



AUDITOR SKILLS IN A  
CHANGING BUSINESS  
WORLD



Published September 2016  
ICAS and FRC  
© 2016

ISBN: 978-1-909883-25-3  
EAN: 9781909883253

This document is published by the Research Committee of The Institute of Chartered Accountants of Scotland (ICAS) and The Financial Reporting Council (FRC). The views expressed in this publication are those of the Steering Committee and do not necessarily represent the views of the Council of ICAS or the FRC.

No responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication can be accepted by the Steering Committee or the publishers.

All rights reserved. This publication may not be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior permission from the publishers.

For requests to reproduce this publication, please contact: [research@icas.com](mailto:research@icas.com)

# CONTENTS

Foreword .....	1
Acknowledgements .....	2
Executive summary .....	3
1. Introduction .....	5
2. The context for the research .....	6
3. Key themes .....	9
4. The next steps .....	15
Appendix A: Research summary .....	17
Endnotes .....	21
Contact us .....	23



# FOREWORD

The annual external audit has long been a cornerstone of corporate governance and the operation of equity and debt markets. However, a series of corporate scandals – such as Enron and WorldCom – and the financial crisis of 2007/2008, led some to question whether audit remains fit for purpose in modern society given the increasing complexity of business.

These challenges have led to some significant changes to audit and to the role of audit in the overall corporate governance structure. Recent innovations include the introduction of enhanced audit reports, and also jurisdiction specific innovations, such as, in the UK extended audit committee reports and viability reports – all of which entail heightened auditor involvement.

Furthermore, technological developments, such as robotics process automation, continuous controls monitoring and the use of data analytics techniques, have highlighted that the role of audit, and indeed, how it is undertaken, will continue to evolve. That evolution will be both demand and supply led: demand, as users seek assurance over new types of information; and supply, as audit firms seek to utilise technological advances to increase the effectiveness and efficiency of the audit.

However, whilst there has been extensive focus on how audit should evolve to meet societal expectations, there has not been the same focus on the skills that auditors will need to use the new technology, provide the audit of the future and make the assessments expected of them.

In light of the challenges and opportunities facing the auditing profession, the Financial Reporting Council (FRC) and ICAS

commissioned two pieces of research in 2013 to assess the mix of attributes, competencies, professional skills and qualities that require 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. The two bodies also established a Steering Committee to oversee these research projects and to produce a report highlighting the implications of the key findings from the research reports.

This report of the FRC/ICAS Steering Committee:

- (i) assesses the findings of the two research teams that were published in April 2016; and
- (ii) builds on those research findings to identify the key themes emerging and to recommend where changes are required to enable the audit to serve the perceived needs of society in the future.

This report will be of interest to anyone who has an interest in audit and indeed corporate reporting. The 2014 EU Audit legislation will undoubtedly have an impact on the audit profession. However, only by keeping pace with market led developments will audit continue to play its key role in the proper functioning of capital markets.

The key themes explored in this report will have far reaching implications for the role of audit and for those who undertake such engagements.

**Richard Fleck CBE**  
**Chairman of the joint ICAS/FRC Steering Committee**

# ACKNOWLEDGEMENTS

ICAS and the FRC would like to thank the members of the Steering Committee who produced this report and the academic team members who undertook the independent research.

## Steering Committee

Mark Allison

Executive Director, CA Education, ICAS

Mark Babington

Deputy Director, Audit Policy, FRC

James Barbour

Director Technical Policy, ICAS

Jim Bishop

Chair of ICAS Member Engagement Board  
and previously Convener of ICAS Audit and  
Assurance Committee

Louise Crawford

Professor of Accountancy, Robert Gordon University  
and member of ICAS Research Committee

Michelle Crickett

Director of Research, ICAS

Angus Duff

Professor, University of West of Scotland  
and previously ICAS Research Advisor

Richard Fleck CBE (Chairman)

Deputy Chair IESBA; Previously Director, FRC  
and Chair of APB, FRRP and Conduct Committee

Douglas Flint

Group Chairman, HSBC Holdings plc

Marek Grabowski

Director, Audit Policy, FRC

Mark Hatton

Partner in Charge of Graduate Recruitment, EY

Steve Maslin

Partner, Grant Thornton

Allister Wilson

Partner, EY and Convener of ICAS Research Committee

## Researchers

### Team 1

Karin Barac

University of Pretoria

Elizabeth Gammie

Robert Gordon University

Bryan Howieson

University of Adelaide

Marianne van Staden

University of South Africa

### Team 2

Stuart Turley

Manchester Business School

Christopher Humphrey

Manchester Business School

Anna Samsonova-Taddei

Manchester Business School

Javed Siddiqui

Manchester Business School

Margaret Woods

Aston Business School

Ilias Basioudis

Aston Business School

Chrystelle Richard

ESSEC Business School

It should be noted that the members of the Steering Committee were acting in their personal capacity and were not representing the organisations for which they work.

# EXECUTIVE SUMMARY

We are facing a future characterised by unprecedented organisational and informational complexity across business, with corporate and business reporting evolving rapidly. If audit is to evolve to keep pace with these changes, now is the time to consider what the audit of the future will look like and whether audit teams have the skills that will be needed to deliver a different kind of audit.

There appears to be a clear choice. The statutory audit could be maintained, much as it is now, to provide a basic policing function within the corporate world; or the audit profession could be a driver for change and develop a more insightful audit for a more complex world, and by providing such an audit, auditors could help to meet the evolving needs of stakeholders, including investors, and society.

The Steering Committee believe that, in relation to the audits of large multi-national companies, the latter option is the way forward. However, the profession currently finds itself in a catch-22-like situation. A real opportunity exists for the audit profession to be at the forefront of evolving the audit into a more holistic assessment of a company's strategy, business model, risk profile, operations and performance. However, based on the findings from the research commissioned by ICAS and the FRC, referred to later in this report, it is doubtful whether the profession currently has the skill base necessary to deliver an audit beyond the traditional financial statement audit. It is important to appreciate that the audit skill base needs to be developed at the same time as the audit of the future evolves – however that might be defined. Waiting for the audit to change before developing the skill base will be just too late, given the time-lag involved in recruiting, developing and training staff.

The Steering Committee recognise that changes to audit do have to be demand driven and it is important that stakeholders, in particular, investors are involved in the debate on the future of audit. The audit is already starting to evolve and there is evidence<sup>1</sup> (Forbes Insights, 2014) that the audit of the future will need to provide:

- more transparency into what has been learned during the course of the audit;
- perspectives on key information generated by management; and
- deeper insights on company performance, operations and risks.

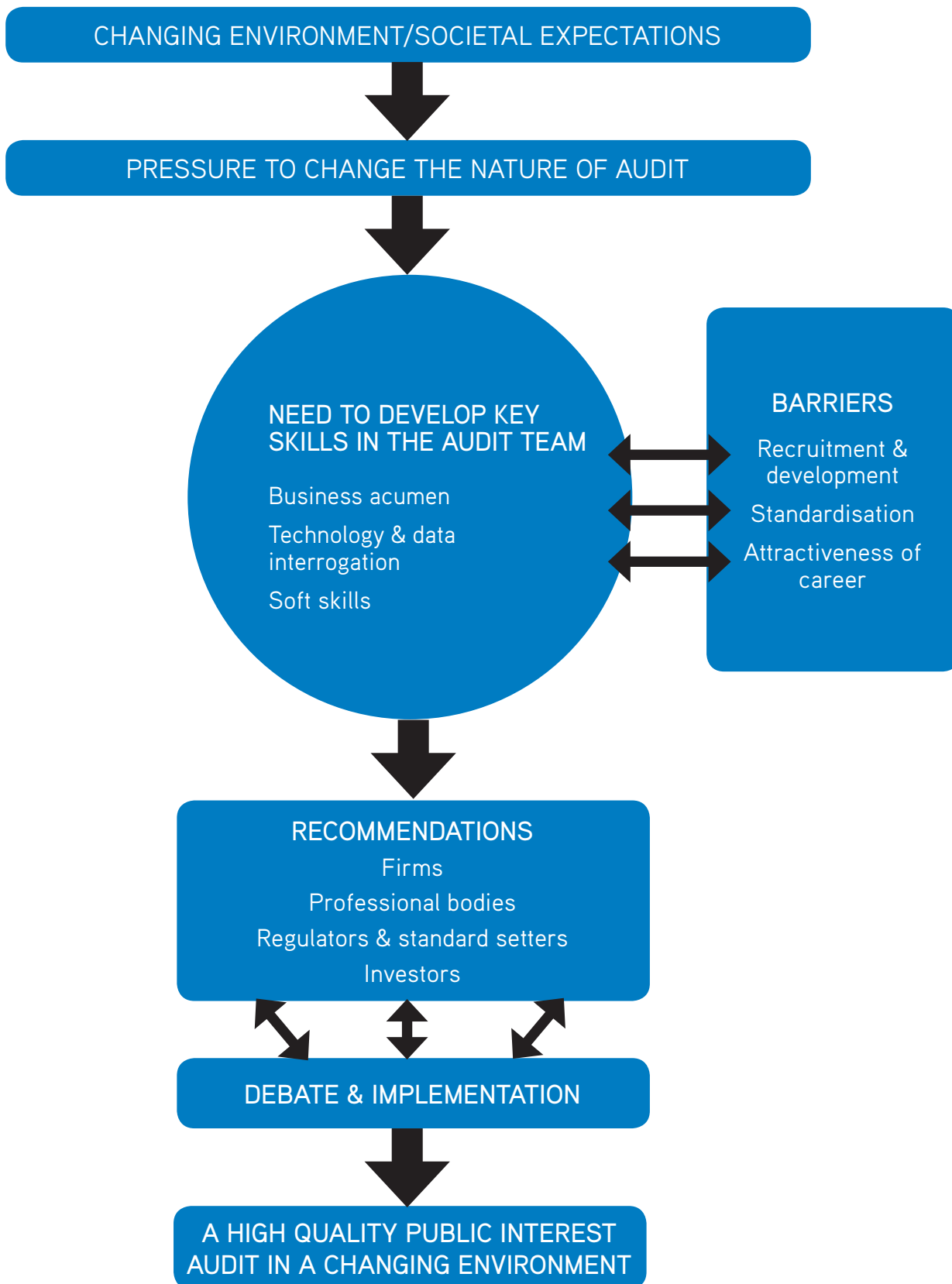
An enhanced audit may also provide a more attractive and compelling audit career path for the profession. In this way, a new, varied and different talent profile may be attracted into the profession to deliver the audit of the future.



