Audit Quality in Practice: A Study of Perceptions of Auditors, Audit Committee Members and Quality Inspectors

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**ABBREVIATIONS**

<table>
<thead>
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<th>Abbreviation</th>
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<tr>
<td>AC</td>
<td>Audit committee</td>
</tr>
<tr>
<td>AIDB</td>
<td>Accountancy Investigation and Discipline Board</td>
</tr>
<tr>
<td>AICPA</td>
<td>America Institute of Certified Public Accountants</td>
</tr>
<tr>
<td>AIU</td>
<td>Audit Inspection Unit</td>
</tr>
<tr>
<td>APB</td>
<td>Auditing Practices Board</td>
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<tr>
<td>AQF</td>
<td>Audit Quality Forum</td>
</tr>
<tr>
<td>ASB</td>
<td>Accounting Standards Board</td>
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<tr>
<td>CCG</td>
<td>Committee on Corporate Governance</td>
</tr>
<tr>
<td>ESB</td>
<td>Ethics Standard Board</td>
</tr>
<tr>
<td>FRC</td>
<td>Financial Reporting Council</td>
</tr>
<tr>
<td>FRRP</td>
<td>Financial Reporting Review Panel</td>
</tr>
<tr>
<td>GAAP</td>
<td>Generally accepted accounting principles</td>
</tr>
<tr>
<td>IAASB</td>
<td>International Auditing and Assurance Standards Board</td>
</tr>
<tr>
<td>ICAEW</td>
<td>Institute of Chartered Accountants in England and Wales</td>
</tr>
<tr>
<td>ICAI</td>
<td>Institute of Chartered of Accountants in Ireland</td>
</tr>
<tr>
<td>IDB</td>
<td>Investigation and Discipline Board</td>
</tr>
<tr>
<td>IFAC</td>
<td>International Federation of Accountants</td>
</tr>
<tr>
<td>IFRSs</td>
<td>International Financial Reporting Standards</td>
</tr>
<tr>
<td>IPO</td>
<td>Initial public offering</td>
</tr>
<tr>
<td>ISAs</td>
<td>International Standards on Auditing</td>
</tr>
<tr>
<td>ISQC1</td>
<td>International Standard on Quality Control 1</td>
</tr>
<tr>
<td>JDM</td>
<td>Judgement and decision making</td>
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<tr>
<td>PCAOB</td>
<td>Public Company Accounting Oversight Board</td>
</tr>
<tr>
<td>POB</td>
<td>Professional Oversight Board</td>
</tr>
<tr>
<td>POBA</td>
<td>Professional Oversight Board for Accountancy</td>
</tr>
<tr>
<td>QT B</td>
<td>Quality threatening behaviour</td>
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<tr>
<td>SOX</td>
<td>Sarbanes-Oxley Act</td>
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<td>URT</td>
<td>Under reporting time</td>
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The aim of this thesis is to provide insights into what the concept of audit quality means for a number of parties who have responsibilities for delivering, commissioning or evaluating audit quality in practice - auditors, AC members and quality inspectors concerning. It explores the influence of internal and external factors in the auditing setting on the construction of meaning of audit quality and how meaning is symbolised in practice. This research is based on an interpretive approach employing research methods of document analysis, semi-structured interviews and a survey questionnaire. Drawing on a symbolic interactionist framework, the research illustrates the process of giving meaning to audit quality in practice.

The study identifies various constructs that give meaning to audit quality in practice – auditors’ characteristics, firm’s characteristics, compliance obligations, the content and control of audit procedures, financial statement quality and client service orientation. It also identifies acts such as asking challenging questions, professional appearance, the quality of interaction between auditor and AC, consultation and training, and objects such as documents and records as fundamental in symbolising audit quality in practice. The study also highlights the existence of possible conflicts between some of these constructs of audit quality and the potential for problems in audit quality in practice.

The research reports that the audit practitioners predominantly framed their conceptions of the meaning of audit quality around four important constructs: client service, compliance obligations, the technical audit process or content, and individual auditors’ characteristics. Client service is found to have a particular importance for the practitioners’ meaning of audit quality. Their construction of the meaning for audit quality is influenced by interactions with other audit market constituents as well as by economic and societal forces in the auditing environment. Auditors perceptions of what quality means in practice are underpinned by factors such as the need to legitimise the conduct of the auditor, to restore trust and confidence in the public at large about the quality of audit services, to maintain profitability and the survival of the audit firm given the competitive and commercial pressures in the audit market, and to legitimise firm methodology and the resulting audit process to outside constituents.

Amongst the AC members interviewed, the meaning of audit quality appears to be associated with the characteristics of individual auditors, in particular, auditors’ interpersonal and behavioural skills, attributes of the audit firm (size and industry specialisation) and financial statement quality. The findings show that AC members perceptions of audit quality significantly depend on the ‘relational’ rather than the technical attributes of individual auditors. The quality of the financial statements also dominates the AC members’ perceptions of audit quality rather than a technical interpretation of the quality of the content of the audit process. The AC members’ conception of meaning for audit quality is influenced by interaction and communication with the external auditors.

For the quality inspectors, the meaning of audit quality is mainly constructed in relation to the conduct or content of an audit. Therefore, the level of challenge to the management of the audit, and the sufficiency of evidence and documentation are important for constructing their perceptions of audit quality. They also ascribe considerable importance to the internal compliance-quality control applied within the audit firm the notion of audit quality.
Overall, the study describes the multifaceted meaning of audit quality and how this is influenced and shaped by interactions – based on role expectations, self-image, economic and social factors – and illustrates the way in which various acts and objects are used to represent practical meaning for the abstract concept of audit quality in practice. These findings have relevance for auditors, other parties to audit engagements, policy makers and regulators concerned with the contribution of auditing to the financial reporting system and for academic researchers seeking to develop a deeper understanding of how that contribution is achieved in practice.
DECLARATION

No portion of the work referred to in the thesis has been submitted in support of an application for another degree or qualification of this or any other university or other institute of learning.

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Sincerest thanks also to all who facilitated and participated in the study but cannot be named.

I thank my husband, Mohammed Hilmy, my parents, my brothers, sisters and friends whose encouragement, inspiration and support have been vital.
DEDICATION

To the memory of my father Sulaiman Muhammad and my brother Aidrus Saidi Sulaiman
Chapter 1

Introduction

1.0 Subject of the Thesis

This thesis takes as its subject the manner in which audit partners, audit committee (AC) members and audit quality inspectors construct meanings for the concept of audit quality that could be influential in the conduct and evaluation of audit engagements in practice, and considers these meanings in the broader institutional and social context of practice. Concepts of audit quality have been examined extensively in research studies looking at the links between observable signals of auditor quality (such as the size of the audit firm or industry specialisation) and indicators of financial reporting quality (such as the issuance of modified audit reports or the quality of reported earnings) (see Francis, 2004 and Watkins, Hillison and Morecroft, 2004 for reviews of literature). In these studies, concepts of audit quality have been normatively defined and narrowed down to specific characteristics or decisions (Humphrey et al., 2007b) and the indicators quality of the audit are restricted to observable aspects of the resultant financial reports rather than the content of the audit process itself. In consequence, less is known about how auditors’ conceptualise the meaning of audit quality or what the term means in the conduct of the audit, that is, the behaviours and attributes that audit practitioners associate with audit quality. In addition, little information is available about the understanding of AC members and quality inspectors of the term and how it features in their evaluation process of audit quality. This study attempts to add to research on these issues.

The remainder of this chapter is set out as follows: section 1.1. provides brief insight into the regulatory framework for auditing in the UK; section 1.2 briefly introduces the issue of audit quality; section 1.3 outlines the research questions and describes the research approach; section 1.4 discusses the justification for this study; and finally section 1.5 describes the layout of the thesis with a summary of the contents of each chapter.

1.1 Regulatory Framework in the UK

In recent years there have been considerable developments in the auditing, financial reporting and governance regimes around the world, with the events involving Enron-Andersen and similar cases heightening the interest of regulators
and the public at large concerning auditing, financial reporting and corporate governance practices. The cases have raised concerns in several areas relating to the quality of audit performance, the integrity of financial statements, and the effectiveness of the AC to oversee both the financial reporting process and the external audit function. In response to these events, various changes to the regulatory regime for auditing and governance practices were made in the US and in other jurisdictions including the UK and the EU. The impact of the cases has been marked by the strengthening of the legal regulations governing auditing and reporting, for example through the passing of the Sarbanes Oxley Act (SOX) (2002) in the US and the Revised Eighth Directive for member states of the EU. These have introduced significant changes in various areas of auditing, reporting and governance practices and include independent inspections of listed companies’ audits, restriction of joint provision of audit and non-audit services, greater independence in the setting of auditing standards and strengthening the role of the AC in the financial reporting and auditing process.

Between the late 1980s and early 1990s some major changes had already been made in the regulatory regime for auditing, corporate reporting and governance in the UK. The changes were partly caused by corporate scandals (BCCI, Maxwell and Polly Peck) which happened at that time. In consequence, the auditing and reporting regime, which primarily comprised company law and self-regulation by the accountancy bodies, was supplemented with the establishment of the Cadbury Committee for corporate governance which led to the introduction of the Combined Code on Corporate Governance, and the Financial Reporting Council (FRC) with its various operating bodies, such as the Accounting Standards Board (ASB) and the Financial Reporting Review Panel (FRRP).

In 2002 the UK government once again undertook several reforms in its accounting, auditing and governance regime in response to Enron and other corporate failures because of concerns with quality of financial reporting, and the effectiveness of the audit process and the oversight role of the AC (CGAA, 2003). Against the backdrop of the corporate failures, the Higgs Committee Report and the Smith Committee Report were released in 2003. The Combined Code on Corporate Governance was also updated during that year (details background on corporate governance framework is discussed in section 2.4). The Accountancy Foundation, which was established by the accountancy professional bodies in 2000, was restructured and ceased regulating professional practice in auditing. In addition, the Ethics Standard Board (ESB) was dissolved. In 2004, three of its key boards – Auditing Practices Board (APB), Investigation and Discipline Board (IDB) and
Review Board – were transferred under the FRC to accommodate the new regulatory structure (see Figure 1.1).

**Figure 1.1: The Structure of Audit Regulation**

Adapted from Turley (2008)

Under the new structure, various operating boards were set up to oversee different aspects of regulatory responsibility. The new structure aimed to strengthen the audit profession, provide an effective system of auditing regulation and raise the standards of corporate governance. One of the most significant impacts of the new structure was to end self-regulation by the profession in favour of independent oversight and regulation of the profession within the FRC (Turley, 2008, p.210).

In December 2004, the APB introduced the International Standards on Auditing (ISAs) (UK and Ireland) based on the International Standards of Auditing (ISAs) issued by the International Auditing and Assurance Standards Board (IAASB). The APB also issued Ethical Standards on the auditor’s integrity, objectivity and independence that to be applied with ethical codes issued by the accountancy bodies. In October 2009 same changes were made in the ISAs (UK and Ireland) that are effective for audit for audits of financial statements for period endings on, or after, 15 December 2010.
In 2006, the Revised Eighth Company Law Directive on Statutory Audit was adopted by the Council of the European Union thereby driving another development in the auditing regime in the UK. Some of the key changes include requirements for audit firms to publish an annual transparency report and disclose information concerning the legal and ownership structure, internal quality control system and audit fees (Humphrey and Moizer, 2008). The adoption has also put emphasis on the importance of communication between the external auditors and the AC. The members’ states are also required to establish independent public oversight boards that are responsible for, among other things, monitoring the audit firm’s compliance with the applicable regulatory framework and audit quality. The most significant change that happened during this time was the establishment of the Audit Inspection Unit (AIU), which is part of the Professional Oversight Board (POB) with responsibility for the inspection of public interest audits and publication of the results of the inspections (more discussion about the AIU is available in section 2.3). The new regulatory framework has thus set new criteria for and placed new conditions on audit practice (Humphrey et al., 2007a).

The UK government has also undertaken a review that has led to the revision of the Companies Act 1985. In consequence, the Companies Act 2006 was issued and a number of changes were made. For example, the Act allows audit firms to limit their liability and establishes a criminal offence when a misleading audit report is issued. The Act also enhances the transparency of the audit process by requiring the name of the individual audit partners signing audit reports to be identified and increases the quality of information available regarding auditor resignations.

On the corporate reporting front, International Financial Reporting Standards (IFRSs) were introduced for financial statements of listed companies for the period beginning on or after 1 January 2005. Listed companies were required to disclose more information in addition to the audited financial statements (such as a Directors’ Remuneration Report, Directors’ Report and Statement of Compliance with the UK Corporate Governance Code), with consequent implications for the role of the external auditors who are now required to verify that information. Some accounting standards in the IFRSs require the use of fair value measurement, which requires a greater use of judgement (both by management and auditor) in the preparation and audit of financial statements (FRC, 2006b).

In concluding this brief outline on the regulatory framework in the UK, it is observed that significant changes have been made to the auditing regime as a specific response to the corporate collapses and auditing scandals. These
developments offer an interesting background to the subject of the thesis. Audit quality as the subject of the thesis will be briefly introduced in the next section.

1.2 Audit Quality

To understand company audits, it is helpful first to understand its rationale and the role played by the external auditors. Company audits exist because of a separation between the ownership and the control of companies in the modern economy where shareholders or owners have given resources to managers with the direction of maximising their wealth. Nonetheless, it is argued that opportunist managers have a propensity for not reporting the true state of the performance of the company, which could result in residual loss to the owners. Therefore, the role of the auditors is to reduce agency costs because of information asymmetry and competing interests between the two parties. For this reason, agency theory, which concerns the control and information asymmetry between the shareholders and managers, is normally used theoretically to legitimate the reason why company audit is important in the modern economy (Jensen and Meckling, 1976; Arnold and de Lange, 2004).

From the economic perspective, audit services are about reducing agency costs through the verification of financial statements by an independent auditor. The verification process involves the accumulation and evaluation of evidence, which later becomes a basis for the auditors to form their professional opinion or judgement on the financial statements. The result of the process, the audit opinion that is stated in the audit report, is believed to enhance the credibility and quality of the financial statements. It can be argued that the value of the audit services depends on the form of opinion issued by the auditors. In consequence, the value of the audit opinion depends on the quality of audit work carried out by the auditors (Moizer, 2005). Audit quality is important because it will affect the credibility and reliability of the audit opinion. If the auditors perform a poor audit, the opinion rendered about the audited financial statements could be misleading, and this would definitely affect the users’ economic decisions. In this discourse, audit quality is thought to protect the economic interest of the owners and other interested parties by enhancing the value of the financial statements prepared by the managers.

Concerns about audit quality and the factors that influence quality have been longstanding subjects of interest in academic, practitioner and regulatory debates about auditing. The objective of enhancing audit quality underlies standard setting
activities and doubts about the quality of audit have motivated investigations and other actions by regulators (see for example, Panel on Audit Effectiveness, 2000; FRC, 2006b and 2008). In like manner, academic research has examined the links between various factors and the possibility of quality differentiation between audit firms. Much of the research literature investigating audit quality relies on the definition proposed by DeAngelo (1981a), that audit quality is the market-assessed joint probability that a given auditor will both: (i) identify a breach in the client company’s accounting system and (ii) report that breach, that is, that the auditor has both the technical competence to detect any material errors during the audit process, and the independence to ensure that material errors and omissions are corrected or disclosed in the auditor’s report. Following DeAngelo, who also argued that because evaluating audit quality is costly, less costly surrogates or proxies such as firm size and reputation will be used as indicators of audit quality, research studies have frequently employed surrogates to test the effects of the independence and competence of the auditors. Although mixed results have been reported, prior research has showed that factors such as industry expertise, the amount of non-audit services, tenure and size of the audit firm may be associated with variations in audit quality (details about studies related to audit quality are presented in Chapter 2).

Notwithstanding the important contribution of archival and other studies which, following a rationalist economics perspective, have looked for systematic evidence that audit quality is influential in audit contracts, some have argued that this approach neglects the wider social, political and historical contexts of auditing (Power, 1996; Humphrey, 2008). The dominance of a functionalist or positivist approach may constrain our understanding of actual auditing practices (Dirsmith et al., 1985). As a result, the importance of the social and institutional dimensions of auditing has increasingly been recognised and incorporated into research studies (Humphrey and Moizer, 1990; Carpenter and Dirsmith, 1993; Curtis and Turley, 2007; Hudaib and Haniffa, 2009). Despite the development of studies that place greater emphasis on understanding audit practice in its context, so far little attention has been given to exploring how the meaning of the concept of audit quality is constructed in practice in the context of the institutional and social environment of the audit setting. Specifically, little evidence is available about how audit practitioners translate the general concept of audit quality into behaviour that affects the actual conduct of the audit in practice, that is, what audit quality means to those who carry out audit engagements. Likewise, limited evidence is available about AC members and quality inspectors understanding of the term of audit
quality or how AC members and quality inspectors, who have oversight responsibilities for auditing and financial reporting, assess the quality of the work performed by external auditors. These issues are essentially the subject of this thesis, which aims, through documentary analysis, semi-structured interviews and a survey questionnaire to enhance understanding concerning the meaning of audit quality in practice.

1.3 Research Questions and Research Approach

The main objective of this study is to understand the meaning of audit quality in practice. The first research question seeks to advance the understanding of the concept of audit quality from the perspectives of those who deliver the audit services, that is, the audit partners, and those who are responsible for commissioning and monitoring the audit services, that is, the AC members and quality inspectors:

Research question 1: How is the concept of audit quality understood and applied by key participants in the audit process?

This study approaches auditing practice as not only a technical activity but also a socially constructed activity. Perceptions and beliefs about audit quality are seen as emerging from a complex series of interactions between various constituents in the auditing environment, influenced by regulatory, societal and economic factors in the auditing environment. The study also concerns the representations of the meaning of audit quality in practice, that is, to understand how various symbols (words, objects and acts) are used to represent the meaning of audit quality. Hence, the study attempts to answer the following research questions:

Research question 2: What are the factors that influence the construction of the meaning of audit quality in practice?

Research question 3: How is the meaning of audit quality represented in practice?

The final set of questions aims to enhance knowledge about the impact of auditing and governance reforms on audit quality. Two further sets of more specific questions are developed to support investigations into this issue.

Research question 4: What is the impact of the AIU on audit quality?

Research question 5: What is the impact of the AC on audit quality?
An analytical framework, which has been developed based on symbolic interactionism, is used to address these research questions. The framework facilitates the development of an understanding of the social meaning of audit quality in its institutional and social context. Semi-structured interviews are employed as the main research method because this allows for in-depth, contextualised study, which is appropriate to address the research questions. A survey questionnaire and archive documents from the public domain including the FRC Discussion Paper and the AIU Annual Inspection Reports are also examined to provide additional evidence from which to address the research questions.

1.4 The Justification and Importance of the Study

As reported earlier, the objective of this thesis is to revisit the meaning of the concept of audit quality and to understand the representation of that meaning in practice. It also investigates the influence of internal and external factors in the audit environment on the construction of the meaning. The motivation for undertaking this study is because there has been no extensive in-depth research that simultaneously explores the practical meaning of audit quality from the perspectives of the audit partners, AC members and quality inspectors. There is also limited in-depth investigation that explores the influence of a range of contextual factors in the auditing setting that may influence the perceptions of audit quality held by audit partners, AC members and quality inspectors. The current auditing and governance environments also provide an interesting context in which to study the issue of audit quality. The importance of the study can be summarised as follows:

1) It adds to and extends the existing body of knowledge on audit quality literature, in particular by providing evidence drawn from audit practice in the UK and by employing the interpretive approach rather than the mainstream or functionalist approach.

2) It will furnish further insights into prevailing factors that affect audit practices and concept of audit quality.

3) It will help regulators, corporate managers, society, practitioners, and academicians to gain a better understanding of the nature and factors that might affect audit quality.

4) It will empirically inform the debate surrounding the potential benefits of direct regulation of audit practices to promote a high quality of audit.

5) It will assist in comprehending the role of the AC members in promoting high quality auditing.
1.5 Structure of the Thesis

This section shows the organisation of the thesis. Chapter 2 reviews the literature and other documentary records that are relevant to the notion of audit quality. This then leads to a discussion and the identification of gaps in the analysis of the literature, that is, the lack of research examining the meaning of audit quality within the institutional and organisational context of audit practice.

Chapter 3 outlines both the theoretical framework and research design employed in this study. Symbolic interactionism is presented, which provides a framework for the analysis and understanding of the empirical work in the study. This provides a basis to consider the complex interaction between auditors and other audit market constituents and environmental factors that influence the meaning of audit quality in practice. This chapter also describes the interpretive research approach that underpins the research methodology, which guides the research design for the study.

Chapter 4 presents the findings of the first stage of the study, which describes views about audit quality expressed in responses of interested parties on the discussion paper, entitled ‘Promoting Audit Quality’ issued by the FRC in 2006. An analysis of the key issues raised by respondents is presented and becomes the basis for further investigation in the second stage of study, which involves semi-structured interviews and a survey questionnaire.

The subsequent three chapters discuss the empirical work of the second stage of the study. The chapters explain the findings regarding the conception of the meaning of audit quality, factors influencing construction of that meaning and the representation of audit quality in practice. Evidence collected from audit partners, AC members and quality inspectors is presented in Chapters 5, 6 and 7 respectively. The potential impact of the role of the AC members and quality inspectors to audit quality are also discussed.

