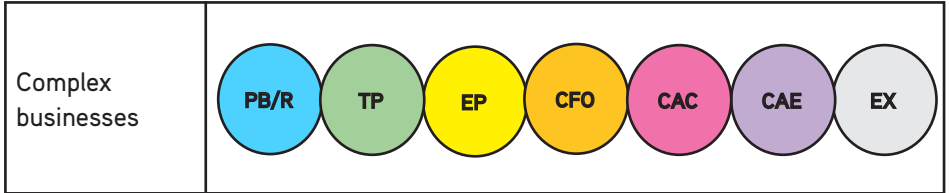
*Audit firm rotation*

Much criticism of and opposition to firm rotation was expressed, especially by TP and EP participants. This criticism was also aired by some of the CFOs who

perceived that a lot of value gets lost by implementing firm rotation and that a lot of inefficiencies result from it. Resourcing issues in particular were highlighted. An Australian CFO mentioned the benefit of having an engagement partner that had come through the firm's ranks (manager then a division partner and eventually an engagement partner), rather than the incoming auditors' engagement partner who is 'green to the assignment'. One South African CFO shared an experience from a company that had just rotated its firm of auditors mentioning that they were experiencing the 'good, bad and ugly'; that this perceived independence came at a high price ('a lot more management time'). The CFO maintained that their biggest challenge was that the incoming auditors were very technical in their approach to the implementation of IFRS, which impacted the reflection of business realities in the financial statements. The CFO further commented on the difference between the outgoing and incoming auditors' knowledge of their business ('it was strongly apparent'), and that in order for the incoming auditors to obtain that deep understanding of their business 'a lot of time explaining and re-explaining until they [the auditors] [were] comfortable with it' was needed, which had huge cost implications. Another South African CFO opposed firm rotation on the grounds that it takes 'the competitive edge away from the firms' because, as an Australian CFO participant commented rotation will mainly involve the Big 4 and considering their audit and non-audit work exposure within regulatory constraints 'you really do end up with a very small playing field'. However, an Australian CFO who also went through a change of auditors, had a different experience as the incoming auditors had previously delivered non-audit services (internal audit) to the client and thus 'they had a fantastic understanding of the business and the people ... it actually meant they did a better audit'. A South African CFO suggested that knowing that the rotation period is limited will encourage firms to downscale on their resource and technology investments in an audit. Two other South African CFO participants commented that in a region where there are limited specialised skills, firm rotation will have the opposite effect from what was intended because 'people will just move between firms'. Thus, as one South African PB/R summarised rotation is going to cause 'more inefficiencies in the process and could potentially ... [introduce] more risk over time'.

CAE participants on the other hand were generally in favour of firm rotation, although, as they observed, it could be costly and it usually takes time for the client to adapt to the new firm; but a new methodology, firm culture and the process of building up of an audit file could expose matters which were accepted by the previous firm. Some CFOs were also supportive suggesting that it was 'absolutely vital' to avoid firms becoming entrenched in their client relationships (Australian

CFO). Tenure suggestions ranged from 10 years (Australian CFO) as ‘that would encourage auditors to show a lot more backbone, because it basically gives them greater tenure, [and certainty] that they can’t just get wantonly tossed out mid-term’ to between 15 to 20 years (South African CFO).



As today’s businesses are evolving they are developing multiple identities which reflect their diverse global operations. All CFO participants mentioned that their companies have advanced over the past years, resulting in diverse operations which not only demand specific industry knowledge, but in fact a variety of industry-specific skills. Some CFO participants questioned whether auditors have an in-depth understanding of the complexities of transactions that companies are now entering into, the technicalities of their emerging products or the volatility of their markets. This requires:

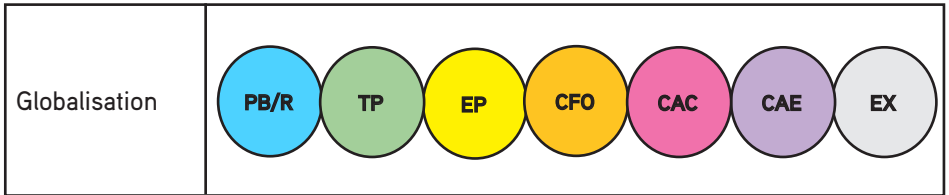
*... a detailed review of the proposed transaction through all its stages to sort of understand why management has gone into it, what were the issues, what did our advisors sort of highlight to us, what was debated at the executive [and] at the board level relating to a transaction, because that would really give them an in-depth understanding of the transaction. (South African CFO)*

EP participants also highlighted the challenges posed by the ever increasing complex business environment. The emergence of new products demands much more specialised audit knowledge, as explained by a South African EP ‘the new initiatives that have been developed - particularly the really complex items - are actually things that only [those] people who ... really are at the cutting edge can understand’. The scale and complexities of risks and IT systems have also changed and clients’ governance has evolved. According to a UK EP, clients have moved away from expecting auditors to simply:

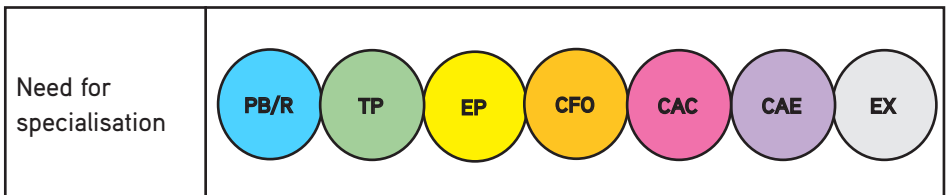
*... come along and tell them what was in the accounts, to [a situation] ... where they [the stakeholders] expect the management to tell them what’s in the accounts, and they [the stakeholders] expect the auditors to express a view.*



Hand-in-hand with the increasing complexity of business is the associated increase in regulation. Participants mentioned the changes in the regulatory environments (including local and international tax laws) in which businesses are functioning which auditors should keep up with. Indeed, all EP participants believed that auditors have to align their work with the emerging regulations. However, the general feeling of CAC participants was that auditors have succeeded in this quest.



Auditors are confronted with clients operating globally, which brings into play geographical, cultural, ethos and regulatory differences between operations in different parts of the world. Two Australian CFO participants expressed their frustration with the inconsistency introduced by different regulatory regimes. Where global operations in some regions were not significant, auditors cannot ‘pull rank’ (South African EP) to obtain the best staff, or the firm may not have representation requiring reliance on a local firm, which may follow a different audit methodology. On the other hand, where local audit expertise in, for example, a developing country was not available for important clients, the audit firms were readily able to ‘parachute’ in appropriately skilled staff.

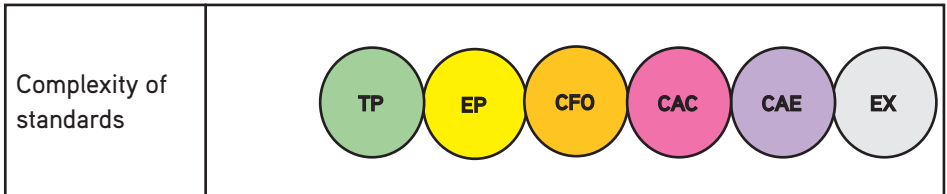


With the acknowledgement that an auditor cannot be a ‘jack of all trades’ (South African CAE) anymore, participants of all cohorts acknowledged the need for specialisation, ‘individuals cannot, with the best will in the world, have the level of specialist knowledge that they need in all of these (complex) areas all of the time’ (UK TP).

All the expert participants believed that their prominence in an audit process had changed over the past years which they ascribed to the greater awareness of the need for specialisation, with engagement partners recognising their value

and benefit. However, some expert participants still perceived resistance to their involvement because of their impact on the audit, the additional costs, and the adjustments needed to the audit process. An IFRS expert participant believed a change in the mind-set of ‘an-auditor-is-an-auditor’ was needed and an actuarial expert advocated that there needs to be ‘more training industry-wide and globally for audit partners on the use of experts and for experts who are going to work in audit’.

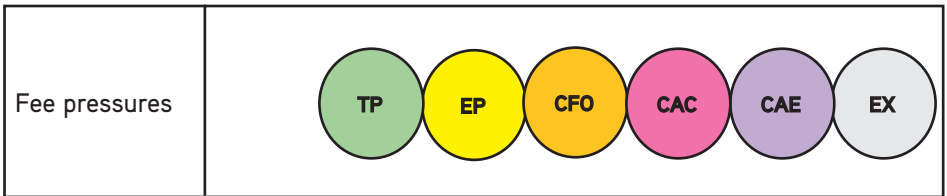
However, there was a view that specialism had gone to ‘extreme lengths’ (UK CAC) and this is undermining the ‘old ordinary auditor’ who is now no longer allowed to touch ‘anything special’. This ‘narrowed focus’ (UK CAC) has the unintended consequence of compromising auditors’ breath of experience, of making them ‘less worldly wise’ (UK CAC) because of diminished exposure to the diversity of service roles audit addresses. One Australian CAC complained that the audit is now very much influenced by technical divisions within their audit firms, and that their views sometimes oppose those expressed by the engagement partner, leading to some frustration.



There was an outcry by South African and Australian CFO participants over the complexity of IFRS. In general they perceived accounting standards as becoming too technical, with significant negative consequences for failing to follow the letter of the standards. Examples given to explain their disquiet included: judgement gets lost because auditors are so rules-driven; interpretation varies even within firms, and companies call on their auditors (with the supposed deeper understanding of IFRS because of their involvement in the development thereof) to arrive at a sensible answer; engagement partners lose control of audits because they are driven by their audit firms’ technical divisions; economic realities are not always reflected; and according to an Australian CFO participant audit firms ‘lack the courage’ to challenge standard-setters (‘none of them really had the fortitude to just say ‘no, this is a nonsensical answer’), and according to another Australian CFO financial statements are becoming ‘incomprehensible’ because of the complexity of the standards. CAC participants were also critical of IFRS, as their application resulted in financial statements which were not always ‘sensible’ or ‘useful’

(Australian CAC). Interestingly EP participants were less critical of IFRS instead venting their frustration with the different accounting frameworks in the world that they are frequently required to integrate in a complex audit. They advocated the development of a single, globally accepted accounting framework which could then be applied by their multinational clients (particularly for those operating in the United States).

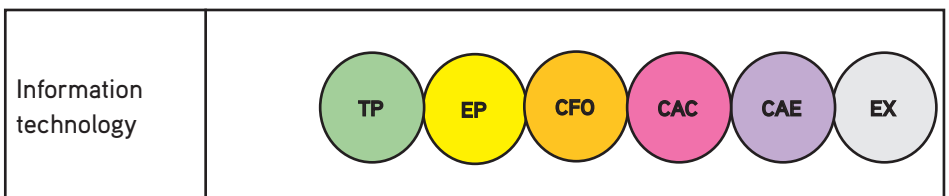
The need for change and simplification of financial statements was identified and supported by participants from nearly all cohorts. Typical sentiments included shareholders do not understand or read the information, so ‘what is the point [of the complex detail in financial statements]?’ (UK EP) and ‘there’s a pretty strong pushback at the moment to make the accounts more simple’ (Australian CAC).



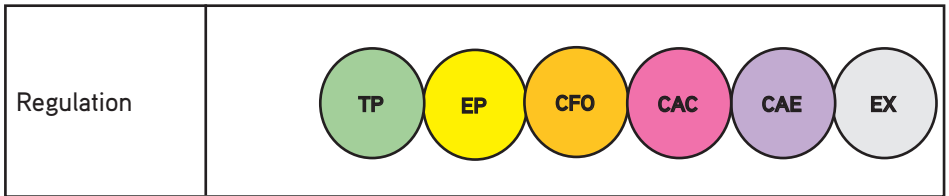
Time is needed to understand complex businesses, but according to TP and EP participants audit firms are experiencing fee pressures as evidenced by the following typical comment:

*All the pressure is about getting people in and out quicker so they [clients] want assurance faster, [and] more effectively, which gives less and less time for people to ... learn, understand and question.*  
 (South African TP)

This also impacts on the use of expensive experts on engagement teams. EP participants generally believe that, due to fee pressures, firms’ profit margins have eroded over the years, requiring firms to carefully consider their cost models and it is envisaged that fee pressures will continue in future. There was only one dissenting voice from a South African CAC who did not share this perception, commenting: ‘pricing - that’s never been an issue’.



IT developments are changing audit practices; they are becoming more automated, and if used properly IT could contribute towards enhanced audit efficiency and enable audit team members to enjoy the flexibility of being able to work virtually from any location at all hours. However the technology can create new risks and be ‘a noose around your neck, or it can certainly be a liberator’ (South African EP). One UK CFO observed that the speed that information flows and its interconnectivity and visibility (for example real-time billing) should be reflected in the thoroughness of the audit process. This was a view supported by actuarial and quantitative expert participants who referred to IT developments as presenting ‘more and more automated solutions’. Indeed one actuarial expert observed ‘we can run a lot more detailed tests now than we could ever before ... [and] go to a level of detail you couldn’t do before’; but cautioned that this requires a different skill set, ‘I mean, you’re using programmers to check journal entries rather than audit clerks - that’s a mind-set change’. Audit teams will be required to have the necessary understanding and, in the view of one South African CAE participant, IT will no longer be a ‘specialised’ domain.



All EP participants reported that regulatory inspections have increased, not only in number but also in duration and nature. Even though all EP participants conceded that there is a need for regulatory inspections and that they had a positive impact on audit quality, some concerns were raised about the regulators. A UK and a South African EP participant referred to their experiences of the reviewing process of the PCAOB (in the United States), and although these were perceived to be ‘onerous’, ‘strict’ and ‘rules orientated’, they ultimately had been a positive experience. The main concerns raised, and the consequences identified as arising from the regulators’ activities in the three regions, were:

*Driving compliance behaviour*

Firms’ audit methodologies are challenged by regulatory scrutiny demanding more focus on detailed documentation. A UK EP mentioned that there were 124 check lists that had to be completed, while another UK EP participant added that the scrutiny means that ‘... a lot of work [is] done now making sure that you tick all the

right boxes, and it's not necessarily the best way to go'. A UK EP perceived the 'fixation of the regulator on documentation' to be manifesting as two parallel audits being conducted:

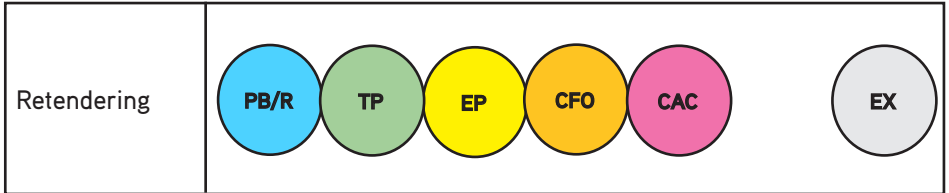
*[B]ecause of the documentation requirements of the auditing standards, and because of the demands that the regulators place on us in terms of very onerous documentation levels (and [they are also] time consuming) that we have to maintain, you do generally have a lot of people who spend a huge amount of time accumulating the documentation necessary to be able to satisfy those requirements.*

A UK CAC also recognised the notion of the occurrence of two parallel audits and commented that 'it can be quite a struggle to get those two to be properly joined up'. This CFO perceived this to be 'a bit worrying and undesirable' because at junior levels staff 'spend a lot of time sitting in front of their laptops', filling out forms which in the view of a South African CFO inhibits the development of their audit capabilities, as it compromises the auditors' critical thinking skills, professionalism (South African PB/R) and restricts the breadth of experience they may bring later to the audit. This compliance orientated mind-set could result in auditors becoming little more than 'competent but dull box tickers' (UK CAE) which negatively impacts on an auditor's ability 'to step back and see the wood for the trees' (South African CAC). This distracts them from a broader view of 'what really matters' (Australian CFO). The more the practice of box-ticking is driven, the more that becomes the defence, which is, 'I did what I had to do; I did what was required of me' (UK CFO). An associated concern with such a 'compliance-driven' approach is that 'regulation makes the job much more boring' (UK EP) and this could result in the profession struggling to attract quality members at the junior level and retain partners at the top level. One UK EP perceived the regulatory burden that is increasingly being placed on partners to be so arduous that to many of them 'it's not really worth the candle and the risk that we're carrying', and they leave the profession. This holds long-term negative implications for the audit profession which will 'end up dumbing down the audit profession generally' (UK EP).

### *Defining a quality audit*

A UK EP argued that 'nobody can actually define what quality means' and that the EP's perception of a quality audit did not agree with that of the regulator. Some EP participants agreed, claiming that they regarded a quality audit as one that issues

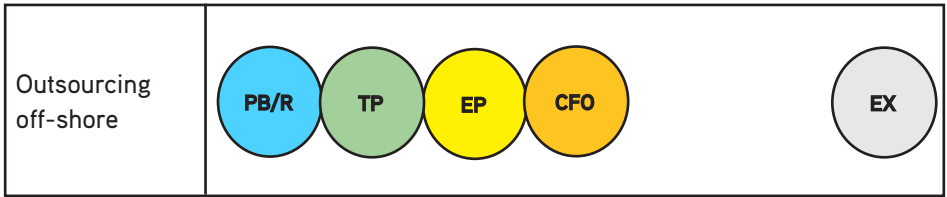
the ‘right opinion’ (South African EP), whilst for the regulator quality is defined by the number of details and exceptions discovered. A UK EP believed some firms’ methodologies for identifying key risks from a ‘top-down, rather than that more [commonly used] bottom-up way’, had resulted in ‘less documentation at process level’ but the regulators’ definition of a quality audit has meant that ‘[this process] has been slammed into reverse’ to the detriment of actual audit quality.



The premise behind retendering based on the ‘alleged problems of audit’ (UK CFO) was questioned, as it was suggested that these allegations were ‘not well-founded on facts’ (UK CFO). However, it was recognised that retendering is intended to create ‘some churn’ and it would result in a ‘more rough and tough commercial world’ for auditors (UK CAC). This was likely to drive attrition in the audit market because ‘the pressure for change will be very high on boards and audit committees’ (UK TP). However, this was not necessarily considered to be in the best interest of audit practice. Several disadvantages of retendering were highlighted. Whilst many participants mentioned the cost implications, one UK EP argued that such an environment would have a negative impact on the value added by auditors, as it is likely to be considered a worthless effort: ‘there’s no prizes for doing that. You can’t retain the client, and you can’t win any additional revenues’. A UK CFO perceived that the impact on the understanding of a client’s business ‘is fundamentally underestimated’ with retendering; ‘it is not something where you just dip into this and dip out at will’. Finally, a UK CFO participant cautioned that retendering could take auditors’ ‘eyes off the ball’ because much focus would then be on obtaining new clients (which takes a lot of time and effort) rather than on maintaining current clients. Firms ‘will be forever tendering [for] audits’ (UK EP), leading another UK EP to express concern that the Big 4 firms would not be able to cope, because they do not have the ‘people, the resources, the money and the time to bid for everything’. More emphasis would be put on a partners’ ability to gain new clients resulting in a changing emphasis on skills set.

Some advantages of retendering were however highlighted by UK CAC participants such as: increased competition between firms; maintaining independence; avoidance of complacency; serving as a catalyst for improvement; and an

opportunity for the expansion of the knowledge base of firms, which would then create development opportunities for staff.



This practice allows for ‘menial/mundane’, (UK TP and South African EP) low risk tasks (such as adding up accounts, taking in bank confirmations, custodian confirmations, proofing accounts) that would generally be done by very junior staff, to be outsourced to an off-shore entity.

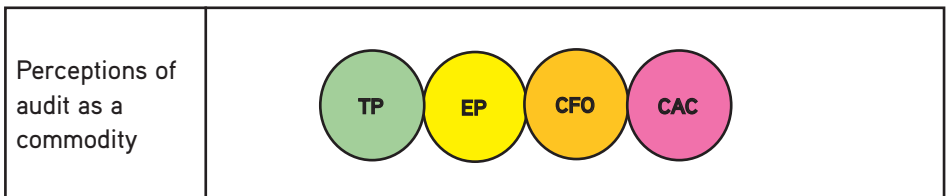
This practice was supported by some participants with comments such as, ‘I must be honest, on a lot of the work I’ve seen they’re actually pretty good - as long as the question, the right question is asked’ (actuarial expert). However, a variety of EP, TP, PB/R and CFO participants expressed reservations. A UK TP stated: ‘you do have to have the protocols in place to make sure that it’s managed appropriately, that’s it’s done to the appropriate level of quality and the appropriate timeframe’. They also highlighted the need to consider security and confidentiality issues. An Australian CFO was very sceptical claiming that the ‘rot has only just started’, while a South African CFO cautioned against applying this practice for the audit of material areas. A UK TP participant expected that regulators would probably limit such practices, and that client inter-face would be compromised if this practice was taken to extremes. Nevertheless, in general EP and TP participants believed that the off-shore outsourcing practice is here to stay, and it was generally thought that this practice will continue ‘growing over the years’ (UK TP) and would not be restricted to mundane tasks but could be expanded to also regularly include data analytics.

Another concern of particular relevance to the development of audit trainees, was that such a practice could negatively impact on the available talent pool as the local skill set could become depleted. An Australian CFO expressed a view that firms were beginning to undermine ‘the ability ... to develop their staff locally’ and predicted that their competence would deteriorate over time. However, the counter-argument which was also raised is that off-shoring gives junior staff more opportunity to undertake more challenging work which enhances rather than detracts from their development. That this may result in a decrease in the demand

for audit trainees was seen as a trend that would eventually reduce the number of professional accountants in practice.