This report highlights the Steering Committee's view of what needs to change to bring about this vision. We focus on three main skill areas that need to be developed to equip the audit team of the future to undertake such an audit that is more holistic and useful for stakeholders and society. These are categorised as advanced business acumen skills, technology and data interrogation skills and soft skills. We also identify barriers or current impediments to change which we believe need to be overcome in order for this vision to become a reality, such as the problems of recruiting and developing audit team members, the extent to which standardisation may impair the development of judgement and audit innovation and the perception of audit as a career of choice. We finally conclude with a number of recommendations for all stakeholders to consider. Maybe the most important of these is that all those in the profession need to engage in a meaningful debate on both the future of audit and the resultant skills needed to meet that vision.

We do not claim to have all the answers to the issues raised in this report but hope that this publication and the academic research which it is drawn from, will be a starting point to that constructive debate. The profession needs to develop a vision of the audit of the future and the skill set needed. And it is essential that the profession engages stakeholders in the debate if it is to deliver a high quality public interest audit for the future.

# Auditor skills in a changing business world



This figure summarises the content of the Steering Committee report and the process which will need to take place to ensure that the profession can meet the needs of changing stakeholder and societal expectations.



# 1. INTRODUCTION

In 2013 The Financial Reporting Council (FRC) and The Institute of Chartered Accountants of Scotland (ICAS) jointly commissioned two major research projects<sup>2</sup> to investigate the competencies and professional skills of auditors of large multi-national companies.

The research teams were asked to address the following key question:

*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?*

The research was commissioned at a crucial time in the evolution of corporate reporting and audit, where public and market confidence in audit was low and a number of regulatory initiatives were being considered by, among others, the FRC, governments, the European Commission, the International Auditing and Assurance Standards Board (IAASB) and the International Accounting Education Standards Board (IAESB) to enhance confidence in the value of audit and to support reform of the audit market.

The research teams were asked to consider whether a fundamental reassessment of the auditor's skills and competencies is required to create an audit team that can enhance confidence and meet the challenges of a changing landscape. In doing so the teams were directed to explore the mix of skills that need to be combined in an audit team for it to perform a high quality public interest audit, and look at associated staffing models and training implications.<sup>3</sup>

The focus of the research and this report is on the audit of large multi-national companies. The Steering Committee recognise that a changing audit and societal landscape will also have an impact on other audited entities but this is beyond the scope of this report.

The research was undertaken in a number of different jurisdictions, seven countries in total, and the Steering Committee report's findings and recommendations are intended to have international relevance. However, owing to practical reasons, the Steering Committee report draws on the regulatory framework in the UK and the UK response to the questions that were raised about the effectiveness of audit (see chapter two). This is used as the basis for considering how audit skills will further need to evolve. We recognise that other countries will have responded in similar or different ways but are unable to cover all these responses in this report. EU and international regulatory responses are also covered in chapter two.

Throughout this report and in the original call for research reference is made to 'audit quality'. Audit quality is hard to define and measure; but is sometimes described as being dependent on two variables. First, the competence of the auditor

*Corporate reporting is changing so as to integrate better narrative and financial reporting. As a result, the nature of audit is changing and auditors need to be more involved in the narrative elements of the annual report.*

*Against this backdrop, it is also likely that the attributes, competencies, professional skills and qualities required of auditors will need to evolve in order to keep pace with the needs and expectations of stakeholders.*

**Richard Fleck, Chairman of the joint ICAS/FRC Steering Committee**

– for example, the ability to detect a breach in the company's accounting system. Second, the objectivity of the auditor – for example, the willingness to report any identified breach in the company's accounting system.<sup>4</sup> It is also the case that 'audit quality' means different things to different constituencies. For example, a regulator will primarily focus on compliance with the relevant framework of auditing standards, on the assumption that such compliance will result in a high quality audit, whilst investors are likely to be concerned more with the reliability of the auditor's opinion and the likelihood that where the financial statements contain material errors that the auditor will discover and report them. Another way of looking at audit quality is to frame it in the context of behavioural attributes and professional competencies, skills and qualities – such as scepticism, professional judgement, industry expertise, and business acumen – all of which have a direct impact on audit quality.

The research projects were overseen by a Steering Committee that combined experienced individuals from the professional accountancy firms, industry, the profession and academia. Richard Fleck chaired the Committee.

This report brings together the key findings from both research reports, and takes forward the issues that the Steering Committee believe are crucial if audit is to meet the changing needs of all stakeholders.

The report is structured as follows:

- chapter two provides context for the research and explores the changing societal and audit landscape, which demonstrates the need for audit and auditors' skills to evolve;
- chapter three identifies the key themes, based on the research and the changing landscape, which the Steering Committee believe need to be addressed.
- the report concludes with the recommendations of the Steering Committee and suggested next steps to take forward the debate.
- appendix A provides a brief summary of the research undertaken and the findings and implications thereof; the full reports can be accessed on the ICAS and FRC websites.<sup>5</sup>

## 2. THE CONTEXT FOR THE RESEARCH

The Steering Committee believe that the audit profession is facing a future characterised by unprecedented organisational and informational complexity across business, and the audit process will be at risk if it fails to respond appropriately to this complexity. Against this background, it is quite possible that the statutory audit could be maintained much as it is now to provide a basic policing function within the corporate world, or the profession could be a driver for change and provide a more insightful audit that would help to meet the changing needs of stakeholders and society. It is within this context that the two research projects were commissioned.

It is important to put the question of audit skills in the context of a changing societal and audit landscape. The value of audit has been questioned post the financial crisis and stakeholders have expressed real concerns about the quality of audit, the value gained from audit and the ability of auditors to be adequately sceptical given the complexity of the transactions and evidence to be assessed. Auditors have a role in society to help meet the needs of investors for reliable information on corporate governance and financial performance so as to facilitate the flow of capital – yet we are living in times when the audit assesses and reports on a system of business and finance that no longer enjoys broad social confidence.

If audit is to meet the expectations of business and other stakeholders and deliver on its public interest role it surely must change. Whilst it is not the purpose of this report to address what ‘audit’ in the future will look like – it is important that there is an awareness of the future direction of travel of audit, if firms and audit teams are going to develop so as to be able to meet future challenges.

This section of the report therefore looks at some of the questions which have been raised about the effectiveness of audit, the regulatory response to date, market led developments, stakeholder demand for increased transparency and the implications of these changes.