Finally, Chapter 8 provides the conclusion of the empirical work of the study. Critical issues with regard to perceptions of audit quality in the organisational and social context in which auditing is conducted are highlighted. This chapter concludes the thesis by considering the contributions and limitations of the study and by making suggestions for future research.
Chapter 2

Perspectives on Audit Quality

2.0 Introduction

The previous chapter presented a brief overview of research relating to audit quality. It introduced the research area and discussed the background to the research problem. The purpose of this chapter is to review a number of major approaches to researching audit quality that have been applied or areas of research that are relevant to audit quality. The literature on inputs and outcomes related to audit quality, audit process, perceptions of audit quality and audit quality in an organisational and social context are evaluated. The evaluation of research concerning inputs and outcomes related to audit quality, audit process and perceptions of audit quality contribute to our current understanding regarding the concepts and definitions of audit quality, factors or situations that affect audit quality in practice, and the perceptions of various participants in the auditing environment concerning audit quality. Evidence shows limited evaluations of the concept and definition of audit quality from those involved (such as audit practitioners, AC members and audit quality inspectors) in the audit process. Evaluation of studies of auditing practice in its organisational and social context has contributed to our understanding concerning the relationship between the audit practice and notion of audit quality, which highlights the issues of legitimacy, image management and conflicts in practice. Evidence reveals that limited studies appear to have addressed wider organisational and institutional dimensions in investigating the concept of audit quality in practice.

This chapter also reviews other documents and publications relevant to audit quality that are primarily drawn from the arena of regulatory policy on auditing. It examines practitioner and regulatory conception of audit quality. The purpose is to develop an understanding of the multiple perspectives ascribed to audit quality and provide a broader viewpoint of the various debates that affect this investigation. The literature on ACs in association with audit quality and documents relevant to AC are also reviewed, which contribute to our understanding about their roles, operations and effects. The review shows that the responsibility of ACs for overseeing audit quality appears to be expanding as a result of the changes in the corporate governance framework. Evidence concerning their effects on the external audit function is evaluated recognising that there is limited understanding regarding
the processes associated with the operation or activity of ACs and the manner in which they influence audit quality in practice.

The remainder of this chapter is structured as follows. Section 2.1 reviews research studies that are relevant to audit quality and a number of themes under this topic are considered. In particular, it draws attention to the limits of the conventional vision of audit quality and related research approaches and to the socially constructed nature of audit practices, thus highlighting the need for research in understanding audit quality within its organisational and social context. This part of the chapter will argue that this approach to auditing research may have the potential to illustrate some additional and different aspects of audit quality in practice. Section 2.2 reviews professional perspectives of audit quality and section 2.3 reviews regulatory perspectives of audit quality, both of which perspectives recognise broader aspects of audit quality. Section 2.4 evaluates prior literature on ACs that examines the AC process and its impact on audit quality. Section 2.5 discusses the implications of the review for the current study. This forms the basis for formulation of the research questions and developing the research objectives of the thesis. Finally, section 2.6 provides a summary of the chapter.

2.1 Research Approaches to Audit Quality

The concept of audit quality has proved difficult to define with certainty. It is not immediately or directly observable and is difficult to measure (Power, 1997). Moreover, audit markets’ participants have conflicting roles and different expectations that lead to different interpretations of audit quality (Sutton, 1993). As a result, different people tend to have different definitions and ways of measuring it (Rasmussen and Jensen, 1998; Watkins et al., 2004), which suggests ambiguity and subjectivity in the term audit quality, as recognised by the FRC:

“There is no single agreed definition of audit quality that can be used as a ‘standard’ against which actual performance can be assessed” (FRC, 2006b, p. 16).

The regulator in the UK and professional practitioners have never defined the term precisely although various initiatives have been built around the term and serve to influence contemporary understandings of such concepts (both practitioner and regulatory perspectives on audit quality are discussed in section 2.2 and 2.3, respectively). The professional literature is inclined to define audit quality in relation to meeting the requirements of the auditing standards during the course of the audit (Krishnan and Schauer, 2001; McConnell and Banks, 1998). In comparison,
various academic research approaches that are relevant to audit quality (see Figure 2.1) have defined and measured audit quality in a number of ways, involving a combination of measures linked to audit outcomes, such as audit failures (Feroz et al., 1991) and the quality of financial reporting (Becker et al., 1998; Gul et al., 2003), process measures that are related to auditor performance (Sutton, 1993; Malone and Roberts, 1996), and to capture quality attributes of relevance to users and preparers of financial statements (Schroeder, 1986; Carcello et al., 1992; Duff, 2009). One research approach takes into account the influence of the organisational and social context of auditing practice. This line of research questions the influence of people, processes and the audit environment such as the role of regulation, AC members, audit clients and professional bodies to audit practice. This thesis essentially adopts this approach as a basis for the research. In the remaining part of the section, various approaches to audit quality are discussed.

Figure 2.1: Aspects to Audit Quality

2.1.1 Research Approaches derived from DeAngelo’s Definition of Audit Quality

A significant body of literature dealing specifically with audit quality has developed from DeAngelo’s (1981a; 1981b) studies of independence and the competence of auditors of large audit firms. Much of the research literature investigating audit quality relies on the economic view represented in the definition proposed by DeAngelo (1981a, p. 186) – that audit quality is the market-assessed joint
probability that a given auditor will both (i) ‘identify a breach in the client company’s accounting system’ and (ii) ‘report that breach’ – that is, the auditor has both the technical competence to detect any material errors during the audit process, and the independence to ensure material errors and omissions are corrected or disclosed in the auditor’s report. Thus, audit quality is connected to both the actuality and the perceptions of two important determinants of audit quality: competence and independence. Following DeAngelo, who argued that assessing audit quality is costly because of the limited ability of the consumers to observe audit procedures used in an audit engagement and the limited information about incentives within the auditor-client contract, she proposed the use of auditor size as a surrogate for auditor quality. She also argued that the larger audit firms are of better quality compared to other auditors because they have less economic reliance on any single client. Moreover, incentives for larger audit firms to reduce audit quality will be lower because of the economic importance of maintaining reputation (larger audit firms with greater numbers of audit clients may have ‘more to lose’ if they fail to detect and report material errors and omissions).

Inputs and Outcomes Related to Audit Quality

A number of strands of research that are largely built on DeAngelo’s definition of audit quality can be recognised and these are summarised in Figure 2.2. The main theme of research in this area involves the consideration of the relationship between measures of ‘output’ quality (such as quality of earnings and regulatory sanctions) and various ‘input’ related variables (such as audit firm size, audit fees and audit tenure).

Figure 2.2: Inputs and Outcomes Related to Audit Quality
Failure to deliver adequate output quality has been inferred from sources such as auditor litigation (Palmrose, 1988) and the imposition of regulatory sanctions (Feroz et al., 1991). Financial reporting quality has been linked to the auditor’s ability to improve the credibility of earnings (Becker et al., 1998; Gul et al., 2003), the accuracy of the audit opinion (Ruiz-Barbadillo et al., 2004), the probability that the auditor will not issue an unqualified opinion for financial statements containing material misstatements (Lee et al., 1999), and the accuracy of the information reported by the auditor (Davidson and Neu, 1993). Input factors that have commonly been tested for evidence of an association with variation in these outcomes include the size of the audit firm, audit fees (as an indicator of audit effort), whether the firm is a specialist in the industry and whether the degree of auditor independence is threatened by the presence of fees from non-audit services and long audit tenure. Although mixed results have been reported, prior research has recognised audit fees, the amount of non-audit services and audit tenure as input factors that may be associated with variations in audit quality.

Audit firm size has been the most commonly studied surrogate for audit quality. It is argued that the larger audit firms are higher quality than the smaller firms for various reasons. First, larger firms are able to hire highly skilled employees because of their reputation. In addition, the larger firms are also able to provide rigorous training for their staff, which contributes to the development of the skills and knowledge of the auditors. Second, it is also argued that more developed and structured audit approach or methodology applied by the larger firms increases their ability to issue accurate audit opinions through greater detection of errors and omissions (Carcello et al., 1995). However, other studies provide limited evidence on the association between the structured audit approaches and the type of opinions rendered (Mutchler and William, 1990).

One of the most common approaches that have been widely investigated in this area is the association between audit firm size and various attributes associated with the quality of financial reporting. Researchers hypothesize that the clients of big size audit firms report more accurate financial information and less earnings management. Large audit firms, such as the Big Four, are argued to be more likely to issue a more accurate opinion and their audit clients to experience fewer restatements of financial statements and be subject to fewer regulatory sanctions (Feroz, 1991).
Big size firms are said to be more conservative in reporting because they have more incentives to reduce litigation loss in order to maintain their professional reputation and independence (DeAngelo, 1981a; DeFond et al., 2002) and are less likely to be economically dependent on a single client (Pearson, 1980). In this context, it is predicted that a higher quality auditor is more likely to control inappropriate behaviour of the client’s management and, thus, more likely to control earnings manipulation and ensure accurate financial information is issued.

Using archival data, some results support the hypothesis that big size auditors are associated with a lower incidence of earnings management (Becker et al., 1998; Kim et al., 2003). Similarly, a few published studies show that reported earnings forecasts of companies audited by big size auditors are more accurate than non-big size auditors, implying more accurate financial information (Chen, Lin and Zhou, 2005; Lee et al., 2006). In contrast, some studies find no significant difference in the reported discretionary accruals of clients audited by the differing size of firms (Jeong and Rho, 2004; Caneghem; 2004; Maijoor and Vanstraelen, 2006).

Kim et al. (2003) concluded that big size audit firms have more incentive to deter aggressive earnings management when: i) there is a conflict or convergence of reporting incentives (income-increasing accounting choices) between corporate managers and external auditors; and ii) there is high litigation risk for failure to detect income overstatement. They argued that when auditors face these two situations auditors of the big size audit firms exercise a high degree of professional scepticism to restrict the aggressive behaviour of corporate managers compared to the smaller firms.

Using archival data from firms listed on the Korea Stock Exchange from year 1994 to 1998, Jeong and Rho (2004) found no significant difference in the reported discretionary accruals of companies audited by either the then Big Six or non-Big Six auditors. This finding is also consistent for companies that switch from non-Big Six to Big Six auditors and vice versa. The results show that there is no quality differentiation between different sizes of audit firms in Korea. In addition, the size of audit firms does not influence variation in the quality of financial reporting (in terms of reported discretionary accruals). Similarly, Caneghem (2004) found a negative association between the size of audit firms and the financial reporting quality based on a sample of listed companies in the UK. He concluded that the relationship between audit quality and the financial reporting quality are rather inconclusive because of weak support for audit firm size ability to restrict earnings management.
Maijoor and Vanstraelen (2006) undertook a comparative study to investigate the issue of earnings management in a European context. They examined the effects of national audit environment, audit firm quality (using proxy of audit firm size) and reliance on international capital markets on earnings management activities. Using data from firms in France, Germany and the UK, they discovered that the magnitude of earnings management practices varies across the three countries. Their study found three important findings. First, stricter national audit environments play a significant role in constraining earnings management activities regardless of the size of the audit firms between the three countries. Second, the influence of big size audit firms on earnings management activities only exists in the UK because of a stricter investor protection environment but not in France or Germany. Finally, firms that rely on international capital markets are associated with a higher level of accruals, which implies that NYSE listing does not deter earnings management. Overall, they concluded that monitoring strength by big size auditors on discretionary accruals is not uniform across the three countries.

A few published studies have used earnings forecasts during the initial public offering (IPO) to investigate the relationship between proxies of audit quality and the financial reporting quality. Chen, Lin and Zhou (2005) provided evidence that suggests that big size and specialist auditors are associated with high quality financial reporting. Using data of Taiwan IPO firms, analysis reveals that the clients of the Big Five auditors reported less unexpected accruals. The result implies that specialist and big size auditors are able to mitigate earnings management, and, thus, contribute to more accurate financial information.

Lee et al. (2006) carried out a study to evaluate the relationship between the size of audit firms on both the accuracy and conservatism of audited earnings forecasts provided in the Australian IPO prospectuses. Using a sample of 215 firms, from year 1991 to 1998, they found that earnings forecasts reported and audited by the then Big Six firms are more accurate than smaller firms. They found that big size auditors are more conservative on reported earnings forecasts, which indicates a high quality of financial reporting.

Prior research shows that larger audit firms receive larger audit fees compared to smaller firms. It is argued that larger audit fees reflect high audit quality through greater audit effort, which influences the ability of the auditors to detect material misstatements (Elitzur and Falk, 1996) and constrain earnings management (Caramanis and Lennox, 2008). In a similar manner, the additional premium associated with larger audit fees is believed to be related to specialised knowledge.
of a particular audit firm that contributes to high audit quality (Palmrose, 1986; Balachandran and Simon, 1994). The larger audit firms with greater clientele within the same industry are believed to have in-depth understanding of the nature of business and risks in that particular industry. Nonetheless, the evidence is mixed and several studies have been unsuccessful in identifying an association between audit fees and auditor effort that are associated with higher audit quality (Dye, 1993; Hoitash et al., 2007). Moreover, the premium on audit fees might be attributed to brand name value or at least the perception of higher quality audit rather than expertise relating to their industry specialisation.

A study by Caramanis and Lennox (2008) examined the effects of audit effort (using proxy of audit hours worked) on quality of earnings. Using analysis from a database of hours worked by auditors on 9,738 audits in Greece between year 1994 and 2002, their study showed that lower audit hours are associated with positive and larger abnormal accruals. In addition, when an audit effort is low managers are more aggressive in managing earnings in order to meet or beat the earnings benchmark. Their findings also showed a significant negative relationship between audit hours and income-increasing earnings management for Big Five firms, which means that big size auditors exert more audit effort (work longer hour) and are able to monitor aggressive earnings management. They concluded that lower audit effort gives an opportunity for managers to aggressively manage their reported earnings.

Some studies have examined the impact of non-audit fees on the competence and independence of auditors. This area of research concerns whether the provision of non-audit services would impair auditors’ independence through economic dependence on a client because of large fees unrelated to the audit. The research also concerns whether the provision of non-audit services will lead to higher audit quality as a result of ‘knowledge spillover’ or whether auditors gain greater understanding of the client and their business processes because of additional services. In general, past research has documented inconsistent results concerning the association between high non-audit service fees and erosion of auditor independence that reduces audit quality (Frankel et al., 2002; Kinney et al., 2004). In similar manner, prior research has shown mixed results concerning the potential beneficial impact of non-audit services on audit quality (Simunic, 1984; Wu, 2006).

Beyond the focus on auditor size, some studies have examined the impact of auditor tenure (Ghosh and Moon, 2005; Stanley and DeZoort, 2007; Manry et al., 2008), and audit and non-audit fees (Frankel et al., 2002; Gul et al., 2006; Lim and
Tan, 2008) on financial reporting quality. There are two main competing opinions in relation to the impact of audit tenure on audit quality. First, some researchers posit that long audit tenure is related to high audit quality through the auditors’ enhanced ability to detect misstatements and errors because of the greater understanding of the client’s business and processes (Johnson et al., 2002; Manry et al., 2008). It is argued that longer audit tenure and the provision of non-audit services would increase audit quality because of the increased knowledge of specific audit clients that is negatively related to the likelihood of financial restatements. While, others assert that long tenure could reduce audit quality for the reasons of complacency or less rigorous audit procedures that reduce auditors’ capacity to detect errors and misstatements (Shockley, 1982; Deis and Giroux, 1992). Some researchers argue that longer audit tenure and high provision of non-audit services would impair auditor independence and, consequently, reduce the propensity of the auditors to issue an accurate audit opinion.

Ghosh and Moon (2005) employed a market-based approach and evaluated the impact of auditor tenure on perceptions of financial statement users concerning the quality of earnings. Specifically, they investigated the perceptions of investors, independent rating agencies, and financial analysts on the impact of auditor tenure on earnings response coefficients from returns-earnings regressions (as a proxy for earnings quality). They found that the investors and financial analysts perceived that longer audit tenure could enhance audit quality. In contrast, the independent rating agencies perceived the unfavourable impact of auditor tenure on earnings quality.

Using non-audit services as a proxy of audit quality, Gul et al. (2006) hypothesized that there is an inverse relationship between non-audit services provided by a firm’s auditor and the earnings quality (measured as the earnings response coefficient) and this relationship is weaker for firms audited by Big Six auditors. Using archival data, from 840 firm-year observations of Australian companies, they found support for the hypothesis; earnings response coefficient is negatively associated with non-audit services as indicated by a negative and significant coefficient on the earnings. The results imply that investors perceived non-audit services affect the credibility of financial statements, but the adverse perception will be less profound if the financial statements have been audited by Big Six auditors.
In general, prior research has documented mixed results on the relationship between audit tenure and audit quality. Again, the evidence of the linkage between the surrogates of audit quality and financial reporting quality provides inconsistent results.

Academic researchers have also investigated audit quality from the analysis of audit failure cases. It is expected that higher audit quality is reflected through less litigation as a consequence of audit failures through auditors’ ability to detect and report material misstatements. For example, Palmrose (1988) examined 472 sample of legal cases related to audit-related litigation against Big Eight and non-Big Eight firms in the US from 1960 through 1985. She found that big size audit firms were associated with less incidence of litigation than other types of audit firm. There are also some studies that employ a case study observation to examine the content of an individual case of a company or audit firm in detail (Erickson et al., 2000; Fuerman, 2004). For example, Erickson et al. (2000) examined detailed legal documents (audit working papers and auditor deposition testimony of auditors) of audit failure of Lincoln Savings and Loan (LSL) in the US. They concluded that lack of knowledge and understanding of auditors in LSL's business and operations contributed to a deficiency in audit procedures, and, consequently, led to audit failure.

Literature on individual auditors tends to focus on the impact of auditor’s professionalism on audit performance. Catanach and Walker (1999) suggest that audit quality is a function of auditor performance that can be classified into two main aspects. First, the professional ability that is related to auditors’ ability to detect material misstatements and omissions of accounting matters that depends on auditor's professional attributes such as technical competence, knowledge, experience, industry specialisation and technological proficiency. These professional attributes are acquired by way of advanced education, training and experience, which characterise auditors as members of a profession (Burns and Haga, 1977). In a similar manner, the Auditors’ Code (APB, 2004b) requires that auditors act with professional skill, which is derived from their qualification, training and practical experience. In this case, auditors are required to have in-depth understanding of financial reporting and business issues, together with expertise in accumulating and assessing the evidence necessary to form an audit opinion. Empirical research, such as the experimental study by Owhoso et al. (2002), suggests that auditors with specialist knowledge are better able to detect both mechanical and conceptual errors in the financial statements. Similarly, an earlier experimental study by Solomon et al. (1999) provides evidence that auditors’ specialist knowledge
deriving from training and direct experiences influences their ability to detect errors in the financial statements.

Second, audit quality is connected to professional conduct, which embraces attributes that may include independence, integrity, objectivity and due professional care (ISA 200 UK and Ireland; Catanach and Walker, 1999). The conceptual framework issued by the IFAC (2005) defines independence as comprising two main aspects. First, independence is an attitude of mind that relates to auditors acting with integrity and exercising objectivity and professional scepticism in his/her professional work. Second, independence in appearance concerns the public perception of potential conflicts of interest that compromise independence in mind. This aspect of professionalism is important for the auditor to report impartial audit opinions by way of resisting client management pressure and being aware of what is right and what is wrong in his/her professional conduct (The Auditors’ Code). Independence is also important for the audit profession because it is related to the credibility of the audit opinion and the financial statements. Suddaby et al. (2009) suggest that auditor independence has long been claimed as a core professional value by the auditing profession, which governs their performance and behaviours that demonstrate audit quality.

Overall, much of the research in the area of audit outcomes has used a market based data and tests the association between certain proxies of audit quality and the related outcome such as the quality of financial reporting (for example the extent of earnings management) and case analysis. In general, the research has been conducted under the implicit assumption that the proxies of audit quality, particularly audit firm size, equate to high audit quality, but has yielded mixed results. Nonetheless, the collapse of Arthur Andersen and the banking crisis in recent years suggest the need to revisit this assumption. This potentially highlights the limited usefulness of audit firm size as a proxy of audit quality, as indicated by the FRC and AICPA – that there is no quality differentiation between the sizes of the audit firm. Despite the contribution of this area of research in enhancing our understanding of audit quality from the perspective of the correlation between the proxies of audit quality and financial statements properties (such as abnormal accruals), it provides limited information about audit practices that contribute to high audit quality. This suggests the need for additional research beyond the association between the proxies of audit quality and related outcomes. The next section discusses other research approaches that relevant to audit quality.
**2.1.2 The Audit Process and Audit Quality**

Prior literature on the audit process that is relevant to understanding audit quality can be categorised into three main fields of enquiry: first, research on audit procedures as a representation of what auditors do, second, studies of the nature of auditors’ judgement and decision making and third, investigation of the prevalence of behaviours which may threaten or undermine audit quality. These are shown in Figure 2.3 and discussed briefly next.

**Figure 2.3: The Audit Process and Audit Quality**

![Diagram showing the audit process and audit quality](image)

**Audit Procedures**

Turley (1985) classifies two broad areas in researching audit process: studies of audit procedures and studies of auditor judgement. Studies of audit procedures include descriptive studies about audit methods used in practice, studies evaluating methods, decision aids and other tools used in practice and studies which aim to develop or test new techniques (Curtis, 2006). Cushing and Lobbecke (1986) examined materials (such as audit manuals, monographs, training materials, questionnaires and checklist) of 12 large firms in the US, which showed the existence of differences in ‘structure’ between the firms. They suggested that firms with structured audit approaches have: “a systematic approach to auditing characterised by a prescribed, logical sequence of procedures, decisions, and documentation steps, and by comprehensive and integrated set of audit policies and tools designed to assist the auditor in conducting the audit” (pg. 32). This study contributed to the identification and classification of audit methodologies used in practice as structured, semi-structured, partially structured and unstructured (Curtis, 2006).
Different audit approaches are argued to have different effects on audit performance. Bowrin (1998) reviewed the literature concerning audit structure and identified the positive impacts of structured approaches on audit effectiveness, audit efficiency and the audit firm’s litigation threat, improvement in consensus of auditor judgements and the accuracy of audit decisions. Nonetheless, prior literature has produced mixed findings about the relationship between audit structure and its potential benefit on various aspects of audit performance (Bamber & Snowball, 1988; Morris & Nichols, 1988; Mutchler and Williams, 1990; Icerman and Hillison, 1991). For example, Bamber and Snowball (1988) conducted a field experiment with 113 audit seniors and examined the impact of different audit structure (structured vs. unstructured) on the consensus of auditor judgements and auditors’ use of coordination and control mechanisms in their audit performance. They found limited impact of a structured audit approach to judgement consensus but auditors from structured firms use greater coordination and control mechanism (such as consultations with peers or audit managers) when faced with greater uncertainty in the conduct of the audit compared to auditors from unstructured firms.