A UK CAC perceived audit firms to be much more risk averse than in the past: ‘they are much more cautious generally about expressing a view outside their core remit’. This CAC ascribed this to today’s audit environment, characterised as it is by increasing occurrences of blame. A UK CAE was very outspoken, stating that over the past five years auditors have been spending an increasing amount of time on ‘box ticking and arse covering’ which was caused in the opinion of another UK CAE by their ‘fear of being sued’ which was ‘box[ing] them into a tight zone’ because it overrides everything they do. Participants of all the cohorts, that commented on this issue, predicted that the litigation fears of auditors will continue to escalate. In general CFO participants agreed with the view expressed by a UK CFO participant that there is ‘more focus from the auditors on protecting themselves’. It was perceived that the litigation risk for auditors ‘seemed to be getting higher’ (UK CFO) and this is reflected in ‘more and more disclaimers in their reports’ (South African CFO). An Australian CFO suggested that as soon as auditors know their opinion’s going to be used in the marketplace rather than just used by management, their processes become a ‘lot more rigid ... as they’re managing their risk rather than trying to serve their client’. The ‘cover themselves in terms of the opinion they provide approach’ in the view of one South African CFO sometimes borders on rendering the audit opinion irrelevant.



Some participants cautioned against the tendency for an audit to become a commodity, and thus a fixed, controllable cost. This perception was foreseen by some participants who commented on this issue as likely to continue to spread. As was observed by a South African TP ‘... the problem is when an audit or anything



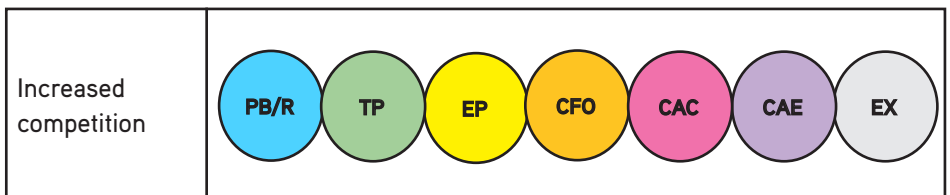
becomes a commodity - then it gets priced as a commodity and that is the lowest common multiple' and then the 'chop and change' (South African EP) rule applies. As clients no longer regard audits as adding value, they are demanding 'the cheapest audit' (South African TP) which causes tensions within the audit firm 'where you have different skill sets that actually reside in different [divisions within the] businesses' (UK TP). This results, for example, in the costs for experts in the consulting/advisory (non-audit) division of a firm no longer being covered by an audit fee.

## Future role

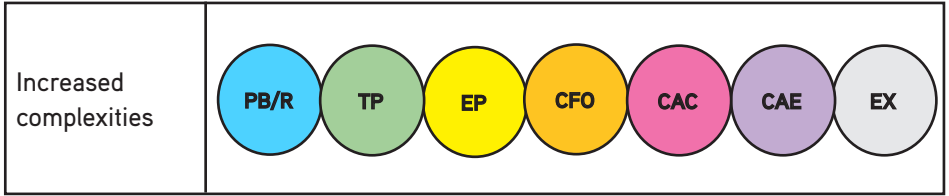
In general, participants of all cohorts acknowledged that the above-mentioned factors and the evolving expectation gap will change the audit profession, which, '[is] in many ways struggling to work out how it responds to the demands of the 21st century' (UK PB/R). There was a feeling that the audit profession was 'just about to embark upon a period of unprecedented change' (UK TP) and whilst no cohort questioned the need for financial statement audits to continue in the future, the relevance of an audit in its current form was questioned. A UK TP explained the situation using the following metaphor:

*Imagine if the company was a car going along a treacherous road: the description of an auditor is [that] of a passenger sitting next to the driver, looking in the rear view mirror, trying to basically describe the road ahead by looking behind them ... the implication being [that] it has a very, very limited value to the driver, trying to negotiate the treacherous path ahead.*

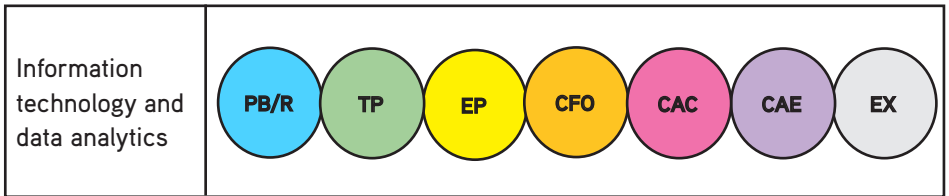
If the audit profession does not embrace its changing role for the future, it will become irrelevant (South African CFO). It is therefore important to consider the predictions regarding the future role, responsibilities and practices of auditors and this in turn will drive the agenda for the development of the requisite capabilities required to deliver this revised role. The predictions will now be discussed in order of importance, as determined by the number of cohort mentions.



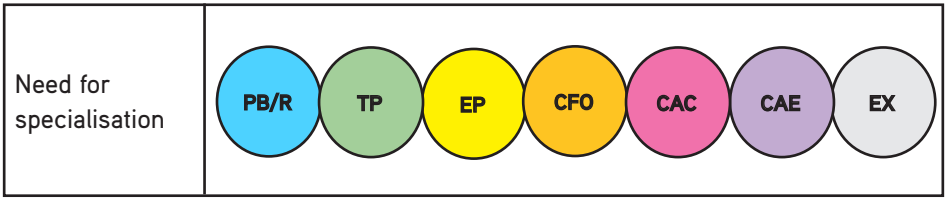
Rotation and retendering will stimulate competition because the largest companies will change their auditors at more regular intervals.



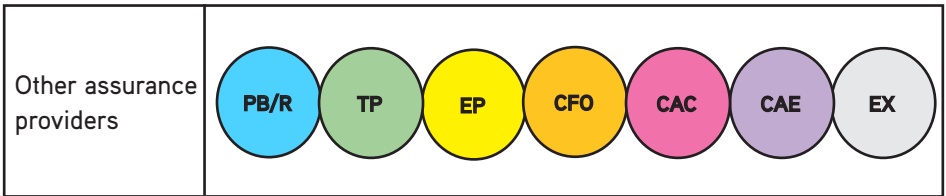
Auditors will be confronted with more complexities due to clients’ intensified internationalisation of their operations. Therefore, a South African TP participant remarked, future auditors will have to ‘think global and act local’. The complexity of business structures will surpass the abilities of traditional practices to audit. The comment was made by a South African and a UK EP participant that an independent project manager, who is not an accountant, may be required to manage complex audits in future. An actuarial expert believed that audit teams will become much more diverse, and used the example of a war game to illustrate the point: ‘you want infantry, artillery and air support in a team, otherwise you get wiped out’. The expert predicted the emergence of the ‘professional expert ... an entire boutique industry of assurance providing experts’. This would create additional competition for a traditional auditor.



As technology develops, audit practices will change. A UK CFO believed that IT specialism was a ‘prerequisite to have ... embedded in each and every audit rather than ... [as] a function that can be called upon from time-to-time’. An Australian CFO referred to data analytics as a growth area, which could replace statistical sampling. It entails the effective checking of every transaction that has occurred in a period and looks for anomalies through algorithms. An Australian CFO perceived that the embedding of IT had great potential both from a cost perspective and from a quality perspective. A data analytics expert and an actuarial expert participant agreed on the potential of data analytics.

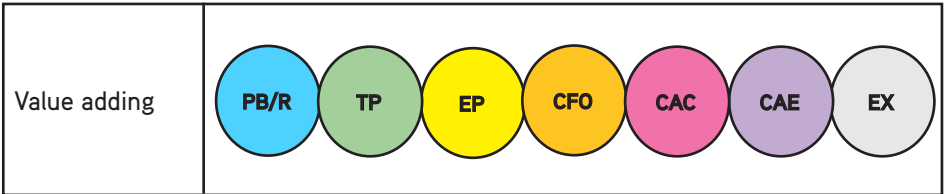


In general EP and CAC participants foresee that industry specialism will become a necessity and reliance on experts even more profound. A South African CAC predicted that future audit firms may even specialise in auditing a particular industry, while a UK EP foresaw that audits will be dominated by technical departments, ‘chewing over decisions and issuing edicts about how things will be reported’. A UK CFO predicted that auditors would need ‘a wider set of tools in their toolkit’ because they will obtain views on a much wider range of specialised matters. This CFO further advocated the strengthening of other specialised areas ‘to make that capability become interlinked in a very enduring, rather than a purely advisory, way’.

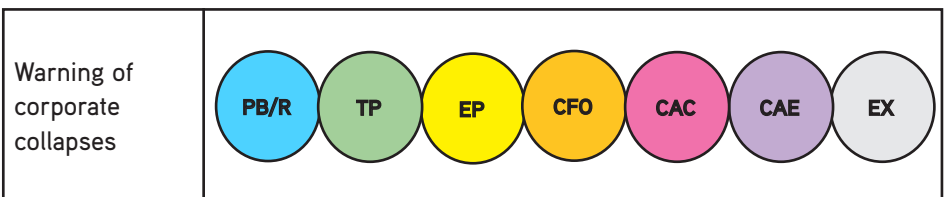


Fee pressure is an increasing driver for improving efficiencies which in future will result in more emphasis being placed on other current assurance providers such as internal audit. Some respondents (especially those in South Africa, because they have been exposed to the King III Report) foresaw that ‘much more holistic assurance [is going to be] provided to clients’ through external audit linking up with internal audit. All South African CAC participants supported the implementation of combined assurance, a model recommended in the *King report on governance for South Africa* (IOD, 2009). This model aimed to optimise the assurance coverage from management, internal assurance providers (such as internal audit, risk management, compliance, forensic, legal health and safety departments) and external assurance providers (such as external auditors). It is argued that the combined assurance provided by internal and external assurance providers and management should be sufficient to ensure that significant risk areas within the company have been adequately addressed and suitable controls exist to mitigate and reduce these risks. CAC, EP, TP and CAE participants from South Africa acknowledged that companies are struggling to implement combined assurance

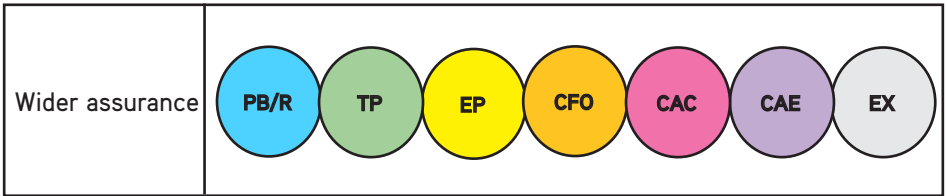
because of the complexities associated with rolling down strategic risks (requiring them to re-define risk, design mitigating structures around them, and to test them) to divisions and business units, because they are not ‘granular enough’ (South African CAC). A CAC and an EP, both from South Africa, ascribed this to the immaturity of business divisions, the attitudes of role players who regard addressing risk as a tick-box exercise, and to cost implications. A South African CAE concurred, observing that ‘the whole concept of combined assurance hasn’t really vested itself in the business, it is not embedded yet’. Two South African CAE participants commented on the benefits of a combined assurance model as follows: ‘it forced [us] into a space where there is a lot more regular interaction and at the different levels’. A South African EP expressed concern, claiming that, other than in the financial sector, internal audit does not have the stature for the model to succeed, and that all assurance providers are not equally committed to the model. A UK CAE supported the principle, not only for external auditors to rely on internal auditors but to work ‘more cohesively’, looking ‘in a lot more detail about what internal audit is actually doing, [identifying] where it is relevant to them, and commenting on it. If they do not think internal audit is doing a good enough job, they should flag that up’.



Participants from all cohorts perceived that auditors will have to give some view on the existence of business risks, or on whether a company’s business model is appropriate for a specific industry. A UK CFO contemplated that unless the role of audit changes it was ‘not ever going to add value’ and this was not tenable for the auditing profession moving forward. An Australian CFO expressed the need for auditors to ‘give some perspectives outside their strict mandate’, to become more involved with their clients placing more focus on the management letter (UK CAE) and to ‘identify trends ahead of time’ and to share those with management who then need to incorporate them in their business models (South African CFO).



A UK TP predicted that auditors will be expected to give a ‘more valuable view on the future prospects of the company’, thus responding to a ‘lot of pressures on the audit fraternity to probably be future predictors’ (Australian CFO). However, a South African CAC shared a pragmatic view on assurance on forward-looking documentation, claiming that auditors could be in the position to assure the methodologies followed by the companies to compile such information, but observed that ‘nobody’s got a crystal ball’, so it will still be unrealistic to expect auditors to assure outcomes. The general belief of EP participants, as articulated by a South African EP, was that this expectation ‘brings a whole new ball game to being an auditor’. The regulatory frameworks in which the profession is currently functioning do not make provision for such a change, and a UK EP cautioned that the ‘barriers to changing the global legal framework are enormous’.



*Forward-looking and predictive*

Whilst the going concern presumption currently looks at the foreseeable future, participants from all cohorts generally believed that capital markets would benefit from an audit process that was far more forward-looking and predictive in nature. CAC participants argued that such information forms a critical part in investment decision-making processes, which will justify an increased audit fee. This will increase the breadth of and demand for wider assurance from auditors. Management Discussion and Analysis (MD&A) sections in annual reports are already beginning to respond to this need, but as an Australian EP argued analysts’ briefings are ‘fairly verbose’ and the demand is for much more assured forward-looking information. In relation to the changes in company reporting a UK CFO made the comment that it was:

*... a complete perversity that the major forum of communication with investors is through half-year and full-year results slides and presentations which are not, themselves, directly subject to audit - it is just completely anathema.*

An Australian CFO and a UK CFO both advocated that auditors need to ‘engage in broader assurance roles’, to ‘broaden their wings’, because this would increase

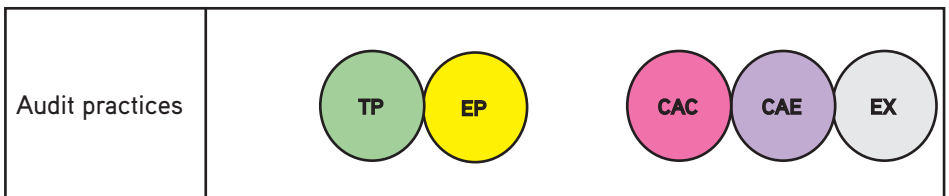
their understanding of a client’s business. Auditors will ‘learn things about the organisation from those other activities if they’re able to engage in those other activities and that will [be a beneficial] spin-off’ (Australian CFO).

All EP participants expected that auditors would have to give assurance on the front-end of an annual report, probably, according to a UK EP, in an ‘agreed-upon procedures kind of way’ (the current practice of giving assurance over some aspects in sustainability reports, is seen as the precursor). Two UK EP participants believed that this expectation will go beyond the front of the annual report to include a wide range of information that could be more useful than financial statement reports, such as extending assurance to companies’ key performance indicators or ensuring ‘more comfort over the quality of their customer facing processes’.

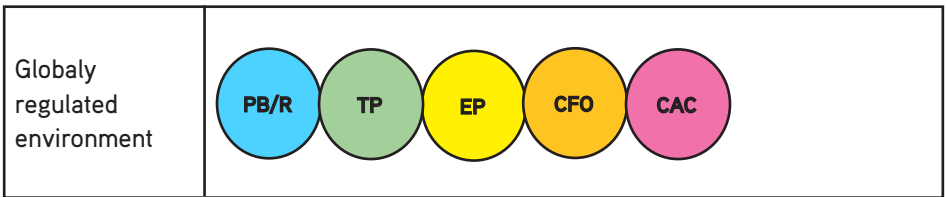
*Business models and processes*

Whilst some CFO participants commented specifically on the need for auditors to give assurance on clients’ business models as well as processes, many cautioned that this would expose auditors ‘to all sorts of litigation liability that’s not reasonable’ (Australian CFO), alluding to the complexities involved when many business processes and plans are fluid (South African CFO). Complexities and fluidity aside, assurance from auditors on some aspects of companies’ integrated and sustainability reports were perceived to be a first step in this direction of providing wider assurances to society. Indeed, an environmental expert believed that society will demand from auditors that they assure the responsible citizenship claims of their clients (‘how companies deal with their social responsibilities, the environmental impacts and how they manage it’), perhaps giving assurance that companies are doing business with parties that have adopted sustainable manufacturing and operational processes (South African CFO).

However, current liability and regulation profiles were perceived to be obstacles and the need was expressed by an Australian EP for regulators to create an environment where this expectation could be met ‘without being so paranoid around litigation consequences’.

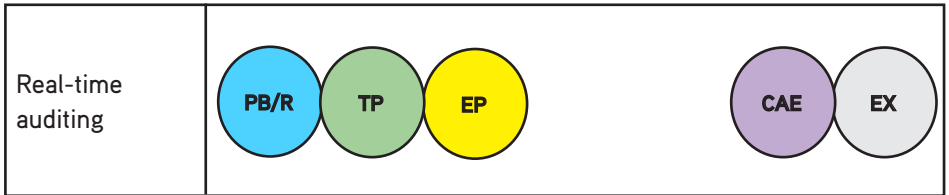


Some EP and TP participants questioned the relevance of firms' reliance on audit trainees (with their undeveloped skills sets) for the audits of today's complex businesses. A South African TP raised the question: 'Is that model that's been applied twenty, thirty years ago still relevant today, after all the changes that we've gone through?'. A UK PB/R predicted that firms would be reluctant to change their business models of 'having lots and lots of Indians producing fairly, some would say, valueless work which ultimately gets up to an audit opinion'. Other EP participants, however, were cautious because, as explained by a South African TP 'trainees are the profit drivers'. A South African CAE questioned the relevance of the pyramid structure of the auditors' business model, and advocated that due to the complexities of businesses more representation at higher levels was needed, (where more insight is required), and this will lead to a 'block structure'. An Australian EP predicted that there will be more scrutiny of relationships generating non-audit fees, resulting in the emergence of 'audit-only firms' which, together with a regime of more frequent tenders, could have huge industry-changing consequences. The changed audit report in the UK has already made a fundamental shift from 'reasonably generic' information to one which elaborates on more than the bald numbers. One UK EP foresaw that this change 'is going to continue to develop'. All EP participants predicted that the need for efficiency from audit firms will increase. A UK EP believed this will require firms to develop 'future cost models more globally', probably 'pushing for more off-shoring and low cost delivery' of routine and mundane tasks. Finally a South African CAC predicated that the relationship between auditors and audit committees in future will be more interactive in that audit committees will increasingly drive issues of audit interest.

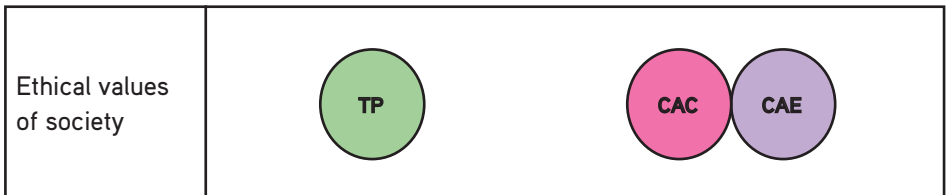


Auditors will have to function in an environment which will become more rules based due to increasing regulation, standards, and audit methodologies, procedures and processes. Some South African EP and TP participants expressed their concerns by arguing that this is not in the interests of the public because it does not 'drive the basis for judgement', and that such an environment will not 'attract quality people, which hold[s] long-term negative implications for the profession'. The comment was made by a UK CFO that auditors should strive to harmonise 'their standards, processes and procedures across countries' in accordance with

consistent criteria, whereas a UK EP expressed the need for a global accounting standard but acknowledged that ‘we’re a million miles away from that’. A UK CFO participant believed that companies’ and firms’ aims to function globally could be handicapped by regulators’ nationalistic drives that could counteract globalisation by taking a ‘more divisive and less global’ route.



In meeting the expectations of the ‘instant culture’ society, the demand, according to a South African TP, will be for real-time auditing. The quality of clients’ data will improve in future as systems become less fragmented and data analytics becomes more efficient. So the prediction is that auditors’ methodologies will grow to accommodate IT analytical and data interrogation techniques. A data analytics expert participant believed that data analytical skills will form part of an auditor’s day-to-day functioning and not be ‘outsourced to experts’. A UK EP was imaginative in forward thinking, arguing that companies may not issue annual reports in future: ‘they’re just producing real-time financial information, almost like open nominal ledgers, and shareholders and investors can go in and drag down whatever information they want’. The audit will then not be on the fairness of financial statements but the provision of assurance on the systems producing the base information.



Some South African TP and CAC participants expressed concern about the decline in ethical values of societies, a trend which they saw as likely to continue, as this could change the face of audit in future. For example, these participants considered that there would be a need for auditors to have more forensic skills. This matter is explored further in Chapter 6 of this report.



## Summary

There was no dissent regarding the need for a statutory audit and although general satisfaction was expressed about auditors' current capabilities and subsequent performance, the statutory audit in its current form was judged as being too static. The latter was apparent from the reservations expressed on the value-adding ability of auditors in the public interest. Auditors were criticised for their inability to provide guidance to management about how to improve their business and insights based on industry and cross-industry trends which could promote improvements within businesses. In addition the expectation gap was perceived to be still evolving and while the ongoing and proposed revisions regarding the content and format of the audit report were perceived as a step to narrow the gap, these were not regarded as being comprehensive enough. Indeed, much of the recent public criticism that has been levelled at auditors was ascribed to the continuing expectation gap and this is clearly an area that still requires to be addressed.

An attempt by regulators to drive up 'audit quality' has resulted in a highly regulated audit environment. This has subsequently driven compliance behaviour and has resulted in firms becoming more practice risk averse. The outcome of this compliance driven behaviour has been two parallel audits, namely compliance and assurance driven audits, with the former focussing on ticking the right boxes and the latter aimed to express an opinion. The practice of compliance-driven auditing has elicited much criticism. However, this increasing regulation, which has now also extended to compulsory retendering (and debates over mandatory rotation) was generally not regarded in a positive light for enhancing audit quality. This is a further area that will require consideration.