### Questions about the effectiveness of audit

Following the financial crisis there have been many evaluations of the role of audit by various bodies around the globe. One such review was undertaken by the Treasury Select Committee as part of its inquiry into the banking crisis in the UK. In its report of May 2009<sup>6</sup> it stated:

*We have received very little evidence that auditors failed to fulfil their duties as currently stipulated. The fact that some banks failed soon after receiving unqualified audits does not necessarily mean that these audits were deficient. But the fact that the audit process failed to highlight developing problems in the banking sector does cause us to question exactly how useful audit currently is. We are perturbed that the process results in ‘tunnel*

*vision’, where the big picture that shareholders want to see is lost in a sea of detail and regulatory disclosures. (para 221, Treasury Select Committee, 2009)*

Likewise, in its Green Paper on audit policy<sup>7</sup>, published in October 2010, the European Commission (EC) stated:

*While the role played by banks, hedge funds, rating agencies, supervisors or central banks has been questioned and analysed in depth in many instances, limited attention has been given so far to how the audit function could be enhanced in order to contribute to increased financial stability. The fact that numerous banks revealed huge losses from 2007 to 2009 on the positions they had held both on and off balance sheet raises not only the question of how auditors could give clean audit reports to their clients for those periods but also about the suitability and adequacy of the current legislative framework. It seems thus appropriate that both the role of the audit as well as the scope of audit are further discussed and scrutinised in the general context of financial market regulatory reform. (pg. 3, European Commission, 2010)*

The EC also commented that:

### **Extension of the auditor’s mandate**

*The focus of audits so far to a large extent has been based on historical information. It is important to consider the extent to which auditors should be assessing forward looking information provided by the company, and given their privileged access to key information, the extent to which auditors should themselves provide an economic and financial outlook of the company. The latter would be particularly pertinent within the context of ‘going concern’. Forward looking analysis, at least for large listed companies, has so far been covered by equity analysts and credit rating agencies. The role of the auditor should thus be extended in this direction only if there is real value added to the stakeholders. (pg. 9, European Commission, 2010)*

### The regulatory response

The EC Green Paper was the starting point for the development of new audit legislation in the EU in the form of an EU Directive (Directive 2014/56/EU) and an EU Regulation (Regulation 537/2014) which were entered into the EU Official Journal in May 2014.<sup>8</sup> These reforms are being implemented by the various EU member states, including the UK, and take effect for periods beginning on or after 17 June 2016.

The introduction of mandatory tendering of audits and mandatory rotation of audit firms for public interest entities has led to firms competing on audit quality and innovation to win tenders by increasing audit efficiency and effectiveness and through the novel utilisation of technology within the audit. The implementation of the EU Audit Regulation will require audits to be tendered in the UK at least every ten years with the maximum consecutive duration of an audit firm tenure being twenty years. In the UK this has been coupled with revisions to the UK Corporate Governance Code<sup>9</sup> and the Order issued by the Competition and Markets Authority (CMA)<sup>10</sup>, which have significantly increased the frequency at which the audits of large entities are put out to tender. This has led to considerable pressures on audit partners to win new audits and also, at least in the shorter term, to seek to retain existing audit clients.

Other regulatory measures in the UK have been introduced, not via legislation, but by the FRC making changes to standards and guidance. One such FRC innovation relates to the reports issued by auditors. The FRC revised its International Standard on Auditing (ISA) 700 (UK and Ireland)<sup>11</sup> to require auditors to provide shareholders with greater insight into the key risks that they had identified in the audit and how they had gained sufficient evidence to mitigate those particular risks. The FRC has published separate analysis of the first two years of implementation of this revised standard<sup>12</sup>, which illustrates the innovation that has taken place within the profession. The International Audit and Assurance Standards Board (IAASB) has also now issued its revised ISA 700<sup>13</sup> which has adopted a similar approach, although unlike the FRC it has not required auditors to disclose the level of materiality adopted.

There has also been recognition of the importance of the narrative component (the 'front-half') of annual reports if companies are to provide a more cohesive and holistic explanation of their performance and their business model. The UK Government introduced the strategic report requirements<sup>14</sup>, which has led to a more cohesive story between the front-half and back-half of the annual report. The FRC subsequently introduced requirements for boards to include a 'viability statement' in the strategic report<sup>15</sup>, this aims to provide an improved and broader assessment of long-term solvency and liquidity than the traditional going-concern requirements.

The FRC also introduced a provision in the UK Corporate Governance Code for annual reports to be 'fair, balanced and understandable'.<sup>16</sup> Whilst this responsibility falls upon the directors of a company, auditors are now requested to report by exception where they believe the annual report prepared by a company's directors is not fair, balanced and understandable. This has led some within the profession to debate the exact nature of the assurance being provided, particularly in relation to the front-half of the annual report. Some experts believe that auditors are now providing negative assurance on such matters; whilst others would argue that the nature of the assurance being provided is outwith the International Auditing and Assurance Standards Setting Board's assurance framework.<sup>17</sup> There is little doubt that what is required of auditors is more than the previous consistency check between the narrative information and that featured in the financial statements.

The EU, in their 2014 revision (Directive 2014/56/EU) of Directive 2006/43/EC on statutory audits, has made no material change to the requirements for skills, knowledge and values either in the initial or continuing professional development area. The basic statutory requirement originating in the 1984 EU Directive and enacted in the UK originally in the Companies Act 1989 have changed little over the past 30 years. Audit is evolving but the qualification requirements in statute are not.

The IAESB<sup>18</sup> issued in 2008 International Education Standard 8 (IES8) - Competence Requirements for Audit Professionals. This has been significantly revised by a replacement IES8 - Professional Competence for Engagement Partners Responsible for Audits of Financial Statements - which is effective from 1 July 2016. Both the original IES8 and the revised IES8 set skills and knowledge requirements for audit professionals yet the effect, currency and recognition of this private sector self-regulation is open to question. Auditing firms are not bound by the International Education Standards (IES), the IES are not referenced in legislation in Europe and both regulators and professional bodies are, at best, ambivalent about application of IES8.

## Market-led developments

As well as regulatory changes that have impacted on the role of the auditor there have also been market led developments in other fields in which the auditing profession has a keen interest. For example, in the environmental, social and governance field, such as the area of natural capital, it is highly likely that some form of assurance will be sought over such information within corporate reports in the future.<sup>19</sup> The introduction of integrated reporting, which is mandatory in South Africa and Brazil, and the work of the International Integrated Reporting Council (IIRC)<sup>20</sup> has also led to discussion on the role of the auditor.

As a result, auditors are breaking new ground and will be issuing assurance opinions over different types of information from that with which they have normally been associated in the past, including key elements of the 'front-half' of the annual report, corporate social responsibility (CSR) reports and other corporate information. Much of this information will be more subjective in nature than that featured in a traditional financial statements' audit, requiring auditors to exercise more judgement and business knowledge. That said, some would argue that considerable subjectivity is also present in various areas of the financial statements of a multi-national enterprise, for example, the valuation of certain financial instruments, goodwill impairment assessments etc.

## Stakeholder demand for increased transparency

Auditors have a societal role and audit is a service that can provide formal structure to the environment of trust that business and society need to operate within. However, trust in the audit and in auditors was dented as a consequence of the financial crisis, although recent evidence suggests that this has recovered.<sup>21</sup> In addition, audit is a 'black-box' process which is largely invisible to those who rely on it, making it difficult for stakeholders to properly understand or trust the audit

process. We therefore need to explore the ways in which audit can demonstrate its value and contribute to a more trust-rich society.

Until very recently the actual output from the audit, i.e. the auditor's report, had not changed significantly since its introduction. Auditors were effectively required merely to issue a binary opinion as to whether the financial statements of an entity showed a true and fair view of its financial performance and financial position. The recent revisions to audit reports, referred to above, have changed how the significant findings of the audit are reported and provide more useful information for users in the audit reports.

These developments have been driven by regulators responding to stakeholder demands for there to be greater insight into the audit process. Stakeholders want increased transparency from auditors; they want more information about the risks being faced by the business, how those risks are managed and the key judgements in the financial statements. Therefore, more light is now being shone on the work that the auditor undertakes behind closed doors before reaching their opinion. This increased transparency is likely to be a continuing theme as stakeholders will want even more information in relation to the key judgements that have been made in the preparation of the financial statements. For example, in the case of goodwill impairment testing, the auditor currently provides details of the work they undertook in relation to forming their judgement on impairment and how they satisfied themselves that the company's provision is within an acceptable range. Going forward, however, it is likely that there will be a need for the auditor to state what he believes the acceptable range to be. The sensitivity of information is likely to become accepted as something that requires to be disclosed to better inform users. The audit profession surely has a role to play in informing stakeholders about the role of audit and what it can and cannot deliver.

## What will the future hold?

It is clear, therefore, that the nature of audit has already begun to evolve more rapidly than has previously been the case and this process is likely to continue. In the future it is likely that auditors will provide more assurance on the annual report as a whole, particularly the narrative sections, than is currently provided. It is also likely that other information that is provided to the market will require assurance, and that assurance will be provided in areas involving considerable uncertainty and subjectivity. Although it is not yet clear what experience and expertise will be involved in providing such additional assurance, audit firms will want to provide these services. The developments in audit since the crisis and the likely changes in the future all point to a move away from 'just' auditing the financial statements to a more risk and judgement based assessment upon a business. Whilst technology will have a part to play in this process, it is important to remember that technological solutions often tend to forget about the importance and role of people. In this respect, enhanced assurance is likely to require considerable professional judgement.

Whilst the creation of new potential income streams will be viewed as an undoubted opportunity for the profession, questions will be raised as to the readiness of the profession to meet the assurance expectations of stakeholders. Indeed, there may be more stakeholders with an interest in reports on matters such as the use of natural capital than there are in relation to financial statement audits. Do audit firms have the breadth of skills required to meet the challenges that are beginning to emerge today and will continue to emerge in the years ahead? If not, how will they bring in the necessary experience and skills?