Mutchler and Williams (1990) studied the relationship between audit technology and audit firms going concern opinion. They found that client risk profiles rather than audit technology had greater influence on auditor judgement. Morris and Nichols (1988) provided evidence of a positive association between a structured audit approach with auditor judgement consensus on materiality decisions based on the examination of information (interest capitalization decisions) in published annual reports. Chow et al. (2006) found evidence of differences in structure of the audit process between Big Four firms and national firms in China. They suggested that differences in the structure of the audit process may potentially contribute to variability and inconsistency in audit performance across auditors and audit engagements.

In an experimental study, Bamber and Ramsay (2000) evaluated the impact of auditors’ specialization on workpaper review process performance. They found that auditors’ specialization did not facilitate a more efficient review process. Agoglia et al. (2009) investigated the impact of audit review format on the quality of reviewers’ judgements. They found that the reviewer’s judgements were affected by the form of review format (face-to-face review vs. electronic review) prepared by the preparers.
**Auditor Judgement and Decision Making**

Auditor performance is also reflected in the extensive literature on judgement and decision making in auditing, which focuses on the quality of auditors’ decisions (Knechel, 2000). An earlier review of the literature by Libby and Luft (1993) classified the effects of knowledge, ability, motivation, and environment that enhance our understanding on potential factors that could affect auditor performance. Solomon and Trotman’s (2003) reviewed of this literature identified the impact of the following topics: multi-person judgement, heuristics and biases, knowledge and memory, probabilistic judgement, environment and motivation, and policy capturing on auditors’ judgement and decision making. Recently, Nelson and Tang (2005) reviewed this literature and classified the impact of three broad categories: audit tasks, auditor attributes and the interaction between auditor and other stakeholders on auditors’ judgement and task performance.

Meixner and Welker (1988) examined the impact of auditor experience on judgement consensus. They found that the level of judgement consensus among participating staff auditors increased with situational and organization experience. In other words, the length of time that staff auditors had been associated with the same audit managers and auditor’s office impacted on the judgement consensus. Kaplan (1985) investigated the impact of combining the evaluation of internal control and audit planning judgments on the auditors’ consensus of the planned number of audit hours. They found no significant difference in the level of consensus on audit hours between groups that performed both tasks and groups that only performed audit planning judgements. An experimental study by Trotman and Yetton (1985) found evidence that the review process significantly reduced judgement variance. They did not find a significant difference in performance in the review process relative to the interacting group (senior and manager) or composite group (two seniors).

Robertson (2010) found evidence of the influence of audit clients on auditor judgement. He showed that clients that used ‘ingratiation’ (a strategic influence tactic) were able to influence auditors to meet their demand. Trotman et al.’s (2005) experimental study, which involved forty-five managers and partners, examined the impact of intervention methods (role-playing, passive consideration of the client’s interests and options, and practice) on the client negotiations process concerning inventory write-down. They provided evidence of the potential benefits of the methods on the auditor’s negotiation ability.
In the absence of definitive measures of the quality of audit judgements, researchers tend to focus on the consistency and consensus of auditor decisions, that is, whether different auditors faced with similar situations will make the same decision. Most of the research involves methodology based on experimental settings for capturing and testing judgement of individual auditors and factors that may be influential to judgements.

**Quality Threatening Behaviour**

One line of research related to auditor performance has focused on identifying factors that would undermine audit quality by way of quality threatening behaviour (QTB) (see Table 2.1 for more examples of QTB). Literature defines QTB or dysfunctional behaviour\(^1\) as actions that could impair the ability of the auditor to detect material errors (Kelley and Margheim, 1990). Herrbach (2001) defines dysfunctional behaviour as actions taken by an auditor during an engagement that reduce evidence-gathering effectiveness inappropriately. While Malone and Roberts (1996) define it as the auditors’ failure to properly execute audit steps.

### Table 2.1: List of Specific Quality Threatening Behaviour

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<th>Quality Threatening Behaviour</th>
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<tr>
<td>- Premature sign off</td>
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<td>- Reducing the amount of work performed below what auditor would consider reasonable</td>
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<tr>
<td>- Failing to research accounting principles</td>
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<tr>
<td>- Making superficial reviews of client documents</td>
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<tr>
<td>- Accepting weak client explanations</td>
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<tr>
<td>- Bias in sample selection</td>
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<tr>
<td>- Reduction in sample size</td>
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<tr>
<td>- Reduction in amount of documentation</td>
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<tr>
<td>- Failing to research technical issues</td>
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<tr>
<td>- Reliance on client work more than appropriate</td>
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Four main categories of variables have been identified that could affect auditor performance – those related to the individual, those related to superiors in the management of the audit, control systems and contextual variables. Mixed results have been obtained from studies that have focused on the relationship between the incidence of QTB and individual variables such as personality characteristics (Kelley

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\(^1\) Quality threatening behaviour is sometimes described as dysfunctional behaviour or audit quality reduction acts. These terms are used interchangeably.
and Margheim, 1990; Malone and Roberts, 1996; Otley and Pierce, 1996a), professional characteristics (Malone and Roberts, 1996; Otley and Pierce, 1996a; Lord and DeZoort, 2001), gender (Pierce and Sweeney, 2003), moral development (Ponemon, 1992; Lord and DeZoort, 2001) and ethics (Lightner et al., 1982). Previous studies have also examined the association between superior level variables such as leadership style and the occurrence of QTB (Otley and Pierce, 1995; Pierce and Sweeney, 2004).

For example, Kelly and Margheim (1990) investigated the impact of the characteristics of the audit senior team (personality traits, structuring behaviour of audit tasks and consideration towards staff auditor) on the behaviour of the staff auditors. They examined whether audit senior characteristics moderates the dysfunctional behaviour of staff auditors caused by time budget pressure in the US. The findings from eighty-five matched pairs of senior/staff responses of questionnaires showed high occurrence of QTB (such as premature sign-off audit report, reduces the amount of work that would be considered appropriate, failure to research accounting principles and make superficial reviews of client documents) in practice. The evidence showed limited influence of characteristics of audit senior on the dysfunctional behaviour of the staff auditors.

The impact of control systems on quality has been examined with respect to performance evaluation (Sweeney and Pierce, 2004), time deadline and budget pressure (Lightner et al., 1982; Alderman and Deitrick, 1982; McNair, 1991; Otley and Pierce, 1996b; Willet and Page, 1996; Kelley et al., 1999; Lee, 2002) and firms’ quality control and review procedures (Margheim and Pany, 1986; Malone and Roberts, 1996; Pierce and Sweeney, 2005). The findings suggest that time deadline and budget pressures are associated with a high occurrence of QTB but have reported mixed results for quality control and review procedures.

Public accounting firms are relying on budgets as a form of control mechanism and performance measurement tool. As a result, the budget has a potential to create pressure within an audit firm because of its dual function. Previous research has highlighted ‘the cost-quality dilemma’ in the public accounting firm because of this practice (McNair, 1991; Otley and Pierce, 1996). In general, increasing the quality of the audit may involve investing more time in the audit and may lead to further costs. In contrast, spending less time would likely affect the quality of auditor performance in detecting material errors. Previous research has highlighted difficulties in achieving an appropriate balance between controlling audit cost and maintaining a high level of audit quality performance. Past studies have shown that
Auditors sometimes respond to the conflict between cost and quality by engaging in dysfunctional behaviour, such as premature sign off on audit steps, reducing the amount of work performed below what the auditor considers reasonable and accepting weak client explanations (Willet and Page, 1996; Pierce and Sweeney, 2004).

Willett and Page (1996) carried out a survey questionnaire to explore irregular auditing practices among junior staff auditors in the UK. One-hundred and twelve (23% response rate) junior auditors responded to the questionnaire. They found that because of time budget pressure irregular auditing does occur among junior staff auditors. In comparison, Lee (2002) conducted a case study approach to investigate the phenomena of irregular auditing in the context of the audit practice environment in the UK. He conducted in-depth interviews with nine junior auditors between August 1994 and November 1996. He found that quality reduction acts normally occur in immaterial areas of audit and when faced with intense time pressure junior audit staff would use their own time to complete satisfactory audit tasks. Otley and Pierce (1996b), in a study of audit seniors in Big Six firms in Ireland found budget pressure had a significant impact on the incidence of quality threatening behaviour. They also found that a high level of organizational commitment and effective audit review lead to lower incidence of dysfunctional behaviour.

Other studies highlight the relationship between QTB and contextual variables such as audit firm structure (Malone and Roberts, 1996), size of audit firm (Margheim and Pany, 1986; Malone and Roberts, 1996), motivation (Lightner et al.,1982), the psychological contract (Herrbach, 2001) and social pressure (Lord and DeZoort, 2001). Collectively this evidence shows there is a significant association between audit quality, as evidenced by QTB, and contextual variables within and around the audit firms.

For example, Herrbach (2001) carried out a survey questionnaire with one-hundred and seventy senior auditors in France. The main objective of this study was to examine the effects of ‘psychological contract’ on auditor behaviour. In other words, this study aimed to investigate how the relationship between the individual auditor and audit firm affect auditor performance. Factors such as work autonomy, salary and training are some of the variables that were investigated. He found limited occurrence of dysfunctional behaviour among the audit seniors. He also found a negative association between high work autonomy, professional training and salary and quality reduction acts.
Using a survey questionnaire, Malone and Roberts (1996) documented a positive relationship between effective review procedures and low occurrence of dysfunctional behaviour among junior and senior level auditors. They also found a negative association between structured audit approaches with the incidence of dysfunctional behaviour.

Analysis of this strand of research shows the value of looking at audit quality beyond simple proxy indicators of auditors’ competence and independence or measures of audit quality in relation to inputs and outcomes. The literature provides some evidence of contextual factors that can influence audit quality.

2.1.3. Perceptions of Audit Quality

Studies on perceptions can be generally divided into two: users’ and preparers’ perceptions of audit quality and research on the audit expectations gap. These are discussed briefly next.

Users’ and Preparers’ Perceptions of Audit Quality

Prior research has investigated users’ and preparers’ perceptions of audit quality and has suggested that preparers, users and auditors view audit quality differently (Schroeder et al., 1986; Knapp, 1991; Carcello et al., 1992; Behn et al., 1997; Chen et al., 2001; Duff, 2004). Schroeder et al. (1986) examined AC chairpersons and audit partners’ perception on factors that could influence the quality of external audits. Eighty-one AC chairs and forty-one audit partners responded to their survey questionnaire. The findings show that audit committee chairs perceive audit team factors (such as the amount of partner and manager attention to the audit, planning and conduct of audit team work, and communication between audit team and management) to be more important than the audit firm factors (such as fees, peer review, size and reputation) when they assess the audit quality. Furthermore, the findings reveal a significant difference between audit partners and audit committee chairpersons’ perceptions concerning six factors: independence, team rotation, quality control procedures, auditors’ technical skills, reputation, and communication between the audit team and the audit committee.

Another study by Knapp (1991) investigated the impact of auditor size, audit tenure and general audit strategy on AC members’ assessment on audit quality. Using an experimental study of 122 AC members in the US, he found that AC members perceive that auditor size and auditor tenure significantly influence the quality of
audit. However, AC members perceive audit strategy as a less important factor during the assessment of audit quality.

Carcello et al. (1992) examined financial controllers’, institutional investors’ and audit partners’ perceptions of audit quality through a questionnaire survey. The results indicated that all three groups perceive audit team factors as more important than audit firm factors in enhancing the quality of the audit. Significant differences were reported between preparers/users and audit partners in relation to quality factors such as compliance with audit standards, the nature and extent of non-audit services, quality control standards and professional certification for firm personnel.

Chen et al. (2001) examined the attributes of audit quality that regulators and auditors felt enhance or undermine audit quality in China. In general, team and individual factors such as competence, ethics, and communication between the audit team and management were rated high as factors that could enhance audit quality. In contrast, factors such as provision of consulting services, cost-saving oriented audit firms and audit rotation were perceived as least important in determining audit quality.

Duff (2004) argued that in addition to the standard definition of audit quality (independence and competence) other aspects such as client service, empathy, service quality and responsiveness should be considered as providing a broader view of audit quality. He carried out a survey questionnaire in 2002 before the implementation of regulatory changes in the post Enron environment in the UK and examined the perceptions of audit partners, finance directors and fund managers concerning the important dimensions of technical quality (reputation, capability, independence, expertise and experience) and service quality (non-audit services, responsiveness, empathy and client service) on audit quality. Overall, his study showed the importance of both technical and service quality dimensions as part of the larger concept of audit quality as perceived by the three groups.

In a follow up study, in 2005, after the implementation of regulatory changes in the post Enron environments, Duff (2009) found that all three groups (audit partners, finance directors and fund managers) rated lower technical quality dimensions as compared to the results of his earlier study. In comparison, scores on service quality dimensions remain unchanged between the two studies. Overall, he concluded that the three groups still perceived service quality, relationship,
independence and competence as an important part of the larger concept of audit quality.

Recently, Beattie et al. (2011) examined the perceptions of two-hundred and nineteen audit partners, one-hundred and thirty AC chairs and one-hundred and forty-nine chief financial officers concerning the impact of economic and recent regulatory factors on audit quality in the UK. Overall, five factors that could enhance audit quality were rated high by the respondents: i) communication between external auditor and AC; ii) financial background of AC; iii) auditor independence (person in position to influence outcome of the audit does not have direct or indirect financial interests with the client); iv) size of audit firm; and v) composition of AC consists of independent non-executive directors. In comparison, three factors that were considered by the respondents to undermine audit quality include: i) management time and cost in changing auditors; ii) budget pressure imposed on staff; and iii) non-big four firm. In general, they found that factors related to recent regulatory reforms (such as disclosure of non-audit fees paid to auditor with detailed breakdown, requirements of audit partner rotation, risk of litigation, AIU independent inspection and publication of reports and risk of investigation by the FRRP) had minimal effect on the level of audit quality.

A few themes are evident in this area of research. First, there is no consensus on what audit quality means. The preparers, users and auditors view audit quality differently. Second, what constitutes audit quality is subjective and varies depending on the perception and expectation of various parties concerning audit services. Finally, most research in this area used either survey questionnaires or experimental study that provide limited understanding about how audit practitioners, AC members and regulators conceptualize the idea of audit quality and its influence on their process and activities since structured questions are used to examine the issue.

**Audit Expectations Gap**

A final field of the auditing literature that is relevant to the underlying issue of audit quality is that related to the notion of the audit expectations gap. The long-established expectation of the role of the external auditors is to improve the credibility of the financial information through independent verification of financial statements (Mautz and Sharaf, 1961; Wilcox and Smith, 1977; Wallace, 1980). The professional standard, ISA (UK and Ireland) 200 (APB, 2009), expects the auditors to express a true and fair view on the financial statements, which is in accordance with the financial reporting framework. The APB issued the Auditors’ Code (APB,
which, among other things, expects the role of the external auditors to provide value by adding reliability and quality to financial reporting as well as providing constructive recommendations to the management that can contribute to the effective operation of the business and the capital market. The company’s management expects the external auditors to provide value for money services and non-audit services (Mills and Bettner, 1992; Beattie and Fearnley, 1995) while the public expect the external auditors to guard companies against fraud and error (Percy, 2007).

Some past research has recognised that diverse expectations on the role of the auditor have resulted in different perceptions and expectations concerning the quality of audit services (Carcello et al., 1992; Sutton, 1993). A number of authors have also highlighted potential conflicts (Wilcox and Smith, 1977; Mills and Bettner, 1992) and the ‘expectations gap’ (Porter, 1991; Humphrey et al., 1992; Porter, 1993; Sikka et al., 1998) in the auditing environment that result from the differences between the views of different groups of participants in the financial reporting process. Prior research, in most cases based on questionnaire surveys, has documented the existence of a gap in various areas relating to auditors’ responsibilities and audit performance (for further reading please refer to: Porter, 1991; Humphrey et al., 1992; Lee, 1994; Sikka et al., 1998). Porter (1993, p.50) provides an analysis of the components of the expectation gap:

1. **The reasonableness gap**: defined as a gap between ‘what society expects auditors to achieve and what auditors can reasonably be expected to accomplish’.
2. **The performance gap**: defined as a gap between ‘what the public can reasonably expect auditors to accomplish and what they are perceived to achieve’.

The audit expectation-performance gap can be further divided into:

1. **The deficient standards gap**: a gap between ‘the duties which can reasonably be expected of auditors and auditors’ existing duties as defined by law and professional promulgations’.
2. **The deficient performance gap**: a gap between ‘the expected standard of performance of auditors’ existing duties and auditors’ perceived performance, as expected and perceived by society’.
Mills and Bettner (1992) highlighted four themes for the expectation audit gaps that exist and possible conflicts in the audit profession due to miscommunication or misinterpretation of the external auditor’s role. The following are the themes:

Gap 1: The audit expectations gap that is linked to the difference between what the public and the auditor believe about the external auditor’s duties and responsibilities. Three possible conflicts are identified as a result of the gap: 1) conflict between the audit firm’s self interest and society’s demand for objective and credible information, which means, the auditor faces a dilemma in providing high-quality audit service at a reasonable price; 2) conflict in meeting growing expectations of the public on social, political and environmental issues that is beyond the focus of the financial reporting; and 3) conflict about the extent of direct regulation of the audit profession to provide control on the profession’s activities to protect the public interest.

Gap 2: Scope of services gap, which is associated with the difference between the client’s expectations on the range of services (for example, management advisory services) and the attestation responsibility of the auditor to the owner or shareholder. The more diverse the scope of services offered by the external auditor the more likely it could create a conflict of independence for the auditor.

Gap 3: Intraprofessional competition gap, which is related to the state of the audit market where the big size audit firms enjoy oligopoly power over large public clients that hinders open competition in the audit market for the other audit firms. As a result, this has created a two-tier profession, which results in conflict associated with competitive behaviour among the audit firms.

Gap 4: The role ambiguity gap is associated with the difference between the values and norms that the audit firm perceives and the audit staff’s own perceptions of those values and norms. A conflict might exist if the audit firm goal is incongruent with the audit staff’s own goal. For example, an internal message about the importance of audit quality might be contradicted by a message about cost cutting to maximise profits.

The above summarises the gaps and potential conflicts that exist in the auditing environment. The themes that emerge relate to: the extent that commercial interest has an effect on activities and the role expected of the external auditor, the degree to which auditors are independent and to whom the auditor should be accountable.
2.1.4 The Limits of the Traditional and Other Approaches to Audit Quality

The above overview of the research literature (section 2.1.1) reveals that traditional research approaches has focused on notions of competence and independence of auditors suggested by DeAngelo (1981a) as analysis frameworks for audit quality. One of the problematic aspects of this definition is that users of the audit services need to assess both the technical competence and the independence of the auditors. To assess technical competence will require the users to assess and examine the audit working papers and compare how well the work is done with established auditing standards and guidelines. However, it is impossible for the users to assess and examine the audit working papers. Therefore, the audit profession and regulatory body demonstrate the quality or appropriateness of the work conducted through a peer review process and inspection by an independent regulatory body such as the AIU or the Public Company Oversight Board (PCAOB).

To assess independence of auditors is more difficult because independence in mind is rather abstract and related to the ethical and moral beliefs of the individual auditors. Nevertheless, independence in appearance of the auditors is more observable and can be related to various aspects of the auditor-client management relationship such as auditor tenure, which is the length of time that auditors have been associated with the company, and the percentage of the non-audit services fees (these aspects of audit quality have been extensively investigated in the traditional view of auditing).

The above discussion highlights the problematic nature of the definition of audit quality in respect of the users gathering the necessary information to evaluate the quality of a particular audit. In addition, this standard definition of audit quality, which serves as a framework of analysis in most audit quality studies, might not be sufficient to represent audit quality because of its narrow focus, which is only on the aspects of the competence and independence of the auditors (Duff, 2004). Furthermore, most of the studies employ agency theory and are undertaken from a North American perspective, often show conflicting results and neglect the social and organisational context of the audit which might influence quality (FRC, 2006b; Humphrey, 2008). From the methodological standpoint, the economic rational does not provide a precise definition or theoretical status for audit quality, and the surrogates or proxies of audit quality that have been examined in the prior research are still inconclusive. Operationalising the concepts of audit quality, therefore, is open for further investigation. Indeed, publications such as ‘Audit Quality’ by the ICAEW in 2002 and ‘Promoting Audit Quality’ by the FRC in 2006 have highlighted
the importance of other aspects of auditing that recognise a broader view of the
concept of audit quality.

Although existing archival studies (such as studies on inputs and outcomes related
to audit quality), surveys (such as, research on users’ and preparers’ perceptions of
audit quality) and laboratory experiments (such as, research on judgement and
decision making) have revealed a considerable amount about the importance of
audit quality in the audit contract, threats to achieving appropriate quality and the
nature of auditor judgement (see Francis, 2004 and Watkins et al., 2004 for
reviews of the literature), these studies are unlikely to provide meaningful insights
into the actual audit practices of auditors. Even if the researcher introduces more
variables or complexity into surveys or experiments or archival data, it is still
debatable whether a researcher can capture or understand the pressure and
influence of the audit environment on the quality of audit performance (Humphrey,
2008).