There is no doubt, however, that the environment within which business operates is constantly changing. This change engenders challenge, both in terms of the current capabilities of the audit team and also whether the scope of the current audit is still fit for purpose. A proper constructive debate on the future of an audit was called for, including all role-players (institutional investors, regulators, auditee companies and auditors) to assess the scope of future audits and forthcoming capability needs. As noted in Chapter 1, some of this debate is already underway.

In terms of the current capabilities, the increasing complexity and globalisation of business, combined with the increasing complexity of financial reporting standards and the opportunities/risks afforded by information technology development, demands increasing specialisation within the audit team. This specialisation comes

at a cost, which provides further challenges as there is a perception that auditors' breadth of experience is compromised, that auditors overly rely on their technical divisions and that there is a lack of integration of the specialists within audit teams and their subsequent impact on the audit fee. Concerns were raised about the audit being regarded as a commodity and hence the audit fee was constantly under pressure. Until the audit is seen to 'add value' this perception is unlikely to change.

Moving to the future, in addition to the audit 'adding value' by providing wider assurance on business models and processes and being more forward-looking, predictive and warning of corporate collapses, several other areas were highlighted that are likely to demand change. However the need for the audit process to be far more forward-looking and predictive in nature, requires changes in current liability and regulation profiles as these were perceived to be factors hindering change. Whilst many of the areas highlighted were simply extensions of the current challenges highlighted above, such as the increased complexities within a global environment, some pertinent areas were highlighted. For example, the opportunities offered by increasingly sophisticated technology could result in real-time auditing and the movement away from problematic statistical sampling to data analytics. Changes such as these will have profound implications for the capability requirements and composition of audit teams in the future.

## 5. CURRENT CAPABILITY REQUIREMENTS

*What are the capabilities needed by auditors (individually and collectively) to perform their current role and meet their current responsibilities?*

### Auditors in general

Participants from all cohorts generally agreed that the Big 4 firms, with their global networks, have the necessary capabilities at their disposal to perform audits of complex clients. As a South African EP observed: 'I don't think the Big 4 firms are ... battling to find any of the skills, just because we have more reach, more size to be able to attract' appropriate talent. In general CFO participants perceived auditors to be competent. A UK CFO for example said: 'they generally served up high-quality people'. Table 5.1 below identifies, according to applicable participant cohorts, the capabilities identified as essential for auditors.

**Table 5.1: Capabilities for auditors in general**









































| Capabilities in alphabetical order as ranked by the cohort mentions | Participant cohorts   |   |   |   |   |   |
|---|---|---|---|---|---|---|
|   | PB/R  | TP  | EP  | CFO   | CAC   | CAE   |
| Adaptability skills   |    |    |    |   |    |    |
| Analytical skills   |    |    |    |   |    |   |
| Business acumen   |  |  |  |  |  |  |
| Change management skills  |   |   |  |   |  |  |
| Conflict resolution skills  |   |   |  |   |  |  |
| Communication skills (written and verbal)                           |  |  |  |  |  |  |
| Consultation skills   |   |  |  |  |   |   |
| Critical thinking skills  |  |   |  |  |  |   |
| Forensic skills   |  |  |   |   |   |   |
| Innovative thinking skills  |   |  |  |  |  |   |

Table 5.1: Capabilities for auditors in general (cont'd)

| Capabilities in alphabetical order as ranked by the cohort mentions | Participant cohorts |    |    |     |     |     |
|---|---------------------|----|----|-----|-----|-----|
|   | PB/R                | TP | EP | CFO | CAC | CAE |
| Interpersonal skills  | ●                   |    | ●  |     | ●   | ●   |
| Insight   | ●                   | ●  | ●  | ●   | ●   | ●   |
| Information technology skills                                       | ●                   | ●  | ●  | ●   | ●   | ●   |
| Knowledge and understanding <sup>1</sup>                            | ●                   | ●  | ●  | ●   | ●   | ●   |
| Leadership skills   | ●                   | ●  | ●  | ●   | ●   | ●   |
| Life-long learning skills   | ●                   | ●  | ●  | ●   |     |     |
| Listening skills  |                     | ●  |    |     |     |     |
| Marketing skills  |                     | ●  | ●  | ●   |     | ●   |
| Negotiation skills  | ●                   | ●  | ●  | ●   | ●   | ●   |
| Problem solving skills  |                     | ●  | ●  | ●   | ●   |     |
| Professional judgement  | ●                   | ●  | ●  | ●   | ●   | ●   |
| Professional scepticism   | ●                   | ●  | ●  | ●   | ●   | ●   |
| Project management skills   | ●                   | ●  | ●  | ●   | ●   | ●   |
| Relationship building skills  |                     |    | ●  | ●   | ●   | ●   |
| Research skills   |                     | ●  |    |     |     |     |
| Team-work skills  | ●                   | ●  | ●  | ●   | ●   | ●   |
| Time management skills  |                     |    | ●  | ●   | ●   |     |
| Self-management skills  |                     | ●  | ●  | ●   |     |     |
| Statistical skills  | ●                   |    |    |     |     | ●   |

**Notes:**

- Accounting and auditing standards, ethical standards, governance, industry-specific regulations, global economy, laws and regulations, listing requirements, risk management concepts, client's business – products and processes

Participants also identified the following traits or distinguishing qualities and attitudes they expected auditors to exhibit:

- assertiveness;
- confidence;
- courage;
- discipline;
- empathy;
- emotional intelligence;
- ethical values;
- independent mind-set;
- inquisitiveness;
- integrity;
- intellectual curiosity;
- open-mindedness;
- passion about client service;
- trust.

Auditors, therefore, have to demonstrate a wide range of capabilities in order to perform their roles competently.

A UK PB/R expressed a critical view by referring to the 'naivety of many accountants' which did not resemble the expected characteristics of an auditor. One capability that received much attention in the interview process was the capability surrounding content knowledge about the client industry and business, as many of the audit failures have arisen due to insufficient competence in this area (South African TP, UK TP and Australian CFO). One UK CAE illustrated this point, by referring to Enron which the CAE stated was effectively a bank and a high risk financial trading business which was audited 'for most of the time it was in existence as an oil company, or an energy company'. Understanding the business is discussed further in the next section.

## Understanding the business, industry and associated risks

Participants of all cohorts agreed that a deep understanding of the client's business and industry is needed to deliver an effective audit. Breadth of industry knowledge is critical because, as a UK EP explained 'it gives you a comparison point of what others are doing; the benchmarks'. There is a need to contextualise such knowledge, to be able to relate your client's position to similar clients and to the global business environment. Another UK EP argued that such a broad view is needed to avoid the risk of 'not [seeing] the wood because of looking at the trees'. This demands a shift in emphasis in order to 'bring the industry perspective' (South African EP) in a more strategic way, by identifying the matters that are most 'important, difficult and judgemental' (UK EP). Industry knowledge is built up over time, along with knowledge of the business, particularly when auditors have been exposed to the 'ups and downs, the cycles, the flows, and what happened; thus it is a 'touch and feel' thing over quite a period of time' (UK CFO). As one data analytic expert mentioned 'clients can get pretty irritated, especially, if you don't understand the business', and the CFO went on to say that such an understanding requires a lot of learning and 'lots of growing pains'.

In general CFO participants were complimentary about auditors' understanding of the business and associated risks, believing that senior levels of the audit team which they encounter have a good understanding. Some CFO participants also recognised that improvements in this regard were evident. An Australian CFO for example stated: 'to be honest with you the ones that we had before, they were there for ten or fifteen years and they didn't have a bloody clue'. Positive comments made by CFO participants on the auditors' industry knowledge included the views that 'they do put a lot of effort into being on top of that' (Australian CFO), 'they have enough industry expertise in the team and around the team in the firm elsewhere' (UK CFO), and 'I've not found them asking questions that suggest they have no idea what they're looking at' (UK CFO). Auditors were also seen to be 'much more risk orientated' (South African CFO), and the auditors' risk perspectives were 'pretty much aligned' with that of the company so that the only real debates were on the prioritisation of certain risks (Australian CFO). Clearly improvements have been made and some EP participants referred to risk-focused planning meetings/briefing sessions held with their team (sometimes including views from analysts, CFOs or fraud experts) to create a deeper understanding of a client's risks and possible complications, and the strategies implemented by the client to manage these. Thus, in general EP participants believed they understood the clients' risks.

CAC participants generally also perceived their companies' auditors to have a good appreciation of risk, and they ascribed this 'greater awareness and understanding of ... business risks' (UK CAC) to the improved articulation of risks by audit committees and boards, made possible by risk mapping, maintaining risk registers and by the involvement of auditors in risk meetings. A UK PB/R challenged auditors to identify risks not reported in the risk register by asking 'if all auditors are going to do is validate what the company says, or replicate [that] ... what's the purpose of the assurance?'

However, it was recognised by CFO participants that the depth of auditors' understanding of the industry and of the client's business and risk would always be questioned because such an understanding is from an audit perspective which does not face the 'challenges of [business] reality' (UK CFO). For example, an Australian CFO stated that auditors are 'never going to win that game', because management unlike auditors, spend all their time in the business. Some participants suggested that to 'really understand a business' one has to actually work in the business (UK CAC) and that engagement partners really only appreciated this if they move from practice into industry and then were involved in running a big business themselves (UK CFO).

Some CFO participants were, however, critical of the audit approach with comments that the auditors are not always looking at the business 'in the right way' (UK CFO): they sometimes fail to see the 'interconnectedness' in business because auditors' understanding should not only be on the completion of individual audit tasks but also on how these inter-relate, thus requiring an understanding of the bigger picture, the end-to-end-product' (UK CFO). An Australian CFO argued that in the design of their audit processes and their various tests auditors at times did not 'understand the business processes and therefore they might design an audit test that is not especially practical or can lead to inconclusive results'. There was also some criticism (CFO and CAC participants) levelled at auditors for simply focussing on the risk register or for risk issues being 'picked up late in the audit' because auditors had not 'initially analysed or understood all the implications of a transaction' (South African CFO). On the other hand, a UK EP questioned whether it could reasonably be expected that auditors could 'be seeing something sinister gestating if management are missing that, especially where clients have large risk [management] and internal audit functions and many individuals considering the company's risks during their day jobs'.

## The capability of the engagement partner

All CAC participants alluded to the importance of the engagement partner, who should be ‘a centre of focus’ (South African CAC). The right engagement partner is crucial to a quality audit on a client in a complex industry and the engagement partner’s competence is the over-riding factor. The engagement partner should be a person ‘who knows the scene and who knows how to make big calls and is able to apply judgment’ (South African CFO). They have to have the ‘courage of their convictions to hang tough’ (Australian CFO), and to confront tendencies to follow ‘the path of what they think is least resistance’ (Australian CFO). The engagement partner must also be able to ‘choose the right team, you must lead them, [and] you must know when you must interfere’ (South African EP). Choosing the right team includes identifying the need for, and then the scope and engagement of, experts within the audit team. CAC and CFO participants generally perceived engagement partners as meeting their expectations, describing them as ‘good’ (UK CAC), ‘I think it would be harsh and wrong to say that they’re not, actually’ (UK CFO).

Relevant experience is a critical prerequisite to becoming an engagement partner, the capability is built up over years of experience, as demonstrated by one South African EP’s quote: ‘you don’t wake up one good day and you’re an engagement partner’. However, conflicting views were expressed on the depth of industry knowledge that would be appropriate. For specific industries, like financial services, mining, and oil and gas, specific knowledge was a high requirement: ‘you have to be able to speak the language of the industry’ (Australian EP); ‘you need to be deeply imbued in [the ethos of the industry]’ (UK EP). This was particularly the case for financial services, whereby it was suggested that engagement partners in this industry should have an in-depth industry knowledge:

*I think it’s valid for most industries but I think in particular the moment that you have both actuarial and accounting and other financial engineering type[s] of businesses [interacting] you can only really get to know that business on the job. (South African CAC)*

By way of contrast, it was not seen to be the case for retail or manufacturing clients: ‘you could run an audit like this with a relatively low degree of knowledge of the industry’ (UK EP); ‘being able to run and organise a global audit is actually more important than you having a detailed pharma background’ (UK EP). This was supported by a UK CAC who, whilst cautioning that within the team, industry knowledge and experience should be apparent, experience of the audits of



multinational companies is more important than the lead engagement partner's specific industry experience. The ideal, according to one South African CAC is for an engagement partner to have deep knowledge of the industry and of the client's business, with exposure to other multinationals. The cross fertilisation gained from working within other industries was also highlighted by the CFO participants who noted 'we get a lot of benefit' (South African CFO) from such exposure. Whilst some CFO participants perceived that auditors were using cross fertilisation reasonably well, a UK CFO expressed reservations 'What they probably don't do ... is bring ... enough people in from other industries', thus allowing learning across industries to get lost.

CAC participants generally believed that a deep understanding of the client's business could not be obtained without the presence of the engagement partner and their team at the client's operations/place of business, where they could interact with personnel at various levels and obtain different views of the business. Whilst some CAC and EP participants observed that engagement partners now spend more time actively engaged on audits than would have happened a few years ago (reporting a 'greater involvement' (South African CAC) and a much more 'hands-on approach' (South African CAC)), one UK EP questioned whether this time was being spent 'in the right areas'. This criticism was further developed by an Australian PB/R who noted that 'partners are being distracted away onto a whole lot of other things ... which involves marketing and networking, ... running a business'.

There was also recognition that the engagement partner does not have to have all the capabilities to perform the audit, but should 'be well aware of the key requirements' of the audit (South African EP), and where and when appropriate assistance is needed, and from whom it is to be sought. Indeed, CFO participants acknowledged that the lead engagement partner relied on various other partners and also the review partner, and that these layers of consultation make it 'more difficult for the client to bully [the] auditors' (South African CFO) and this was perceived in a positive light. However, it was stressed that an engagement partner's identity should not be lost by relying on other experts to the extent that the engagement partner 'cannot make any decisions', and not be able to exercise professional judgement (South African EP). This would reduce the engagement partner to the status of little more than a vanilla-flavoured project manager. At the end of the audit it is still the engagement partner who signs off on the financial statements and carries the personal reputational risk irrespective of whether the engagement partner project managed the process or participated fully in the audit.

In general, all participants perceived engagement partners to be competent with the necessary experience and industry knowledge. However, there was recognition that the 'strongest partners' (UK CFO) had been 'hand-picked' (South African CAE) to lead the audit teams of the largest multinational clients. Whilst partners were not 'thinly spread' on 'crown jewel clients' (UK EP), there was a general perception by the EP and CAC participants that the current pool of engagement partners who have the capability and presence to stand up at board level and provide a 'robust challenge' (UK EP) to be 'very small' (EP UK and South African CAE). Succession planning is therefore a real issue for audit firms as unfortunately in the view of one South African EP 'some of my partners have got it and some haven't got it'. Development of the right individuals is therefore critical in order to provide the relevant experience. As one South African TP explained: 'I certainly don't want a manager to step into a complex environment as a first year partner. I need an experienced partner to step into an experienced partner's shoes'. Without this experience, two CAE participants (UK and South Africa) were of the view that engagement partners are less prepared to be 'controversial and provoking' in an environment dominated by members of the client's management team who have significantly more years of experience in a 'bruising, highly competitive market'. However, firms need to be able to retain developed individuals and this proves a further challenge when in the view of one South African CFO audit firms are increasingly ineffective in their ability to retain talented people. The restrictive supply of appropriate talent is further exacerbated in the view of one UK EP participant by the licensing barriers imposed by various territories, which prevents multinational client engagement partners from moving around in the world.

Participants, from all cohorts, expected engagement partners to have the previously mentioned capabilities listed in Table 5.1. However, in addition, specific capabilities were also highlighted. These are listed in Table 5.2 in alphabetical order. All the capabilities that were expressed by the various cohorts are listed, resulting in some inevitable overlap between some of the capabilities.

Table 5.2: Specific engagement partner capabilities

| Capabilities in alphabetical order | Participant cohorts |    |    |     |     |     |
|------------------------------------|---------------------|----|----|-----|-----|-----|
|                                    | PB/R                | TP | EP | CFO | CAC | CAE |
| Adaptability skills                |                     |    | ●  |     | ●   |     |
| Analytical skills                  |                     |    | ●  | ●   | ●   |     |
| Business acumen                    |                     |    | ●  | ●   | ●   |     |
| Client negotiating skills          | ●                   | ●  | ●  | ●   | ●   | ●   |
| Conflict management skills         |                     | ●  | ●  |     | ●   | ●   |
| Consultation skills                |                     |    | ●  | ●   | ●   |     |
| Coordination skills                |                     |    | ●  | ●   | ●   |     |
| Insight                            | ●                   |    | ●  | ●   | ●   | ●   |
| IT skills                          |                     |    | ●  | ●   | ●   |     |
| Judgement skills                   |                     | ●  | ●  | ●   | ●   | ●   |
| Leadership skills                  | ●                   | ●  | ●  | ●   | ●   |     |
| Lifelong learning skills           | ●                   | ●  |    | ●   |     |     |
| Marketing skills                   | ●                   | ●  | ●  | ●   | ●   | ●   |
| Problem solving skills             | ●                   |    | ●  | ●   | ●   |     |
| Professional scepticism            | ●                   | ●  | ●  | ●   | ●   | ●   |
| Project management skills          |                     | ●  | ●  | ●   | ●   | ●   |
| Risk management skills             |                     | ●  | ●  | ●   |     | ●   |
| Self-starter skills                |                     | ●  |    |     |     |     |
| Soft skills                        |                     | ●  | ●  | ●   | ●   | ●   |
| Strategic skills                   | ●                   | ●  | ●  | ●   | ●   | ●   |
| Team building skills               | ●                   | ●  | ●  | ●   | ●   | ●   |
| Time management skills             | ●                   | ●  | ●  | ●   | ●   | ●   |

In addition to the capabilities listed above, traits or distinguishing qualities which were also identified as essential for engagement partners to demonstrate were:

- assertiveness;
- courage;
- confidence (not only the engagement partner's self-confidence but also in the team);
- decisiveness;
- enthusiasm;
- ethical behaviour;
- enquiring mind;
- independence;
- integrity;
- passion;
- resilience;
- robustness;
- supportiveness;
- strength;
- vitality.

Whilst many of the capabilities listed in Table 5.2 were simply identified by the cohorts as desirable, several of the capabilities garnered further discussion. In particular, the view was expressed that the engagement partner has to effectively manage and lead their team, whilst simultaneously effectively engaging with the client, in order to exercise judgement and reach an appropriate opinion.

Leadership of the audit team is crucial, 'it all comes down to the leadership on the audit' (Australian CFO). One South African EP commented 'you're a leader more than an audit partner, because you're bringing together a suite of skills and you need to know which skills to draw on and where to get them'. As teams often involve up to 500 people on global audits (UK EP) effective project management was also regarded as a prime capability.

In terms of the client, a key distinguishing characteristic of a lead partner is the

ability to report 'what really matters' to those charged with governance (South African EP). As one Australian EP suggested '[it] is very often not intellectual horsepower, but communications' that counts. Thus, client negotiating skills are necessary on many levels to build good, open relationships with senior management, the audit committee, and also at the highest level 'to garner the support of the board' (Australian CFO). This involves:

*... having an honest, transparent conversation with the client about the risks associated with the engagement, the specialist expertise that's required to manage that risk, and reaching an appropriate agreement on how that's going to be paid for.* (UK TP)

Without appropriate client negotiation skills 'they're just proved to be too malleable for their clients [to benefit from their insights]' (Australian CFO). Related to this capability is the ability to balance opposing views, as according to one South African EP 'how ... you manage conflict through all that process ... how you take that energy of conflict and direct it so that it actually gets you to the outcome that you're looking for'. In general CAC participants expressed their satisfaction with the communications skills displayed by engagement partners, observing that those skills appear to have improved over time.

In terms of reaching an appropriate opinion, it was stressed that engagement partners need to know 'when to ask the question and then how to play it' (UK EP), an ability to 'prioritise' (South African EP), and to know 'when to blow the whistle and when to call for help' (South African EP). In addition, all EP participants emphasised the importance of professional scepticism, defined by one Australian EP as 'having the experience and ability to actually see [and define] something that just doesn't look quite right'. 'Gut feel' as a partner, defined as being 'a combination of the technical skills, the professional skills and the professional scepticism coming together collectively and ... saying you know 'does this [really] make sense?' (South African TP), is therefore important. Professional scepticism was emphasised by the CAC participants who looked for engagement partners who challenged management in a 'constructive way' (UK CAC) and were prepared to stand up to them 'more firmly' (Australian CAC). A UK PB/R participant perceived it as the ability to 'critique' a company's assessment. A UK CAC participant perceived auditors as needing to demonstrate a higher level of professional scepticism by challenging management 'in a more overt way'. The CAC, however, questioned whether, when that happened, they were 'just doing that to tick the box'. According to the majority of CFO and CAC participants, engagement partners were

'quite effective in raising concerns and being sceptical about management's actions' (Australian CFO). However, one South African CAC was less complementary perceiving there to be a lack of professional scepticism in the industry at present ('it is very disappointing').

## Engagement team

All CAC participants acknowledged the essence of a good audit starts with the team, 'it can't be a one man band' (UK CAC), a view supported by a South African EP who highlighted that without a balanced team the audit of a complex client is not possible. Whilst CFO participants expressed satisfaction that their audit teams collectively had the necessary capabilities, it was stressed by CAC and EP participants that there is not a single or generic 'perfect team' (UK EP) because the composition of a team depends on the industry and the business of the client. A UK EP criticised the concept of collectiveness within teams '... so the idea that the team is a collective thing is not really how it works on very big multinational audits'. Thus it is a matter of balancing strengths within the team. Therefore, whilst teams are expected to demonstrate all of these capabilities as listed in Table 5.1, it was acknowledged that it is not necessary for each individual team member to demonstrate all the capabilities. However, achieving an appropriately balanced team is not always straightforward and there was unanimous agreement from all cohorts that putting together a well-balanced team requires a lot of planning. As one UK EP stated 'it's the balance between the perfect team that encompasses all the skills and the perfect team that's got the right structure from an economics perspective'. Interestingly in terms of structure, CAE participants perceived that engagement teams had both grown in size and increased in diversity of capability.