How will audit evolve in the future? Will we move to real time continuous audit – continual monitoring of controls and assurance at any point in time and more focus on real-time assurance on communications to the market place, rather than just corroborative assurance over historical financial information? Or will we be auditing the culture of an entity? Whilst this appears a long way from the traditional audit, an assessment of an entity's culture is important in any audit risk assessment. The FRC's current 'Culture Project'<sup>22</sup> already includes a workstream 'embedding and assurance' which is looking at measuring and monitoring culture, the role of internal audit, risk management and public reporting of cultural indicators. A 2014 Forbes Insights report, which was commissioned by the Global Public Policy Committee (GPPC) of the largest six accountancy firms, and based on engagement with hundreds of stakeholders worldwide, suggested that audit needed to evolve to provide:

- more transparency into what has been learned during the course of the audit;
- perspectives on key information generated by management; and
- deeper insights on company performance, operations and risks. [Forbes Insights, 2014<sup>23</sup>]

The Forbes' study purposely did not address implementation challenges. This Steering Committee report therefore takes the debate further by covering some of the implementation challenges relating to the composition and skills of the future audit team.

In summary, there are a number of changes that have and indeed are taking place in business and in society that will continue to impact on the role of the auditor. The Steering Committee believe that these developments will require a change in the skills required of tomorrow's auditor. It is within this changing context that the research was commissioned and undertaken. Appendix A provides a short summary of the research findings of the two research projects<sup>5</sup> that were commissioned to consider the professional competencies and skills needed by audit teams to deliver a high-quality audit today and in the future. The next chapter looks at the key themes which the Steering Committee believe have emerged from the two research studies and seeks to provide suggestions as to how the role of the auditor, the assurance services to be provided and the related skill sets are set to develop.

### 3. KEY THEMES

In this chapter of the report the Steering Committee assess the skill set that is currently required of a competent auditor and contrasts that with the skill set that would put that auditor into a much stronger position to deal with the changing expectations of an auditor in a fast developing business/societal environment. The barriers to change are then discussed before concluding with questions which need to be debated and addressed in order to achieve the audit skill set necessary for the future.

The chapter draws upon and highlights its acceptance of the findings from the research commissioned by ICAS/FRC, which are summarised in appendix A of this report. The Committee's assessment is based on both the full research reports and the collective knowledge and experience of the members of the Steering Committee.

#### **The changing nature of audit - a future skills crisis?**

The research undertaken by the research teams confirms that audit teams have the skill sets to meet today's requirements. However, as discussed in chapter two, demands on corporate reporting and auditing are changing and the financial crisis brought increased challenge to the role of reporting and auditing. Many have criticised the audit profession for failing to 'see the train coming down the line' and, whilst it is questionable as to whether this was due purely to a skills shortage in the auditing profession, the crisis and the subsequent investigations and debate have changed expectations.

The concerns that the Steering Committee has as to the skill set that the audit profession requires are borne out by the research which suggests that – whilst there is a general satisfaction with auditors' current capabilities – there is a concern about a skills shortage in the future, especially if the scope of audit is to widen.<sup>24</sup> Whilst auditors will continue to be required to provide assurance on historical financial data, this may be a subset of what will be expected of them in the future. It is likely that the range of the information that will be subject to audit or assurance will expand. In particular, there will be a focus on more forward-looking and narrative information within the annual report and also to new types of assurance on issues such as corporate culture, natural capital, social and environmental issues. Indeed, some of this is already happening.<sup>25</sup>

The revised International Education Standards issued by the IAESB (IES2-6) effective from July 2015, set requirements in the areas of professional scepticism and professional judgement, softer skills, data analysis and business strategy at the point of initial qualification. The revised IES8, effective from July 2016, applied these requirements specifically to the role of the audit engagement partner. Whilst there is currently little evidence of the effect of these changes, the Steering Committee consider that a plan for gathering such evidence should be established and that the full suite of International Education Standards (1-8) be reappraised in light of the findings of this research.

These changes in audit have implications for the required skill set of auditors and these are explored in the following section.

#### **Key skills required**

If audit teams are to be equipped to meet the challenges of today and tomorrow, the Steering Committee has concluded that auditors will need to enhance the following key skills:

- i. business acumen;
- ii. technology and data interrogation; and
- iii. soft skills.

The research reports, particularly the Barac *et al.* report, identify a large number of skills and competencies required of auditors today and in the future. The Steering Committee recognise the extensive and broad base of skills required of auditors and rather than repeat the research findings here we focus on these three key areas which the Committee believe require specific attention.

#### ***Business acumen***

Both research projects identify business acumen as a key skill. However, it appears that the development of business acumen requires greater focus than it currently receives within the firms, especially at the entry and lower levels of the profession. Put simply, if an auditor does not understand the dynamics of the business, that auditor cannot audit or challenge it effectively – because he or she will not have the necessary understanding to assess any information or explanations that may be provided.

The auditing standards require the auditor of an entity to have an adequate understanding of that entity's business, and its industry. In order to have that adequate understanding, the Steering Committee believe that there needs to be much more emphasis within the audit firms on ensuring that members of audit teams better understand the businesses they audit and the drivers of value within their industries.

Business and commercial acumen is also perceived to be essential as the scope of audit increases, in response to stakeholders' expectations, to cover more of the narrative or 'front-half' of the annual report or wider company information. Such acumen is essential if the risks to the business and thus the audit are to be identified. As financial statements have become more complicated, the auditor has a role to play in helping users interpret information. This is seen in the extended audit report, introduced by the FRC in the UK, and also more recently by the IAASB. In this more detailed report, the auditor takes time to draw to the users' attention and to help them understand, not just the technical issues, but the business implications and key risks that might impact on the financial statements. In addition, the key judgements and their impact on the financial statements are now highlighted by the company and the auditor is expected to be able to report by exception on whether the annual report is fair, balanced and understandable.

Given that both research reports demonstrate that business acumen is an essential skill, the challenge is to enable auditors to acquire this skill set, especially at the trainee and early career stage. It would not be realistic to expect that the auditor should have more business specific knowledge than those running the business. However, new methods of increasing business knowledge within audit teams need to be adopted. This may be achieved through training, particularly ‘on the job training’ with a focus on understanding business models. Audit firms may also obtain the necessary knowledge and experience by employing people from business or facilitating secondments from practice to business. The Steering Committee concur with the recommendation of the Barac *et al.* research team that audit teams of the future should include industry specialists who receive appropriate training in audit to make them effective members of an audit team. Furthermore, as well as developing business acumen in audit teams, there may also be a case for increased dialogue between institutional investors and audit firms to better understand the information needs of investors.

The Steering Committee believe that the experience gained from undertaking other types of accounting services such as due diligence and forensic services helps staff to develop more business acumen and enhance their audit skills. Whilst auditors used to be able to obtain this type of experience, there is a perception that this is no longer the case. Enhanced ethical and independence standards now reduce or prevent audit firms from accepting such engagements for audit clients, although such engagements are undertaken by the firms for non-audit clients. However, these assignments are largely undertaken by corporate finance teams, thus audit team members do not gain the valuable experience from undertaking such assignments.

### ***Technology and data interrogation***

The technological landscape is changing fundamentally and this requires a fundamental rethink on how we plan and conduct an audit. Does the profession currently have the skill set to do this?

Advances in technology provide opportunities for improving audit quality. The Steering Committee believe that the key question is how firms can audit big data most effectively and efficiently in the future in order to provide a more insightful audit. Do the firms have the skills and technology to do so and do we have the auditing standards that enable such innovation. At the moment there appears to be a disconnect between the firms’ approach to auditing big data using data analytics and auditing standards. The implication of this for auditing standards is discussed later in this chapter.

The Steering Committee welcome the fact that the larger firms are making substantial investments in data analytics. Data analytics enable audit teams to interrogate entire populations of data, rather than relying on results of sampling a small part of the data available. This resource should enable companies and their auditors to identify inconsistencies in business activity – often an indicator of impending business problems and fraud and offers the opportunity for significant improvements in audit effectiveness and efficiency. The use of data analytics requires significant specialist expertise, for example to identify

the objective and data requirements of the analysis, to apply the necessary technology to capture the data, and finally to organise the data in a meaningful way so that the results of the analysis can be interpreted appropriately in order to provide relevant audit evidence.

There is no doubt that the firms have individuals and specialists with extensive technology skills. However, to be able to make use of that expertise, the audit teams need to have the knowledge and experience to identify when to commission these services, to know what questions to ask the internal specialists, and to know how to decipher the answers they get back. The Steering Committee question whether audit teams generally have the necessary experience to make use of internal specialists to make effective use of technology, to mitigate the risks that such technology poses and the ability to interrogate and interpret data.

There is also the opportunity for firms to deploy in their audits some of the analytical tools used in their advisory businesses, such as fraud analytics tools, to provide some of the greater insights which are being demanded by stakeholders.<sup>1</sup>

Advances in technology also pose new challenges and risks both for businesses and their auditors. These new challenges include auditing in an environment of robotics process automation and continuous controls monitoring, and these new risks include issues such as cyber security and reputational risk. Against this background, the question is whether auditors have the requisite skills to recognise and analyse the risks that ever advancing technology poses to the companies they are auditing and the ways in which technology risks can turn into major business risks for the client.