Power (2003, p.379) points out that limited research has addressed auditing
practice ‘in context’ and as a result, much less is known about auditing in its social
and organisational context, as compared to experimental settings. For example,
there is still a great deal that is not known about the nature of actual audit
practices and the meaning those who conduct audits and those who oversee auditor
appointments and work performance associate with the concept of audit quality.
Little attention has been given to questioning how the meanings of the concept of
audit quality are constructed, promoted and operationalised by individual auditors,
that is, how ‘real audit practice’ relates to audit quality. Furthermore, little is known
about how individual auditors construct or negotiate terms of audit quality with
different outside constituents. In a similar manner, there is limited understanding
about how auditors’ interactions between other audit market constituents, such as
the regulator and AC members, influence their conception of audit quality or vice
versa. There has been little attention given to questioning how the meanings of the
concept of audit quality are constructed, promoted and reacted to by individual
auditors, the regulator and AC members. This study attempts to add to research
findings and knowledge on these issues.

Most prior research has concentrated on issues surrounding audit quality without
really examining how it is operationalised and given meaning and the potential
influence of internal and external factors in the auditing environment on the
meaning of audit quality. It can be argued that much of the prior literature does not
address the societal context of audit practice or how audit quality is understood
within its organisational and institutional setting. In line with calls for more research that understands accounting and other phenomena within their social and institutional context (Burchell et al., 1980; Dirsmith et al., 1985), there is a need to approach the study of auditing practice with reference to its practical context. The next section will further discuss some research on auditing in its organisational and social context that is relevant to audit quality and contributes to the development of the underlying concerns of this thesis.

2.1.5 Auditing Practice in its Organisational and Social Context

This section reviews existing auditing literature the purpose of which is to develop an understanding of audit practice in its social and organisational context. The call to consider auditing in context has resulted in a stream of research that considers the way in which auditing practices both shape and are shaped by the environment in which they operate (Humphrey and Moizer, 1990; Pentland, 1993; Hudaib and Haniffa, 2009). The position implicit from this approach to auditing is to go beyond the traditional view of auditing as a neutral, objective and scientific phenomenon. Accordingly, this approach concerns the understanding of the auditing phenomenon as a socially constructed activity that defines and constitutes certain aspects of reality, which are influenced by its organisational and social context. Research with this focus has, whether explicitly or implicitly, acknowledged and sought to address limitations in more rational-economic or functionalist approaches to auditing research. A range of critical and sociological approaches has been brought into the auditing arena in this process. This section will argue that this ‘alternative’ set of approaches have enhanced our understanding of auditing practice in various ways.

Audit Practice and Production of Audit Quality

A number of field studies in auditing provide significant evidence of the ‘messy realities of practice’ that draw attention to auditing as a socially created activity (Pentland, 1993; Power, 1995; Fischer, 1996). The studies show auditing practice is context dependent and can serve different roles and functions (Burchell et al., 1980; Nahapiet, 1988). Humphrey and Moizer (1990), support this view of auditing as a socially created activity, where from a series of interviews with 18 audit managers in the UK, they found that commercialisation of the audit firms and company managers influence the audit planning. They argued that planning serves not only as a techno-rational function designed to enhance the quality of the audit (in terms of efficiency and effectiveness), but also as a tool to legitimise the auditors’ decisions about the extent and the nature of audit work, and as a
marketing device to enhance the revenue generation of the audit firms. Different
roles of audit practice are also supported by Carpenter and Dirsmith (1993) who
viewed statistical sampling as more than a technical function that aims to serve the
effectiveness and efficiency of gathering audit evidence for better audit judgments
and saw it as also playing a significant role in legitimating and controlling abstract
knowledge of the audit profession. A similar view is also forwarded by Fischer
(1996) who from a study of implementation of audit technologies within several Big
Six firms showed that change or innovation in audit process was not because of
better audit but also drives by business side of auditing that legitimised sample size
reduction or ‘over-auditing’.

Pentland (1993) conducted a fieldwork study that examined the formation of audit
judgement by auditors. In particular, he examined how auditors become
comfortable with figures in the financial statements and the representations
presented by the corporate management. Based on case studies of two audit
teams, he concluded that auditors relied on ‘gut feeling’ or audit ritual to produce
such comfort rather than ‘structure’ or the technical function of audit. The
production of comfort from a rituals perspective highlights how comfort is treated
as an article of trade within the participants involved with audit services such as
audit teams, the audit firms and the capital community at large. Pentland showed,
for example, how the production of working papers that support the audit opinion
produce order and comfort within the audit teams, and become a foundation of the
community’s trust in auditing from the external viewpoint. The notion of patriarchal
settings (the priests) and acts of ceremonial character (the signature is sacred)
signify the social and contextual aspects of auditing activity.

Mills and Bettner (1992, p. 192) suggested the auditing profession uses the ‘rituals’
of the audit process involving planning, evidence gathering and audit reporting to
represent, among other things, objectivity, integrity, professional scepticism,
technical competence or, in general, the quality of the audit services. This ritual is
also perceived as important for the legitimacy of the auditors’ actions, to build trust
and confidence in the profession, and in maintaining the ‘social order’ of financial
markets and economic systems.

From the social perspective, auditing is not seen as an economic rational response
to the business demand but rather it is either seen as social construction through
negotiation of audit knowledge and creation of auditable environments (Power,
1996, p. 294) or as a social function that changes according to social change and
needs (Flint, 1971, p. 287). Power (ibid) argued that audit activity is derived from
the active process of ‘making things auditable’, which, contrary to official images, is not derived from a neutral activity. He stated that auditors needed to construct and count what can be regarded as audit evidence within the audit knowledge. Hence, audit activity creates environments in which its knowledge base is legitimate and successful. In this respect, auditing is treated beyond a technical exercise of verifying financial statements. Therefore, auditing is a product of interaction and negotiation between auditors and other parties within the auditing ‘system’.

A number of field studies in auditing provide some evidence of the influence of regulatory, political and economic conditions and other audit market constituents (audit client, professional associations and regulatory bodies) in the audit setting on audit practices, how the audit practitioners come to see themselves and the construction and presentation of legitimate and useful knowledge of auditing. In other words, role, practices or performance of auditors may partly be shaped and influenced by their interactions with various societal institutions including professional bodies, audit clients, regulatory bodies and the public in general.

More recently, Khalifa et al.’s (2007) study of the discourse of audit methodology provides an example of the influence of competitive pressure in the audit market on the development of audit methodology that promotes business risk auditing for ‘clients’ rather than enhancing the quality of audit in practice through enhancing audit effectiveness. A study by Curtis and Turley (2007) highlighted conflicting roles of audit methodology in the organisational context of audit practice to legitimate the production of audit and production of profits that result in tensions between administrators in a large audit firm and audit practitioners.

The literature on regulation and its impact on audit practices and, in consequence, audit quality is relatively scant. Nonetheless a few studies provide some evidence about the potential impact of regulation on audit quality. Nagy and Cenker (2007) conducted interviews with auditors in the US and show that increased regulation through implementation of SOX (2002) has impacted auditors’ professional judgement and overall audit quality through creating a compliance approach to audit that hinders auditors’ reasoning capabilities. An earlier study by Francis (1994) indicated that new regulations as response to accounting scandals normally lead to highly standardised and structured audit approaches that potentially reduce audit quality by limiting dependence upon professional judgement. In like manner, Hatherly (1999) suggested that increased regulation and economic pressures in the auditing setting might displace some level of professional judgement from auditing to achieve cost effectiveness.
Richard (2006) considered how the role and the relationship of the financial director and auditor influence the quality of the audit process. Using an interpretive approach, sixty interviews were conducted among sixteen listed firms and eight audit firms in France. The results suggest that relationship dualism (professional/personal relationship) and hybrid trust provide the foundation for the affiliation of the financial director and auditor. Richard argued that professional/personal relationship and trust is a relevant dimension in the audit process. She further explained that trust and personal relationship influence the audit process such as the speed and performance of audit services and the exchange of information. Richard recognises the existence of a peers’ relationship that emerges from the hybrid trust and the dualism of the financial directors and auditors’ relationship. The peer relationship is shaped by its social structure, professional and cultural norms (normative isomorphism), frequency of the relationship and the multiplexity of the relationship. The author proposes the concept of parity from this interpretative conception, which influences the independence and competence of the auditor (audit quality).

Hudaib and Haniffa (2009) studied the meaning of auditor independence in Saudi Arabia and applied concepts of social interaction, joint action and differential degree of power in symbolic interactionism. Based on interviews, observations and document analysis they found that construction of the meaning of independence was influenced by auditors’ reflective perspective concerning their reputation and ethical reasoning. It was also found that commercial activities and image management of the audit firm as well as political and social-economic structures of the country influence the meaning of independence. Similarly, earlier work by Sucher and Kosmala-MacLullich (2004) showed the construction of audit independence in Czech Republic was influenced by socio-economic and cultural pressures in the country. Both studies showed the influence of interaction between auditors and others in a ‘social system’ to form the concept or representation of independence. Therefore this suggests a social construction aspect to the reality of auditors’ independence.

Overall this literature has identified a range of issues in auditors’ social and organisational context which influence audit practices. These studies recognise the complex and ambiguous nature of the audit environment and highlight that in the auditing context, where the quality of output in terms of assurance cannot be measured, audit practices (e.g. audit planning and methodology) serve symbolic as well as technical functions and have much to do with creating a sense of legitimacy for audit practice and abstract audit knowledge.
Auditing has been recognised as a ‘profession’ that influences the ideology and practices of its members. According to Burns and Haga (1977) public accountants are considered to be a profession because they meet these two conditions: first, the function or role of the public accountants is crucial to others (such as investors, lending institutions, and regulator) and, second, public accountants possess ‘mystique’ or expertise, technical knowledge and specialised training that is not available or cannot be performed by ordinary people. Flint (1988) outlined five attributes that qualify auditing as a profession:

(i) Auditing provides a service to the public, and its members have specialist knowledge and skills or competence that is acquired from advanced level education, training and experience that are based on systematic theory and intellectual knowledge;
(ii) Due to the nature and complexity of the audit service, non-members are unable to critically judge its quality;
(iii) The nature and complexity of the service require the profession to have a procedure that is designated to its members;
(iv) The members of the profession are required to be objective, impartial, honest and not-self interested;
(v) The profession has a procedure to monitor its members for maintaining standards of competence and behaviour and also has a right to take disciplinary action for breach of the standards.

From the above, several important features of auditing as a profession can be identified, which influence its social significance and perceptions about its work practices. First, the formation of ‘serving the public interest’ as an ideology in pursuit of social acceptability and the credibility of the profession, which establishes the importance of the work to society. The ideology also creates a self-image that gives social value to the role and function of the auditing profession. Baker (2008) argued that the profession has used the ideology of ‘public interest’ as a rhetorical claim to gain legitimacy from a wider public about the role of the auditors and the quality of their work performance. He suggests the importance of the idea of public interest in providing a socially integrative function for the profession to legitimate and justify its authority, practices, activities and function.

Second, the establishment of ‘specialist knowledge’ or expertise through professional qualifications, training and experience, which underlie audit practices, are important symbols of professionalism for acceptable representation of the work practice of the auditors and, to some extent, of its quality (Power, 1996). Hines (1997, p.89) suggested that the profession had used the symbols of professionalism to claim and maintain an abstract and incoherent body of knowledge for the profession. She also suggested that the conceptual framework of the accounting profession concerning the importance of image or the appearance of
the body of knowledge to maintain status quo restricts competition as well as the intervention of regulation on the profession. Third, in addition to the assessment by the accountancy profession (such as peer review), the existence of standards and guidelines (e.g. codes of conduct) were seen to be important in signalling that a certain standard of quality had been achieved and maintained in members’ work performance and the autonomy of their work.

Some researchers have argued that the deterioration or de-professionalization of the status of auditing as a profession has led to a crisis about the role of the auditor and quality of audit work (Humphrey and Moizer, 1990; Sikka et al., 2009). In particular, the crisis is strongly connected to the shift in ideology of the profession, which shows that the role of auditors and audit practice is more to accommodate the commercial interests of the audit firms rather than the public interest (Hanlon, 1994). Baker (2008) highlighted the distortive aspects of the ideology that are caused by the economic interest of the profession rather than public interest, which leads to a conflict in values and practices within the profession. Wyatt (2004) highlighted a change in culture in firms that focuses on revenues and profits that drive commercial actions and behaviour.

Sikka at al. (2009) suggested that auditors are members of a commercial professional service firm that seeks to increase its profit and market share. As a result, the personal aspect and conduct of its members, and representation of audit knowledge and practice should be consistent with economic pressure and client legitimacy rather than in favour of public interests. Some researchers have argued about the impact of the commercial interest of the profession on the auditor’s independence and audit performance. For example, time budget pressure, which is caused by the emphasis on revenue, can have a negative impact on audit quality through auditor’s engaging in dysfunctional behaviour, such as reducing sample size or prematurely signing-off the audit report (Kelley et al., 1999; Otley and Pierce, 1996a). The commercial interest of the audit firm may also have a negative impact on the appearance of audit quality by reducing the ability of the auditors to maintain their independence because of a significant amount of non-audit fees received from the audit client (Pany and Reckers, 1984).

Some researchers have suggested that the notion of professional appearance is important for the auditors in managing the impression of their client as an indication of audit quality rather than their professional attributes or values. The qualitative case study by Grey (1998) reveals that auditors regard the notion of professionalism to be closely related to forms of behaviour or self-presentation.
rather than professional accreditation and technical skills. Grey noted that this aspect of professionalism espouses a whole range of self-presentation including:

"Communication; self-confidence; initiative; ability to win confidence and respect from clients and colleagues; performance under pressure; cooperativeness; reliability; self-motivation; business sense; appearance; presentations skills; contributions in meetings; rapport with client; managing client expectations; logical organisation of written work; neatness of written work; meeting deadlines" (Grey, p. 575).

Similar to Grey, the interview study by Anderson-Gough et al. (2002) showed that the auditors’ understanding of the meaning of professional is primarily connected to issues pertaining to personal conduct and appearance, which are important for managing the impression about the quality of audit activity rather than determining the content. Furthermore, both studies suggest that the idea of professionalism as appearance is largely constructed around the ‘client’ of the audit firms. The recent study carried out by Carrington (2010) suggests that professional appearance is important to indicate that sufficient quality is performed in the conduct of the audit, although there is no necessary connection between appearance and performance of work tasks. He indicates the importance of appearance for the legitimating role of the auditor as the result of a weak knowledge base of the audit.

Power (2003, p.385) mentioned that external auditing emphasises appearances and processes (such as, expertise, competence, working papers and audit planning) to signify audit quality when the quality of the output is unobservable within the practice as well as to the outside people. Since auditors are unable to demonstrate an objective measure of their output, focus on appearances and processes are important to symbolise quality in their claim to the knowledge base of auditing and work practices. In fact, auditors themselves face problems in determining what good quality is:

"Even where audit effort can be made transparent, audit quality is obscure to auditors themselves. It is not analytically clear what ‘good auditing’ really is, since outputs are sufficiently ambiguous for auditors themselves to be unsure. Auditors do not know if they are good auditors or not, however much effort they put in signal to outsiders” (Power, 2003, p. 389).

Power (1996) provided an analytical framework for understanding the knowledge base and production of the audit and suggests four elements that are involved in the process (see Figure 2.4). The first element is referred to as the knowledge structure of audit practice. At this level, audit knowledge is established and legitimised through the construction of codified rules, auditing standards and audit regulations, which are issued by various professional institutes and regulatory
bodies. In addition, auditors also use audit working papers to convey audit knowledge to the public (especially legal and regulatory audiences). Second, the elements of the auditing knowledge system explain the use of education, licensing requirements, professional examinations, training and continuing education by the auditing profession to legitimate their abstract knowledge. The third level addresses the level of audit practice such as audit judgements and audit procedures (sampling and risk analysis). Power argued that the audit process and procedures shape the representations of audit knowledge. Finally, the fourth level involves quality control, such as peer review and various other feedback mechanisms that are created to mediate the practice and official knowledge structures.

**Figure 2.4: The System of Auditing Knowledge**

![Diagram of the System of Auditing Knowledge]

Source: Power (1996)

Auditors also undertake various legitimating strategies and acts such as espousing norms and values as an independent expert auditors acting in the public interest and emphasising procedural aspects of audit, not only to represent and communicate audit quality but more importantly to secure their professional status, claims to expertise and to maintain legal monopoly power granted to them. Neu (1991) suggested that the audit profession engages in ‘impression management techniques’ through four sets of techniques (entry requirements, standards and guidelines, disciplinary activities and charity activities) that are used to create and maintain a schema of trust that helps to maintain legitimacy and professional privilege as well as other functional aspects of audit practices.
The above discussion highlights the importance of auditors’ personal conduct and appearance as well as various ‘impression techniques’ and processes as representations of quality in the absence of observable features in quality of work performance. The analysis also highlights the issues of role conflicts and the commercialisation of audit firms which may influence the nature and practice of audit.

2.2 Professional Perspectives on Audit Quality

From a more practitioner perspective, audit quality has been examined with reference to the degree to which the audit conforms to applicable auditing standards (Cook, 1987; Aldhizer et al., 1995; McConnell and Banks, 1998; Tie, 1999; Krishnan and Schauer, 2001). For example, Krishnan and Schauer (2001) documented a positive association between audit firm size and compliance with generally accepted accounting principles (GAAP) disclosure requirements (after controlling for other factors such as client size, financial health and participation in peer review). McConnell and Bank (1998) discuss audit quality in relation to the confirmation of accounts receivable according to SAS no. 67. They argue that audit quality will be enhanced if auditors have a thorough understanding of the accounts receivable confirmation process as it will likely detect material misstatements.

Practitioner approaches to audit quality also tend to place more emphasis on the process around the audit and within which professional judgement is exercised. For example in the UK, the ICAEW identifies five factors that could drive audit quality in practice: (1) leadership, (2) people, (3) working practices, (4) monitoring quality practices, and (5) client relationships (ICAEW, 2002). They argued that these are the major factors underpinning audit quality in practice; activities or practical things that a firm could or should pursue to build, promote and maintain audit quality.

"Audit quality depends on a number of critical factors: people and their training, audit firms and their processes, clients and corporate governance" (ICAEW, 2002, p. 2).

"Audit quality has many contributing factors including good leadership, experienced judgement, technical competence, ethical values and appropriate client relationships, proper working practices and effective quality control and monitoring review processes” (ICAEW, 2002, p. 9).

This construction of audit quality suggests that quality is about the auditors’ professional judgement, which is supported by people who carry out the audit processes, people who command and oversee it, systems of quality control that monitor it, and individuals and the firm’s values that uphold it. It is clear that rather than defining what audit quality is, much of the effort now concentrates on
identifying activities or factors that could have an impact on the audit processes and audit quality.

"The quality of audit opinion lies in that of the judgements the auditor makes. These in turn dependent on the quality of the evidence that has been gathered and the quality of the people gathering it" (ICAEW, 2002, p. 7).

"Ultimately, auditors provide a quality service to shareholders if they provide audit reports that are independent, reliable and supported by adequate audit evidence" (ICAEW, 2002, p. 8).

Obviously, the quality of the audit judgements cannot be directly assessed or measured. As a result, the central feature of audit quality highlighted by the profession is about the quality of the audit process that supports their professional judgement. The focal point of discussion in the paper is about the importance of activities, events, or conditions, or ‘inputs’ to the audit processes and the effect on the quality of the output (judgement):

"Inputs can be judged by the quality of the output. If errors are often made or poor judgement is exhibited, then the inputs need to be considered. These include the quality of staff training” (ICAEW, 2002, p. 48).

Further analysis shows that the practical construct of audit quality proposed by the ICAEW can be categorised into three main elements (Figure 2.5). The first element is governance and the control of the firm, which comprises working practices, monitoring quality processes and client relationship. Good working practices are argued to influence the quality of audits. For this reason, it is important for audit firms to clearly define the roles and responsibilities of their members. Good working practices are also supported by adequate audit planning, the characteristics of the people that are executing the plan and the people that are reviewing the practices. Good working practices are also recognised as part of the control in the audit process:

"Good working practices need to be embedded in the audit process; they are an intrinsic part of the firm’s quality control procedures” (ICAEW, 2002, p. 11).

Another important aspect of the governance and control of the audit firm concerns its monitoring quality processes. Formal and informal quality monitoring procedures are set up or implemented to assess the quality of audits. These include control reviews, audit reviews, compliance reviews, training and learning and office memos.
Figure 2.5: Practitioners’ Construction of Audit Quality

The importance of control in managing audit clients is also highlighted in the ICAEW’s paper. For instance, control is necessary to monitor client acceptance or continuance, which could reduce the risk of audit failure. The impact of non-audit services should also be safeguarded to ensure that independence will not be impaired or influence audit quality. Finally, effective communication and an open relationship between the auditors and audit committees are important to the performance of the audit.

The second element of audit quality is the individual or people in the firm. The practitioners stress the importance of individual expertise, experience, skills and values to the quality of audits.

"Audits are performed by people, so audit quality depends on their quality...The quality of a firm’s people and their performance depends on their competence and motivation“ (ICAEW, 2002, p. 18).

The third element of audit quality is the culture of the audit firm. Effective leaders are responsible to set the overall tone in the audit firm. They are responsible to establish firm wide policies and procedures that embed quality culture to promote audit quality. For instance, the firm’s policies and procedures such as recruitment, reward and training should reflect quality as important features. Leaders are also responsible to promote quality by communicating it at all levels in the firm.