A UK EP observed that it was rare for teams to function at an optimum level, because teams are not static as 'people come and go quite regularly'. However, this movement both within and between teams was regarded in a positive light as staff movement allows team members to gain a diversity of experience 'and then to utilise the experience they gain' to the benefit of the audit team and ultimately the audit client (UK EP). Sharing and teaming of staff on a global basis was particularly welcomed in order to expose staff to international practices (Australian EP).

Audit teams function on a hierarchical basis headed up by the engagement partner (see previous section). The other layers of the audit team are discussed below.

### *Partner levels*

All CFO participants expected partners engaged in the audit to have a good understanding of their industry, their corporate goals and an appreciation of external pressures. A UK EP acknowledged that multinational clients 'probably (have) the best partners on their audit teams'. Partners were expected to think matters through and understand the consequences so that robust decisions could be taken. In addition, some CFO participants advocated that partners should be exposed to other industries to promote cross-industry learning. Partners are not born, but built through years of experience with a client. By observing a client's board and management in action, and the controls they have put into operation, partners get, according to one UK EP, to develop an 'intuitive appreciation' of where the key risk areas and what the new risk areas will be. The importance of the role of the so called 'second partner' was emphasised by a South African EP, who explained that at this level the partners' collective experience and their roles on the team are carefully matched and their limitations are considered and compensated for.

### *Senior levels (other than partners)*

With the increasing complexities of business, more senior experienced people, with a broader knowledge of the business and industry, are being used on teams, therefore the pyramid shape traditionally associated with audit teams is changing. Once these senior individuals are involved in the planning of the audit, they start 'thinking about the risks they need to address, then their brain sort of engages with what matters' (Australian CFO). All CFO participants and most EP participants expected senior staff to have a good industry and client understanding. Indeed, one UK EP argued that it is at the senior level where specialism becomes important, that they 'stay in the sectors and actually build up a proper level of expertise'. However, one South African CAE perceived that at managerial level teams appeared 'thinly spread' as managers have to attend to many different tasks over a relatively short period of time. This distracts their focus and makes it difficult to find time to 'apply their minds' (South African CAE), which could impact the quality of team member performance and availability at managerial level. This CAE ascribed this to high turnover rates, social transformation pressures, and retention threats, resulting in premature retirements and premature promotions to and from managerial levels.

### *Junior levels*

Junior audit staff were subject to some criticism as evidenced by the commentary of a UK PB/R that 'the audit profession has eons of people who are wet behind the ear ... and all they do is sit in a room, punch [questions into the] computer, checking numbers'. An Australian CFO suggested that staff at junior levels have a lack of understanding of commerce, industry and audit and that they just followed audit programmes without grasping the essence of what they were doing because they have been 'rote taught'. This CFO further believed that this rote learning contributed to the inability of lower level staff to subsequently demonstrate any professional scepticism. Criticism was also levelled at their ability to communicate (South African CFO) and another South African CFO questioned the attitude and conduct of some trainees whose aim appeared to be completing their qualification rather than a desire to engage with the audit client. According to the majority of CFO participants, staff at junior levels required much assistance from company staff during an audit. In the opinion of one Australian CFO when audit teams were struggling it was generally when they had assigned 'someone too junior or inexperienced' to do the work without appropriate supervision.

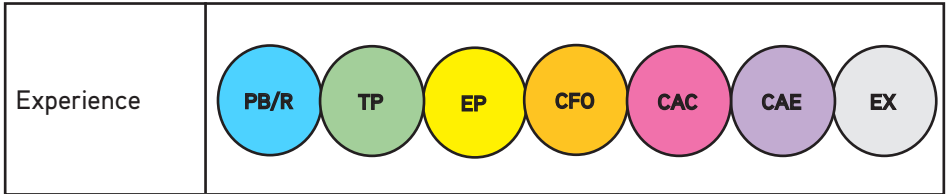
### *Experts*

All expert participants explained that they operated in varying sizes of expert teams which formed part of larger audit teams. Some expert participants drew attention to the multidisciplinary nature of their expert teams, which consisted of a mixture of actuaries, auditors, computer programming specialists, engineers, IT specialists, natural scientists, mathematicians, quantitative analysts, risk specialists and statisticians. A data analytics expert participant mentioned that at senior levels the expert team was kept 'fairly stable', but according to all expert participants efforts are made to continuously strengthen expert teams with new appointees. A quantitative analyst expert described the interaction between members of the expert teams: when the quantitative analyst experts needed an understanding of the accounting requirements and when 'an area is a bit grey or it gets a bit tricky' they referred matters to the firm's technical accounting division, acknowledging that 'we work very closely with them; they have a fair understanding of what we do, we have a good understanding of what they do'. If needed, experts will involve other independent experts on their teams. For example, an environmental expert participant identified the need to involve an environmental lawyer for 'the interpretation of the regulatory requirements pertaining to the specific industry'.

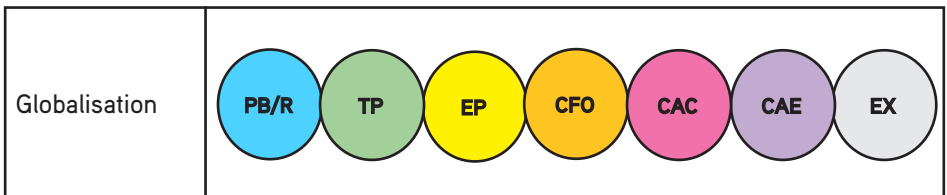


## Considerations for a balanced team

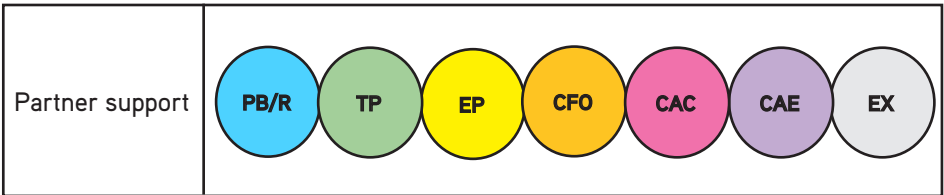
Cognisant of the importance of putting together appropriately balanced audit teams for a complex audit, both in terms of capability cohesion and economic efficiency, cohort participants identified several factors that need to be considered. These are listed in order of cohort mentions.



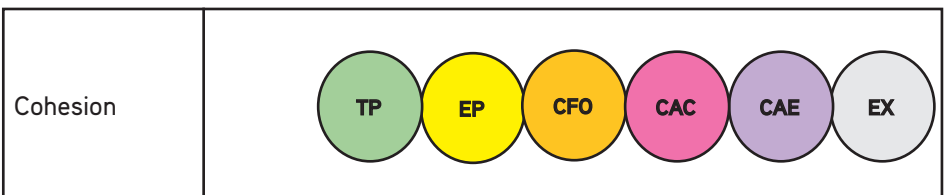
In addition to general auditing experience, participants of most cohorts agreed that the team as a whole should have the depth of experience, the knowledge and the understanding of the complexities of the industry and the client's business, in order to perform the audit. A UK CAC made the distinction between expertise and experience: 'they all claim expertise ... [but] it's really a question of how deep is their experience in these areas'. There was, however, recognition of the economic consequences of having a top heavy team and it was therefore important to have the 'the right balance' between youth and experience (Australian CFO) making sure that coaching and on-the-job experience was there to up-skill the lesser experienced team members. As one UK TP explained: 'It's a cascading effect: the better [the level of] experience or the more experience you have at the top level, the better your chances [are] of giving that experience right through the team'. A mix of people with specific industry experience and experience in other industries was also recommended because 'there is considerable crossover' (UK EP) between industries, although there was generally a feeling that the engagement partners should be very experienced both as an auditor within the client's industry and within the client's business.



All CFOs expressed the need for their auditors to demonstrate a geographical spread. Whilst Big 4 firms are in the best position to display this geographical strength, relying on their international footprints for their effectiveness, the increasing globalisation of clients poses many problems. Notwithstanding the obvious challenges of communicating across borders, cultures, language differences and time zones, one Australian CFO highlighted that firms appear to struggle to perform ‘a true seamless global audit’ because at times overseas offices function as separate partnerships with different audit processes, based on separate income arrangements and separate legal constraints. Where clients operate in remote places, where the depth of audit expertise may be questionable, the audit team needs to include ‘a competent centre of excellence’ (South African CFO) to support these operations. In the view of CAC participants this situation is exacerbated when in order to obtain appropriate audit coverage of clients’ operations in remote jurisdictions, other audit firms are engaged to contribute (these include small or middle tier firms). In these situations the engagement partner cannot ‘blindly accept a report’ (South African EP) but needs to get an understanding of the regulations and methodologies followed in these countries, which could be especially challenging in remote jurisdictions where the calibre of people could be questionable.



The TP and EP participants in particular highlighted the importance of having partners (preferably those who are familiar with the client or other clients in the same industry) and senior managers or associate directors on audit teams who are able to assist the engagement partner with managing the team. A South African TP said: ‘I often refer to ... [the additional partner, senior manager or associate director as] a wicket keeper ... [as] they are the ones that need to make sure that nothing slips through’.



The ability of the team to function in 'a fully integrated way' (UK CAC), and 'pull in the same direction' (South African CFO) was highlighted. However two main concerns were raised in this regard.

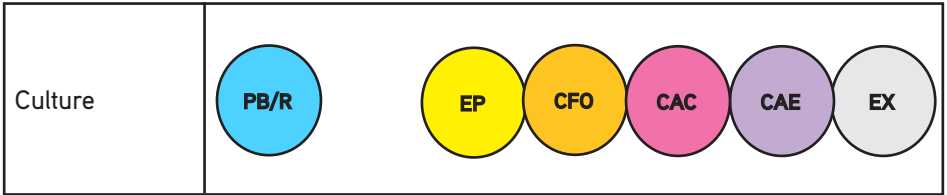
The first concern centred around audit team members working in silos, 'I don't think you manage your risk particularly well when you operate in a silo. So ... [the sooner] you're able to get a single team, a single audit team mind-set, so much the better' (South African EP). A UK EP agreed, advocating that barriers between streams (partners, high level team members, experts and the lower levels of the team) should be removed 'so the team really felt that they were working towards a common goal, and doing things which everybody knew ... was being done and why it was being done'. This EP believed that this prevents the danger that the top levels of the team 'all know what the big issues are', while at the lower levels members are just 'ticking the boxes'. An Australian CFO provided an example of this referring to a situation where a matter had been dealt with at the senior levels of a team, while at junior levels they were following a standard program, 'which hasn't been modified or customised to suit what's been agreed at the high level in the team'. This CFO even referred to junior levels 'doing a different audit'.

The second concern related to the fragmentation of the audit team, whereby 'the team [should] interface more' (South African CAC), the team should 'join up', they should not 'trip over each other' and all members should understand their roles and communicate effectively 'across, down and up' (UK CAC). However, in the view of one Australian CFO, 'I've not seen that for a long time'. Several examples of fragmentation were put forward by CFO and CAE participants. For example, one South African CAE explained: 'more audit partners [are] being thrown at the problem'. This means that as they sign off on different units/divisions in a group there is the danger that important aspects of the overall business model, or how and why important decisions are taken, might get lost in this fragmentation. A UK CAE illustrated this issue by explaining that a specific partner: '... could be looking at a little part of a business, like a little spoke in the wheel that looks, on its own, to be alright, but if you put it into the context of the whole thing, it might then not look right'. An Australian CFO gave another example by describing a situation relating to a central audit team and their component auditors who are dealing with separate divisions of the audit client 'so we had the risk of two layers of auditing ... on the same issue' because the firm did not control the two different processes.

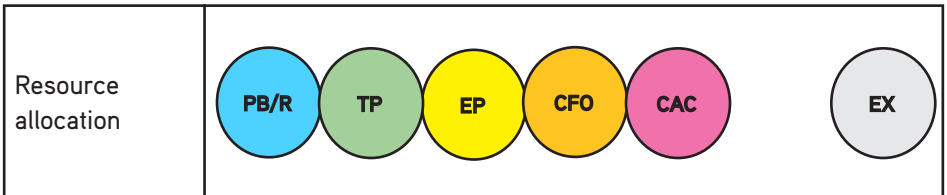
Another associated issue relating to cohesion is the flexibility within the team to accommodate additional members when the need arises during the audit. For

example, allowing an expert or other team member to ‘join the team at that particular juncture’ without jeopardising the cohesion of the team (UK CAC).

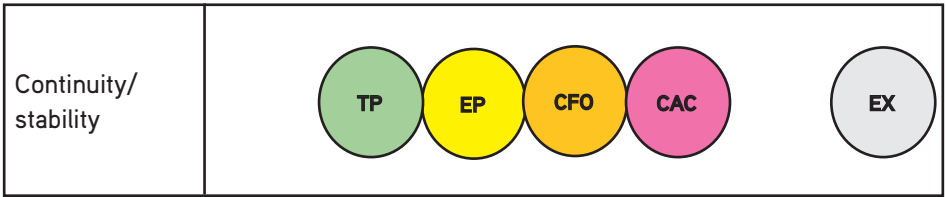
Disparate streams or fragmentation within a team could result in partners ‘missing things’ (South African TP) or in misplaced efforts at the lower levels, thus creating inefficiencies. Addressing this, according to a UK TP requires forward thinking: ‘the problem is it’s trying to get ahead of the game rather than just simply reacting to what’s happened in the past and trying to play catch-up’.



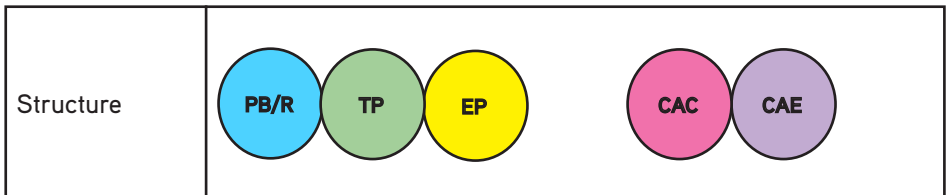
The culture within the team, and not just at partner level, should mirror that of the firm whilst also being responsive to and reflective of the client’s culture. This is of particular relevance when a change in the client’s management has brought about a significant culture change. Indeed, one Australian CAC participant viewed the culture fit within the audit team to be critical, and highlighted that having ‘a lead auditor who doesn’t fit in the culture of the organisation, or understand the culture of the organisation, can be chaotic’.



Ideally engagement partners should have the flexibility to put teams together without constraints, such as geography or staff availability. A South African CAC regarded the audit of a complex client as a continuous, year-long process, (requiring ‘living with it right through the year’). Whilst CAC participants generally believed that the firms have the necessary resources (taking account of their international networks and non-audit divisions) to permanently allocate staff to their audit teams, two South African CAC participants believed ‘they may become stretched’ where they do not have the depth of staff available.



A UK TP participant articulated this challenge as ‘balancing continuity versus refreshing a team’. According to a UK EP the aim is to ‘maintain the team and succession planning in the right shape, so that you continue to have the right people, in the right place, at the right time’. However, maintaining the stability of the team is not always easily achievable as experienced by one Australian CFO who commented on the recent and ‘massive increase in turnover’ on teams which the CFO regarded to be in the region of 30%, ‘so we’re sort of resigned to the fact that we are forever training their audit teams on how to do their audit, and what the numbers mean, and how the business operates’. Whilst some of this movement is due to team members either moving through the firm or moving off into different careers, rotation requirements and the firms’ own independence rules also have an influence (UK TP). Succession at senior levels was also a concern to both EP and CAC participants who advocated that succession at senior levels should be carefully contemplated.

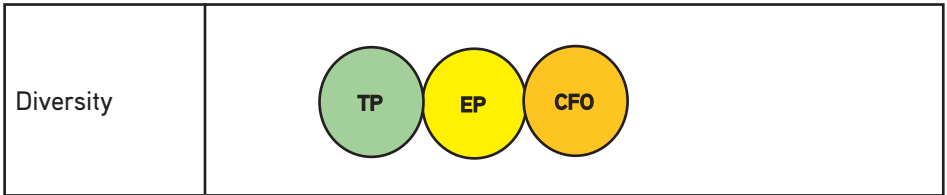


On a related theme to experience is the structure of the audit team. All EP participants believed that mixtures of different levels of experience, industry and technical knowledge, together with non-technical capabilities should be considered in structuring an audit team. This obviously varies from client to client, as indicated by a UK TP who stated: ‘there is no one formula [for] ... the right structure ... It is going to be responsive to size, scale, location and all of that for [each] client’. A good structure allows for the appropriate balance between undertaking tasks that members are familiar with, good at and experienced in, but also giving them the opportunity to do new things and develop. Several participants perceived more seniority within current audit teams than was experienced in the past. For example, a UK TP mentioned that audit matters ‘have definitely gravitated upwards within an audit team’, resulting in more being done by senior managers and partners ‘than

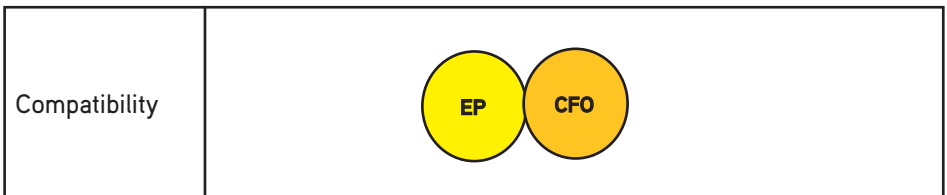
maybe was done historically’. A UK EP went on to question whether the historical pyramid structure is still the most appropriate shape for engagement teams of today; should such a pyramid be ‘slightly less steeply sided’, or should the form change to perhaps ‘becoming more cylindrical in shape?’, although another UK EP suggested that this change to a more cylindrical ‘bloated’ form had already taken place. The resulting challenge, according to one UK EP, is to put together a team that will allow individual members to develop by gaining experience and moving up, and ‘then [attempting] to leverage ... [the team] across relationships’. An Australian PB/R also questioned the historical pyramid structure of audit firms:

*I think the pyramid structure might have worked, you know, better when you [had] a different audit approach which wasn't so much based on high level skills. You would need about understanding the business, the soft skills you needed, identifying the risks, and it goes back to partners, and also not being involved enough in the planning process up front and bringing, you know, their skills to it and sitting down with the team. You know, we've been saying to the firms, they need to do more of that.*

This view was shared by a UK PB/R who supported a structure in which there was a much narrower pyramid with a ‘much higher preponderance of highly skilled people’.



Participants identified the need for diversity, defined by racial, ethnic and gender features, as critical.



As a UK EP pointed out, 'not everybody gets on with everybody and not everybody works effectively in different environments'. It is therefore important, to select members, especially at senior levels, with compatible working styles so that they can 'work effectively with their own team members' (UK EP) and compatible personalities with the client so they can interact more effectively (South African CFO).

## Joint audits

In South Africa banks have to have joint audits, which a South African CAC participant explained was a legacy of the past, where skills were limited and two firms could 'at least put a team together'. However, there was no consensus on the effectiveness of this particular requirement. Some South African CAC and EP participants suggested that audit quality was improved due to a wider capacity of expertise, thus the client could rely on the strengths and views and cross-reviews of two firms. Indeed, one South African EP intimated:

*... it just makes it easier ... to stagger the rotation of partners at a group level and also at a divisional level. It does provide better continuity and understanding of the complexities [of the entity being audited].*

The fact that the South African banking industry 'came up relatively unscathed in the [2009 financial] crisis' could be attributed to many factors, but the strength of the audit profession in the country is acknowledged as having contributed to this. However, one South African CAC and some South African EP participants expressed some criticism of this joint audit requirement ('it is not the best' (South African CAC) because it can create duplication, additional costs and allows for one firm to dominate.

## Experts

Participants of all cohorts agreed that a complex client in today's business environment necessitates the inclusion of experts (or specialists) on engagement teams. Participants identified the following experts as those that would often be needed:

- actuaries (financial modelling experts);
- biologists;

- corporate finance specialists;
- corporate recovery specialists;
- economists;
- engineers (specialising in various disciplines including petroleum and mining);
- environmental specialists;
- forensic/fraud specialists;
- geologists;
- governance specialists;
- insolvency (business recovery) specialists;
- integrated reporting specialists;
- internal audit specialists;
- IT (including sub-specialisms and data analytics) specialists;
- legal counsel;
- mergers and acquisitions specialists;
- meteorologists;
- microbiologists;
- pension fund specialists;
- property valuation specialists;
- quantitative analysts;
- quantity surveyors;
- regulatory specialists;
- risk management specialists;
- statisticians;
- tax specialists (various sub-industry specialists were identified for example mining tax and transfer pricing);
- technical teams (as IFRS has become significantly more complex);
- treasury specialists;



- sustainability experts;
- valuation experts.

Indeed, there was recognition that audit teams now include many more experts than in the past, and for some industries, particularly financial services, this was a welcome development. However, actuarial, insurance and IT expertise were identified as skills with depth constraints which are increasingly coming to the fore because, according to a UK EP, these are ‘very, very fast-growing areas’. This is especially true for ‘financial evaluation modelling skills, because those get built up over years of experience and seeing [being exposed to] different financial contracts’ (South African EP).