On a more positive note the advances in audit technology, whilst requiring new skills, may also offer an opportunity to reduce the time spent by staff on ‘routine’ audit tasks, enabling them to spend more time analysing evidence, following up anomalies, and exercising professional judgement (with the benefit of their greater understanding of the business) – the value added elements of the audit process.

### ***Soft skills***

The ability to apply professional judgement and exercise professional scepticism are pre-requisites for audit quality. Whilst not new skills, the auditor will be expected to exercise judgement over a much greater range of professional issues and the Steering Committee question whether professional judgement receives sufficient ranking in firms’ development and performance measurement procedures.

Applying professional judgement is not easy and it is a skill that takes time to be developed and needs appropriate mentoring and coaching. The ICAS Professional Judgement Framework first published in 2012 and updated in 2016 aims to support professionals in making a judgement and can also be used as a training resource.<sup>26</sup>

There is a perception, identified in the Turley *et al.* research, of 'auditors being stuck in a room' somewhere and not spending sufficient time 'face-to-face' with client staff. Yet challenging management requires the auditor 'to be able to read the person across the room'. The remoteness of audit teams from the client and the client's staff means that this skill is potentially not as developed as it should be. If auditors had more engagement with the client, they would surely understand the business better and the thoughts and motives of the client staff. Auditors are also increasingly required to consider and assess the ethical and cultural make up of boards, management and organisations and the resultant impact on risk. Audit teams are also required to have a greater understanding of different international cultures on a multi-national audit.

To exercise professional judgement and professional scepticism more effectively, the Steering Committee believe that much greater emphasis should be given to the development of the psychological and behavioural skills that are key to successful auditing. These skills are essential to the auditor's assessment of management, its integrity and reliability, and board culture. Whilst the ability to apply judgement and scepticism is gained through experience, training auditors in how to evaluate corporate culture, behaviours and conscious and unconscious bias would help with the development of these skills.

If the audit profession is to earn respect and deliver its role in society, the profession and the individuals within it must act ethically and with integrity, and importantly must be seen to do so. The Steering Committee believe that giving audit professionals appropriate training in ethics and a supportive environment is key if individually they are to learn how to challenge judgements and be able to stand up for their views.<sup>27</sup>

To some, these issues are ones which have all been discussed before and are nothing new. The ICAS motto *Quaere Verum* meaning 'seek the truth' and the Latin for 'audit' comes from 'to hear' – demonstrates that such skills have always been required in the profession. However, the context in which audit is undertaken and the complexity of modern business have changed - so the time is right to find a modern day solution.

## Barriers to change

The current environment is not necessarily conducive to the changes required and a number of barriers or impediments to change do exist. So if audit teams and skills are to change to ensure the viability of a high-quality audit what barriers to change need to be overcome?

The Steering Committee has identified the following main barriers to change:

- i. recruitment and development issues;
- ii. the implications of standardisation; and
- iii. the lack of attractiveness of a career in audit.

## Recruitment and development

In an audit requiring more and more sophisticated judgements, who will have the experience and expertise to make these judgements? Junior staff cannot be expected to have the requisite skills for these judgements. If they are not exposed to the audit decision makers and the processes for making these judgements, they will not develop the skills necessary to make these types of decisions in the future. The firms' current pyramid training model does not appear conducive to the development of staff with the appropriate business knowledge and skills required for the future. The traditional pyramid model in accounting firms refers to a business model where high numbers of trainees are recruited to undertake accountancy training, with large numbers then leaving upon qualification and only a minority staying to progress to more senior levels within the firm.

The profession competes in the market place for student intake from prestigious universities. However, there is a view that whilst high quality talent is being recruited, some of the initiative and enthusiasm is driven out of the trainees by the time they qualify, due to the routine nature of the work they undertake. Others believe that the current recruitment process does not obtain the 'right' talent. New initiatives in the UK include recruiting school leavers in addition to the traditional university graduates and removal, in some cases, of the academic requirements.<sup>28</sup> Diversity is required within the profession if we are to bring in people who are willing and able to challenge the 'emperor's new clothes'. A third view arises from the fact that, whilst you can teach the technical and accounting elements, it is more difficult to teach someone to develop an enquiring mind – and there is concern that the recruitment process focuses on whether the candidate is likely to pass their professional exams, without equivalent focus being given to the personal characteristics of the individual and whether they are suited to one of the many disciplines that firms now undertake, including audit.

The Steering Committee believe that audit recruitment processes need to recognise that the required skill set for auditors has changed. These skills are identified in the research (see appendix A) and are discussed further on pages 9 to 11 of this report. In particular, the Steering Committee believe that the profession needs to recruit for the audit practice individuals who have a questioning mind. However, this is challenging. Audit has become a smaller proportion of fee revenues for the firms and, as a result, a more client focused attitude has prevailed. Yet the 'personality' needed for audit may not be the same as for the more client focused service lines within the firm. How will the person who is keen to find problems, i.e. 'look for trouble', and have the courage to escalate issues be identified and recruited? And most importantly how will these individuals be retained within audit after completion of their qualification?

The research reports identify the need for multi-disciplinary teams with individuals with specific specialisms, for example geologists, engineers etc., being brought together on audit teams. Whilst to some degree this is already taking place, the integration and functioning of these teams and the impact on

how and who the firms recruit, and on the traditional pyramid model, needs further consideration. As discussed previously, there is also a need to consider how such specialists should be trained and/or qualified in audit to make them more effective members of the audit team. The dynamics of any team are crucial, yet not easy to manage, especially if individuals are coming to the team with different backgrounds and specialisms. Firm and audit team culture are therefore an important issue. Having a team that enables the development of less experienced staff and gives individuals the courage to ask the 'stupid question' is essential if skills are to be developed at the same time as the delivery of a high-quality audit. There has to be scope for staff to have access to 'on the job' training, which will cover aspects such as knowledge of the business, communication skills and professional scepticism.

Both research reports reveal that at least some now believe that the audit firms' pyramid model, with its associated high staff turnover, will need to evolve. In fact, its shape is already starting to change. The model is dependent upon people leaving the firm. But there is a concern that the firms are losing the 'wrong' people from audit - with the best leaving to pursue a career outwith the firms or in another service line. In addition, the recruitment of more specialists is likely to have an impact on this model. A change to this model, with a higher ratio of senior to junior staff and the recruitment of specialists, could lead to an improvement of the knowledge of business as a result of more senior and thus experienced staff being involved in an audit. This would also provide an opportunity for more mentoring of junior staff - which would, in turn, provide an opportunity to educate junior staff in handling the difficult judgemental areas and in business acumen etc. This however may have implications for the pricing of audit services and the economies of engagement, and may impact on the ability to build a strong development 'pipeline'.

For all these reasons, the Steering Committee believe that firms should review how they recruit, develop and retain talented individuals to provide the skill needs identified in this report.

### **Standardisation**

The research reports demonstrate the importance of auditors being able to apply professional judgement and appropriate scepticism to ensure the delivery of a high-quality audit. As demonstrated in chapter two of this report, it is likely that enhanced levels of professional judgement will be required in the future if the profession is to be able to meet demands from society for further or broader assurance in the future.

Despite the existence of different recruitment and qualification models operating around the world, not one model appears to produce an obviously different outcome in terms of audit quality. So, if the profession is recruiting the best talent with the appropriate individual skills, is there something in the way in which the profession currently operates which prevents the quality of individual judgement and scepticism and challenge coming through?

The research identifies a concern that the current levels of global standardisation, where an auditor needs to follow a firm's methodology through its audit software, may inhibit the exercise of professional judgement and therefore audit quality. Audit firm methodologies, regulation and international auditing standards are all interlinked and may all contribute to this problem. For example, it is argued by some on the Steering Committee that regulatory inspections impact on firm methodologies resulting in a documentation rather than a judgement focus. The Steering Committee is concerned that the current regulatory approach and firm methodologies, although focused on increasing quality, may instead be driving out judgement and affecting recruitment and retention of quality people within the audit function. The Steering Committee believe that this may be an area that the firms and audit regulators should consider collectively in order to see, first, whether there is indeed an issue and, second, if there is that a solution might be found.

Audit firms establish global audit methodologies for very good reasons - to ensure compliance with standards, for regulation purposes, for consistency and uniformity across the globe, to facilitate staff mobility, to ensure appropriate levels of quality control and to mitigate risk. However, does the existence of such methodologies create a lack of space for auditors, in the first instance, to develop and ultimately exert professional judgement and scepticism? The Steering Committee is concerned that any potential enhanced quality from recruiting and training the best individuals may get subordinated to the requirements of firm's methodologies which in turn may constrain individual judgement and restrict innovation and potentially inhibit issues being elevated within the firm. Audit methodologies and standardisation in general may, therefore, present an evolving threat to the profession.