"Whatever the size of firm and however it defines audit quality, this will only be achieved if its importance is central to the strategy and objectives of the firm’s leadership and it is translated into practical actions. Audit quality is a collective responsibility but the tone has to be set up from the top and people have to be accountable“ (ICAEW, 2002, p. 13).
“...quality audits are the results of people working together and being prepared to take on the responsibility of ensuring that right result is achieved. Senior people within an audit firm have to take on a leadership role...the desire to perform the quality audit will result from the sense of professional obligation and the character of those in charge of the firm...audit quality is achieved only if it is the keystone of the firm’s overall strategy” (ICAEW, 2002, p. 9).

In brief, the construction of audit quality as proposed by the ICAEW emphasises a wider view of audit quality that recognizes the influence of interaction within and between the firm and various internal and external factors in the auditing environment to audit quality.

### 2.3 Regulatory Perspectives on Audit Quality

The auditing profession and its members are governed by laws and regulations. In the UK, the members or professional auditors are required to comply with standards and requirements such as the Auditors’ Code (APB, 2004b), the International Standard on Quality Control 1 (ISQC1) (APB, 2009), the International Standard of Auditing (UK and Ireland) (APB, 2009), APB Ethical Standards (APB, 2004a), and the UK Audit Regulation and Guidance. These standards and regulations highlight four fundamental elements that could influence audit practice and performance: (1) individual characteristics, (2) firm characteristics, (3) the audit report or the output of audit services, and (4) the value of the audit report.

First, the standards, requirements and guidelines emphasise the importance of individual characteristics to the quality of audit performance. For example, the Auditors’ Code (APB, 2004b) stresses the imperative of individual characteristics such as accountability, integrity, objectivity and independence, competence, rigour and judgement of the auditor in the conduct of the audit. The APB Ethical Standards (APB, 2004a) further point out the imperative of auditors’ independence as a fundamental characteristic of professional auditors.

Second, standards such as the ISQC1 (APB, 2009) specifically discuss the elements of quality at the firm level. The standard frames requirements about policies and procedures that should be established within the audit firm to achieve quality services. These include leadership responsibility for quality, ethical requirements for auditors, acceptance and continuance procedures for the audit client, human resources, engagement performance and quality monitoring.
Third, regulators identify that another important element of quality is the output of the audit services – the audit report. The report should be able to provide some indication about the quality of the audit performance. The Auditors’ Code (APB, 2004b) indicates that the report should contain accurate, clear, complete and true information.

Finally, the quality of audit is also associated with additional value created by the services. The Auditors’ Code (APB, 2004b) considers the importance of audits to enhance the quality and reliability of the financial reporting. In addition, the auditors should also be able to give constructive recommendations and suggestions to the management of the company during the course of the audit in the areas where weaknesses are identified. Here, the ‘value’ of the audit services involves producing and enhancing the trust and confidence of the users of the financial reports to the individual company and the capital market as a whole. Next, the audit services could assist in improving the efficiency and effectiveness of the company’s performance.

Overall, the UK regulatory framework put forward four main elements of audit quality in its standards and guidelines (Figure 2.6). These elements propose the importance of inputs (individual and firm characteristics) and outputs (audit report) of the audit processes and value (trust and confidence) resulting from the processes. The issue is how the elements of audit quality can be monitored or measured or verified by the regulator. In the absence of visible criteria in the quality assessment of the output of audit services, the regulator is more concerned with the quality of processes involved in producing the audit report.

**Figure 2.6: Regulators’ Construction of Audit Quality**

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<table>
<thead>
<tr>
<th>Elements contributing to construction of audit quality</th>
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</thead>
<tbody>
<tr>
<td>Individual’s characteristics</td>
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<tr>
<td>Verifiability of audit process</td>
</tr>
<tr>
<td>Valued added services</td>
</tr>
<tr>
<td>Firm’s characteristics</td>
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<tr>
<td>Audit report</td>
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The audit report is a vehicle where professional auditors express their professional opinion about the true and fair view of the financial statements. The opinion of the auditor involves a considerable amount of professional judgement. Because of the limitations in evaluating the quality of judgement, the regulators are more concerned with the quality of processes that are involved when auditors form these judgements. The importance of the verification of the audit processes brings a focus on the importance of the ‘quality of documentation’ of those processes as ‘evidence’ to support the auditors’ judgement. This effort is reflected in the work of the Audit Inspection Unit (AIU), which is the body responsible for monitoring the quality of audit services offered by the public accounting firms.

2.3.1 The AIU Perspective on Audit Quality

The AIU was set up in 2003 after the reforms in the corporate governance and audit regulation regime following the Enron-Andersen collapse in the US. The AIU is an independent unit, reporting to the POB, which is within the independent regulator of the FRC. The AIU is responsible for monitoring the quality of audits of listed companies and other major public interest entities. The AIU is also responsible for monitoring public accounting firms’ compliance with the regulatory framework for auditors in the UK. The arrangement for independent monitoring provided by the AIU is set out in paragraphs 13 and 23 of Schedule 10 of the Companies Act 2006. The work of the AIU is intended to enhance confidence in the audit process by enhancing the transparency of the work of the auditors and the judgements made by them.

Scope and Monitoring Approach

The scope of the AIU work covers audits of all companies incorporated in the UK - listed companies and other entities whose financial condition is considered to be of major public interest (AIU, 2011). The POB is responsible for approving the scope and work programme of the AIU and determining which audited companies are classified within the ‘major public interest’ category. The responsibilities of the AIU cover an independent inspection of major public accounting firms – the Big Four and five other major firms. The AIU also reviews other firms or ‘smaller firms’ that also fall under the scope of the work. The cycle of inspection is annual for the Big Four firms and two years for other major firms.
The AIU’s independent inspection is intended to ‘challenge’ the audit firms and auditors, and to focus on audit judgements and audit processes. The AIU’s monitoring framework focuses on these attributes (http://frc.org.uk/pob/audit/):

1. Quality of auditing
2. Thorough, robust and challenging approach to inspection visits;
3. Wide-ranging reviews of firm-wide procedures, including an assessment of how the culture within the firms impacts on audit quality;
4. Risk-based selection of individual audits for review, utilising a risk model covering listed and AIM listed entities;
5. In-depth reviews of individual audits, addressing identified areas of risk and including critical assessment of the key audit judgments made in reaching the audit opinion; and
6. An assessment of the quality of communication with the Audit Committee.

The monitoring framework can be classified into three major areas: quality control, independence and ethics, and audit performance (AIU, 2009). The AIU assess and review firm wide policies and procedures, key input elements to the audit process and a firm's individual audit engagements based on the following characteristics:

Table 2.2: The AIU Monitoring Framework

<table>
<thead>
<tr>
<th>Key areas</th>
<th>Principal themes and issues</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Quality control</strong></td>
<td>1. Leadership, strategy and communications&lt;br&gt;- Tone at the top, which supports audit quality through the firm's strategy, objectives and targets, internal communications and reward mechanisms&lt;br&gt;2. Performance evaluation, promotions and remuneration&lt;br&gt;3. Other human resource matters&lt;br&gt;- Audit training and communications&lt;br&gt;- Credit crunch communications&lt;br&gt;- Client risk assessment and acceptance/continuance&lt;br&gt;4. Consultation and review&lt;br&gt;- Engagement quality control review&lt;br&gt;- Pre-issuance technical reviews&lt;br&gt;5. Audit quality monitoring&lt;br&gt;- Effective internal audit quality review and other monitoring procedures by the firm; appropriate and timely actions in relation to weaknesses identified by the audit quality review or through the external monitoring process</td>
</tr>
<tr>
<td><strong>2. Independence and ethics</strong></td>
<td>1. Ethical policies and consultation&lt;br&gt;- Direct assistance by staff from clients’ internal audit departments&lt;br&gt;2. Compliance monitoring procedures&lt;br&gt;- Annual compliance confirmation&lt;br&gt;- Scope of services&lt;br&gt;- Non-audit services&lt;br&gt;3. Rotation policies and monitoring&lt;br&gt;- Rotation monitoring&lt;br&gt;- Long association and key audit partners</td>
</tr>
</tbody>
</table>
### Table 2.2: The AIU Monitoring Framework (continued)

<table>
<thead>
<tr>
<th>Key areas</th>
<th>Principal themes and issues</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>3. Audit performance</strong></td>
<td>1. Audit methodology</td>
</tr>
<tr>
<td></td>
<td>2. Assessing and responding to risk</td>
</tr>
<tr>
<td></td>
<td>- Identification of significant risks</td>
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<td></td>
<td>- Fraud risks</td>
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<tr>
<td></td>
<td>- Preliminary analytical review</td>
</tr>
<tr>
<td></td>
<td>3. Audit evidence and related judgments</td>
</tr>
<tr>
<td></td>
<td>- Impairment reviews</td>
</tr>
<tr>
<td></td>
<td>- Provisions and accruals</td>
</tr>
<tr>
<td></td>
<td>- Post-employment benefits</td>
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<tr>
<td></td>
<td>- External confirmations</td>
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<tr>
<td></td>
<td>- Using the work of an expert</td>
</tr>
<tr>
<td></td>
<td>4. Communicating with Audit Committees</td>
</tr>
<tr>
<td></td>
<td>5. Audit finalisation</td>
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</tbody>
</table>


The first public report on independent inspection was published in June 2005. The report published findings from inspections of the four largest UK audit firms (Deloitte & Touche LLP, Ernst & Young LLP, KPMG Audit LLP and PricewaterhouseCoopers LLP). In the following year, the AIU reported findings from inspections of the four largest audit firms and five other major firms (Baker Tilly, BDO Stoy Hayward LLP, Grant Thornton UK LLP, PKF (UK), LLP and RSM Robson Rhodes LLP). In 2008, the AIU publicly reported findings from the inspection of individual audit firms to enhance its transparency following heightened interest in the form and content of public reporting (POB, 2007).

Since the first publication of the public report by the AIU in 2005, audit quality has been constructed around the ‘verification’ of the audit process and related activities, events or conditions that contribute to the formation of the audit opinion or judgements (Figure 2.7).

**Figure 2.7: AIU Verification of Audit Quality**

![Figure 2.7: AIU Verification of Audit Quality](image-url)
For this reason, the assessment of audit quality is centred on the ‘quality of documentation’ that is supposed to reflect the evidence of a high audit quality. As a result, adequacy and sufficiency of audit documentation of an audit firm’s wide audit policies and procedures, and individual audit engagement are subject to examination. The assessment of quality of documentation is reflected in the various procedures and processes of the audit firms. As indicated in the reports issued by the AIU:

"The AIU continues to believe that the thought processes underlying significant audit judgments need to be properly evidenced at the time and that failure to do so increases the risk of them being incomplete or misguided and of inappropriate audit judgments being made as a result" (ICAEW, 2008, p. 4).

"We identified a need to improve the quality of audit documentation across all firms, in respect of many of the audit engagements we reviewed. This was also an issue that the firms themselves had recognised as needing to be addressed following previous internal and external reviews. In many cases we found that audit work undertaken could not be fully understood without obtaining oral explanations from the audit team and that the rationale for key audit judgments was not adequately recorded on the audit files. It was apparent that actions previously taken to improve the position (such as issuing reminders to audit staff of the need to document properly all work undertaken) had not been effective” (AIU, 2005, p. 20).

The external monitoring of audit firms, which has been implemented over the years, often spoke of enhancing the quality of audits. This effort is intended to make audit quality more visible to outside parties. Audit quality and its related activities, which were previously unknown to the world outside of the profession, can now be seen, observed and evaluated. It is an attempt to enhance the transparency of the audit firm’s governance and control in relation to audit quality. A key aspect of the monitoring and assessment of the inspection unit is the review of the professional judgements undertaken by the auditors. The inspection unit emphasises the importance of adequate and proper documentation of the process in the audit judgements as part of the evidence concerning audit quality.

2.3.2 The FRC Perspective on Audit Quality

In February 2008, the FRC issued a framework of audit quality with the intention that the publication would provide clear guidelines to companies, audit committees, regulators and other stakeholders in their assessment of audit quality. The framework followed consultation on the Discussion Paper on Promoting Audit Quality in 2006. The framework outlines five major drivers that can promote high quality audits (FRC, 2007):
1. The culture within an audit firm  
2. The skills and personal qualities of audit partners and staff  
3. The effectiveness of the audit process  
4. The reliability and usefulness of audit reporting  
5. Factors outside the control of auditors

The framework proposed by the FRC recognised a wider view of the factors that could influence audit quality (Figure 2.8). The framework identified audit reports as the key output of the audit process. Consequently, the effectiveness of the audit process is dependent on the internal and external factors within the audit firms. It identified three levels – individual, firm and institutional – that contribute to the attainment of high audit quality.

![Figure 2.8: The FRC Audit Quality Framework](image)

For example, at the individual level, the skills and personal qualities of the partners and staff of the audit firms are important to the effectiveness of the audit process. At the firm level, quality culture plays a significant role in the conduct of the individual. Lastly, the framework indicates that interactions and communication between the audit firms, audit clients, and the audit committees could influence the overall audit performance. In general, the interaction and relationship between these three levels could influence the quality of audits in practice. The framework explicitly recognises the wider aspects of audit quality and the performance of the auditors is influenced by various internal and external factors in the auditing
environment. More detailed discussions about the FRC audit quality framework and comments letters to the discussion paper are available in Chapter 4 of the thesis.

2.4 The Corporate Governance Framework

In response to the corporate failures (e.g. Polly Peck, Maxwell and BCCI) in the late 1980s and early 1990s, the FRC, the London Stock Exchange and the accountancy profession formed the Committee on the Financial Aspects of Corporate Governance in May 1991. This committee was later to be known as the Cadbury Committee and issued its report in 1992. The report made a number of recommendations concerning the relationship between the chairman and chief executive, the role of the audit committee, the role of external auditors and reporting on internal control and the company’s position (FRC, October, 2010b). Subsequent to the Cadbury report, various reports were issued and revised: the Greenbury Report (1995), the Hampel Report (1998), the Higgs Report (2003), the Smith Report (2003, FRC, 2005, and 2010c) and the Combined Code (FRC, 1998; FRC, 2003; FRC, 2006a and FRC, 2010a). Once again these were in response to corporate failures and scandals either internally (banking crisis) or as a reaction to corporate events in other parts of the world. These reports have become a formal framework for the UK corporate governance regime. In May 2010, the FRC issued the UK Corporate Governance Code to replace the Combined Code. The new code applies to all companies with a UK premium equity listing, regardless of whether incorporated in the UK or not, for accounting periods beginning on or after 29 June 2010 (FRC, 2010). The code carries through the corporate governance framework that operates on a ‘comply or explain’ basis. The code’s main principles are in five sections, concerning: leadership, effectiveness, accountability, remuneration, and relations with shareholders. The Code C.3.1 states:

"The board should establish an audit committee of at least three, or in the case of smaller companies two, independent non-executive directors. In smaller companies the company chairman may be a member, but not chair, of the committee in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman. The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience".

It can be seen that the discussion of corporate governance has gained popularity due to the incidents of corporate collapse that have contributed to the development of the role of the AC in the arena of corporate governance (Zaman, 2002).
2.4.1 The Audit Committee

Despite the widespread use of the term of corporate governance, there is limited consensus on what it is (Razaee, 2009). According to Cadbury (1992), corporate governance is the system by which companies are directed and controlled. The definition focuses on the systems of control, financial or otherwise, so as to achieve a company’s main objectives. It is also suggested that corporate governance is related to the effectiveness of regulatory initiatives to penetrate the organization and ensure compliance with rules via specifically designated officers, audit committees, and other internal structures (Power, 1997, p. 41). In the corporate governance arrangements, the AC is considered one of its key mechanisms, and is responsible for oversight of matters related to financial reporting, auditing and overall corporate governance (DeZoort, 1997).

There has been a significant increase in the adoption of ACs by companies since the issuance of the Cadbury and other reports (Collier, 1996; Adelopo, 2010). The adoption further increased in 1998 when the London Stock Exchange required listed companies to disclose compliance with the Combined Code as part of its listing requirements. There are other reasons that contribute to the adoption of an AC in the UK. Collier (1996) argued that the adoption of the AC by UK companies is a result of the direct influence of corporate governance practices in the US. However, the corporate governance practices adopted for UK companies are flexible because of the principle-based approach of the UK corporate governance framework. This is in contrast with the corporate governance regime in the US, which adopts a rule-based approach where compliance is compulsory. On a similar note, both the UK and the US place great emphasis on the role of the AC as one of the key players in the corporate governance framework.

Legislative pressure has also been identified as a factor that influences the rise in the adoption of the AC in UK companies (Zaman, 2002). Although efforts to legislate for the adoption of the AC have failed and adoption remains voluntary, the persistence of the attempt, such as the 1976 and 1988 Companies Bill (Audit Committees) to secure legislation may have influenced the rise in adoption (Adelopo, 2010). Pressure from the accountancy profession has also been identified as a factor that contributes to the adoption of the AC in the UK. For example, the ICAEW (1987), in response to the Eighth Company Law Directive, stated their strong support for a statutory requirement for an audit committee in all public companies. Another noticeable factor that has influenced the adoption of the AC is
related to the incidents of corporate collapse that resulted in greater expectations concerning the role of the AC in improving corporate governance (Adelopo, 2010).

The Cadbury Committee (1992) defined AC as a sub-committee of the main board that comprises mostly independent directors or non-executive directors with the responsibility for the oversight of auditing activities. The SOX (2002) section 205 (a) defines AC as:

“a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer”.

Razaee (2009, p. 120) provides a broader definition of AC, which includes its expected roles and responsibilities to all other stakeholders:

“The AC is a committee composed of independent, non-executive directors charged with oversight functions of ensuring responsible corporate governance, a reliable financial reporting process, an effective internal control structure, a credible audit function, an informed whistleblower complaint process and an appropriate code of business ethics with the purpose of creating long-term shareholder value while protecting the interests of other stakeholders”.

The terms of reference of the expected role and responsibilities of the AC is outlined in Section C.3.2 of the UK Corporate Governance Code (FRC, 2010a) as follows:

1. To monitor the integrity of the financial statements of the company and any formal announcements relating to the company’s financial performance, reviewing significant financial reporting judgements contained in them;
2. To review the company’s internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company’s internal control and risk management systems;
3. To monitor and review the effectiveness of the company’s internal audit function;
4. To make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;
5. To review and monitor the external auditor’s independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;
6. To develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm, and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken.
Section C.3.6 of the UK Corporate Governance Code further emphasises the principal responsibility of the AC regarding the appointment, reappointment and removal of the external auditor. In situations where the AC’s recommendation is not accepted by the board, the Code requires full disclosure on the matter in the annual report. In December 2010, the FRC Guidance on Audit Committees (formerly known as the Smith Guidance) (FRC, 2010c) was updated to assist members of the committee in carrying out their roles according to the relevant provisions of the UK Corporate Governance Code.

The Guidance outlines four major areas of best practice for the AC:

1. Establishment and role of AC, which includes membership, procedures and resources. It also covers issues of appointment, meetings, remuneration, and skills, experience and training of committee members (Paragraphs 2.1-2.19).
2. Relationship with the board (Paragraphs 3.1-3.5).
3. Roles and responsibilities. It provides guidance on the role and responsibilities of the AC concerning financial reporting, internal controls and risk management, whistle blowing, internal audit process and external audit process (Paragraphs 4.1-4.44).
4. Communication with shareholders (Paragraphs 5.1-5.3).

Paragraphs 4.17-4.44 of the Guidance specify the role and responsibilities of the AC concerning the external audit process. The guidelines can be summarised under four major areas:

1. Appointment of external auditor. The responsibility of the AC to review the external auditor’s selection and appointment process as well as investigate the reason for the auditor’s resignation. The AC should assess annually the qualification, expertise and resources, and independence of the external auditors and the effectiveness of the audit process.
2. Terms and remuneration of external auditors. The AC should approve audit fees and review terms of engagement. In particular, the AC should review the scope of the audit with the external auditors and can ask for additional work to be performed by the external auditors if the scope is inadequate.
3. Independence of external auditors. The AC should assess the independence and objectivity of the external auditors by taking into consideration the relevant UK laws, regulations and professional requirements (e.g. APB Ethical Standards for Auditors). The AC should review and approve non-audit services provided by the external auditors.
4. Annual audit cycle. The AC should review and discuss with the external auditors the findings of their work and discuss the effectiveness of the audit process. During the review and assessment the AC should among others:
   - Review the appropriateness of the audit plan, which includes planned levels of materiality and proposed resources to execute the audit plan;
   - Review key accounting and audit judgements;
• Discuss with the external auditor major issues that arose during the course of the audit and have subsequently been resolved and those issues that have been left unresolved;
• Review whether the auditor has met the agreed audit plan and understand the reasons for any changes, including changes in perceived audit risks and the work undertaken by the external auditors to address those risks;
• Consider the robustness and perceptiveness of the auditors in their handling of the key accounting and audit judgements identified and in responding to questions from the audit committees, and in their commentary where appropriate on the systems of internal control;
• Obtain feedback about the conduct of the audit from the key people involved, e.g. the finance director and the head of internal audit; and
• Review and monitor the content of the external auditor’s management letter, in order to assess whether it is based on a good understanding of the company’s business and establish whether recommendations have been acted upon and, if not, the reasons why they have not been acted upon.

From the above, it can be seen that the degree of codification of best practices and the attention given to the activities of the AC have greatly increased (Zaman, 2002; FRC, 2010c), particularly the role of the AC in relation to the external audit function. The AC now has greater roles and explicit responsibility for overseeing audit quality as commissioned by the UK Corporate Governance Code and the FRC Guidance on Audit Committees. The issue of communication between AC and external auditors has also been prevalent in the auditing standards. Nevertheless, the level of expectation concerning the role should be realistic given that its effectiveness and activity may depend on various factors that influence its effects and outcomes (Kalbers and Fogarty, 1993; Turley and Zaman, 2007).