All participants agreed that an engagement partner of a Big 4 firm was able, in the majority of cases, to obtain access to experts in-house, as these firms have become self-sufficient. However, a UK PB/R expressed doubt on the apparent direct involvement of experts in clients’ audits with the comment:

*How many of them ever spend any time near an audit? ... I don't argue that they have expertise, for example they do in the actuarial world, but you tell me, how much time [do] they spend on the audit, in the audit process?*

The scope of expertise contained within Big 4 firms was cited by all CFO participants as a significant reason for choosing a Big 4 firm to undertake their audit. CFO participants also welcomed the fact that these experts were in-house, thus ensuring a consistency of approach and an adherence to confidentiality undertakings. As one UK CFO stated: ‘I’m not sure I want a lot of third parties wandering around, that doesn’t make me feel very comfortable’.

EP participants explained how they first make use of internal experts, often calling in experts who operate within the firms’ non-audit divisions, and only thereafter will they look outside. As one Australian EP stated ‘on a very rare occasion we will hire someone independently’ (Australian EP). This could happen where there is a very limited need for these capabilities within the audit firm, such as in the case of engineering expertise or quantity surveying expertise or ‘if the [auditors’] concerns were aroused for some reason ... it’s certainly within their power’ (Australian CFO) to seek independent third party expertise.

It is also possible for auditors to refer to the work of experts that are contracted by the client (for very specialised services, for example, geologists, meteorologists or specialised engineers such as reservoir engineers) and auditors will subsequently place reliance on their work. Where auditors rely on external experts then they have to:

*... accept that they are taking accountability as an intermediary in that process, and that, at the end of the day, the standards to which they are held will be the same whether they have done the work directly or whether they have done it through third parties.*

(UK CFO)

The practice of engaging external experts engendered some debate, with one UK CAC suggesting that this practice should be more widespread, questioning whether audit firms were compromising audit quality by choosing to rely on their in-house experts in non-audit divisions rather than consulting outside where they might be able to utilise some superior specialist knowledge. The opposing view was proffered by one South African PB/R who expressed concern that auditors place excessive reliance on experts employed by the client and a UK EP who intimated that they 'err on the side of using [external] specialists more often than we actually need to' in an attempt to manage the firm's risk.

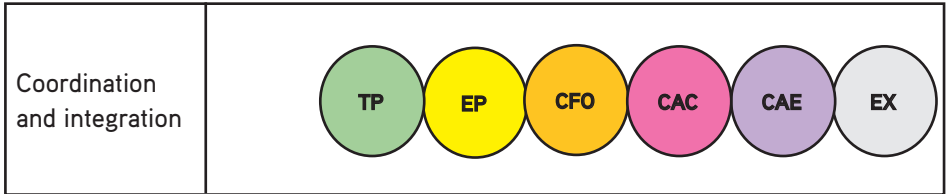
All expert participants were convinced of the value of their roles to provide audit support and mentioned the importance of them being involved throughout the entire audit process. This was particularly stressed by the IT expert who highlighted that much of the work of IT experts is done upfront to determine the appropriate audit methodology, therefore it is crucial that they are involved at a very early stage in the audit. Indeed, all the expert participants stressed the significance of being exposed to the initial orientation briefing whereby 'you talk through the client, you talk through the year that they've had, potential risks, potential new transactions that they've entered into, and any exceptional circumstances for that year' (tax expert). Thereafter, they gave examples of the practices followed by their firms to ensure their initial involvement in the planning process, and continual involvement thereafter, such as weekly meetings with the engagement partner. They also mentioned that their work was subject to the same review process as other parts of the audit.

Whilst there is no debate about the involvement of experts on the audit team, whether resourced internally or externally, participants of all cohorts shared a

UK TP's view that 'the more experts you've got the more complicated it is for the engagement partner to integrate all of that' and to manage timeframes. Therefore the decision to involve expert capabilities should be carefully considered.

## Challenges surrounding the engagement of experts

The challenges that need to be addressed when engaging experts in audit teams will now be discussed in order of their cohort mentions.



Engagement partners need to coordinate and integrate experts' involvement. For example, a UK TP articulated:

*I think the challenges then come in [as to] how you integrate them, how you scope their work, how you review their work and understand what they have and haven't done; then the exceptions coming out from that ... how the different pieces potentially impact on each other.*

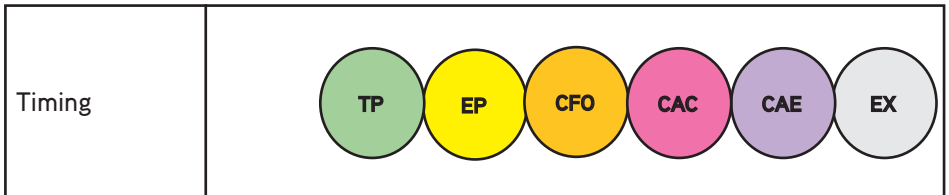
Experts should be embedded within a team: 'it's not just a plug-and-play-and-then-move-on' engagement (South African EP). A possible disconnect could occur where experts made an isolated expert contribution without having the context, background and insight on specific client's issues. A UK CFO explained this phenomenon as the fragmentation challenge, where experts who were not dedicated to one client ('they are a pooled resource'), sometimes became 'an unrelated limb of the business' that could occasionally be called upon, and that sometimes leads to a disconnect between experts' narrow view and the full context views of the team. For example, a quantitative analyst expert highlighted that if:

*... quants ... do the work and the CAs [auditor team members] do the liaising with the client, but they ... [don't] actually have an understanding of what the quants do, there's a disconnect. Also when you have teams that are pure quants they have absolutely no concept of the accounting, which is often disastrous because the accounting drives the valuation.*

A South African CAC also stressed the importance of contextualisation; experts should see their contribution in relation to the dynamics in the industry and the client’s business: ‘if you have just technical experts without being able to bridge those aspects and to bring them to the fore, you know you are not going to get the best answer’. A lack of integration of experts into the team can also cause tension with the client, particularly when an opinion is expressed and then this is subsequently overturned. An Australian CFO gave an example to illustrate this:

*... where some relatively innocuous kind of accounting issues are opined on, and then subsequently when they are tested by someone with a bit more specialisation or a bit more experience, they’re [found] to be wrong all kinds of negative consequences can follow.*

Whilst some expert participants perceived that at times they were not fully integrated into the audit team, and were regarded as an add-on to the audit, or simply ‘plugged into the process’ (data analytics expert), the expert participants in general perceived that they were much more effectively integrated in audit teams than in the past.

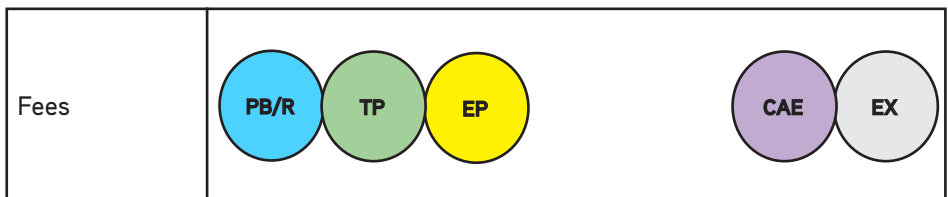


If the engagement partner fails to access the expert when required, it could hold serious repercussions. However, ‘it isn’t easy to get the timing of that right’ (UK EP). A South African EP explained that in the EP’s firm experts’ involvement is now on-going, as opposed to the practice of only utilising them ‘at crunch times’. In the view of an Australian EP ‘bottlenecks’ could still occur at peak reporting times. In an ideal world the use of experts on an engagement team should therefore be anticipated:

*... knowing who the people are within the organisation who’ve got the right skills ... That is one of the biggest challenges, being able to clearly identify where you’ve got a gap. In some ways identify the gap ahead of time. (South African EP)*

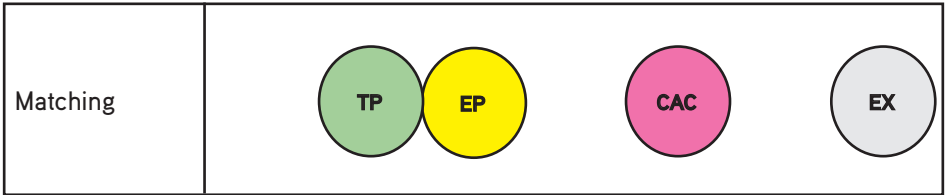
However, some CAC and EP participants highlighted that a need could arise during the audit when an unexpected situation is noticed, and thus it might be ‘difficult finding the right person at the right time to come in’ (UK EP). For example, the need for an expert could arise as part of a ‘natural discovery that happens on audit’ (actuarial expert) or a non-financial services client could enter into a complex structured transaction which could require the involvement of an expert because ‘a lot of last minute instruments pop out of the woodwork that need to be valued’ (actuarial expert).

Despite the importance of involving the experts from the initial planning stage of the audit, the expert participants (with the exception of the IT expert) maintained that in some instances the engagement partner did not involve them early enough in the audit process, allowing them little time for quality input. For example, an IFRS expert participant explained that ‘we get called ... at the eleventh hour’ and sometimes it is expected of us to ‘quickly resolve something’ which might not be possible within the limited timeframe. This situation was also highlighted by an actuarial expert who explained: ‘the difference between the good guys and the bad guys is taking the time to think about what you’re doing - that’s the only difference’. If the expert only becomes involved at the end of the audit process, the matter is ‘invariably badly documented, so you can’t really get to the essence of everything’ (actuarial expert) and the people you need to interview are busy with the year-end conclusion and under pressure. A quantitative analyst expert further confirmed from experience that if the engagement partner realised too late that their expert involvement was needed and they were called upon ‘at the last minute’, this could potentially then cause ‘a great deal of unhappiness’- due to the limited time and information available, and the inaccessibility of the client’s staff: ‘if we’d just been called in in advance, given sufficient time, given sufficient access to the client, then maybe it would have gone smoother’ (quantitative analyst).



The use of experts on engagement teams is complex and expensive (experts are usually senior people) and if the timing and co-ordination is not properly managed, then this not only has a resulting impact on audit quality but also on fees (UK

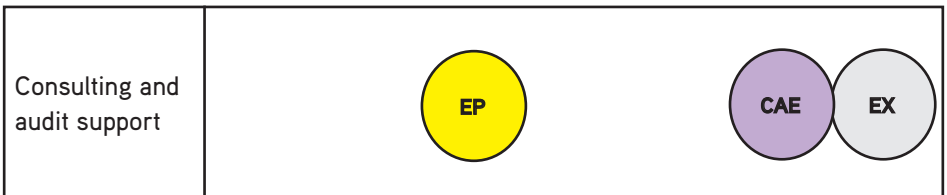
TP). All expert participants alluded to audit fee pressures which could limit their involvement on an audit and advocated a more balanced approach in managing audit budgets. An IFRS expert cautioned that it could be short-sighted not to involve experts due to fee constraints, because one could end up with either a hasty and potentially incorrect answer or an expensive additional audit through a different route, both of which could have unpleasant consequences.



An actuarial expert participant commented that one of the biggest challenges was to understand ‘the strengths and weaknesses of the expert’ and ‘what the expert is doing and not doing’, in other words, knowing when the expert would not be able to answer the question. Some participants in other cohorts made the point that it is of no value to have experts at their disposal (as in the case of the Big 4 firms with their global networks and consultancy or advisory divisions), if such expertise is not properly utilised. A UK TP, for example, highlighted:

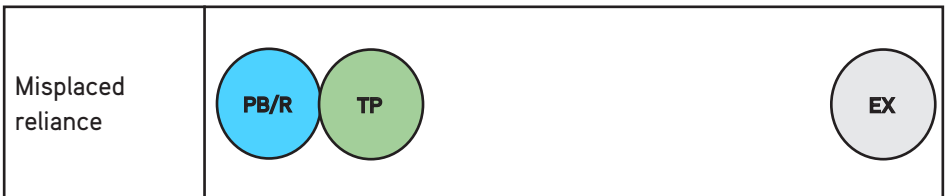
*I think where a gap occurs, it’s because we have possibly failed to apply the right expertise in a particular situation. So it’s alright having an expert, but if you don’t point him at the right things, then you’ve got a gap there potentially.*

A UK CAC further cautioned that experts should not solely be matched with an audit on their qualifications in a particular field; the engagement partner should also consider the depth of their experience.



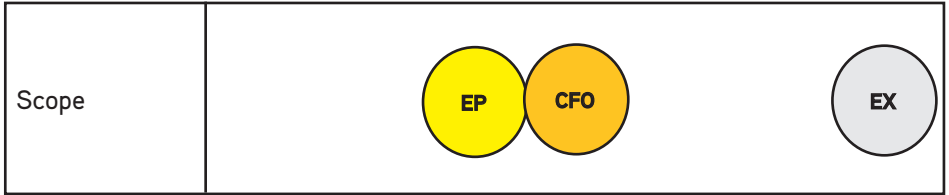
A South African CAE referred to the danger of mixed loyalties where experts act as consultants to their own clients and they subsequently have to balance that with their audit support function, which could lead to tension. An Australian EP

perceived that this tension was being fuelled by the current restrictions on the amount of non-audit work that could be done for audit clients. However, the expert participants were defensive of their position. According to a quantitative analyst expert it was not a challenge to balance audit support and consulting work because they understood that they had a role to play in both types of engagement. Whilst all expert participants perceived their audit support function, where they were contracted by an engagement partner, as critical, they also emphasised the role consulting had to play in the development of their capabilities. However, they were quick to point out that they all followed their firms’ practices to avoid any conflicts of interest with consulting work, for example, a data analytics expert and an IT expert both mentioned that they split teams to cover either audit support or consulting. For example, an actuarial expert claimed that consultancy work assists in keeping abreast of market practice which is needed to avoid sub-standard work on audits, a view supported by an environmental expert who explained: ‘You must be able to consult and be involved with pure consultants in your same field in order to understand new industry technologies, new thinking etc., because it is an evolving field’. The comment was also made by a South African EP that very few actuaries or IT experts ‘want to carve a life out of just audit support’. Without the consulting/ advisory divisions, the Big 4 firms would struggle to have the specialised capability on hand ‘where you can just tap into that resource in a very quick and agile way, without imposing a massive cost on the overall process’ (Australian EP).



A quantitative analyst expert participant explained that ‘there’s a very delicate balance between the audit team understanding enough of the specialist areas’ and the need to call in an expert. Some of the expert participants were quite critical in this regard. For example, an actuarial expert and an IFRS expert referred to some engagement partners who believed, due to ignorance or budget constraints that they had ‘the expertise within their own teams’ even though that depth could be questioned, and they were therefore reluctant to consult an expert (actuarial expert) as they believed ‘they could deal with it’ (IFRS expert). One quantitative analyst expert explained that at times an engagement partner could ‘be a bit too adventurous’ in that they think ‘they can do things that they actually don’t have

the skills to do’. They could get it wrong, sometimes without even noticing, and that could hold adverse consequences. The expert went on to remark that a ‘little knowledge ... [is] a dangerous thing’.



Experts should know exactly what is required of them. However, this requirement should be driven by the engagement partner as opposed to the client, who in the opinion of one UK EP, could have extravagantly broad and unrealistic expectations. This EP cited an example of a client where ‘they want to absolutely, absolutely nail down the minutiae of the pension assumptions’. Expert participants did, however, refer to gaps occurring where the expert and the engagement partner did not fully appreciate each other’s understanding on the scope of the assignment. For example, an actuarial expert illustrated the point with an engineering example:

*You might get an engineer in to say that ‘the stresses on that bridge are fine’, whereas what the audit partner thinks is, you’re saying that ‘the bridge won’t fall’, and all he [the expert] is doing is checking that the stresses on the bridge are fine [within normal tolerances].*

An environmental expert ascribed this disconnect to a lack of sharing ‘the full picture’ by the engagement partner either because of limited knowledge and understanding, or worse, because limited information was provided on the expectation that the expert should ‘question and probe and make sure that it does all make sense’.



Expert participants cautioned and questioned ‘how do you ensure that your team or the senior people in your team are actually able to interpret what you find?’ (data



analytics expert) or fully understand the implications of what has been presented (quantitative expert)? This is further exacerbated when the engagement partner does not 'like the answer' provided by the expert (South African IFRS expert).

## Summary

Auditors are expected to demonstrate a wide range of capabilities and there was a general consensus that the Big 4 firms have access to the requisite capabilities within their global networks. Whilst it is recognised that auditors can never have the same insight as those involved in a business on a daily basis, a deep understanding of the industry in which the client operates, the client's business and business processes are regarded as key. Such understanding, developed over time, facilitates appropriate risk-focussed audit procedures. Although it was acknowledged that auditors have a good appreciation of risk, which was ascribed to improved risk articulation by boards and audit committees, disquieting views were raised about the depth of risk understanding reflected in audit approaches. Auditors were criticised for not considering the interconnectedness and interrelationships within businesses during their risk identification and assessment processes.

Assigning the most appropriately competent and experienced engagement partner who is actively engaged on an audit is pivotal to audit quality. Industry, multinational and across industry experience are relevant. Project management, communication and negotiating and conflict resolution skills, as well as the ability to apply professional scepticism and to challenge and stand up to management are critical for engagement partners on large complex audits. In general engagement partners were perceived to meet expectations, albeit with some reservations. For example, criticism was levelled at their ability to cross fertilise knowledge gained from working within other industries, to spend time on pertinent matters and to demonstrate the required level of professional scepticism. The engagement partner should make use of experts where appropriate but should remain in charge of the audit through decision making and the exercise of professional judgement. Succession planning, especially for those with the capability and presence to be able to robustly challenge management, and retention strategies were highlighted as areas of concern and these should be prioritised to ensure that current engagement partners are supported to remain in the profession and more junior partners are given the appropriate development opportunities to enhance their capabilities. This was especially apparent in South Africa where social transformation pressures resulted in premature retirements and promotions.

Junior audit staff were subject to some criticism, which was ascribed to poor communication skills and compliance driven practices resulting in rote learning and a lack of exposure to the commercial world of the client. Inappropriate supervision subsequently compromised their development of professional scepticism.

Without a balanced, cohesive and compatible audit team of the right size and structure, with requisite industry and client business experience and an appropriate mix of capabilities across all the relevant technical areas, a high quality audit of a complex client is not possible. Careful assignment of audit work to team members, appropriate supervision and appropriate use of experts are equally important. Team composition elicited some criticism. These include their collectiveness, functioning as a whole as opposed to in silos, the distinction between expertise and depth of experience of team members, the seamless functioning of global teams, full integration of team members because they are operating in disparate streams which become fragmented, stability of teams and the historic pyramid structure of audit teams. These factors need to be considered when putting together a team to balance capability and cultural cohesion with economic efficiency. Cohesion within audit teams is particularly relevant when the utilisation of experts or specialists is concerned. Although the use of experts on audit teams is considered to improve audit quality, several challenges exist. There can be mixed loyalties and tension when experts act as consultants to their own clients but subsequently have to balance that with their audit support function. The use of audit firm in-house experts was supported for ensuring a consistency of approach and an adherence to confidentiality undertakings, with the counter-argument that audit quality could be compromised by not considering the superior knowledge of outside experts. The direct involvement of such experts in clients' audits was questioned and the impact of accommodating contradicting experts' views during an audit process was highlighted as a concern. Timely involvement of appropriate experts as part of a cohesive audit team is costly and, if not properly managed, may not have the desired positive impact on the audit outcome due to misunderstanding of experts' roles and their contribution to the audit and inappropriate interpretation of their findings.

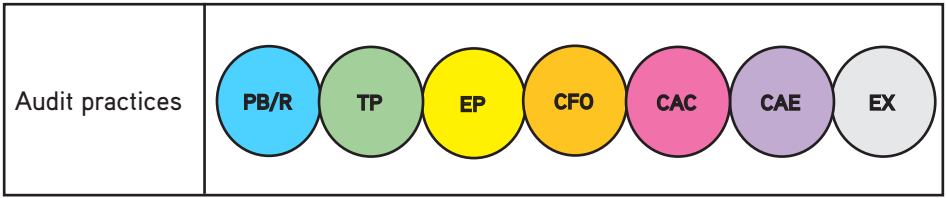
## 6. FUTURE CAPABILITY REQUIREMENTS

*How should the capabilities needed by auditors (individually and collectively) change to meet expectations of their role and responsibilities in future?*

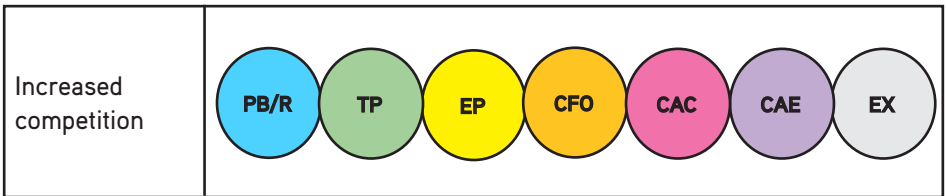
Participants believed that the capabilities of future auditors will have to take cognisance of the ideals and expectations of the different generations who are currently growing into economic maturity. Generation Y was mentioned by some EP, TP and CAE participants as an example of this. Generation Y was regarded as the 'brat pack' (Australian TP), an 'instant' generation (South African TP), fast moving, highly motivated and opinionated, seeking constant challenge and demanding fast progress, being more self-centred and self-oriented than previous generations, showing a 'sense of entitlement' (South African TP) and making lifestyle choices rather than being money-driven. For Generation Y technology is critical: they prefer to communicate electronically rather than through face-to-face engagement, to use smart devices where 'data will follow you and not you follow the data' (South African CFO). Audit firms have to recognise these traits as many of their staff will be from Generation Y, as will many of the staff employed by the audit client (South African TP). Also, the tendency of Generation Y to 'Google' everything and obtain instant solutions means that they will take 'a lot longer to learn problem solving skills because ... you can't just ask Google to quickly [tell you] what the answer is; you have to work through the steps' (South African PB/R). A UK EP also raised the issue of ethics, predicting that agreeing on a uniform code of ethics will become more challenging to businesses and firms in future because 'their [Generation Y's] sense of [being guided by an] ethical compass I think is different to those of the previous generations'. The participant ascribed the challenge to Generation Y individuals' inclination to be more self-centred and self-orientated when making decisions and taking action. This implies that Generation Y individuals may hold different ethical views than those of the profession.