The research highlights that a common feature of highly regulated modern audits is that different parts of the audit are being undertaken by different members of the team, with different mind-sets<sup>29</sup> - junior members of the team focussing on ensuring compliance with the auditing standards and undertaking mechanistic tasks, whilst senior members of the team apply judgement to enable the expression of the auditor's opinion. If trainee staff are only involved in the 'compliance or more mechanistic part of audit', how can they develop the necessary judgemental skills required if they are to stay within audit and progress to more senior levels. It is also worth noting that even junior members of an audit team need judgement skills so that they know when to escalate issues to more senior members of the team. Also, the resultant reputation of auditors as 'box tickers' does nothing to encourage recruitment and retention of quality staff.

Do we currently have the international auditing standards which enable innovative use of technology in the modern audit, for example the use of data analytics? It is not realistic to expect auditing standards to always keep pace with developments in practice and particularly technological developments - not least because actual experience is necessary to inform the limitations and risks involved in using new technologies and so inform the development of the standards. Whilst the auditing



standards do not prevent firms from using data analytics in their audit, there is currently some duplication of effort as despite testing of an entire population of data, the standards still require further testing in order to ensure compliance with the specific requirements of the standards. Thus for firms to be able to take advantage of data analytics in their audits and dispense with other testing, some commentators have argued that international auditing standards and the approach of regulators would need to be updated to reflect this innovation in audit evidence.

The Steering Committee is concerned that technology will increasingly introduce a disconnect between the way in which audit has been traditionally done and the way in which the audit objective could be achieved in the future. So unless the standards catch up and there is a transition in methodologies, there may be an inevitable duplication of effort in audit procedures. Whilst as explained above this is currently an issue in relation to the use of data analytics, this issue will continue to arise with future technological advances. This is clearly a matter that needs to be debated by regulators and practitioners.

However, the Steering Committee believe that if a closer adherence to a more principles or objectives-based approach was adopted, then auditors could use their judgement on how best to meet the core principles of an auditing standard and thus advances and practices, such as data analytics, which could improve the quality of an audit, could be adopted without requiring changes to the auditing standards. In this case, an auditor would (and should) be judged by whether the objective of the standard was achieved – and not by whether every step in the process set out in the standard has been observed. If auditing standards do not develop in this way, they will continue to be outpaced by technology and will hold back opportunities to enhance the effectiveness and efficiency of the audit process.

### ***Auditing - an attractive career choice?***

Audit quality relies on quality people delivering the audit. The key is both to attract and to retain quality people within the audit profession. So how can the audit profession attract and retain the next generation?

In the past a professional accountancy qualification has perhaps been seen as a route to a 'good career', with good prospects and good earnings potential. And there is a perception that audit, rather than having its pick of talent from the profession, is the place where people who do not find jobs elsewhere in the profession are left. Yet those in audit are dealing with complex clients, meeting and dealing with a large variety of people, assessing risks, making significant judgements and assisting their clients and the wider economy, and gaining valuable experience of a variety of different businesses. The profession should emphasise the wider societal contribution that audit makes, as well as the value to business and investors.

The Steering Committee believe that the profession needs to take this opportunity to reposition audit to the next generation by demonstrating the role which audit plays in society and changing the perception of the accountancy profession in general and

of audit in particular. Collectively the profession needs to 'sell' the story and demonstrate that the audit profession can be an exciting and fulfilling career choice. In essence, therefore, audit should be promoted as a key specialism, involving intellectual rigour, and requiring specialist skills in the same way as other service lines, such as tax and corporate finance. There is an opportunity to promote the fact that 'to cut it in the audit world, one will need to be a quality operator'. This promotion needs to be targeted at those already training within the firms and to those considering a career in business or the profession. The 'audit professional role' needs to be respected by others within the firm as well as by external parties if it is to attract the best talent.

Another issue which came through the research which affects the retention of quality staff within the audit function, is the extent to which audit is now seen as a regulatory compliance function. There is a perception amongst the Steering Committee that regulation can often be directed at finding where people have done things wrong and punishing them - rather than highlighting good practice and encouraging its wider adoption. This may lead to a fear of making decisions in case the wrong decision is made and, as a result, subsequent judgement paralysis. Some research participants argued that this can already be seen in the firms, with audit inspections and the regulation burden specifically mentioned as a reason for quality partners and senior managers leaving the firms. Regulatory approaches differ internationally, so it may be hard to generalise and it is notable that in the UK the FRC is currently positioning itself as an 'improvement regulator', rather than a 'punishment regulator'.

The research and the Steering Committee recognise that regulation has led to identifiable improvements in audit quality, however, this unintended consequence of regulation needs to be highlighted and resolved – as currently this is perceived as acting as a barrier for the profession to retain and promote the best people.

### **Concluding thoughts**

The Steering Committee recognise that it is raising as many questions as it is addressing. However, one of the aims of this project has been to provide a platform for considered debate amongst firms, professional bodies, regulators and other interested parties.

If we are to achieve the audit skill set necessary for the future a number of key questions need to be addressed. These are summarised below under three broad themes.

#### ***Motivation for change***

- Is there a demand for broader assurance from the investment community? What are the costs and benefits?
- Is there an appetite for change within the professional firms, the audit regulators and the corporates?
- Whilst the role and services provided by an auditor will evolve, an auditor cannot do everything or be an expert

in everything. Is there an understanding and acceptance amongst stakeholders and society that there are limitations to the auditor role?

- Who will pay for the additional cost of higher level staff and experts undertaking an audit? Or will the greater use of technology reduce the overall staff costs in audit?
- In an increasingly global, litigious and regulated environment, if there is an appetite for more forward-looking assurance, can this be met without a change to the auditor liability regime? Alternatively, is that change inevitable – and, therefore, the consequences must be addressed?
- If the scope of assurance changes, who will provide any additional assurance provided? What impact will a changing competitive landscape have on the firms and demand and supply of assurance experts?

- How can business acumen be effectively developed at the entry and lower levels of the profession?
- How can the profession improve the perception of a career in audit and how can the firms retain some of their best people in the audit function?
- How can the profession most effectively incorporate specialists into audit teams?

The next chapter of this report identifies how the Steering Committee believe the profession should respond if we are collectively to address some of these questions and the emerging skills gap.

### ***Compliance versus judgement***

- Is regulation, in its drive to improve audit quality, actually having the opposite effect and driving out judgement?
- Whilst a dual mind-set approach within an audit team may be acceptable and a necessity in the short term to address current regulatory requirements and standards, should regulators and the profession not be working towards a one audit mind-set which satisfies both the public interest and the regulatory compliance requirements. Would objectives-based auditing standards help resolve this issue?
- Can regulators accept a more principles or objectives-based approach to standard-setting – or is political and societal focus on being able to hold people to account (which is facilitated by prescriptive behavioural requirements) always going to take precedence?
- Firms are wary of not just the financial exposure but also the reputational exposure which acts as a barrier to innovation. Reputational risk to both individual audit partners and firms may, therefore, inhibit the development of audit and the use of professional judgement. How can these risks be managed?
- How can the notion of ‘value added’ for audit and the implications for perceived or actual auditor independence be reconciled?

### ***Development of individuals***

- Are the statutory requirements for knowledge, skills and values for auditors fit for purpose?
- Do the revised International Education Standards (IES1-8) go far enough in their footprint of relevant knowledge, skills and values?
- Can firms develop a culture that values ‘forensic’ mind-sets that challenge and identify problems, and then escalate any problems through the hierarchy?
- How do audit team members gain the experience and knowledge to enable them to understand diverse international cultures?

## 4. THE NEXT STEPS

To some the findings of the research may be no surprise, in fact to some members of the Steering Committee the research findings were actually more positive than expected. But unless action is taken are we walking into a crisis - with audit becoming less and less relevant, the audit profession failing to attract and retain the best, the profession being unable to deliver the requisite skills and thus being unable to meet the demands of complex company audit. Yesterday's solution will not solve tomorrow's problem. So what next?

The Steering Committee recommend the following next steps:

### Recommendations for the firms

#### *People*

- A review of recruitment procedures:
  - to focus on the skills identified in the research and this report; and
  - to identify those with an enquiring mind and judgement potential, and to allow those individuals to develop their skills in these respects.
- A re-assessment of how firms retain talented individuals within their respective audit teams.
- Initiatives should be undertaken to change the perception of audit and promote audit as an attractive career choice, both within the firm and externally.
- More time should be devoted to on the job training, more direct client contact and more exposure to senior members of the team, difficult accounting issues and judgements.
- An acknowledgment that not all members of a team need to be chartered accountants, instead specialists could be provided with wrap around audit training or provided with a post-graduate auditor qualification to enable them to become more effective members of an audit team. This will need to include appropriate training on professional ethics.

#### *Environment of the audit firm*

- A re-evaluation of audit firm methodologies which appear to promote consistency over judgement and may restrict innovation. This should be carried out in parallel with the audit regulators to ensure that the objectives of audit methodologies and audit inspections are aligned.
- An appropriate audit team and firm culture is essential to encourage the recruitment and rewarding of sceptical individuals and to provide an encouraging and supportive environment for the development of judgement. It is essential that professional ethics is embedded into that culture.
- There should be consideration as to how the current pyramid model will need to evolve and change.