2.4.2 Audit Committee Effects on the Audit Function

AC members are among the parties who are responsible for overseeing the external audit function. The UK Corporate Governance Code and the FRC Guidance on Audit Committee have emphasised the need for the AC to evaluate various aspects of the external auditor’s work, which includes monitoring auditor’s independence, appointment and remuneration, and effectiveness of the audit process. Thus, this section directs particular attention on the influence of AC on audit quality and its effects on external audit function.

The Link between Inputs and Outcomes Related to Audit Quality and the Audit Committee

Prior research lends mixed support for the association between the characteristics or effectiveness (composition, independence, financial literate member and frequency of meeting) of the AC, and inputs and outcomes related to audit quality.
Overall, past studies have documented inconclusive evidence on the association between the existence and the characteristics of the AC with financial reporting quality. Prior research tends to focus on the impact of the presence or characteristics of the AC on earnings management, financial restatements and regulatory sanction. It is expected that the presence of an AC will be likely to inhibit companies from engaging in earnings manipulation (Dechow et al., 1996) and result in less adjusting errors in prior reports (DeFond and Jiambalvo, 1991).

Felo et al. (2003) found a positive association between financial expertise and high quality of financial reporting but were unable to identify any association between independence and financial reporting quality. Xie et al. (2003) found similar evidence that showed financial expert members are associated with high financial reporting quality. Multiple regression analysis used in the study revealed a significant relationship between active (more frequent meetings) and expert members, and lower discretionary accruals. Qin (2007) also found a significant relationship between accounting expertise and earnings quality. He suggested that AC members with previous accounting positions such as public accountant, auditor, principal/chief financial officer, controller, or principal/chief accounting officer relates to high quality of reported earnings.

Bedard et al. (2004) evaluated the impact of AC characteristics: financial literacy, independence and meetings frequency on earnings management. Using the level of income increasing/decreasing abnormal accruals, results are consistent with expectation and show that aggressive earnings management relates to less financial expertise, independence and meetings frequency.

Piot and Janin (2007) documented mixed associations between the proxies of audit quality, AC characteristics and financial reporting quality in France. Specifically, they examined whether auditor size (reputation) and audit tenure, and the existence of an AC and its independence influence the level of earnings management. Archival evidence reveals some interesting findings. First, they reported no significant association between the Big 5 auditors and the level of abnormal accruals. Similarly, they did not find any evidence that supports the suggestion that an increase in audit tenure leads to a decrease in audit quality (increase in abnormal accruals). Second, although the presence of an AC relates to lower earnings management, other AC characteristics such as independence appeared to be insignificant. In contrast, Klein (2002) found that an independent AC is associated with lower earnings management. Using data from 692 observations from year 1992 to 1993 of S&P 500 companies in the US, analysis
showed a negative association between AC independence and abnormal accruals. Furthermore, Klein found that the less independent the AC composition, the larger the abnormal accruals become. This may infer that independence of AC members is important to oversee the quality of financial reporting process by ensuring lower earnings management.

Abbott et al. (2003a) examined the effects of expertise and AC meeting frequency on financial restatements. Results showed a significant negative relationship of both variables with financial restatements. Carcello and Neal (2000) examined the issue of whether independence of AC members influences the type of audit opinion issued by the external auditor. Using data from 223 financially distressed companies in the US, they examined the association between AC composition and the likelihood that the auditor will issue going concern modified reports. The findings indicate that the greater the percentage of affiliated directors in the AC, the lower the probability that the auditor will issue a going concern opinion.

For example, Abbott and Parker (2000) highlighted the link between AC characteristics and the appointment of an industry specialist auditor. Using archival data of 500 US companies, the results showed that independent and active AC members (that meet at least twice per year) are more likely to select auditors that specialise in the company’s industry. The results imply that an independent and effective AC will demand a high quality of audit and therefore will appoint an industry specialist auditor on the assumption that they are better in detecting material errors in financial statements. Chen, Moroney and Houghton. (2005) replicated and extended the study by Abbott and Parker (2000) by looking at other variables (director qualifications, number of directorships and provision of non-audit services) in their model. Using data from 510 listed companies in Australia, the analysis of the results indicated that AC independence influences the use of an industry specialist auditor, which was consistent with Abbott and Parker’s (2000) study. In contrast, the proportion of directors with financial qualifications and the frequency of AC meetings were not associated with the selection of an industry specialist audit firm. The contradictory results might have been due to different regulatory settings or different variable specifications and measurements. A key limitation of the above-mentioned studies was that AC effectiveness and industry specialist auditor causality cannot be directly examined.

The existence of the AC has also been argued to have an effect on either increasing or decreasing the audit fee. A number of rationales can be offered for this possibility. First, it is expected that the audit fee will be higher if the AC aims for
higher audit quality through demanding a high level of audit coverage. Second, strong internal control associated with AC could reduce audit fees because of less audit coverage. Collier and Gregory (1996) examined both these propositions in their analysis of 315 companies of the FTSE 500 in the UK. They found that the presence of an AC is associated with higher audit fees but found no significant relationship for the second. In contrast, O'Sullivan (2000) found no evidence that the characteristics of the AC influence auditors’ pricing decisions. Prior research has also examined the association between the characteristics and effectiveness of the AC, such as independence, expertise and meeting frequency with non-audit fees (Abbott et al., 2003b; Stewart and Kent, 2006). Researchers have theorized that effective AC members have an incentive to limit the provision of non-audit services as it could compromise auditor’s independence. Abbott et al. (2003b) suggested that AC members perceive that a high level of non-audit services could impair auditor independence, hence, the ACs use their span of control to limit the provision of non-audit services. The findings from archival data were consistent with expectations and show that independence and meeting frequency were negatively associated with the ratio of non-audit to audit fees, suggesting that an effective AC is able to influence the scope of audit coverage and limit the provision of non-audit services. However, Lee and Mande (2005) found no significant relationship between AC effectiveness and non-audit fees. The inconsistent results highlight the limited effect of the AC on the scope of external audit and auditor’s remuneration.

In addition to focusing on the non-audit fees ratio, Gaynor et al. (2006) investigated three research questions in relation to non-audit services. First, whether ACs consider the effect of non-audit services on quality of audit before any approval of the purchase of non-audit services from the auditor. Next, the extent that mandated fee disclosures affect the AC’s pre-approval decision. Lastly, the extent to which the audit committee’s decision in relation to the joint provision of audit and non-audit services is consistent with investors’ preferences. The experimental study revealed three important results. First, ACs are willing to appoint an auditor for non-audit services if it improves the quality of audit. Second, the AC’s pre-approval decision is affected by fee disclosure requirements. Third, relative to the AC members, investors believe that the joint provision of non-audit services will improve audit quality. Thus, this study lends support to investigating the importance of ACs in improving audit quality (specifically on auditor independence in fact and in appearance). An important limitation of the study is
that experimental work might not provide similar results to those in an actual setting.

In the UK, the Financial Reporting Review Panel (FRRP) is responsible for taking action against companies for flawed financial statements. The study carried out by Peasnell (1999) showed an insignificant relationship between the presence of the AC with a sample of 47 UK companies that were subject to FRRP action. Windram and Song (2000) showed a significant negative relationship between FRRP action and the characteristics of the AC (financial literacy, the number of outside directorship and number of meetings). Beasley (1996) found the presence of the AC has no significant effect on the likelihood of financial statement fraud.

Prior research has also investigated the perception of AC members on factors that influence audit quality in practice. Using data collected from a survey questionnaire of AC chairpersons in the US, Schroder et al. (1986) found that factors related to audit team (e.g. attentiveness of manager and partner, and planning and conduct of audit team) are perceived to be more important than audit firm factors (e.g. relative audit fees size, the results of peer review and litigation). A subsequent study on AC members’ perceptions of audit quality was carried out by Knapp in 1991. He employed an experimental study that specifically examined the perception of ACs on the impact of audit firm size, audit tenure and type of audit approach (structured vs. unstructured) on audit quality (auditors’ ability to detect and report material error). He found that ACs that had experience of working with differing sizes of audit firm did not perceive big size audit firms as better quality than the smaller firms. The auditor’s tenure was perceived to be positively related to audit quality in the early years of the audit engagements, but negatively related to audit quality in subsequent years. Interestingly, the study suggests that the AC members’ lack of in-depth understanding and knowledge about different types of audit approach, which would enable them to substantiate its impact on audit quality that draws attention to the limited skills and knowledge of the AC. Several studies have also highlighted the sufficiency of knowledge and expertise of AC members, which may inhibit their capacity to discharge effective oversight function (DeZoort, 1997; Lee and Stone, 1997).

Beattie et al. (2011) examined the perceptions of the AC chairpersons concerning factors that enhance audit quality in the post Enron environment in the UK. Among factors that were rated highly by the chairs of the AC that could enhance audit quality were auditors’ communication on various issues relating to the audit, audit fees relative to audit scope, and audit firm’s internal quality monitoring procedures.
They also perceived that AC members’ independence and financial literacy were important factors that could enhance audit quality.

**Operation of Audit Committee and its Effect on External Audit**

There are a small number of studies that attempt to understand the impact of the AC on the audit process as well as to understand the operation of the AC in relation to the external audit. Cohen and Hanno (2000) can be regarded as one of the first studies that examined the issue of corporate governance and the audit process. Using experimental methods they investigated the impact of the oversight activities of directors and the AC (independence and frequency of meetings), and management control philosophy to preplanning (client acceptance process) and audit-planning. The findings indicate that corporate governance activities (strong or weak) and management control activities (strong or weak) influence the audit process. In particular, strong corporate governance and control activities influence auditor consideration concerning the client acceptance process, as well as the auditor assessment of client business risk. Likewise, both corporate governance factors and management control philosophy have a significant effect on auditor planning judgement and subsequent substantive testing, and subsequent control risk assessments. From a financial reporting viewpoint, the results suggest the importance of having strong corporate governance mechanisms that can influence audit quality and financial reporting quality. Strong control environments are associated with less financial restatements and fraudulent financial reporting, which might inhibit the attainment of high quality financial reporting.

In an extension of their earlier study, Cohen et al. (2002) carried out a semi-structured interview with 36 audit practitioners (seniors, managers and partners), to investigate the impact of corporate governance factors on the audit process. Specifically, the study attempted to examine three main research questions: first, the auditors’ perception on the structure, importance and the effectiveness of corporate governance factors; second, how auditors consider the impact of the corporate governance factors in audit planning and the conduct of the audit; third, auditors’ views concerning the importance and role of corporate governance in the audit process, in audit engagement, client acceptance and in the future. The study revealed that auditors perceived company management as an important structure in corporate governance. Surprisingly, the auditors perceived the AC as unimportant and ineffective in the governance process. Next, all of the respondents indicated that they gather and use corporate governance information in audit planning and audit performance. Furthermore, the respondents perceive that
corporate governance is important in the client acceptance stage and for multinational clients. Finally, the majority of the auditors indicated the greater importance of corporate governance factors in the audit process now and in the future. In general, this study provides weak support concerning the impact of the AC on the audit process. Nonetheless, it is important to note that this study was conducted to demonstrate AC effectiveness in overseeing the external audit process before the Enron environment when the AC was less scrutinised.

There is some research concerning process issues in the operation of the AC and its relation to external audit. Analysis of the fieldwork case study carried out by Gendron et al. (2004) suggests that the existence of the AC is for more than ceremonial purposes and the AC meetings are more than formal ritual. The case study evidence showed the important aspects of asking challenging questions, and assessing the written and verbal information provided by auditors in the operation of the AC that contribute to AC effectiveness. This finding is in contrast to an earlier study by Spira (1999) who argued that audit committee activities, such as meeting documentation and the process of questioning lack substance and mainly serve as ceremonial performance to gain the external symbol of legitimacy. Comparatively, Turley and Zaman (2007, p. 775), using a case study of UK public companies, showed minimal impact of the AC on external auditor activity. The study provides limited evidence on: i) impact of the AC on audit design, ii) authority of the AC to appoint and remunerate auditors, and iii) the ability of the AC to challenge and question the audit findings in the AC meeting. These results suggest limited effects of the AC on external audit, and, in consequence, audit quality.

To synthesize, although mixed results have been documented, prior research generally suggests that there is an association between the existence and characteristics of the AC and various proxies of audit quality. Nonetheless, most of the research in this area has employed archival or experiment methods, which provide limited understanding concerning how the AC contributes to high audit quality. Similarly, surveys do not provide much information about AC activities or how the AC evaluates the effectiveness of the audit and audit quality. DeZoort et al. (2002, p. 69) identified the dominant focus of archival and survey methods in AC research and suggested that other methodological approaches might be better in understanding additional aspects of AC activity. Their analysis and synthesis of the AC literature suggested that there is a need for more research on relationships and interfaces between the AC and external auditors.
Turley and Zaman (2004) provided an analytical review of the effects of AC on three main aspects: audit function, financial reporting quality and corporate performance. Overall, they suggest more work: i) to understand the operations and processes of the AC, and, in consequence, its effects; and ii) to understand the role of the AC within its institutional and organisational contexts; and iii) more qualitative research methods (case studies and interviews) to complement existing research beyond documenting the association between the AC characteristics and its expected outcomes.

2.5 Implications of Review and Research Questions

This chapter has evaluated different strands of research that are relevant to audit quality. The description of the research aspects related to audit quality set out in this chapter has drawn attention to the limitations of this work in several areas. First, notwithstanding its wide-ranging nature and extensiveness, it is apparent that there has been rather limited progress in our understanding concerning the meaning of the concept of audit quality beyond the technical competence and independence of auditors. Essentially, there is a gap in relation to how those involved in the audit process conceptualise audit quality in practice. Thus, this thesis sets out the objective of examining the practical conception of the meaning of audit quality from the perspective of key participants in the audit process – auditors, AC members and quality inspectors, using semi-structured interviews, archive documents and a questionnaire survey. This is important because even if we identify a relationship, such as the size of firm being linked to higher quality signal, we do not know how the practitioners in a particular class of firm are viewing the task and what they are doing which gives rise to this link. In like manner, there is limited understanding concerning how AC members commission audits in order to satisfy their expectations for high audit quality in practice or how the operation and activity of the AC has an effect on audit quality. Similarly, evidence on how audit inspectors evaluate quality and contribute to the achievement of high quality auditing in practice is rather limited. Therefore, the current research, which focuses on how audit quality is given meaning by those involved in conducting, commissioning and evaluating auditing in practice, is worthwhile and will contribute to the extant literature. The three groups and specific research design are chosen for two reasons. First, they are directly responsible for delivering or ensuring the quality of auditing and thereby the integrity of financial reporting and therefore could provide rich information on the research topic. Second, the research aims to gain an in-depth and detailed knowledge of the topic based on the groups’ opinions, feelings, actions and
thoughts. As such, qualitative enquiry through archive documents, semi-structured interviews and a questionnaire survey are best matched with the research objective. The first research question is formulated to reflect the objective of providing additional evidence about how the concept of audit quality is given meaning by those involved in auditing, as follows:

Research question 1: How is the concept of audit quality understood and applied by key participants in the audit process?

Second, the analysis presented in this chapter suggests that only a relatively small number of studies consider wider social, organisational and institutional dimensions in the investigation of audit quality. This has illustrated that quality of audit performance is influenced by various internal and external factors in the auditing setting. Nevertheless, relatively little is known about how the factors in the auditing environment influence and shape the construction of meaning of the concept of audit quality by key participants in the auditing process. There has been little effort to understand the possible influence of organisational and social factors on the construction of meaning for audit quality in practice. Despite the development of studies which place greater emphasis on understanding audit practice in its context, so far little attention has been given to exploring how the meaning of the concept of audit quality is constructed in practice in the context of the social, regulatory and economic environment of the audit firm. Thus, this thesis aims to examine the impact on the meaning of audit quality of interactions between the key participants in the auditing setting and their environment, such as the social, economic, regulatory and institutional arrangements in which they operate. This investigation is important because auditing activity is conducted in a social and organisational setting that may potentially influence what is been regarded as audit quality in practice. The second research question is formulated to achieve the research objective as follows:

Research question 2: What are the factors that influence the construction of the meaning of audit quality in practice?

Third, the description of auditing practice in its organisational and social context (section 2.1.4) has shown that quality of audit services cannot easily be measured and, as a result, audit practices can be linked both to technical functions, and efforts to preserve and strengthen the legitimacy of the auditing profession. Relatively little is known about the relationship between the meaning of audit quality and audit practices and how that meaning is represented in practice. There
are a limited number of studies that examine how the meaning of audit quality is perceived by the auditors, AC members and quality inspectors and how it is symbolised in practice and to what purpose. Thus, this thesis aims to examine how the meaning of audit quality is represented in practice by the key participants in the audit process. The following question is formulated:

Research question 3: How is the meaning of audit quality represented in practice?

Finally, the review presented in this chapter has highlighted considerable changes in the auditing and governance framework in the UK as a specific response to the corporate and auditing failures. As a result, the AC has now greater and more explicit responsibility for overseeing audit quality as commissioned by the UK Corporate Governance Code. In addition, there is now greater emphasis on the importance of communication between the external auditors and the AC towards achievement of audit quality in practice. In like manner, the changes in the auditing framework have introduced the AIU as a prominent party to monitor the level of quality of audit services delivered by the audit firms. The interactions between auditors with the AC members and quality inspectors may potentially influence delivery and achievement of audit quality in practice. Despite significant developments on the regulatory framework in the UK in recent years, there is rather limited understanding concerning the impact of the changes in the auditing and governance framework to the delivery and achievement of audit quality in practice. Thus, this thesis sets out the objective of investigating the impact of the AIU and the AC members on the achievement of audit quality. The following questions are formulated:

Research question 4: What is the impact of the AIU on audit quality?

Research question 5: What is the impact of the AC on audit quality?

2.6 Summary

The main premise of the thesis is that auditing is a socially constructed activity, thus, the meaning of audit quality is socially constructed and is influenced by societal and organisational contexts: interactions between various parties, and regulatory and economic factors in the auditing environment. This study seeks to investigate how the concept of audit quality is given practical meaning by audit practitioners, AC members and quality inspectors. Rather than viewing audit quality as an attribute of the individual audit that can be identified and ‘measured’, it explores the way in which auditors, AC members and quality inspectors interpret
and apply the concept and construct meanings that can influence the manner in
which the actual audit process and oversight evaluation of that process are
conducted. Therefore, an interpretive approach and qualitative methodology were
selected to provide better insights into various factors that shape and influence the
perceptions of audit quality within its social and organisational contexts. These will
be discussed in the following chapter.
Chapter 3

Theoretical Framework and Research Design

3.0 Introduction

Chapter 2 identified that in the extant auditing research, and more specifically, in that pertaining to audit quality, there is very limited consideration of what audit practitioners, AC members and quality inspectors understanding to be the meaning of audit quality and the possible influence of institutional, organisational and social factors on the construction of that meaning in practice. In other words, there is limited understanding about how interactions between auditors and other audit market constituents, such as AC members and quality inspectors influence their conceptions of audit quality or how the meaning of the concept of audit quality is constructed, promoted and reacted to by those groups. The purpose of this chapter is to develop a framework, drawing on symbolic interactionism, to understand the process of giving meaning to audit quality in its organisational and social context. This chapter also explains the research approach, research design and research methods adopted in addressing the research questions outlined in chapter 1 (section 1.3).

This chapter is organised into five sections. Section 3.1 briefly explains three main research perspectives in accounting research. It specifies in detail an interpretive or social constructionist perspective that determines the methodological approach used in this study. Section 3.2 discusses the theoretical framework informing the analysis. Section 3.3 describes the research methods used, including data collection and data analysis. Finally, section 3.4 provides a summary of the chapter.

3.1 Research Methodology

Chua (1986) identified three methodological assumptions of accounting research that delineate a researcher’s way of viewing and researching the world. First, the positivist/functionalist (mainstream) research approach, which believes that society or reality is objective and external to the subject, theory is separated from observations and human beings are passive and rational in pursuing their goal. This approach favours the use of quantitative methods of data analysis (hypothesetical-deductive accounts) and collection of data by experiments, surveys and archival methods to understand social reality or objects that allow for generalisation of findings. The second research approach mentioned by Chua is the critical approach
that views human beings as having inner potentialities that are alienated through a restrictive mechanism. The critical approach believes theories are temporal and context bound. As such, historical, ethnographic and case studies are commonly used to understand social reality (for details of both approaches, refer to Chua, 1986).

The third research approach, and the one applied in this thesis, is called interpretive research. This approach assumes the nature of social reality to be fluid and subjective; it does not exist in a concrete sense. In contrast to the positivist approach, the interpretive focuses on individual meaning and people’s perceptions of ‘reality’ rather than any independent ‘reality’ that might exist external to them (Hopper and Powell, 1985). The interpretive approach focuses on understanding the subjective nature of the social world from the frame of reference of the subject being studied. In other words, social phenomena that happen in society are understood from the point of view of the participant or actor rather than the observer (Morgan, 1980). In addition, the interpretive approach views social reality as socially constructed where reality is emergent, subjectively created and objectified through human interactions that are given an ‘objective’ form through performances, rituals, symbols and artefacts (Berger and Luckmann, 1967; Chua, 1986; Richardson, 1987, p. 346). The interpretive approach also considers that actors’ definition and understanding of social reality is influenced by the interaction between the actor and their environment, such as the social, economic and institutional arrangements in which they operate.