### **Additional and revised capabilities**

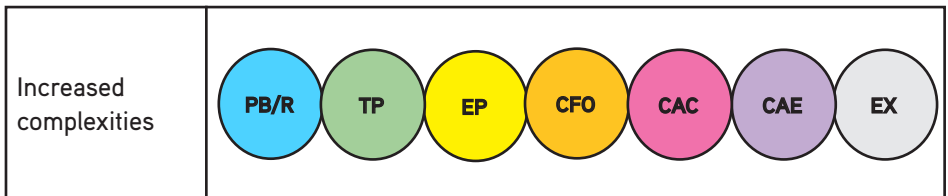
Taking into account participants' predictions of the future audit environment, participants were then asked to identify what specific changes are likely to result in additional or revised capabilities for future auditors. These are discussed in order of their cohort mentions below.



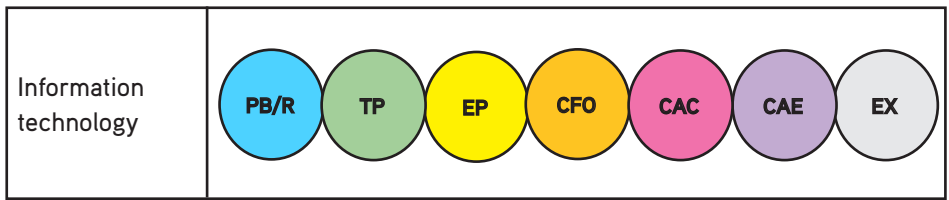
Some changes in audit practices were foreseen, impacting on auditors' capability requirements and ultimately the firms' business models. It was generally accepted that an auditor will need a wider skill-set and that the composition of audit teams will change. The latter will take cognisance of growing off-shoring practices, a change in the nature of audit firms, possibly becoming audit-only firms, expanding reporting requirements and the growing of firms' global identities.



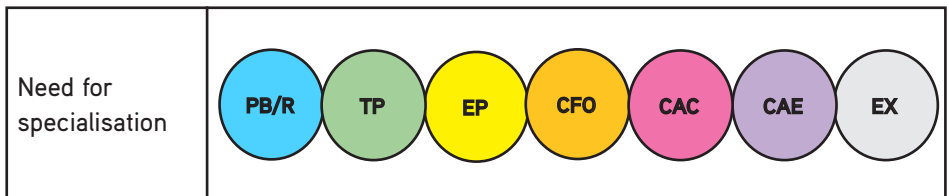
Audit firms will require an augmented capability set, with strong emphasis on marketing skills and on building relationships, to compete for tenders as this will compel audit firms to find selling skills to achieve 'business development, winning new work and new relationships' goals (UK EP), which a UK TP participant regarded as 'quite a different proposition to what people [auditors] have dealt with in the past'.



The audit profession will have to evolve along with developments in the globalisation of businesses. This could even require a new 'type' of auditor. As a UK PB/R participant explained, with reference to the legal profession 'we didn't have patent lawyers who are [also] biochemists and electrical engineers when I started, which we do now'.

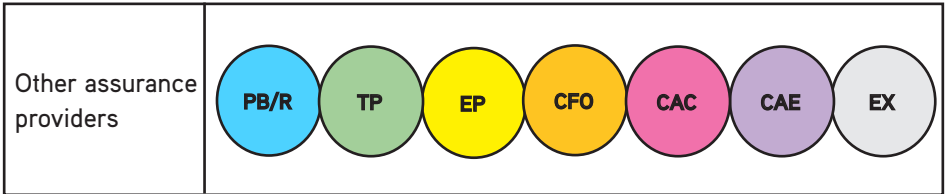


Participants expected advanced IT skill sets to become standard, and focused on the growing prevalence of mobile technology and data analytics. The current huge investment required to bring data analytics into the daily round of auditing will be reduced and recouped in future, which will make it more cost-effective. More focus will be on IT interrogation and analytical techniques, which, if done successfully will almost dispense with traditional statistical sampling because they allow for efficient testing of a whole population on a real time basis. Thus, there will be a demand for more analytically-skilled people who are capable of analysing and interpreting the data generated. However, in order to introduce all transaction, real time auditing 'auditing standards will need to be rewritten because current auditing standards do not contemplate that you can undertake an audit in this way [remove some of the alternate substantive procedures]' (UK EP).

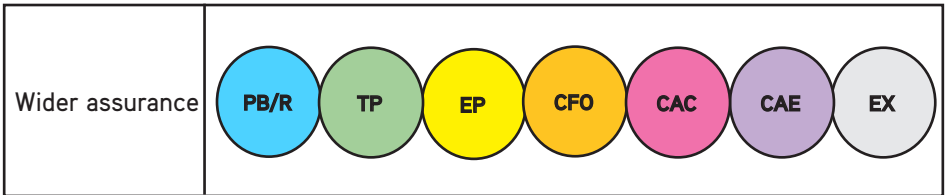


There will according to a South African TP be an increasing imperative to understand the 'multiple uniqueness and nuances for a particular industry, the regulatory frameworks, the challenges, [and] the different business impacts, [whether its labour issues, fraud issues]', and therefore much more industry specialisation is foreseen for auditors. In addition, auditors of the future will need more general business acumen which in the view of one UK CAC questions the relevance of the firms' training models which are more directed at audit rather than business specialisation. This CAC advocated that training should serve as the foundation for 'accounting-centric business people' rather than 'deep functional (accounting and audit) specialists'. A broader business qualification is already being seen as needed for commercially astute audit team members. A broader set of capabilities will be required, enabling auditors to provide insight within the constraints of regulations but by using cross-industry knowledge. A South African and a UK CAE participant predicted that 'auditors of tomorrow probably will do

well coming from industry’, or at least ‘know what it is like to work in a big public company’ because there will be a greater need for a higher level of business acumen. An Australian EP predicted that there will be a shift from graduate recruitment to lateral hires, which will ‘accelerate their learning in pure audit skills, or compliance skills, or industry specialist training’, thus training specialists to become auditors as opposed to the current practice of trying to convert auditors into specialists.

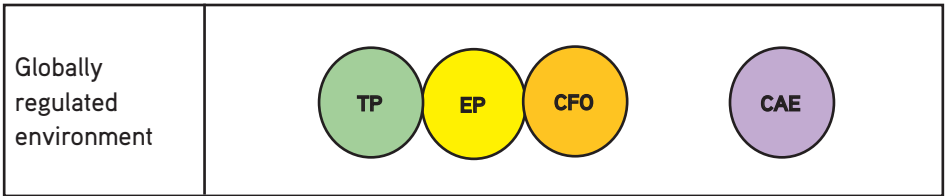


More use will be made of other assurance providers, in particular internal audit and this will require a greater ability to interact with others and other disciplines. The ‘superior’ attitude, as described by some participants, of external audit in relation to internal audit will have to change and external audit will in the future have to respect the contribution that internal audit makes to the overall assurance provided about an organisation.

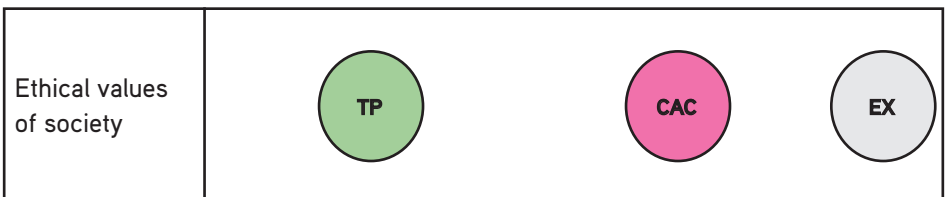


In order to provide wider assurance, such as reporting on forward-looking information, the audit firms’ business model will need to change to incorporate a ‘much broader skill set’ (UK EP and UK TP) and be less compliance driven. This was illustrated by one South African TP who commented: ‘we would have to change our model in terms of having more people focused on business valuations and understanding the future [impact of the current] strategy of the company in much more detail’. This change in focus was supported by a UK EP who saw the skills required for wider assurance to be in line with ‘skills that at the moment are more commonly associated with things like strategy consulting, and corporate finance, M&A advice, and forensic accounting review’. Thus, according to one UK EP, firms will need to adopt ‘a very significantly enhanced model of experienced-hire induction’, and then provide training in assurance for people with

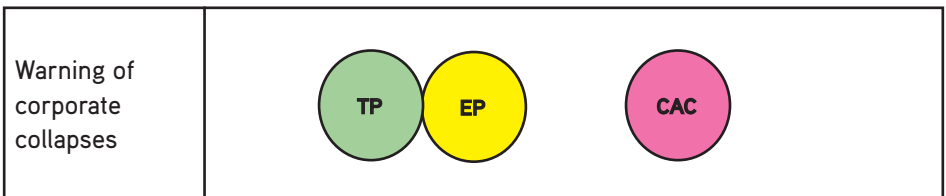
deep technical competence in different areas, with even more ‘in-depth industry operational knowledge’. A UK PB/R claimed that if auditors want to ‘talk about the state of affairs of a company, rather than purely provide some account of what’s spent and earned’ they have to have skills that go beyond the traditional audit skills.



Increased levels of corporate globalisation are foreseen, which will lead to more complex businesses. Two participants (UK EP and South African EP) predicted that in future the audit of such globalised businesses could become so complicated that expert project management skills could be required.



Due to the increased questioning of ‘accepted’ ethical values, higher demands will be made on auditors to detect and report on fraud – forensic skills will be more represented on audit teams. A UK PB/R perceived that forensic skills will enable auditors to unpick businesses, similar to due diligence practices of critiquing and pulling apart, and this will help them to understand ‘where they’ve had the wool pulled over their eyes’.



The expectation that auditors have a responsibility to warn of corporate collapse will require more emphasis on the technical skill of ‘valuation’ (fair value estimates), and in particular the structuring of types of transactions. A different skill set for exercising judgement, requiring according to a UK EP participant a ‘commercial and

consulting mind-set', will be needed, as well as management experience, which an Australian EP participant believed will encompass 'understand[ing] the markets and what information users need and what drives their decision-making'.

## Summary

An augmented capability set for auditors was identified which, if ultimately developed, could change the traditional nature of an auditor. Skills include:

- marketing skills and relationship building skills to compete in a retendering environment;
- enhanced problem solving skills;
- data analytical skills to analyse and interpret big data;
- business acumen skills in line with broader business qualifications and to assist in the assurance of more 'forward-looking' information;
- in-depth industry knowledge;
- negotiation and relationship building skills to interact with various assurance providers;
- project management skills to manage audits in a globally regulated environment; and
- forensic skills to unpick business in a society with decreasing ethical values.

However, it is recognised that the augmentation of current capability within an audit team to address all of these areas is unlikely to be achieved within the 'traditional' audit team. Moving forward, it is envisaged that the composition of audit teams will change in order to meet the challenges of the future audit environment. More of the 'mundane' work will either be off-shored or replaced with more sophisticated IT system interrogations and data analytics. The increasing complexities of both business and regulatory frameworks, combined with the requirement to provide wider assurance will result in an increasing need for individuals with more diverse backgrounds. Thus, it is envisaged that auditor teams in the future will all have core specialist skills but these specialisms will be different. Some individuals will have a core accounting and audit specialism and wrapped around this will be a general industry and business knowledge, with an understanding of other specialist areas such as valuations, data analytics, etc. Other individuals will be, for example, industry experts or data analytic experts and wrapped round this core competence will be general audit knowledge. Thus, instead of audit firms training auditors to become specialists, firms will also be training specialists to become auditors.



## 7. IMPACT ON RECRUITMENT MODELS

*How should recruitment models used in practice be adapted to ensure that those auditors that are recruited meet the current and future capability needs of audit teams?*

Recruitment models for accountancy trainees were different dependent on region as a result of the varying rules regarding professional accountancy training. For example, in South Africa, all entrants to the profession must have an undergraduate degree in accounting and by far the majority of graduates appointed by the Big 4 South African firms also have a postgraduate degree in accounting. In the UK the Big 4 appoint both accounting and non-accounting graduates with the majority of their intake coming from a non-relevant degree (other route) background. In Australia, whilst traditionally recruitment has exclusively been from accountancy degrees, the advent of a bridging programme has opened up accountancy training to a wider range of graduates. This scheme allows the firms to spread the recruitment net wider as they are no longer restricted to graduates with accounting specialisations (Australian EP). In addition to the annual intake of new trainees the firms also made lateral hires at all levels, including at partner level, as and when the need arose.

### Structure of firms

#### *Industry specialisms*

All TP participants explained that their firms' recruitment models and training and development programmes were aligned with the manner in which firms were operationally structured. This structure varied dependent on firm. For example, structures of auditing/assurance divisions within firms varied and reflected the firm's size, the geographical locations of its operations, its client profiles, critical mass and the functioning of other divisions or service departments. The operations of some firms were divided into business units, distinct service lines based on industry specialism groups, it 'is about having peak skills in a particular sector to enable you to understand that sector and essentially operate within it' (UK TP). Other firms opted for a more hybrid approach. The latter made provision for the separation of clients in the financial sector as a group requiring specialised service, while that was not the case for clients operating in other industries. This allowed for multi-industry exposure for staff, especially at lower levels. Some firms also

made provision for sub-industry specialisation in concentrated industries: for example financial services could be sub-divided into asset management, insurance, banking and capital market clients, each with its corresponding specialist audit team. EP and TP participants subsequently commented on different practices in their firm relating to streaming incoming trainees into specialised industries. Opinions were expressed by all cohorts of participants on the appropriateness or otherwise of streaming trainees into industry specialisms from the beginning of their training.

Most participants were of the view that trainees should get a wide range of experience before subsequently specialising, and different reasons were suggested for this stance. One UK EP, for example, claimed that those 'with experience in other industry groups are [more] likely to be able to challenge ... the business model than people who have, in effect, come up just within that one area' CAC participants also suggested that this 'fixing' of a career path at an early stage has negative value adding consequences, for individuals' subsequent contribution to the audit, as these people would have sacrificed breadth of experience for a narrow focus. Some CFOs also expressed concern whether early career specialisation was in the best interest of an individual's career development, as it could compromise cross fertilisation between different industries and audit teams. Other participants highlighted the difficulty that trainees would have in trying to identify the area for specialisation at such an early career stage. For example, a South African EP believed that an initial wide exposure to different industries and sizes of clients situated both locally and abroad, all contribute to the realisation of their specialisation interests by the time they reach the more senior levels of the firm. Indeed, if individuals specialise too early into an area that they subsequently do not enjoy, then they will redirect their career elsewhere and in the view of some CAC participants this is a reason why firms struggle to retain staff in their audit divisions. In addition, career opportunities as auditors in some industries can be quite limited, as a South African TP remarked 'there are only so many jobs in mining and so many jobs in insurance' and specialisation too early could restrict career progression.

The only support for an industry-related 'career apprenticeship' (UK EP) was in the financial services industry, where it was recognised that industry-specific training right from the start is generally beneficial. A preference which is ascribed to the complexity and diversity within the sector (subdivisions such as retail, investment and fund manager), and because of its onerous regulations. CFO participants from

the financial services industry, in particular, advocated early specialisation. As a UK CFO explained:

*... it is true; banking has cocked up because it puts retailers in charge of banking, and retailers did not understand that selling was occurring at a price that didn't reflect the risk they were going to run for the next 20 years. That was a fundamental error.*

The breadth versus depth challenge was succinctly summarised by one UK EP who stated:

*... there is a fine balance between making sure people develop enough breadth, and [ensuring] that we have got enough [depth of] technical expertise to be able to do the job that our clients want us to do.*

There was subsequently little dissent by any of the EP participants that by the time auditors reach managerial levels, then the emergence of industry specialism should become apparent and is appropriate.

### *Use of experts*

All the Big 4 participants (TP and EP participants) believed that, regardless of the way in which their firms were structured, they all allowed for an appropriate focus on the industry in which their audit clients operate. This involved industry knowledge-sharing across engagement teams to ensure that teams are 'immersed in those businesses and understand the risks as far as they possibly can [be understood]' (UK TP) and bringing 'on board experts in particular subject matter areas in those complex industries [requiring it]' (South African TP).

Expert service departments (such as IT, tax, corporate governance and forensic divisions) were found in all firms. In some participants' firms these service departments, together with other specialist divisions, formed part of a separate advisory or consultation division within the firm. A South African CAC believed that 'very experienced and capable' experts are hired for these divisions. Firms make use of them for expert needs on audit engagement teams, and all EP participants were emphatic in stating that they would not be able to do these complex audits if they did not have such expertise readily available.

### *The audit-only firm debate*

The engagement of experts within audit teams drew out a debate regarding the potential impact an audit-only firm structure would have on audit quality. A UK CFO for example, claimed that non-audit exposure ensured a sufficient breadth of experience that enabled people to see the bigger picture and to 'offer a broader commercial insight than merely, [and] just literally following a whole set of procedures that are set up with a computer'. An Australian CFO elaborated on this idea, saying that limitations on non-audit work of auditors 'is probably doing everyone a disservice', because with such exposure 'it actually meant they [the auditors] did a better audit'. Some EPs highlighted the importance of retaining a non-audit division within their firms as this division: aided retendering, as firm and industry knowledge could be gleaned through consultancy activities; retention of staff by providing various career-enhancing opportunities, or in the view of one South African CFO actually attracted staff to audit on the back of the consultancy arm; enhanced the development and training of staff by exposing them to a wider range of the firm's services; and nurtured specialisation. Indeed, an actuarial expert identified the need for a non-audit division in firms as a necessary strategy to retain experts. The expert argued that to try and keep experts within firms only for audit support is 'not a viable business model', because their audit support work is not extensive enough. Moving on to discuss whether experts could simply be sourced from outside if firms were forced to become audit-only firms, the expert participants were generally of the view that the benefit of having in-house experts was that they 'actually know how to give assurance and how to review because there's a difference between doing and checking' (actuarial expert). An actuarial expert further questioned whether the alternative of entering into strategic relationships with external vendors could work in an audit environment where 'a lot of the rules coming out of America are extremely punitive in terms of joint venturing'. The expert therefore believed that the 'either consult or audit' rules that are being debated 'is fine for the audit partners' but not for expert partners. If this separation finally reaches the statute books, expert partners would be 'removed from business practice which presents a weakness and a risk to the audit' (actuarial expert).

However, not all participants were so supportive of the contribution that the non-audit arms of the Big 4 made to the audit practice. Whilst CFO participants commented that the allocation of non-audit work to their auditors was diligently done within the regulatory rules, an Australian CFO made the point that non-audit services had been 'detrimental to the competency of the audit practice'. In this CFO's view they had fundamentally changed the business model, not just financially

but operationally as well, by presenting 'better or more exciting opportunities' in non-audit divisions of the firm, thus resulting in a brain drain from the audit arm. Indeed, one UK CAC was rather outspoken about the extent of the Big 4 firms' consulting/advisory divisions, claiming that firms do have the required skills to perform a top quality audit but that 'they are not being used in audit' rather, they are being used in their non-audit divisions. An associated issue raised by a UK CAC is where consulting/advisory division experts join firms at high levels, so called lateral hires, and they reach partner levels without progressing through lower levels, which does not necessarily enhance the morale of the auditing side of the firm. Another problem according to both a South African and UK CAC and Australian TP participant was the fact that firms invested in these non-audit divisions because they get a better return than they do for audit services, and this has changed the 'culture' of the firms. A South African EP counter-balanced this with the suggestion that this was to the benefit of the audit client as there is cross-subsidisation between the tight margin audit engagements and the more remunerative non-audit work.

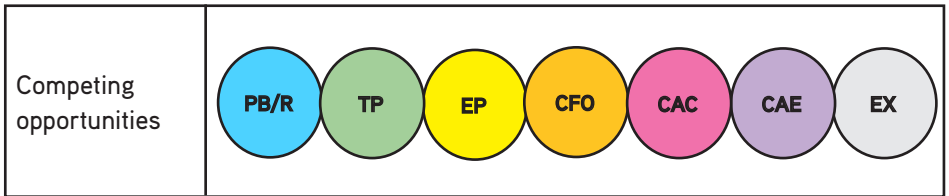
## The challenge of recruitment

TP and EP participants agreed that their firms aim to recruit and appoint staff who either have the capabilities as mentioned in Table 5.1 or who exhibit the potential to rapidly develop these. It is foreseen that increasingly the additional or revised capabilities as discussed in this report will also be required. Participants from all cohorts commented on the enviable position that the Big 4 have in terms of recruiting staff, which might not be the case with middle tier or smaller firms, with comments such as: 'the audit profession is still recruiting the best and the bright[est] graduates and they're all perfectly competent' (UK CAC). TP and EP participants, however, remarked about the decline in the quality of graduates attracted to the audit profession, which they ascribed to questionable school systems, and undesirable, and inaccurate, publicity which had created negative perceptions about the profession. In addition, 'questions are being asked of the profession in terms of how limited the talent pool is that we [the Big 4 firms] draw from' (UK TP), and in this context firms are still challenged to 'make sure your people are competent' (UK TP).

EP and TP participants generally agreed that attrition is an embedded element in an audit firm; it is part of the business model, and therefore it remains a challenge to have adequate resources always available at various levels. Some EP and TP participants perceived their firms to be workplaces of choice because of the career-enhancing desirability of their types of clients, and much time and effort was being

invested to create a comfortable, socially responsible working environment without the fear of retrenchment. A South African CFO commented that in an ideal world firms would have attracted experienced business people at the end of their careers to give back to the audit environment, but the reward levels and the risks of the audit environment do not make it a feasible option.