#### *Skills*

- An emphasis is needed on developing the business acumen of audit staff and new methods of increasing business knowledge in audit teams should be adopted.
- There should be a focus on the development of IT skills within audit teams to complement the use of IT specialists within the firms.
- Further consideration is needed of the integration and functioning of multi-disciplinary teams and the impact on how and who the firms recruit.

### Recommendations for professional bodies

- Provision of wrap around training or post-qualification audit training to specialists to enhance their contribution to the audit team.
- Initiatives should be undertaken to change the perception of audit and promote audit as an attractive career choice.
- Professional bodies' requirements at IPD and CPD need to reappraise the emphasis on:
  - understanding businesses;
  - psychological and behavioural skills – 'reading the client'; and
  - the risks and use of technology, particularly data analytics.
- Professional bodies, firms and IFAC should evaluate the appropriateness of IES2-8.

### Recommendations for regulators and standard setters

- There needs to be a constructive debate on how to combine the two different mind-sets (compliance versus judgement) which currently operate within an audit team.
- Auditing standards should be more principles or objectives-based. This would alleviate the problem of standards lagging behind practice and technology.
- Regulators should assess audits on whether the objective of a standard has been achieved, rather than whether every step in a standard has been observed.
- Whilst the expanded audit report has played a role in improving transparency and hopefully reducing the expectations gap, further initiatives should be debated to continue to educate society and stakeholders on the role and scope of audit.
- Whilst regulation is essential for audit quality and the public interest, care needs to be taken that regulation does not have a perverse effect on audit quality by deterring the exercise of judgement and deterring capable individuals from remaining within the audit profession.

- Regulators should question whether current statutory requirements for the content of the qualification of auditors are sufficient to address the changing need for skills, as identified in the research.

## **Recommendations for investors**

- The introduction by the FRC of the expanded audit report is probably the most significant innovation in auditing for a generation. It has provided investors with significantly greater insight into what goes on in the auditing black box. However, for the audit of the future to evolve in the way suggested in this report, it is essential that investors – as the primary beneficiaries of the audit – become fully engaged in the debate.
- The evolution of the audit is too important for investors to remain as silent spectators. The profession, regulators and standard-setters need their commitment to engage in a meaningful way.

## **Engagement in meaningful debate**

- There needs to be a willingness from the profession to adapt to society's changing expectations of audit and acceptance that the 'status quo' is not a solution.
- All those involved in the profession need to demonstrate its response to these issues and engage in a meaningful debate on the way forward. This will need to involve all stakeholders.
- The research and resulting Steering Committee report has focused on the largest multi-national audit clients and the largest audit firms but this is only one part of the audit profession and market. The profession should also investigate the issues in other tiers of the audit market and identify whether the skills and pressure points are the same.

The Steering Committee recognise that this report, and the underlying research reports, do not have all the answers but hope that it is a first step in a constructive debate on the future skills' requirements of audit teams.

# APPENDIX A: RESEARCH SUMMARY

In the following two sections a brief summary of the research undertaken by the two research project teams and their findings and/or implications are outlined. For further details please see the full research reports, which are available on the ICAS and FRC websites.<sup>30</sup>

## The capability and competency requirements of auditors in today's complex global business environment

*Researchers: Barac, Gammie, Howieson, Van Staden*

This project involved 84 interviews with relevant stakeholders in three countries: Australia, South Africa and the United Kingdom. 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. In addition, stakeholders who have some oversight, public policy or educative role in audit also participated in the study.

The researchers propose the following recommendations that are aimed at ensuring 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.

### Individual capabilities

#### *Regulators*

- Professional competence of engagement partners responsible for audits of financial statements (International Education Standard (IES) 8) should include guidance 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 and forensic skills.
- CPD offerings of professional bodies should provide the above mentioned skills.
- Education and training models of professional bodies should, as some already do, be adapted to 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 and include practical courses on data interrogation and analytics.

### Collective capabilities

#### *Audit firms*

- The requirement for collective capabilities within more multi-disciplinary teams will involve recruiting and training graduates who will specialise in accounting and auditing but who will gain exposure across a range of global audit clients. The complexity of financial services demands specialism from an early stage.
- Graduates should be recruited and trained within specialist capabilities such as IT, valuation, actuarial work, business consultancy and then subsequently develop their audit capability.
- 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. 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.

- Need to emphasise the potential that the assurance environment holds 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 multi-national 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 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 as their training and recruitment practices.
- 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 taken this forward.
- 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.

### ***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 (i.e. a compliance and a judgement audit), 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.

### ***Professional bodies***

- Professional bodies could offer conversion programmes to provide the wrap round training for 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 multi-disciplinary 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, including suggestions of audit-only firms.

## **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 and increase the public profile of the profession.

## Skills, competencies and the sustainability of the modern audit

*Researchers: Turley, Humphrey, Samsonova-Taddei, Siddiqui, Woods, Basioudis, Richard*

This project involved a series of focus group discussions across several European cities. The European locations (Paris, Stockholm, London, Edinburgh, Brussels, Dusseldorf and Birmingham) were chosen to capture a wide range of viewpoints and experiences. Focus group participants included individuals from a variety of relevant backgrounds: audit partners in public practice, audit committee members, users of financial statements, regulators and audit quality inspectors, academics, and early career accountants in practice.

The approach adopted in this study centres on discussing the overall competence and sustainability of the audit function rather than defining a specific schedule of skills or a new competency framework for auditors. The analysis in this report uncovers a series of significant 'pressure points' for auditor skills and competency. Eleven pressure points, discussed in four categories, are identified as being important for effective auditing in the current and likely future environment. These are:

### The context of the specific audit engagement

- Understanding the complexity of modern business – The auditor's ability to understand the business is critical.
- Accounting complexity – Developments in financial reporting have given rise to concerns that 'the auditor is no longer the accounting expert'.
- Systems complexity – The speed, complexity and remoteness of information processing places considerable pressure for skills to supervise and evaluate analytical work and is changing the nature of what constitutes evidence for audit purposes.

### The development of audit personnel

- Individual professional judgement and resilience – The ability to exercise professional judgement and possessing 'soft skills' such as psychological awareness and courage are widely seen as critical for auditing, but the routinisation of audit processes and reliance on checklists can undermine the development of the quality of judgement required.
- The development of staff and partners – How can firms ensure that it is the best quality auditors who progress to senior positions and partnership?

### Firms as suppliers of audit services

- Recruitment and retention of suitable staff – The loss of attraction of auditing as a destination career.
- The place of audit in multi-service professional firms – Auditing has become less identifiable as a defining characteristic of the firms.

## Interactions with stakeholders and society

- Satisfying the requirements of regulation – The dominance of a compliance mind-set is detracting from the development of other important judgemental skills.
- Governance contribution – High quality communication with those charged with governance can make a considerable difference to audit effectiveness but the requisite interpersonal skills place additional pressures on audit recruitment and training.
- Value to the reporting entity – The capacity for auditors to develop and demonstrate suitable understanding of the entities they audit is advocated as being essential to the development of auditor insight and respect. Commercial pressures on audit fee margins, regulatory restrictions on auditor-client relationships and the intangible nature of audit quality are all factors capable of being cited as impacting on the 'value contribution' of audit.
- Communication with stakeholders – How can developments to enhance the quality of auditor communications succeed?

The following challenges are identified, which the authors argue should be confronted if auditing is to have a sustainable future and be regarded as a valued and highly skilled function relevant and appropriate for the demands of the modern, 21st century business environment and broader society:

### Conceptualising the audit as a skilled, judgemental activity

- Continuing to make more visible the nature and value of the exercise of professional judgement.
- Developing a structure for audit skills beyond just individual attributes to give consideration of the contextual influences on audit practice and the overall competence of the audit function.
- Revisiting the professional and regulatory emphasis on audit uniformity, typically represented by the notion and insistence that 'an audit is an audit', in order to give due recognition to the fundamental, idiosyncratic essence of audit and the acceptability of variation in the ways of meeting/being compliant with 'standards'.

### Recruiting and developing suitable audit professionals

- Ensuring that generic firm recruitment processes sufficiently reflect the necessary attributes that are specific to audit.
- Enhancing the nurturing of the development of relevant disciplinary expertise in ways that prioritise intellectual curiosity and not just technical compliance.
- Reviewing the manner in which softer skills (such as psychological awareness and interpersonal capabilities) are developed and assessed through education, training and experience.

## **Managing the delivery of the audit as a professional service**

- Ensuring that audit teams exhibit a collective competence that goes beyond the generic standards and skills required of each individual auditor.
- Recognising that the overall effectiveness and sustainability of audit depends critically not just on the people employed as auditors but also on the structures within which such auditors work.
- Re-asserting the importance of auditing and associated skills and competencies to the identities and defining characteristics of professional firms and in relation to professional career development paths.