Berger and Luckman (1967, p. 78-80) proposed that social reality is constructed during three dialectical moments. First, externalization - conceptions of social reality are given objective form through performances, rituals, symbols and artefacts. Second, objectification - conceptions of social reality are accepted as part of social reality then achieve objective reality in life. Third, internalization - objectivity of social reality is internalized through socialisation processes (e.g. education and training) that reflect meaning.

In the case of audit quality, auditing services involve undefined activity and the quality of its output is unobservable. Normally, the process and procedure of the audit begin with a series of planning decisions that are tailored to a specific audit client. It involves various assessments such as reviewing clients’ risks and internal control systems that later influence the scope of the audit in terms of the type and extent of the audit tests. Here, auditors need to exercise their ‘professional judgement’ to get comfort that the scope of the audit is appropriate and sufficient.
to allow them to be reasonably satisfied that a high audit quality is achieved and the financial statements are free from material misstatements and presented in accordance with generally accepted accounting principles. Nonetheless, determinations of ‘sufficient’ ‘appropriate’ and ‘reasonable’ are somewhat subjective and are always supported by the phrase of ‘professional judgement’ (Humphrey et al., 1992, p. 148). In this case, auditors must make a decision about the extent and nature of audit evidence and the level of audit quality that he/she is aiming to achieve. As a result, different views may be formed as to what audit quality is. Thus, this highlights the subjective dimension about the reality of audit quality in practice.

As indicated in Chapter 2, auditing is more than a neutral technical practice and the activity of auditing can be seen as being socially constructed. For example, although auditing may involve certain procedural elements the role of judgement or choice of methods is conducted in a social and organisational setting, which means it cannot be treated as a standard set of tasks. This is to say that auditing involves interaction in the process; individual auditors interact with other members within the audit firm and with various constituents in auditing settings. For example, auditors interact with peers, superiors or subordinates within the audit firm. The auditors also interact with the audit client, AC members and regulators who are among key participants in the auditing and financial reporting system. These interactions reflect particular interests and expectations that may, in turn, affect the auditing practices and, consequently, the performance of individual auditors. In addition, auditing activity involves interaction with the environment where it operates, such as economic and regulatory conditions in the audit market. All of these factors may potentially influence what is been regarded as audit quality in practice.

It has been noted that much of the auditing literature is dominated by so called ‘mainstream auditing research’ or positivist research that fails to investigate and acknowledge the social construction of audit practice (Humphrey, 2008). Prior research provides little information about how audit firms carry out or produce their audits and the consequences for audit practice (Hopwood, 1996; Sikka et al., 2009). Consistent with this, many have called for research evidence about audit practice from the institutional, organisational and societal context of auditing (Kirkham, 1992; Hopwood, 1998; Humphrey, 2001; Power, 2003). According to Humphrey:
"What are certainly needed are studies and approaches that seek to understand what is, or has been done, in the name and development of audit practice. The problem with so much audit research is that it does not explore audit practice per se, but rather fabricates such practice, studying around the edges of the “black box” of auditor decision-making or constructing experiments that cannot ever really be expected to replicate either the real pressures and career challenging or threatening scenarios that some auditors can encounter in their actual working environment" (Humphrey, 2008, p. 193).

Previous studies of auditing, which adopt such approaches have been described in section 2.1.5. These illustrate that research that considers auditing in its institutional and organisational context is helpful in understanding the phenomena of auditing. In spite of the contribution of this body of research, there have been many calls for more contextually based studies of auditing (Lee and Humphrey, 2006; Sikka et al., 2009). Humphrey, in calling for research on audit practice, commented:

“There is also a great need for more work exploring audit firms as institutions – on explaining the forces driving working priorities and practice changes, on understanding the organisational cultures within firms, the reward and remuneration structures and the impact these have on the construction and behaviour of auditors, audit teams and audit clients” (Humphrey, 2008, p. 194).

This current study responds to such calls by providing a rich descriptive account about the conception of meaning attributed to audit quality in practice within its social, organisational and institutional context. This thesis uses a symbolic interactionism perspective as a framework to understand the perceptions of auditors, AC members and quality inspectors concerning the meaning of audit quality in practice, factors that influence the construction of the meaning and related symbols that signify the meaning. The next section will further discuss the symbolic interactionism perspective that underpins the analysis of the study.

3.2 Theoretical Framework for the Research

This section explains the principles of symbolic interactionism and their application to the study. The framework presented in Figure 3.1 builds on relevant aspects of symbolic interactionism, which considers the dynamic interactions between various constituents in the auditing setting and the environment that influence the construction and representation of the meanings of audit quality in practice, appropriately grounded in its social and institutional context.
The central ideas of symbolic interactionism were developed from the work of American scholars, such as George H. Mead, Herbert Blumer and Norman Denzin, who endeavoured to understand the process of making meaning of a social reality (Charon, 2007). This perspective pays particular attention to understand how meanings are constructed based on interactions between people and their environment. Blumer (1969) asserted that symbolic interactionism is based upon three principles:

1. Human beings act towards things on the basis of the meanings that the things have for them.
2. The meaning of such things is derived from, or arises out of, the social interaction that one has with others and one’s self.
3. These meanings are handled in, and modified through, an interpretive process used by the person in dealing with the things he/she encounters.

Thus, human meaning is seen as a social object, which is formed in the context of social interaction with others and the thinking of the actor and is used by people in their actions. Charon (2007, p. 47) explains that a social object is any object in a situation that an actor uses in that situation. That use has arisen socially. That use is understood and can be applied to a variety of situations. The perspective regards human meaning as symbolic and behavioural, which means that meaning entails signification and intention that can be seen in the symbolic realm and related meaningful action (Prasad, 1993; Hewitt, 2003). Accordingly, meaning as a social object is signified, created and communicated through the use of symbols (words, objects and acts) not only to others but also to our self (Charon, 2007). To quote Charon:

"Social objects and therefore symbols are socially established and understood. This means that symbols are defined in interaction, not established in nature. People make them, people discuss them, people agree on what they shall stand for. Symbols are conventional, a socially established use for the purpose of representations. Conventional means that the symbol is arbitrarily and purposely developed to refer to something" (Charon, 2007, p.48-49).

According to this perspective, symbols are important for the individual to operate or define meaning of the social object for the person and others that they interact with. Symbols are also important to manage other people's impressions that later influence other people's definitions of situations and their conduct (Dolch, 2003, p. 394).
Following on from symbolic interactionism, the reality of audit quality is not just 'out there’ but must be constructed in the activities of external auditors, AC members and quality inspectors. Accordingly, the ‘reality’ of audit quality has to be signified and communicated using various symbols internally and externally by the individual actors (for example, professional qualification, audit review, auditing standards, consultation, audit documentation or audit committee meetings). In this case, audit quality becomes a symbolic representation of reality that those individual’s use to arrive at a certain (satisfying or unsatisfying) degree of comfort and confidence in the performance of audit delivered by or presented to them in the situations in which they find themselves.

Symbolic interactionism states that the meaning of a social object can be understood by focusing on how people interact in a particular situation, and how the environment may influence their perceptions and actions (Puxty, 1993). As people are self-reflective, their perceptions and acts are not only caused by forces within themselves (instincts, drives, needs, etc.), or by external factors (political, social or economic systems, etc.) but also what lies in between, a reflective and socially derived interpretation of the internal and external stimuli (Meltzer et al., 1975). In the case of the audit firm, the influence of commercial activities and image management of the audit firm as well as the legal, political and social-economic structures may influence the auditor’s work performance (Sucher and Kosmala-MacLullich, 2004; Hudaib and Haniffa; 2009).

The perceptions of people concerning social meaning are also influenced by the role or expectations of behaviour that are expected by others in their social interaction (Dolch, 2003, p. 393). It is argued that people perform a wide variety of roles in different domains of their everyday lives that cause multiple and frequently conflicting interpretations and meanings of social objects (Gopal and Prasad, 2000, p. 514). Consider the audit firm: the expected roles of external auditors from other significant parties such as the regulator, client management and audit committee during interaction may influence the construction of meaning of audit quality and related behaviours. It is important to acknowledge that auditors need simultaneously to satisfy various role expectations from these groups who may hold competing interests and have different authority. As a result, when there are differing role expectations, it may create role conflicts for the auditors and have the potential to affect their performance and the quality that is achieved (Koo and Sim, 1999). The inevitable consequence of this is that any given meaning of audit quality has the potential to create conflict depending on what others consider to be audit quality.
The symbolic interactionist perspective also suggests that the meaning of a social object can be understood by looking at the process of 'self-interaction', which focuses on how an individual’s perceptions, conceptions and communications about/with themselves influences meaning and action:

"First, the actor indicates to himself the things toward which he is acting; he has to point out to himself the things that have meaning. The making of such indications is an internalized social process in that the actor is interacting with himself. This interaction with himself is something other than an interplay of psychological elements; it is an instance of the person engaging in a process of communication with himself. Second, by virtue of this process of communicating with himself, interpretation becomes a matter of handling meanings. The actor selects, checks, suspends, regroups, and transforms the meanings in this light of situation in which he is placed and the direction of his action” (Blumer, 1969, p. 5-6).

In this case, the self-conception of external auditors as a professional occupational group and their perceptions of a public service oriented audit function that facilitates the public interest may influence and shape the meaning of audit quality. Furthermore, the increasing commercialisation of audit practice for profit making and economic efficiency may influence external auditors meaning of audit quality. Correspondingly, how the quality inspectors and the AC members view and define themselves may influence and shape the meaning of audit quality.

In brief, symbolic interactionism emphasises that the perceptions of people concerning the meaning of a social object can be understood through three important concepts. First, 'self interaction’, in particular self-conception, influences the construction of the meaning of a social object. Second, the meaning of social object is influenced by social interaction with others in a particular situation and other environmental factors, and thus social meaning is influenced by various internal and external stimuli. Third, acts and objects are used as symbols to communicate and represent meaning of the social object to self and others. In applying these concepts for the purpose of this thesis, this study uses interviews, a survey questionnaire and public documents to understand the range of meanings and symbols that are shared, communicated and manipulated via the interactions between the participants in the auditing setting.

This study regards auditing practice as a socially constructed activity and audit quality is regarded as a social object. Hence, the perceptions and beliefs of individuals about audit quality are seen as emerging from a complex series of interactions between various constituents in the auditing environment, and influenced by various environmental factors such as coercive pressure imposed by laws or regulation and commercialisation of audit practice that affects the work of
the external auditors (Humphrey and Moizer, 1990; Nagy and Cenker, 2007). It is important to note that external auditors do not work in isolation. Therefore, it is important to understand how the people, processes, and environment that auditors interact with influence their understanding of the audit task and, therefore, their performance and, consequently, their perceptions about the quality achieved (Nelson and Tan, 2005, p. 59). In like manner, changes in the legislation on ACs as a response to corporate collapses, particularly in relation to external audits may influence the perceptions of AC members concerning audit quality, and, in consequence, auditors’ working practices. In addition, recent changes in audit regulation have introduced the AIU as a prominent actor in the auditing environment, which may have a different conception about audit quality, as such, interaction of external auditors with the AIU may influence their meaning for audit quality and associated action.

Symbolic interactionism has been applied in auditing and accounting research. Hudaib and Haniffa (2009) studied meaning of auditor independence in Saudi Arabia and applied concepts of social interaction, joint action and differential degree of power in symbolic interactionism. Based on interviews, observations and document analysis they found that construction of the meaning of independence was influenced by auditors’ reflective perspective concerning their reputation and ethical reasoning. It was also found that commercial activities and image management of the audit firm as well as political and social-economic structures of the country influence meaning of independence. Willmott (1986) incorporated interactionist approach to study the development of the accountancy profession in the UK. In his historical analysis, he found that the major accountancy bodies play a significant role and become an important instrument for constructing and projecting meaning of ‘profession’ through defining and securing status, value, and social identity of accountancy profession. Further, the approach identified the presence of competing interests and tensions between and within the major accountancy bodies causes by problems of organizational identity and internal governance as well as disproportional financial and political strength. Preston (1986) employed participant observation in a single case study of plastic containers division of large organisational to examine managers understanding of meaning of production information system. He paid particular attention to symbols - mechanics and media used in the process of informing (for managers to inform each other and themselves) and found that media of interactions, observation, personal record keeping and attending meeting were important in constructing and maintaining aspects of information processes within an organisation.
It should be noted that the symbolic interactionist perspective suffers criticism as interactionist researchers do not rely on the use of strict scientific methods in their investigation (Athens, 1984). Blumer (1969) stressed that the perspective focuses on understanding social reality from the perspective of the individual. He argued that the value and validity of this perspective lies in the direct examination of people being studied and their own interpretation rather than the ‘objective’ view of the empirical social world. The central principle of symbolic interactionism is that it concerns the understanding of what the actors themselves believe about the world (Charon, 2007). Therefore, testing hypotheses and defining two or more variables and testing the causal relationship between them would not capture the perspective of the individual actors.

The theoretical framework based on symbolic interactionism has been outlined and is used to help achieve the objective of understanding the focus of this research. The following section continues to explore the research design and includes a description data collection and data analysis, which complements the theoretical framework of this study.

**Figure 3.1: Theoretical Framework**

![Theoretical Framework Diagram](image)
3.3 Research Method

This study uses an interpretive approach that requires the use of the qualitative methods to provide insight into the topic under study. This approach gives an opportunity to the researcher to investigate the issue of audit quality within its social, organisational and institutional context in an open and flexible way. Qualitative methods are thought to be most appropriate, as the issue needs to be explored in detail from the participants’ own perceptions and beliefs. Furthermore, the concepts and variables of the study are difficult to measure and an understanding of the subject might not be achieved through more structured research. Patton (2002) mentions that qualitative methods allow examination of a social issue in an open and comprehensive manner without some predetermined categories. It also permits the researcher to gather rich information and enhances the understanding of social phenomena with a small number of people or cases.

Patton (2002, p.4) states that qualitative methods are recognised from three types of data collection: (1) in-depth, open ended interviews (which yield direct quotations from people about their experiences, opinions, feelings and knowledge); (2) direct observation (which involves detailed descriptions of people’s activities, behaviours, actions, and a full range of interpersonal interactions and organisational processes as part of the observable human experience); and (3) analysis of written documents (comprising studying excerpts, quotations, or entire passages from organisational, clinical, or programme records; official publications and reports; personal diaries; and questionnaires and surveys). Consistent with this view, the data for this study were gathered from written documents, semi-structured interviews and survey questionnaires. The next section further explains the data collection and data analysis used in this research.

3.3.1 Research Design

Research design provides a framework for the collection and analysis of data (Bryman and Bell, 2007). In this thesis, the study of official publications and reports, semi-structured interviews and survey questionnaires were used to answer the research questions established in Chapter One. These questions were addressed using two separate stages of related studies. In the first stage, documentary study was employed to identify relevant issues in audit quality from the comments submitted by a wide group of interested parties who responded to the discussion paper ‘Promoting Audit Quality’, which was issued by the FRC in 2006. The issues identified were used in developing an interview guide so that relevant themes were
covered in the second stage of the study, which involved semi-structured interviews with audit partners, AC members and quality inspectors. In this way the interview could be structured around the matters for which there was already some evidence of their relevance to the understanding of audit quality. An on-line survey questionnaire was used to complement interview data collected from quality inspectors as it was not possible to negotiate access to interview a large number of inspectors directly, due to the sensitivity and confidentiality of their work. The research design for all of the studies is explained in the following sub-sections.

3.3.1.1 Collection of Data and Analysis of Comment Letters

In 2006 the FRC issued a discussion paper Promoting Audit Quality (FRC, 2006b) and invited comments from various stakeholders, audit market participants and commentators by a deadline of 31 March 2007. A summary of the discussion paper is described in Appendix 1.

The FRC received thirty-nine sets of comments concerning the discussion paper, which are available as part of the public record and published on the FRC website (www.frc.org.uk/about/promotingauditqualityresponses.cfm). The views expressed in all the comment letters submitted to the FRC were examined to identify potential and significant issues that ought to be explored during the interview stage. Detailed findings from the examination are reported in Chapter 4.

This study is based on a qualitative content analysis of the comments received by the FRC. Qualitative content analysis is defined as:

“any qualitative data reduction and sense-making effort that takes a volume of qualitative material and attempts to identify core consistencies and meanings” (Patton, 2002, p. 453).

Qualitative content analysis is an accepted approach of textual investigation to identify the occurrence, patterns or themes within its specific contexts (Babbie, 2001; Berg, 2006). Zhang and Wildemuth (2009) identify several key differences between qualitative and quantitative content analysis. Quantitative content analysis is developed in the research area of mass communication with the purpose of counting manifest textual elements. Its analysis is deductive in nature with the purpose of testing hypotheses against an existing framework or theory. Quantitative content analysis prefers the selection of random sampling or other probabilistic approaches to ensure the validity of statistical inference. It concerns producing numerical data that can be manipulated with various statistical methods. In comparison, qualitative content analysis is developed in the research area of
anthropology and sociology and aims to understand the underlying meaning of
texts. Its analysis is inductive in nature and involves discovering patterns, topics or
themes in one’s data. In terms of sample, qualitative content analysis involves
purposively selected texts that relate to the research questions. This approach
produces descriptions or typologies together with expressions from subjects of the
research that reflect how they view the social world.

Quantitative content analysis pays particular attention to the reliability of its
measures but suffers in terms of the validity of the findings. The approach is argued
to be more objective and reliable but fails to understand the deeper meaning of the
text’s context. In contrast, the main advantage of the qualitative content analysis is
that it increases the likelihood of genuine understanding of the deeper meaning of
the texts. However, the method cannot be easily replicated, is influenced by the
researcher’s own experience, opinions and background, and suffers from a lack of
detailed numerical information.

As for this study, the objective of this textual investigation is to collect views from
the respondents about various issues related to audit quality. Therefore, qualitative
content analysis is employed to understand the meaning of the data from the
variety of forms of response to the discussion paper.

This analysis is included in Appendix 2 and summarised in Table 4.2. Several steps
were taken in the analysis of the comments:

1) First, the comments were read through twice, converted into rich text
   format and imported to NVivo software.
2) Next, a set of themes or categories was developed from the data, which
   were then reviewed to ensure all of the issues had been identified.
3) Lastly, each of the responses were reviewed again to identify which
   respondents had commented on each of the issues identified and a detailed
   analysis of the comments on significant issues by respondents was
   prepared.

The FRC report summary of significant issues highlighted by the commentators and
Audit Quality Framework publication following the consultation were also read to
ensure completeness of the issues identified. NVivo was used to code and
categorise the large amount of narrative information, which allows flexible and
efficient coding of the data under themes determined by the researcher. Thus, a
large volume of information is reduced into certain patterns, categories and
themes, which could be done through the use of diagrams or charts to link the themes and categories, and link emerging case explanations with available theories (Ryan et al., 2002). The software also facilitates storage, coding, retrieval, comparing and linking of data (Patton, 2002, p. 442).

### 3.3.1.2 Collection of Data and Analysis of Semi-structured Interviews

The first step in designing the interview study was to contact potential respondents for the study. The first group of respondents was the audit practitioners. Individual audit partners were identified from the directory of the ICAEW members. The BoardEx database was used to identify members of the audit committee as the second group of respondents in the study. The third group of respondents was the quality inspectors who were contacted personally.

All of the groups of respondents could be regarded as a credible source in relation to the topic under investigation. These groups are in one way or another involved in the assessment and achievement of audit quality in practice. For the audit partners, they are responsible for delivering audits that they consider to be of suitable quality. Therefore, the issue as to whether they are fulfilling their responsibility in doing a good job or delivering the quality of audit that is expected by users of the audit services is relevant. For the AC members, they are part of the important governance mechanism that is responsible for commissioning, monitoring and reviewing the effectiveness of external audit function, which protects the interests of the shareholders through improving audit quality and financial reporting quality. Thus, the issues as to whether they are fulfilling these anticipated roles are important. In addition, the issue as to whether the quality that has been delivered to them is meeting the standards that have been established on behalf of the shareholders is pertinent. For the quality inspectors they are responsible for evaluating and monitoring audit quality by way of ensuring audit firm’s compliance with the regulatory framework and extent of ‘quality of challenge’ of the auditors to the management. Subsequently, the issue as to whether the quality that has been delivered to them is meeting the standards that have been established on behalf of the society is relevant.

Thus, the inclusion of these groups in the study is important. It is also worth noting that a lot of prior research has been done in comparing auditors with other groups such as management of the audit client and investors. Therefore, simultaneously comparing audit partners, AC members and quality inspectors is an important contribution to research on audit quality.
A total of two hundred potential interviewees (AC members and audit partners) were contacted by letter on July 2009 (Appendix 3). After the initial contact, ten individuals agreed and fifteen declined to participate in the study. After three weeks from the initial contact, follow up letters were sent to encourage participation and twelve more individuals were willing to participate in the study. Two individuals involved in quality inspection agreed to participate in this study through personal contacts. The number of individuals who participated in the study is shown in Table 4.1. Patton (2002, p. 244) when explaining about sample size suggests:

“There are no rules for sample size in qualitative inquiry. Sample size depends on what you want to know, the purpose of the inquiry, what’s at stake, what will be useful, what will have credibility, and what can be done with available time and resources”.

Pertaining to this, the aim of this study is to gain an in-depth understanding or ‘information richness’ rather than generalisation of the issues. It is also worth mentioning that time and resources also play a significant factor in determining the sample size.