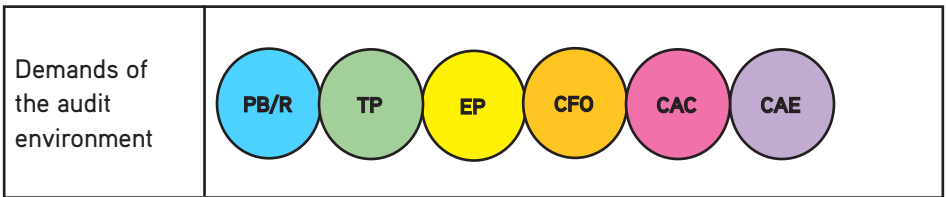
As staff are the lifeblood of organisations such as the Big 4, the recruitment and retention of staff is critical in the delivery of audit quality. The challenges that were highlighted by the various participants are now discussed in order of their cohort mentions.



‘[There] is always going to be a challenge around keeping [the] kind of critical resources that have built experience within the profession’ (South African TP). Whilst EP and TP participants acknowledged that firms were training institutions and that a high staff turnover, especially for entry-level professionals, is expected, the continuity of staff remains critical. Conflicting views on the competing opportunities for staff were expressed, although in general it appears that, from an audit perspective, firms are ‘fairly comfortable’ (Australian EP) with their resources. The economic downturn has, however, played a part on the ‘exceptionally low’ staff turnover rates experienced over the past few years (South African EP) as industries such as the financial services sector in effect closed their ‘employment tap’ (South African EP). An Australian TP cautioned that ‘the market will come out of the slump at some point and ... we’ll be back to that labour shortage’

Traditionally audit firms are regarded as ‘hunting grounds’ for the market (Australian EP) or a professional staff resource pool (South African CFO) and this situation remains in place. The marketplace outside of the audit profession for qualified accountants remains competitive and staff ‘can leave for a lot more money quite easily’ (UK EP). Indeed, one South African EP complained that ‘banks poach our quality staff’ and this was subsequently confirmed by a South African CAE. As the world increasingly becomes a global village where international opportunities lure people, the retention of staff is further complicated particularly in a developing country such as South African CFO.

At partner level the pool of competent engagement partners for global clients in complex industries was perceived to be very limited with one UK CAC suggesting that the increasing internal competition within firms further exacerbates the situation because ‘nowadays you lose a lot of people out of the audit practice to the rest of the firm’. Some expert participants (an actuarial expert, data analytics expert, environmental expert and quantitative analyst expert) also perceived their expertise to be in short supply (not only in South Africa but also globally), and their services in the market place to be in high demand, thus compounding the challenge of skills retention within the firms. However, a tax expert suggested there are ‘quite a lot of people in the market’, due to the economic downturn.

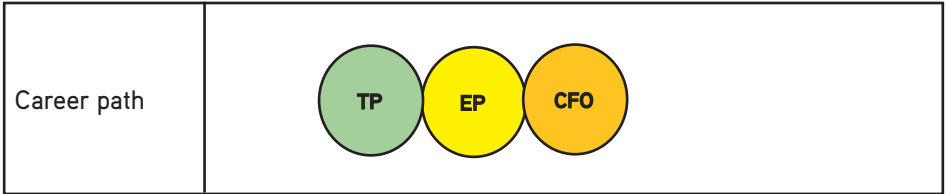


Participants from the majority of cohorts agreed that the pressures of an overly complex compliance regime and the demands of the business environment negatively impacts on the firms’ abilities to attract and retain quality staff.

*I think the complexity of the environments [in] which ... auditors and firms and partners [are required] to remain skilled, and [required] to ensure that their teams remain skilled to perform audits in [these] complex environments is driving auditors out of the profession. I think, they’d rather go and become a financial director and prepare financials. (South African EP)*

A South African CFO remarked, auditing is perceived as one of the risky professions and if future stakeholder expectations are met it will become a dangerous place and firms will subsequently battle with retention of quality staff. An Australian CFO commented that the regulators are rapidly making auditing an industry ‘that not many people are going to want to be part of’ and if future regulation demanded audit-only firms this ‘in turn will lead to firms that have lower quality people, less expertise, and fundamentally poorer audits’. In addition, to the fear of litigation or failing an inspection, EP and TP participants also highlighted poor work/life balance and time pressures as contributory factors in the challenge to recruit and retain staff. A UK EP and UK CFO participant both further articulated

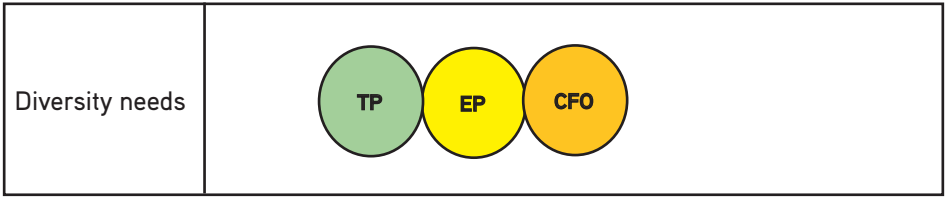
that the recent bad publicity putting the audit profession in the spotlight, in the aftermath of the financial crisis, ‘doesn’t help’ (UK EP) ‘it will have a negative impact on the quality (and number) of people being attracted to the audit profession’ (UK CFO).



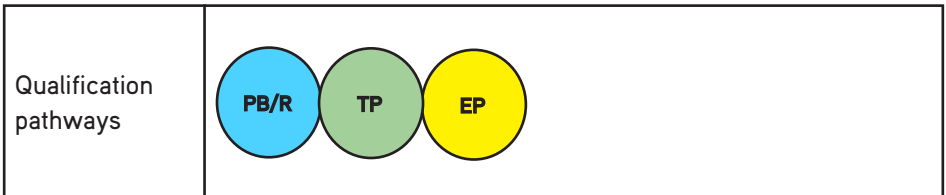
‘I think our biggest challenge is making sure we keep people motivated and understand what careers they can build in our business’ (UK TP). This is especially true for assurance services – ‘keeping the talent within the assurance line’ (UK TP) because non-audit divisions create an internal career path ‘far greater, far more diverse than it was before’ (Australian TP). A UK CFO mentioned that a large part of efforts to retain quality staff comes down to whether firms were offering a career that has interesting prospects, and ultimately whether that would be in the audit firm or outside; and whether there was a suitable breadth of experience available to the employees of those firms, such that they could have a varied and interesting career. According to some EP and TP participants, some trainees simply view their training period as a means to obtain a professional qualification, questioning (by implication) whether the offered career path holds rewarding prospects. These trainees do not aspire to become partners and this could be ascribed to the ignorance of trainees of the long term benefits of being an auditor, the perceived attraction of working in consulting, and the high demands of the auditing environment negatively impacting the work/home life balance. Given Australia’s unique geography and South Africa’s challenges as a developing country with a new democracy, there is always the attraction of following a career path elsewhere in the world. Some EP and CFO participants also commented on an apparent increase in the number of partners leaving the profession, with an Australian CFO making the point that many leave the profession while ‘there is still a lot to learn and a lot to be gained by being there’. Another problem foreseen by one of the South African EP participants is the impact of enforced retendering or rotation on a specialist engagement partner, who could rotate off a client, or the firm could lose the engagement, ‘where does that leave the partner from a progression perspective?’. In addition, firms could potentially lose ‘the vision of partners with great experience [in a narrowly defined industry or the partner could



be recruited by the winner of the tender which would negate the objective of the tender process.



‘We should not recruit people that are all quite similar to each other – all from a similar background’ (UK TP). Some participants cautioned against the fostering of a social and academic monoculture in a firm. They believed that the trainees recruited should come from diverse backgrounds, have varying views and opinions, and have the potential to respond to a diverse spectrum of clients. Without this diversity audits could be more challenging, particularly if engagement teams do not ‘reflect the diversity of your clients and the people that you meet in your client environments’ (UK TP). Participants specifically referred to racial representation (especially in South Africa where transformation remains a challenge and challenges in Australia to represent its changing demographics), gender representation (the Big 4 are regularly criticised for failing to promote women to the higher levels) and the need for a ‘culture fit’ (UK EP) both within the firm and with the client.

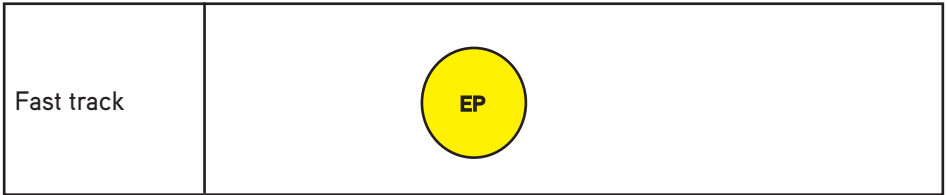


Several concerns were raised by TP and EP participants in relation to qualification and development pathways. For example, the restrictive practice of mainly employing graduates who meet specific background requirements, may exclude others with potential. As one UK TP stated:

*... [we are ignoring]... people who might not quite have the exam performance background that we insist upon, but actually would have been very, very competent and very strong in other areas, [who] would have been good enough to pass the exams and grown and developed into very good auditors.*

An Australian TP participant rightly questioned: How do we target them [those with a non-accounting background] and what do we do to then bring them in to make them successful in an area like accounting? A ‘one size fits all’ approach was also criticised for failing to recognise the strengths of different personalities and their inherent abilities in the recruitment and qualification processes (a South African TP participant believed ‘we’re actually pretty poor at identifying early on the polarisation of people’s personalities and inherent abilities’). This could give rise to generic talent management processes which may not present the optimal solution for an individual because ‘we don’t direct them towards their potential’ (South African TP).

The applicability and relevance of the three year qualification pathway in the light of increasingly higher expected outcomes (for example, complex businesses, complex standards and globalisation are sub-optimally addressed) was also raised and the point was made that trainees are not recruited to become auditors, ‘they’re being recruited to become chartered accountants’ (South African EP), and thus the scope of their training is too superficial.



In an attempt to retain staff, firms sometimes have to turn to promotion options. One South African EP participant cautioned against the practice of ‘fast tracking’ staff (especially in regions where skills are scarce, as they are in South Africa with its transformation pressures) in an attempt to retain them, because auditing is ‘an experience game’ (South African EP) and this practice holds negative implications for the profession over the long term.

## Summary

Attracting quality people to the profession, and providing them with appropriate training, will remain of paramount importance in the future. With the exception of the financial services industry, which is complex and diverse and subject to onerous regulations, audit trainees should be exposed to a wide range of industries before specialising. Concern was expressed about the practice of early career

specialisation because it holds negative value-adding consequences for individuals' subsequent contribution to audit as it sacrifices breadth of experience for a narrow focus. This was also raised as a reason for firms struggling to retain staff in their audit divisions. A suggestion was made to include industry-related traineeships in the audit profession's training model. However, by the time individuals reach managerial levels, industry specialisation is appropriate.

The increasing use of experts was also mentioned in relation to the recruitment model as if the structure of audit teams change (as advocated in Chapter 6) then the recruitment practices will have to change accordingly. The engagement of experts within audit teams drew out a debate regarding the potential impact an audit-only firm structure would have on overall audit quality. Arguments against audit-only firms include that non-audit exposure enhances the development of a sufficient breadth of experience. Restricting audit to audit-only firms also has implications for embedding specialists into audit teams as there may be insufficient work to offer them a full-time role. Such additional capacity within firms aided retendering as firm and industry knowledge could be gleaned through consultancy activities, staff could be retained by providing various career-enhancing opportunities and development and training of staff could be enhanced by exposing them to a wider range of the firm's services. Some minority counter-arguments were however also expressed. Situating experts in firms' consultancy/advisory divisions were perceived to have a negative impact on the capabilities of the audit practice; arguing that they have fundamentally changed the culture, operational and financial business models of firms and could even compromise quality audits if firms employ such expertise for consulting rather than in the audit function. Moreover, they could be detrimental to the morale of the audit side of firms because such experts join firms at high levels and reach partner levels without progressing through the lower ranks.

In addition, several recruitment and retention challenges were highlighted. Concern was expressed about both the quality and diversity of graduates attracted to the audit profession. The reason for this was ascribed to the negative perceptions about the profession; articulated as risky, over-regulated, offering poor work/life balance, possibly boring and with onerous entry and complex update requirements. Retention of quality staff at all levels was also identified as problematic as attrition of professional staff, to the consultancy arms within the Big 4 or to audit clients or other organisations outside of the Big 4, regularly occurs which causes continuity challenges to the audit team and succession planning for engagement partners. Given Australia's unique geography and South Africa's challenges as a developing

country with a new democracy, the attraction of following a career path elsewhere in the world remain a challenge in these countries. Indeed, competent engagement partners and experts were deemed to be in short supply, despite a high demand.

## 8. IMPACT ON TRAINING AND DEVELOPMENT PROGRAMMES

*How should training and development programmes for auditors be changed to align them with current and future capability needs of auditors?*

### The training model

In general TP participants saw firms, not only as businesses in the auditing and related fields, but also as training institutions ('we are very much aware that we have people that [need to be] ... developed and we need to invest time' (South African TP)). The onus is therefore on the firms to support trainees, through development and training interventions, to become competent. From an audit perspective firms follow a 'grow your own timber' (South African EP) approach and it was generally perceived that firms are still getting 'good quality people through the system' (South African EP). Indeed, EP and TP participants agreed that their firms' training and development programmes are aimed at meeting the capability requirements listed in Chapter 5 of this report, and that these, in future, will be adapted in line with the additional or revised capabilities discussed in Chapter 6 of this report. A UK EP was more critical claiming that training and recruitment models of firms have not evolved as firms' audit practices have evolved and hence are 'still way behind'.

EP participants reported on the huge investments made by their firms on training and development interventions, and highlighted that, whilst in the past, the focus was more on soft skill training, in the current audit environment people are being exposed to more extensive training which includes the regulatory and technical aspects of the audit environment. Much of the training today centres around risks and fraud. Some TP participants reported that their firms' training and development programmes are based on their firm designed professional competency frameworks and to meet the continued professional development (CPD) requirements of professional bodies. For example, according to a UK TP an emerging competency is the requirement to be knowledgeable of the global economy, to obtain an international dimension, and in response firms 'have an increasingly international focus to that training as well'. Similarly, an Australian EP believed professional scepticism is now regarded as an explicit concept to be incorporated in internal development and training initiatives:

*... [And] it's not just at the partner level; it goes right through to the junior levels. And we give examples and case studies and all sorts of things to try and draw out how you should be sceptical in certain circumstances.*

Whilst formal training takes place, the EP and TP participants articulated how the Big 4 firms mainly relied on experience and on-the-job-training to 'build [competencies] over time' (South African TP). This was illustrated by a UK TP and an Australian TP who explained the 70/20/10 training model used by their firms: The UK TP commented as follows:

*... 70% of your effective learning is learnt through doing in the workplace, 20% of your effective learning is learnt through being coached through a process and doing self-taught learning [and] the final 10% is the structured, traditional classroom based model of training that everybody is very familiar with.*

A UK and a South African EP participant both mentioned the value of exposing junior staff to client meetings, while another UK EP mentioned a meeting scheduled for the team where top management (CEO, CFO) and the chair of the audit committee addresses them. Other engagements between the audit team and stakeholders of a client's business were also mentioned (Australian TP). These experiences are supplemented with development and training interventions as a staff member moves through a development cycle (from newly appointed trainee to managerial or even partner level).

Most of the CAC and some of the CFO participants had favourable views on firms' training models ('it's quite a good model' (UK CAC), 'pretty good' (UK CFO)). Whilst there was only one adverse comment made by a UK CAC, who shared a negative experience of an acquaintance that underwent training at a Big 4 firm: 'The training was absolutely abysmal', because he audited 'one hedge fund for three years', the CFOs were more critical. For example, one UK CFO referred to limitations inherent in firms' training models in that business exposure was somewhat compartmentalised, while an in-depth understanding of business required a much broader view. The CFO believed that as training was done from an auditing perspective ('training by being in an audit firm') it could not be regarded in the same light as having 'the scars ... [from] ... doing a job [wrong]'. The expert participants also advocated wider exposure to social matters in the education of the firm's audit

trainees to obtain a worldview on sustainability (environmental expert) and wider business exposure (quantitative analyst). An Australian CFO challenged firms to develop staff with 'differential thought processes' rather than promoting 'similarity of thought' that ultimately manifests in a herd mentality mantra of 'I can do it where I've experienced it or somebody has led me, but I can't think of the next thing that will be the real problem'.

The three year training period was questioned by a South African EP as insufficient to reach competence and recommended that it be extended to four years. Whilst another South African participant went on to challenge the effectiveness of CPD arguing that many regard it as just a 'ticking-the-box exercise', and then further suggested that more rigorous assessment with some oversight appears needed (South African PB/R). A South African CAE further articulated that, because it is becoming more difficult to 'pull people out of the work environment for training because of the pressure', there was a danger of it not taking place at all. This results, in the view of both a UK and a South Africa CAE, that too much reliance is being placed by firms on on-the-job training. It was also suggested by some expert and TP participants that staff who are 'work[ing] in very specialised industries' should be required to obtain an additional specialised qualification. In fact this requirement is already in evidence whereby it was expected of staff at senior levels to acquire an additional professional qualification in the IT field (IT expert).

Some further suggestions were made to mitigate the criticisms levelled at the training and subsequent development of audit staff. For example, a UK CFO recommended training programmes to be presented by 'people who have actually run' businesses rather than those 'who have been trained to think they know what a business does'. This idea was supported by an South African CAC who suggested that retired business people with years of experience in specific industries should become involved in presenting training sessions to staff. However, this practice was already utilised in some instances where training interventions were industry-specific and were presented by industry experts; for example mining engineers addressing auditors of mining clients (South African TP). Another suggestion made by an Australian CFO to develop business capability was to offer a secondment to industry. Whilst this was not suggested by any of the TPs, there was a general view by the TP participants that in the future staff should receive more exposure to commerce and industry.

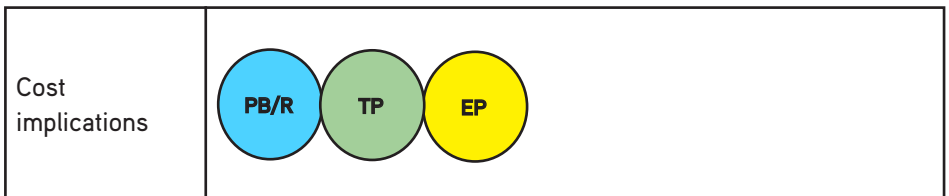
Having the ability to second staff to a consulting/advisory division within the firm was highlighted by two EP participants (UK and South Africa) as an excellent

mechanism to obtain specialist knowledge: ‘you learnt a huge amount through doing that non-audit work, and it was work that was then of benefit when you were carrying out your audit’ (UK EP). However, one expert indicated that a secondment experience was not always successful because it depends ‘on the individual and how much they get out of on-the-job coaching’. Despite these potential mitigations a UK EP cautioned that it is just not possible to train staff to demonstrate the level of specialised knowledge that is required, and therefore firms will still have to appoint and rely on experts. It is much easier to train ‘an actuary how to audit than to teach an auditor how to be an actuary’.

It was clearly apparent from the expert participants that different development paths had been taken. Some expert participants (such as the tax, IFRS and IT audit experts) have come up through the ranks of the firms, while others (such as actuarial and environmental experts) were lateral hires. All expert participants mentioned the value of on-the-job training for their development that has enabled them to give quality audit support. An actuarial expert participant referred to the legal profession where a lot of guidance is given by lawyers to experts to become expert witnesses (‘in terms of what you are allowed to say and not allowed to say and should say’) and the actuarial expert perceived it to be ‘exactly the same on audits in terms of what you can do and can’t do’.

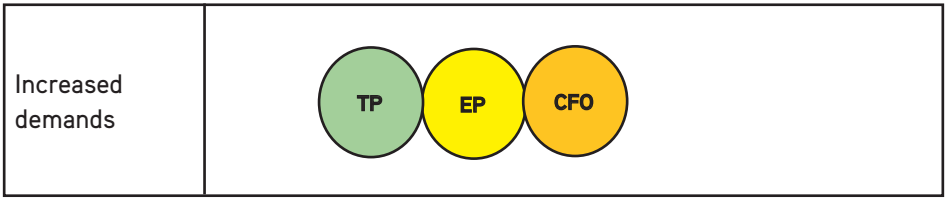
## Staff development challenges

Cohort participants identified several staff development challenges and these are now discussed in order of the magnitude of cohort mentions.

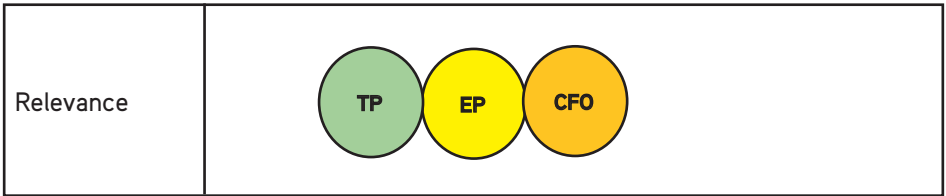


An Australian PB/R participant claimed that the mind-set within firms is driven by cost implications and recognised it as a challenge for auditors ‘to not be thinking so much commercially’. A balance between experience, on-the-job-training and more formal training and development interventions is needed because the latter two hold direct cost implications for the firm.

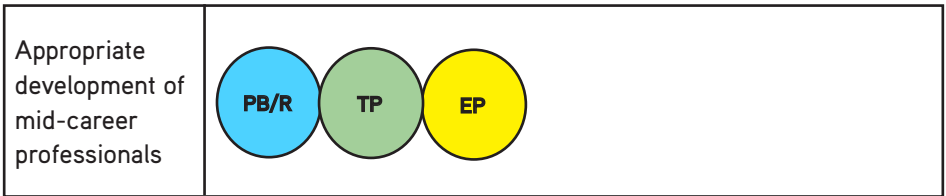




There is a need, according to a UK TP ‘to up-skill people much more quickly than we have done in the past’ and therefore, as another UK TP asserted, ‘the interventions have certainly increased over the years’.