# ENDNOTES

- 1 Forbes Insights (2014), *Future role of audit: A more insightful audit for a more complex world*, Research report for the Global Public Policy Committee (GPPC).
- 2 An open call for research was issued and following a number of applications the following teams were selected to undertake two complimentary projects, using different research methodology and locations, to address the research question. The two teams were as follows:
  - Karin Barac (University of Pretoria), Elizabeth Gammie (Robert Gordon University), Bryan Howieson (University of Adelaide) and Marianne van Staden (University of South Africa).
  - Stuart Turley, Christopher Humphrey, Anna Samsonova-Taddei and Javed Siddiqui (Manchester Business School), Margaret Woods and Ilias Basioudis (Aston Business School) and Chrystelle Richard, (ESSEC Business School).
- 3 The questions of specific interest to ICAS and the FRC and outlined in the initial call for research were:
  - What is required of auditors today and what are they responsible for?
  - How do they currently deliver what is required of them and what should they be doing that they are not currently doing?
  - What skills and competencies are needed in order for auditors to execute a high quality audit?
  - Is there a need to reconsider the staffing model for the audit of complex businesses to incorporate, for example, individuals with relevant business experience within the audit team and, if so, what are the training implications thereof?
  - Is there a gap between firms' existing competency frameworks for auditors and the skills needed to achieve audit quality?
  - Are the recruitment models and development processes of the modern audit firm adequate to address future needs?
- 4 DeAngelo, L. E. (1981), 'Auditor size and audit quality', *Journal of Accounting and Economics*, 3(3), 183-199.
- 5 The research reports are available at [icas.com](http://icas.com) and [frc.org.uk](http://frc.org.uk). Details below:
  - Barac, K., Gammie, E., Howieson, B. and Staden, M.V. (2015), *The capability and competency requirements of auditors in today's complex global business environment*, ICAS and FRC, Edinburgh.
  - Turley, S., Humphrey, C., Samsonova-Taddei, A., Siddiqui, J., Woods, M., Basioudis, I. and Richard, C. (2015), *Skills, competencies and the sustainability of the modern audit*, ICAS and FRC, Edinburgh.
- 6 Treasury Select Committee (2009), *Ninth Report, Banking Crisis: reforming corporate governance and pay in the City*, May 2009, available at: <http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/519/51902.htm>.
- 7 European Commission (2010), *Green Paper, Audit Policy: Lessons from the Crisis*, October 2010, available at: [http://ec.europa.eu/internal\\_market/consultations/docs/2010/audit/green\\_paper\\_audit\\_en.pdf](http://ec.europa.eu/internal_market/consultations/docs/2010/audit/green_paper_audit_en.pdf).
- 8 Directive 2014/56/EU amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts and Regulation 537/2014 on specific requirements regarding statutory audit of public-interest entities, available at: [http://ec.europa.eu/finance/auditing/reform/index\\_en.htm](http://ec.europa.eu/finance/auditing/reform/index_en.htm).
- 9 Financial Reporting Council (2014, 2016), *The UK Corporate Governance Code*, available at: <https://frc.org.uk/Our-Work/Corporate-Governance-Reporting/Corporate-governance/UK-Corporate-Governance-Code.aspx>.  
<https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2016/April/Revised-UK-Corporate-Governance-Code-Guidance-on.aspx>.
- 10 Competition and Market Authority (2014), *Statutory Audit Services Market Investigation*, available at: <https://www.gov.uk/cma-cases/statutory-audit-services-market-investigation#orders>.
- 11 Financial Reporting Council (September 2014), *ISA (UK and Ireland) 700, The independent auditor's report on financial statements*, available at: [https://www.frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/ISA-\(UK-and-Ireland\)-700-The-independent-auditor's.aspx](https://www.frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/ISA-(UK-and-Ireland)-700-The-independent-auditor's.aspx).
- 12 Financial Reporting Council (2015), *Extended auditor's reports: A review of experience in the first year*, March 2015, available at: <https://www.frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/Extended-auditor-s-reports-A-review-of-experience.pdf>.  
Financial Reporting Council (2016), *Extended auditor's reports: A further review of experience*, January 2016, available at: <https://www.frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/Report-on-the-Second-Year-Experience-of-Extended-A.pdf>.
- 13 *IFAC Reporting on Audited Financial Statements – New and Revised Auditor Reporting Standards and Related Conforming Amendments*, available at: <https://www.ifac.org/publications-resources/reporting-audited-financial-statements-new-and-revised-auditor-reporting-stand#node-32595>.
- 14 *The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013*, available at: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/206241/bis-13-889-companies-act-2006-draft-strategic-and-directors-report-regulations-2013.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/206241/bis-13-889-companies-act-2006-draft-strategic-and-directors-report-regulations-2013.pdf)

- 15 Financial Reporting Council (September 2014), *Guidance on Risk Management, Internal Control and Related Financial and Business Reporting*, available at: <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Risk-Management,-Internal-Control-and.pdf>.
- 16 Financial Reporting Council (2014), *The UK Corporate Governance Code*, September 2014, available at: <https://frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf>.  
For a review of the impact of the implementation of FBU see Fraser, I. and Lee, B. (2016), *Fair, balanced and understandable: Enhancing corporate reporting and assurance?*, ICAS, Edinburgh, available at: [icas.com](https://www.icas.com).
- 17 The framework is available in the latest IAASB *Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*, available at: <http://www.ifac.org/publications-resources>.
- 18 The International Accounting Education Standards Board (IAESB) is an independent standard-setting body that serves the public interest by establishing standards in the area of professional accounting education that prescribe technical competence and professional skills, values, ethics, and attitudes. The education standards are included in the *Statements of Membership Obligations* produced by the Board of the International Federation of Accountants (IFAC). For further details, visit <http://www.ifac.org>.
- 19 For further information on current developments in this area please see the work of the Natural Capital Coalition: [www.naturalcapitalcoalition.org](http://www.naturalcapitalcoalition.org).
- 20 For further information on the IIRC see: <http://integratedreporting.org>.
- 21 For further information, please see the FRC 'Confidence in Audit' survey: <https://frc.org.uk/News-and-Events/FRC-Press/Press/2016/July/Confidence-grows-in-audit-but-more-needs-to-be-do.aspx>.
- 22 For further details, please see: <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/Culture-Project.aspx>.
- 23 Forbes Insights (2014), *Future role of audit: A more insightful audit for a more complex world*, Research report for the Global Public Policy Committee (GPPC).
- 24 This finding is also replicated in recent ICAS UK based research on the implementation of the 'fair, balanced and understandable' requirement introduced by the FRC. See Fraser, I. and Lee, B. (2016), *Fair, balanced and understandable: Enhancing corporate reporting and assurance?*, ICAS, Edinburgh, available at: [icas.com](https://www.icas.com).
- 25 In the UK the Department of Business, Energy & Industrial Strategy is currently consulting on the UK implementation of the EU Directive on disclosure of non-financial and diversity information. The Directive introduces European wide disclosure requirements for environmental, social, employee, human rights, anti-corruption and bribery matters, and Board diversity and one of the member state options is whether there should be assurance around the non-financial statements.
- 26 ICAS (2016), *A professional judgement framework for financial reporting: An international guide for preparers, auditors, audit committees, regulators and standard setters across business and not-for-profit sectors*, ICAS, Edinburgh, available at: [icas.com](https://www.icas.com).
- 27 ICAS, in its 2015 publication *The Power of One*, emphasises the importance of the individual accountant and states that no matter the career stage or level of seniority, every CA can have a strong role in shaping the culture and values of the organisations in which they work, available at: [icas.com](https://www.icas.com).
- 28 EY announced in 2015 that in the UK students will no longer be required to have a minimum of 300 UCAS points (equivalent to 3 B's) and a 2:1 degree classification to make an application. Instead, EY will use a new and enhanced suite of online 'strengths' assessments and numerical tests to assess the potential of applicants for 2016.
- 29 In the research this is often referred to as performance of a parallel audit.
- 30 The research reports are available at [icas.com](https://www.icas.com) and [frc.org.uk](https://www.frc.org.uk). Details below:
- Barac, K., Gammie, E., Howieson, B. and Staden, M.V. (2015), *The capability and competency requirements of auditors in today's complex global business environment*, ICAS and FRC, Edinburgh.
  - Turley, S., Humphrey, C., Samsonova-Taddei, A., Siddiqui, J., Woods, M., Basioudis, I. and Richard, C. (2015), *Skills, competencies and the sustainability of the modern audit*, ICAS and FRC, Edinburgh.

# CONTACT US

## ICAS

t: +44 (0) 131 347 0237

e: [research@icas.com](mailto:research@icas.com)

w: [icas.com](http://icas.com)

## FRC

t: +44 (0)20 7492 2300

e: [enquiries@frc.org.uk](mailto:enquiries@frc.org.uk)

w: [frc.org.uk](http://frc.org.uk)



CA House 21 Haymarket Yards Edinburgh EH12 5BH  
research@icas.com +44 (0)131 347 0100 icas.com



8th Floor 125 London Wall London EC2Y 5AS  
enquiries@frc.org.uk +44 (0)20 7492 2300 frc.org.uk