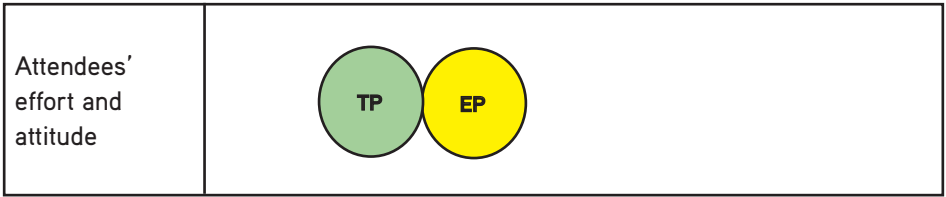


Development or training should remain relevant. According to a UK TP this requires ‘delivering the right training to our people, to ensure that they are appropriately equipped to deal with the auditing environment as it changes and develops’. Realisation of this expectation was considered a difficult challenge by a UK TP because ‘what everyone would really like to have is training that is relevant personally to them ... that fills their personal gaps in their knowledge. The reality is that’s very, very hard to achieve’. However, it was also recognised that staff members should take responsibility for their own development. In other words staff members should understand that they ‘own and drive’ (Australian TP) their own career ‘it’s more ... about managing what it is you’re looking for [for] your own development’ (South African TP).

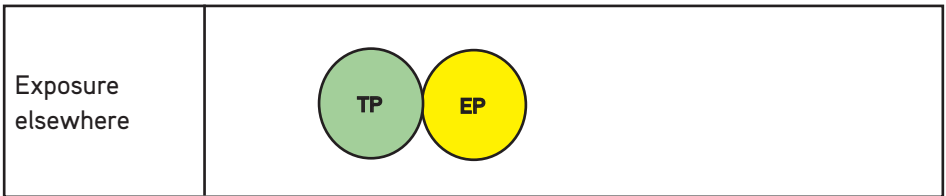


A UK PB/R questioned whether firms place sufficient emphasis on the development of mid-career professionals’ although another UK PB/R reported that during regulatory visits, CPD progress reports for mid-career professionals are reviewed. These are benchmarked against *IES 8* to gain ‘comfort that the standard was applied in practice’ but it was questioned whether this practice was shared by

all audit firms. The cost-benefit implications for presenting specialised industry training only from managerial level up was discussed although the TP participants' views were mixed on whether this was appropriate or not.



The outcome of development and training interventions varied as it depends on the attendee's effort and attitude. A South African TP believed that people embracing it 'really get good quality out of it'. However, a UK TP believed it is 'very easy to deliver technical training in a very dull way which doesn't necessarily get the message across'. It was therefore suggested that line partners, as opposed to technical partners, were identified as ideally positioned because 'it makes it more relevant; you can talk about examples more easily. You can reflect on your own experiences more easily' (UK TP). The effectiveness of web-based training and development was also questioned. Interestingly, one UK TP participant indicated that the assessments at the end of a web-based intervention had been discontinued within the TP's firm due to poor performance, thus indicating a lack of engagement. However, in the view of a UK TP the flexibility around time and location whilst 'being able to cover the matter at one's own pace', were prime considerations and hence this type of training is likely to stay.



The global nature of the Big 4 firms allow provision for staff to be exposed to firms' global networks in order to either obtain suitable experience in another jurisdiction or to participate in global development and training interventions. As one UK TP indicated 'we will ship people out to ensure that they're getting the right industry-specific experience from wherever'. These practices could gain more momentum because through such exposure staff could 'either formally [as an academic-style presentation] or through secondment' gain different insights (UK TP).

## The role of coaching

Coaching was defined as ‘imparting the knowledge that you have and the experience that you have onto the younger people and get[ting] them up to the right level’ (South African EP) or ‘taking people by the hand [and] helping them. In the general auditing field it is to manage people at the end of the day’ (South African TP). Coaching and mentoring were perceived as two critical strategies to support audit staff in their development, especially because audit staff develop at different paces, ‘creating an organisation that has a place for everyone to develop in their own way, ... you can’t have one solution for all’ (South African EP). Coaching was also highlighted as being of particular relevance when junior staff were introduced to more complex areas, they should be ‘well coached and mentored and their work also properly reviewed’ (South African CFO).

Despite the obvious benefits, CFO participants were, in general quite critical of the firms’ coaching practices. An Australian CFO example stated ‘it’s endemic within the firms, where they struggle to get that knowledge and that direction and comprehension down to their lower level staff’. Another Australian CFO perceived a ‘break-down’ to occur at times when conveying a specific concept was regarded as ‘too hard to communicate ... to five individuals, so they say ‘oh just follow these programs’. A related area of contention for a South African PB/R was the practice of ‘people [being] left alone on jobs as opposed to being given proper coaching and mentoring’.

TP and EP participants also recognised that some work needed to be done in this regard. As one UK TP indicated firms are:

*... strengthening the culture [of lifetime learning] around mentoring and coaching, strengthening the training and support that are given to those with the responsibility for mentoring and coaching, and ultimately to measure people’s performance based on their success in performing that role.*

Whilst another UK TP participant intimated ‘the other thing we’re trying to encourage - we’re not quite there yet - is better use of mentors’.

## Summary

Audit firms make huge investments in training and development of staff and there was general feeling that this is appropriately targeted at the capabilities highlighted

in Chapter 5. In general, favourable views were expressed on firms' training models but some dissenting views were also raised. Traditional training models were perceived to lag behind audit practices. Firms' emphasis on the development of mid-career professionals was questioned, training was perceived to lack breadth as business exposure was compartmentalised and limiting because it was done from an auditing perspective with little emphasis on social matters. This resulted in a consentaneous way of thinking. Firms were challenged to adopt a changed mind-set to allow for a less cost driven approach when it comes to training.

If some of the predicted audit scope changes take place, there will be a need to adapt training and development programmes in line with the changed capability requirements. This may require some additional specialist qualifications to be undertaken. The different types of training were discussed and the importance of experiential training and coaching were highlighted, although it was suggested that coaching and mentoring of more junior audit staff was not sufficiently embraced within audit teams. In addition, whilst formal training appeared to be mostly concerned with the regulatory and technical aspects of the audit, it was suggested that more could be done to auditing staff to industry, commerce and non-audit work to further develop their capabilities, utilising individuals with actual experience of the industry to deliver some of this training.

## 9. PROPOSED STRATEGY

The aim of this study is to propose a strategy that will ensure that the auditors of today and tomorrow, both individually and collectively as audit teams, have the necessary capabilities and associated competencies to deliver high quality public interest audits. However, it is difficult to evaluate the current and future capabilities of auditors without first considering the context within which audit teams deliver their opinion. The strategy therefore needs to be placed within context and this in turn has led to wider recommendations that extend to both the scope of the audit and the audit report itself.

### Audit report and scope

Having the right people with an appropriate balance of capabilities within a fully integrated and cohesive audit team is crucial to audit quality. Within the current scope of audit, there was broad satisfaction, both by participants within the firms delivering the audit and by participants within companies which were the subject of audit, that audit teams were delivering good quality audits. Although some participants perceived that audits were not a value-adding activity because audits had changed little over time, there was a general feeling that many of the recent public criticisms levelled at auditors were misplaced. The continuing expectation gap was highlighted as a cause for this inappropriate criticism. It is, therefore, vitally important to the global audit profession that steps are taken to reduce this expectation gap otherwise the audit profession will continue to be discredited which will have ongoing implications for future recruitment. The revised UK audit report, which expands the traditional short form audit report to elaborate more about the auditors' work, introduced by the FRC in June 2013, was regarded as a very positive move in this direction and this approach should be rolled out globally. It is noted that the IAASB has taken this forward.

Questions were raised, however, whether this revised audit report had gone far enough and there was evidence from the participants that there is an appetite for having a proper constructed debate about the future of audit. With increasing political pressure from Europe to instigate change, aspects of which have been vociferously criticised, now is the time for regulators, professional bodies, audit firms and multinational organisations to combine forces on a global basis to drive forward change from a position of knowledge and experience. Several suggestions were made by participants regarding where the future scope of audit might go.

Questions were also raised about whether increased regulation had in fact improved audit quality and there was a view that the increasing checklists and the requirement for box ticking had resulted in audit firms becoming very defensive in their approach and had encouraged parallel (both compliance and assurance driven audits) rather than fully integrated audits.

## **Audit report and scope recommendations**

### *Regulators and professional bodies*

- There is a requirement to be more pro-active in articulating in a public forum the roles and responsibilities of auditors to narrow the still evolving expectation gap. More needs to be done to increase the public profile of the profession by focusing on its need for the proper functioning of capital markets, alluding to the capabilities of auditors, promoting realistic expectations for the audit of today within its materiality constraints and thereby resisting mere commodity perceptions or the notion of the profession as the ‘whipping boy’.
- The expanded UK audit report should be disseminated as best practice and subsequently adopted on a more global basis. It is noted that the IAASB has recently introduced revisions to international auditing standards that are consistent with the UK changes (IAASB, 2015).
- Consideration needs to be given to the appropriateness of the current regulatory regime to evaluate whether the perceived current checklist approach is in fact in the best interests of audit quality.

### *Regulators, professional bodies, audit firms and global business*

- There is a need to work together in a cohesive manner to have a constructive debate about the future of audit. Whilst this debate needs to be led by the regulators, without such action audit changes may be imposed which are neither welcome nor likely to improve audit quality. A combined consultation document on the future scope of an audit could be issued by regulators from the three countries in this study, namely Australia, the UK and South Africa to allow audit stakeholders in the three countries to debate the subject and give feedback on suggestions.

## *Firms*

- Firms should ensure capability needs are met by their business models taking into account the following future expectations:
  - increased competition due to higher levels of rotation and retendering;
  - increased risk complexities and globalisation of business;
  - increased complexity of financial reporting standards;
  - embedding the application of technology and data analytics in audits;
  - adding value by providing wider assurance on client's business models and risks;
  - being more forward-looking, predictive and warning of corporate collapses; and
  - improved audit efficiencies requiring more reliance on other assurance providers.
- Consideration needs to be given to firms' audit methodologies, adapting them to promote fully integrated audits and to discourage parallel audits, thus capitalising on the training and development opportunities offered by integrating more junior staff on the assurance aspects of the audit in addition to the regulatory aspects.

## **Capabilities**

Irrespective of any fundamental changes to the current scope of audit which may or may not come about following the debate recommended above, this research identifies some areas of concern that are worthy of both consideration and action in order to improve auditor capabilities thereby driving audit quality. These are considered in turn below.

### **Individual capabilities**

Individual auditors have to demonstrate a wide range of capabilities in order to perform their roles. The environment within which business operates is rapidly changing; their operations are globalised; and the scale and complexities of their risks and IT systems have significantly increased. Such an environment together with changes in audit practices demand augmented capabilities from auditors. These include:

- data interrogation and analytics;
- broad business acumen;

- project management;
- forensic skills;
- team dynamics; and
- relationship building and marketing skills.

Auditors have to have an understanding of the business, industry and associated risks. Even though it was acknowledged by interviewees that auditors' knowledge on risks has improved, the depth of risk understanding reflected in their audit approaches and the breadth and depth of their business knowledge remains a concern.

In general, while capabilities of engagement partners were perceived to meet expectations, the capabilities of junior staff were subject to some criticism and the development of mid-career professionals was also criticised. Dissenting views questioned engagement partners' abilities to demonstrate professional scepticism and for junior staff it was believed that compliance driven practices resulted in rote learning and this was exacerbated by inappropriate supervision which subsequently compromised the development of professional scepticism.

The level of investment by firms in the training and development of individuals' capabilities was acknowledged and generally considered in a favourable light. However, it was recognised that some of the areas identified for improvement would come at a cost and this would ultimately challenge the firms' cost-driven attitudes.

## Individual capabilities recommendations

### *Regulators*

- The narrow focus of the revised *Professional competence for engagement partners responsible for audits of financial statements* (IES 8), to simply consider the particular role of an engagement partner needs some further thought as appropriate guidance needs to be provided for mid-career professionals. This could include a standard on competence levels expected from managers of audit engagements.



### *Professional bodies*

- Competency frameworks should be adapted for the development of data interrogation and analytic skills, broad business acumen (emphasising a deep understanding of business risks) and forensic skills.
- CPD offerings of professional bodies should provide the above mentioned skills which should be presented from a business perspective.
- Education and training models of professional bodies should, as some already do, include hybrid training options, allowing trainees in public practice to undergo industry-related training periods.

### *Firms*

- Firms should revise the competency maps for individuals to include the augmented capabilities identified in this study (data interrogation and analytics, broad business acumen, project management, team dynamics, forensic skills, and relationship building and marketing skills) and they should align their training and development programmes accordingly.
- Firms should offer programmes directed towards the development of mid-career professionals with a view to exploring their potential to develop into engagement partners.
- Firms should offer programmes directed towards the development of professional scepticism as an attribute for junior staff members and audit simulations could be used to teach them this skill.

### *Educators*

- Educators should expand their syllabi in accordance with competency framework adaptations. Educators should change their teaching methods to foster learning of broad business acumen skills by introducing real-life business case studies and by including practical courses on data interrogation and analytics.

## **Collective capabilities**

Collective capability needs are reflected in the composition of audit teams. The complexity of business in the current fast moving global environment demands collective capabilities representing both a degree of specialisation in technical financial related areas and a thorough understanding of the industry in which the client operates. Recruiting audit staff as trainees into industry focused pillars

and subsequently developing them within this narrow focus does not necessarily achieve these objectives. Neither does importing staff with particular specialisms or expertise into the audit team. It is therefore advocated that the collective capabilities within an audit team should be much more multi-disciplinary. The proposed strategy or long-term plan for success is based on the wise words of a UK EP participant:

*... if you want to improve audit quality and improve the [public's] trust in the profession ... then you want to have many more multidisciplinary teams, rather than having to use your network to go and track down people when you need someone.*

The Big 4 have well-developed advisory and consulting divisions with a wealth of expertise. Many of these specialists or experts are not involved in firms' audit practices and if they are involved, the extent of their involvement was found to be relatively limited. Whilst there was general support for the role that the consulting/advisory divisions within firms had on expert or specialist availability for audit engagements and little support for audit-only firms, various challenges (such as resource allocation, team stability, cohesion and structure) were identified to compose a full functioning audit team.

Although the Big 4 are currently using various specialists and experts on teams, the inter- and intra-connectivity within these teams needs to be enhanced. Inter-connectivity, a concept widely used in social network theory, is a theoretical construct useful to study the relationships between individuals (audit team members), groups (teams), and organisations (firms) within their societal responsibilities. The term is used to describe a structure determined by interactions whereby all parts of a structure interact and rely on one another simply because they are part of a social network. Staff members with needed capabilities from various divisions (for example industry specialisations and experts) are joined and work together as an integral part of the audit effort. Intra-connectivity refers to the relationships of these role players within a team, without barriers or restrictions of protocol. Such an approach allows for people with needed capabilities to be embedded in a team, as opposed to buying people with specific capabilities in to join the team for short periods of time.

This strategy, suggesting a model for enhancing collective capabilities, will require not only a change in the way that firms recruit but will also require a change in the subsequent training and development of the more diverse individuals recruited to

join these multidisciplinary teams, thereby strengthening the collective capabilities within audit teams.

## Collective capabilities recommendations

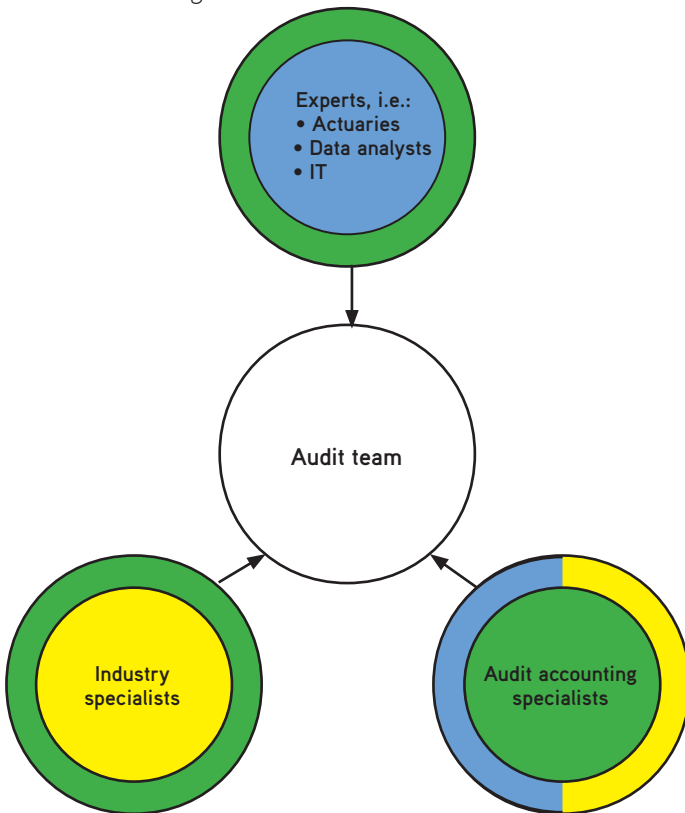
### *Audit firms*

- The requirement for collective capabilities within more multidisciplinary teams will involve recruiting and training graduates who will specialise in accounting and auditing but who will, with the exception of those graduates who are involved in the delivery of financial services audits, gain exposure across a range of global audit clients. The complexity of financial services demands specialism from an early stage and thus it would appear appropriate to recruit directly into this service line.
- Graduates should be recruited and trained within specialist capabilities such as IT, valuation, actuarial work, business consultancy and then subsequently develop their audit capability. The IT capability, in particular, within audit teams will be fundamental as the potential offered by technology to dispense with a statistical sampling approach and to adopt full population audits using data analytics must surely be readily embraced.
- Lateral hires will need to be made, bringing more senior people with direct industry experience or key specialist capabilities into the audit team.
- It is proposed that there are three types of individuals who make up an audit team, some of whom will be recruited as school leavers and at the graduate level and others will be hired in laterally. These three categories of individuals will have different core capabilities and wrapped round these core capabilities will be different complementary capabilities which will enhance their core specialism to that of an effective audit team member. The three types are as follows:
  - Those with a core specialism in accounting and audit who receive appropriate industry training and some exposure to the different specialism of relevance to the particular audit client.
  - Those with a core industry specialism who receive appropriate training in audit to make their contribution to the audit team more effective.
  - Those with specific core specialisms required by the particular audit assignment who receive appropriate training in audit to make their contribution to the audit team more effective.

Firms' future employment practices will need to emphasise the potential that the assurance environment holds for these three different types of auditors, therefore providing an environment that is attractive both for recruitment and retention.

- Specific training and development interventions, such as mentoring and coaching should be introduced for the development of potential engagement partners for multinational clients in complex industries, thereby expanding the pool of engagement partners to lead such audits.
- Achieving compatibility and cohesion within such a diverse team will necessitate a cultural shift in attitude by the firms to accommodate this new structure. Partners will also need training in how to manage the inevitable change in team dynamics that are likely to result from this change.

This is demonstrated in Figure 1.



- Firms' structures, operational and financial business models should be aligned with the suggested strategy. For example firms will have to consider whether expert team members (those with specific core specialisms required by the particular audit assignment who receive appropriate training in audit) should be situated in their consultancy/advisory or assurance divisions and how that will impact upon the structuring of their internal groupings, their engagement team planning, as well their training and recruitment practices.

### *Professional bodies*

- Professional bodies could offer conversion programmes that would enable those individuals who have developed their 'specialism' outside of the audit and accountancy specialism route the opportunity to acquire the audit skills and competence that would make them suitable members of audit teams.

### *Regulators and professional bodies*

- Guidance should replace the auditing-is-only-done-by-auditors mentality with a more inclusive approach by providing requirements for a mutually supporting team of multidisciplinary specialists.
- Guidance and standards, in particular *ISA 220*, should be revised to include factors to consider for the composition of an appropriate audit team.
- Guidance and standards, in particular *ISA 620*, should be revised to provide clarity on experts' responses to assessed risks.
- Consideration needs to be given to the impact of the proposed strategy on current developments in the audit landscape to promote audit-only firms.



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In 2013 ICAS and the UK Financial Reporting Council (FRC) commissioned two international teams of researchers to investigate what mix of attributes, competencies, professional skills and qualities need to be combined in an audit team in order for it to perform a high quality public interest audit in a modern and complex global business environment.

This team from the University of Pretoria, Robert Gordon University, The University of Adelaide and the University of South Africa explore the views of key audit stakeholders from three countries – Australia, South Africa and the UK – to address this crucial question.

The research is based on interviews that focused on six of the most significant public companies, each from a different industry, from each jurisdiction. For each of the six companies from each jurisdiction the relevant Audit Engagement Partner and non-auditor experts who participate in the audit team, the Chief Financial Officer, the Audit Committee Chair and the Chief Audit Executive (internal auditor) were contacted to enlist their support in being interviewed. Individuals in each of the three countries who have some oversight, public policy or educative role with regard to audit were also interviewed. In the end, a total of 84 interviews were conducted.

The report's findings are structured around five key sub-questions which cover: expectations on auditors' current versus future roles; current capability requirements; future capability requirements, impact on recruitment models; and impact on training and development programmes. Based on these findings the researchers conclude with a proposed strategy to ensure that auditors of today and tomorrow have the necessary capabilities and associated competencies to deliver high quality public interest audits. This strategy is broad and covers both the audit report and its scope, as well as individual and collective responsibilities.

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