**Table 3.1: Categorisation of Interviewees**

<table>
<thead>
<tr>
<th>Respondent</th>
<th>Number of respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit partners</td>
<td>11</td>
</tr>
<tr>
<td>Audit committee members</td>
<td>11</td>
</tr>
<tr>
<td>Quality inspectors</td>
<td>2</td>
</tr>
</tbody>
</table>

The study involved twenty-four semi-structured interviews with audit engagement partners, quality inspectors and AC members of the FTSE 100 in the UK. Eleven partners were interviewed within a period of three months (from October to December 2009). Eight of the interviewees were from Big Four firms and the remaining three from mid-tier firms. Similarly, eleven AC members, nine of whom were chairs of the AC, were interviewed during the same period. The two representatives from quality inspection were interviewed in November 2009. The interviews took place in several places: London, Manchester, Birmingham and Leeds. The interviews took place either at the offices of the interviewee or other places that were convenient to both the researcher and the interviewee. The majority of the interviews lasted between one hour and one and a half hours. Several steps were taken to improve the reliability of the data collected in the interview process. An interview guide was used to provide a consistent framework and coverage of topics in each interview. All of the interviewees were given assurances of anonymity in advance of the meeting to encourage open and honest
responses. All of the interviews were digitally recorded and a few notes were taken in order to promote an open dialogue on the matters being discussed.

The interview guide, comprising a schedule of open-ended questions, was developed to ensure that relevant themes were covered consistently with all interviewees and to ensure appropriate questions to tackle the complex issues in depth. The interview guide is reproduced in Appendix 4. These themes were: definition and concept of audit quality, the role of firm culture, regulation, governance and control, quality of personnel, auditor-audit committee interactions, independence, and judgement and audit methods. In general, the interview guide served as a basic checklist to ensure all relevant themes were covered during the interview. The guide was developed from a review of the professional and academic literature on audit quality, and also from an analysis of the issues referred to in the comment letters submitted in response to the discussion paper Promoting Audit Quality, published in the UK in 2006 (FRC, 2006b). In this way the interviews could be structured around the matters for which there was already some evidence of their relevance to the understanding of audit quality held in the professional and practitioner community.

Patton (2002, p. 343) proposed that the use of an interview guide has the advantage of allowing the interviewer to decide how best to use the available time and it improves the consistency of coverage of relevant topics, while leaving the interviewer free to explore and probe interesting comments and issues that arise in the course of the interview. Open-ended questions encourage interviewees to provide a full account of their experiences. This format facilitates the development of a good flow to the conversation, and a good rapport between the interviewer and the interviewee.

All of the interviews were transcribed by a professional transcriber, and the transcripts were then rechecked against the audio files. The transcripts were reread to improve familiarity with the data. In this particular study, the analysis of data involved searching and identifying for recurring themes and patterns together with consistencies and meanings in the information. The initial themes were established based on the issues covered by the interview guide but were later refined as the analysis of data progressed and patterns emerged. Three main activities were performed for the analysis of qualitative interviews data: data reduction, data display, and conclusion drawing/verification (Miles and Huberman, 1994):
1) Data reduction encompasses the process of selecting, focusing, simplifying, abstracting and transforming the data contained in the transcriptions.

2) Data display involves organization, compression and assembly of the information to support analysis, verification and conclusion drawing.

3) Finally, noting regularities, patterns, explanations, possible configurations and causal flows are some of the activities that are involved in arriving at conclusions from the data.

In this way, the qualitative data was subject to careful exploration and rigorous analysis of themes in order to create a ‘thick description’ and understanding of the issues. Again, the computer assisted package, NVivo, was used to assist in coding and categorising large narrative information collected from the semi-structured interviews. The detailed findings from the interviews of each group are reported in Chapters 5 (audit partners), 6 (AC members) and 7 (quality inspectors). Commonality and differences between groups regarding audit quality issues are discussed in chapter 8.

### 3.3.1.3 Collection of Data and Analysis of Survey Questionnaire

The questionnaire was pilot-tested by reference to a senior member of the inspection unit in order to identify and rectify any weaknesses with an aim to increase the response rate. The questionnaire was administered through a web survey between December 2010 and January 2011. The total population for the quality inspectors was identified as twenty individuals, all of whom were surveyed. Table 8.1 below provides a summary of the response rates.

<table>
<thead>
<tr>
<th>Group</th>
<th>Total</th>
<th>Returned</th>
<th>Useable response rate (percentage)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quality inspectors</td>
<td>20</td>
<td>12</td>
<td>60%</td>
</tr>
</tbody>
</table>

The questionnaire included 85 statements in five sections in addition to a personal background section. A full copy of the questionnaire is attached in Appendix 5, and detailed findings from the various issues investigated are reported in Chapter 7. The form of questions used in the questionnaire incorporated a five-point Likert scale for responses. A Likert scale has the advantages of being relatively easy to construct and administer and is easily understood by respondents, making it especially useful in surveys (Tull and Hawkins, 1993). The questionnaire consisted of closed-ended questions. Care was taken in keeping the length of the
questionnaire reasonable whilst ensuring that it covered all of the important issues. In the wording of the questions asked, care was also taken in order to ensure that they were clear and understandable. In addition, statements concerning potentially sensitive areas were formed with care. The confidentiality of information given to the respondents was guaranteed in the introduction of the questionnaire.

The questionnaire used in the study was developed after reviewing both prior literature and the findings from the interviews. The questionnaire consists of six main sections. The first section includes several personal background questions related to the respondents. The second section covers the perceptions of quality inspectors about the attributes of audit quality in practice. In other words, it aims to understand the quality inspectors’ conceptualisation of the notion of audit quality in practice. The third section asks the views of the quality inspectors about the impact of business, accounting and the auditing environment on audit quality. The fourth section covers their views on how actual audit quality is achieved, that is, to understand their perceptions of how audit quality is operationalised and presented in practice. The fifth section aims to collect information about potential problems in audit quality in practice as perceived by the quality inspectors based on their assessment of work of the external auditors. The final section collects views of the quality inspectors about the actual level of audit quality in practice.

Descriptive statistics analysis such as central tendency and dispersion of the data (median and mean) are used to present the results of the data collected from the survey questionnaire. Although good proportionate coverage of the quality inspector group is achieved in the study, it is still a relatively small number of responses. As a result, more detailed statistical analysis or testing (such as differences within the sample) is restricted.

3.4 Summary

This chapter has outlined and described the methodological and theoretical approach undertaken to examine the perceptions of auditors, AC members and quality inspectors concerning the meaning of audit quality in practice. It has attempted to explain how and why the research was carried out in a particular way.

This study has applied an interpretive approach that is concerned with understanding the social meaning of audit quality. The study used symbolic interactionism as an analytical tool to understand the meanings of audit quality as a social object that are formed by the interactions of people in the auditing
environment, and which subsequently influence their action. This chapter describes two stages of qualitative studies to answer the concerns of the research. The qualitative research approach provides a new insight about issues concerning audit quality. The approach also offers rich description and flexibility to understand the societal, organisational and institutional factors that might affect audit quality.

In the remaining parts of the thesis, chapters 4, 5, 6 and 7 present the empirical results of the study. The next chapter begins by describing the results of the analysis of the textual study, as a backdrop to ensure that issues relevant to the study were covered in the interviews.
Chapter 4

Audit Quality in Practice - The FRC Discussion Paper

4.0 Introduction

This chapter presents the analysis of responses to the discussion paper Promoting Audit Quality published in the UK in 2006 (FRC, 2006b). Reporting upon the analysis of responses, the objective of this study is to analyse views from the respondents about various issues related to audit quality. This study constitutes of how subject of audit quality is seen in practice and as influence in work carried out in second stage of the research that reported in subsequent chapters. The chapter is set out as follows: section 4.1 briefly describes the FRC discussion paper exercise and the justification for its inclusion in this study; section 4.2 presents an analysis of the comments on the discussion paper; section 4.3 presents key issues from the analysis of the comments and draws out areas for further investigation in the subsequent study, which will be presented in the following three chapters. Finally, section 4.4 provides a summary of the chapter.

4.1 Introduction and Justification for the Documentary Study

In November 2006, the FRC published a discussion paper on promoting audit quality (FRC, 2006b) and invited comments from interested parties by the 31 March 2007. While responses were invited on any aspect of the subject, the FRC sought answers to seventeen specific questions that relate to five main drivers of audit quality:

i) culture within an audit firm,
ii) skills and personal qualities of audit partners and staff,
iii) effectiveness of audit process,
iv) reliability and usefulness of audit reporting, and
v) outside factors beyond the control of auditors that affect audit quality such as the approach taken by management and the contribution made by the audit committee.

The text of these questions is reproduced in Appendix 1 and analyses of the responses to the specific questions are included in Appendix 2 to the thesis. Thirty nine sets of responses were received in response to the discussion paper: eight from audit firms, ten from professional bodies, nine from institutional investors, two from the corporate sector and ten from other interested parties (Table 4.1). Of the
eight sets of responses received from the audit firms, four were received from the Big Four and four from middle tier firms. Of the ten responses received from the professional bodies, eight were from bodies in the UK or Ireland and two from South America.

**Table 4.1: Respondents to the Discussion Paper**

<table>
<thead>
<tr>
<th>Respondents</th>
<th>Number of responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit firms</td>
<td>8</td>
</tr>
<tr>
<td>Professional bodies</td>
<td>10</td>
</tr>
<tr>
<td>Investors</td>
<td>9</td>
</tr>
<tr>
<td>Corporate</td>
<td>2</td>
</tr>
<tr>
<td>Others</td>
<td>10</td>
</tr>
</tbody>
</table>

The FRC subsequently published all of the responses on its website (http://www.frc.org.uk/about/promotingauditqualityresponses.cfm). The text of all thirty nine responses was analysed as the basis for this study. Appendix 2 includes a list of respondents, together with an analysis of their responses to the specific questions posed by the FRC and other significant issues identified in the comments. Table 4.2 provides a summary of the significant aspects of the detailed analysis in Appendix 2. A report published by the FRC in October 2007 that summarises significant issues of the responses and Audit Quality Framework publication following the consultation was also read to ensure completeness of the issue identified.

The responses to the discussion paper were generally structured around the specific questions posed by the FRC. The structured nature of the discussion paper with its seventeen questions, determined in most cases the structure and content of the responses received. It could be argued that more meaningful responses could have been elicited using a more open-ended approach. However, respondents are not obliged to structure their answers in a particular way, and any very strong feelings about the issues under review would have been likely to emerge regardless of the structure. As such, the respondents made a significant number of additional comments in their covering letters or response pages.

A number of limitations need to be noted regarding the nature of the documentary evidence. These include the fact that public statements may not capture full picture on privately held views, subjectivity in responses and self selection in population of those who responded. Nonetheless, comment letters submitted to the discussion paper still represents a significant available source of evidence on audit quality as
the collection of view expressed by a wide group of interested parties and therefore worth analysing.

In order to understand how subject of audit quality is seen in practice the approach to the analysis is to go beyond counting comments or score points as a means of drawing conclusions but also to identify certain key themes that consequently influence on work reported in subsequent chapters.

The issues referred to in comment letters, together with a review of the professional and academic literature on audit quality, also served an important role in this study as a basis for developing the interview guide so that relevant themes were covered during the interviews. In this way the interviews could be structured around the matters for which there was already some evidence of their relevance to the understanding of audit quality held in the professional and practitioner community.

**Table 4.2: Analysis of Significant Responses Received by the FRC on the Discussion Paper Promoting Audit Quality**

<table>
<thead>
<tr>
<th>AF</th>
<th>PB</th>
<th>II</th>
<th>C</th>
<th>O</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total number of respondents</strong></td>
<td>8</td>
<td>10</td>
<td>9</td>
<td>2</td>
</tr>
<tr>
<td><strong>Key Issues of the Comments</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>The Culture of the Audit Firms</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Concern about tick box mentality culture</td>
<td>5</td>
<td>4</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Concern about focus on documentation</td>
<td>4</td>
<td>2</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Concern about commercialisation of the audit firm</td>
<td>0</td>
<td>0</td>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>Suggest professionalism as part of culture of the audit firm</td>
<td>0</td>
<td>0</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>Sought greater information about governance and control of the audit firm</td>
<td>0</td>
<td>2</td>
<td>7</td>
<td>0</td>
</tr>
<tr>
<td><strong>The Quality of people</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Diverse and up to date skills and knowledge</td>
<td>8</td>
<td>5</td>
<td>7</td>
<td>1</td>
</tr>
<tr>
<td>Concern about attractiveness of the profession</td>
<td>7</td>
<td>1</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Concern about availability of audit staff</td>
<td>7</td>
<td>5</td>
<td>0</td>
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</tr>
<tr>
<td>No fundamental review of the qualification and training requirements</td>
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<td>5</td>
<td>3</td>
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<tr>
<td>Concern about requirement of partner rotation</td>
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</tr>
<tr>
<td><strong>The Effectiveness of the Audit Process</strong></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Concern about excessive and/or overly complex audit standards and regulations</td>
<td>7</td>
<td>6</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Concern about move to compliance/prescriptive audit approach</td>
<td>7</td>
<td>5</td>
<td>3</td>
<td>2</td>
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<tr>
<td>Regulators should promote and enhance principles based audit approach</td>
<td>5</td>
<td>6</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Important role of audit client to audit process</td>
<td>7</td>
<td>6</td>
<td>5</td>
<td>1</td>
</tr>
<tr>
<td>Important role of audit committees to audit process</td>
<td>7</td>
<td>6</td>
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</table>

AF – Audit firms  
PB – Professional bodies  
II – Institutional investors  
C – Corporate  
O – Others
Table 4.2: Analysis of Significant Responses Received by the FRC on the Discussion Paper Promoting Audit Quality (continued)

<table>
<thead>
<tr>
<th></th>
<th>AF</th>
<th>PB</th>
<th>II</th>
<th>C</th>
<th>O</th>
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<tr>
<td><strong>Total number of respondents</strong></td>
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<td><strong>Key Issues of the Comments</strong></td>
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<td>The Reliability and Usefulness of Audit Report</td>
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<td></td>
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<td></td>
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<tr>
<td>Reputation of audit firm and audit profession</td>
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<td>3</td>
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<td>Greater information from audit firm</td>
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<td>Understand ability of audit report</td>
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<td>2</td>
<td>5</td>
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<td><strong>Other Factors Affecting Audit Quality</strong></td>
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<td>Important role and support of the management</td>
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<td>Important role and responsibilities of audit committee</td>
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<td>Audit committee discharging adequate responsibilities</td>
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<td>Sought detailed guidance for audit committees to evaluate effectiveness of audit</td>
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<td>2</td>
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<td>4</td>
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<td>Sought summary of work of audit committees in annual report</td>
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<td>4</td>
<td>1</td>
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<td>5</td>
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<td><strong>Other Issues</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Welcomes references to discussion paper</td>
<td>8</td>
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<tr>
<td>Concerned about lack of empirical evidence to support some of the assertions</td>
<td>3</td>
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<td>Insufficient attention to other critical dimensions of audit quality</td>
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<td>Resource concern</td>
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<td>Concept or definition of audit quality requires clarification</td>
<td>0</td>
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</tr>
</tbody>
</table>

AF – Audit firms  PB – Professional bodies  II – Institutional investors  C – Corporate  O – Others

4.2 Comments on the Discussion Paper

This section outlines findings from the analysis of comments letter to the discussion paper. As noted earlier, the discussion paper is structured around five major drivers of audit quality. This section is organised according to that structure together with other issues that emerged from the analysis. The detailed discussion will be presented in subsequent sections.

4.2.1 Audit Firm Culture

In general, respondents agreed that the culture of the audit firm was an important driver for audit quality. Auditors, investors, professional bodies and companies all made similar comments on this point. They viewed the indicators identified by the FRC such as leadership, auditing and ethical standards, promotion of consultation, partner and staff development systems, and information infrastructure as essential to achieve high quality audits. For example, RSM Robson Rhodes observed that:
"We consider that these are important indicators of a strong quality culture. In particular, in our view, it is the effectiveness of partner leadership on quality matters (the "tone at the top") combined with the cascade of this through the business, which underpins a quality culture within the firm”. Similarly, an institutional investor, Electricity Pensions Services Limited, recognised that technical competence, risk management and staff training were an essential part of the quality culture in the audit firm. A professional body, the ICAEW, emphasised the significance of good technical support and that the culture of leadership throughout the audit firm that drives audit quality.

While accepting the importance of culture to audit quality, most of the audit firm respondents were keen to describe concerns and problems about the changing culture in the audit firm created by the current regulatory framework. Eleven respondents claimed that the changes have diverted audit firms’ attention from the principles to rule based procedures that could create a culture of a ‘tick-box’ or compliance approach in audit. The compliance approach has also created an excessive focus on documentation that could reduce the use of knowledge and professional judgement in the conduct of the audit. The respondents argued that the prescriptive approach was restricting the auditor’s ability to exercise professional judgement, shifting the nature of the audit to compliance work, thereby affecting the quality culture of the audit firms and impacting the effectiveness of the audit process. These eventually would undermine the quality of the audit.

"The approach of the regulator has a direct effect on the culture of an audit firm and a relentless focus on documentation will drive a culture in the audit firms that detracts from evidence gathering and making judgements” (PWC).

"Rules based, rather than principle based, auditing standards could result in a tick box mentality to auditing” (KPMG).

"We consider that having an overly complex financial reporting regime can have a detrimental impact on audit quality as it can mean that partners and senior staff spend too much time on accounting issues or in preparing documentation for the benefit of regulators. We understand that this has been an increasing problem for firms” (ICAEW).

In consequence of the culture, it was frequently claimed by a number of the investor respondents that commercial interests have become a major aspect of the culture of the audit firms and could compromise the audit quality. For example, the Association of British Insurers voiced concern about the commercial objectives of the audit firms that could create a threat to audit quality. Similarly, its counterpart, the Investment Management Association opined:
"We consider that one contributory factor in recent years to a decline in audit quality is the way firms have tended to shift to a more aggressive, commercial business model".

Further, four investors suggested that the audit firms should promote and encourage culture of professionalism - an audit that serves the public interest for the benefits of shareholders and other users of the accounts as part of the indicators of their quality culture. Eight respondents advocated that greater information about quality initiatives and the governance and control of the audit firms could enhance their confidence in the quality culture of the audit firm. In general, the respondents highlighted the lack of information about audit firm’s policies and actions that they take to embed a culture of quality within the firm.

"Fostering of reputation is a prerequisite for long-term success in a properly competitive business environment. In the case of accountancy firms the quality and professionalism of what should be seen as the core discipline, that of audit, is key. It is disappointing how little prominence some of the largest accountancy firms give to their audit business in the way they present themselves to the outside world" (ABI).

"...way of demonstrating to their ultimate paymasters, the shareholders, that they are providing a valuable service" (Hermes Investment Management).

Overall, the majority of the respondents agreed that within the context of the audit firms, culture is imperative and will influence the quality of audit practice. The user group representative, that is the investors mentioned great concern on culture of commercialisation of audit firm that could undermine audit quality. The audit firms and professional associations draw attention on negative effect of the audit regulation to the culture of the audit firms.

4.2.2 The Quality of People

Almost all of the respondents fully agreed with the importance of the auditor’s knowledge, skills and personal qualities of the audit personnel for attainment of high audit quality. Investors, auditors, companies and professional bodies all made similar observations on this point. Similarly, investors such as the Investment Management Association and the National Association of Pension Funds pointed out the necessity for auditors to keep their technical skills up to date with to the changes in the business environment. Likewise, a professional body respondent, ICAI, believes that technical skills, personal qualities, professional scepticism and practical experience are key drivers of audit quality.
The audit firm respondents asserted it is important for the auditors to have diverse and up to date skills, and sufficient experience. These attributes are important in supporting professional judgement and an effective audit process during the conduct of the audit. As such, the audit firm respondents emphasised the importance of academic qualification, entry and selection requirements, and training procedures in the audit firm to advance the knowledge and skills of auditors to achieve high audit quality; quality audit judgement.

"...this gained from the ability to work on a wide variety of companies; gain experience from a wide range of disciplines (from audit to tax to transaction services); and the undertaking of a rigorous set of exams for the audit qualification. To undertake high quality audits in the context of current and evolving business practices and accounting standards, it is particularly important that audit firms have available (and under their control and subject to their quality control processes) a sufficiently broad range of technical skills including information technology, taxation, valuation and actuarial skills" (KPMG).

In relation to the skills, the audit firms and the professional bodies frequently stressed points concerning the potential adverse impact of the current regulatory environment on the quality of people in the audit firm. They argued that complex accounting rules and auditing standards, and the check-list audit approach resulted in changing the nature of audit work to a more compliance based activity that had an unfavourable impact on the attractiveness of the profession to hire and retain quality audit staff. In addition, intrusive audit regulations, imbalanced reviews by the regulators and the threat of litigation reduce the attractiveness of the profession to attract and retain quality audit staff.

"Whilst the profession continues to attract high quality graduates, the attractiveness of the profession appears to be declining as evidenced by decreasing job satisfaction, brought about at least in part by increased regulation. Remaining in the profession post-qualification is becoming a less attractive option partly as a result of the amount of compliance-type work carried out during the training contract. Unless the best people see audit as an interesting, profitable and safe environment they will not join it and no amount of "tone from the top", training and information infrastructure will overcome that fundamental weakness" (ICAEW).

"There are concerns that the attractiveness is being impacted by: the overall reputation of the audit profession, complex accounting rules that involve a check list approach to review, an increase in accounting rules rather than principles, and regulators that place too much emphasis on the application of the rule rather than principles” (KPMG).

Another issue that was voiced by some of the respondents was related to the requirements for partner rotation. Some of them believed that the requirement for partner rotation of every five years might not contribute to audit quality because
longer tenure will help build greater expertise and experience required for complex and high risk audit clients. These views were supported by the major professional bodies and audit firms.

"We support audit partner rotation, although we question the need for the five year rotation period that applies in the UK. ....the impact of the audit partner’s ability to build sufficient trust with management, such that the audit team is passed the information that they need, or that the audit partner does not develop detailed knowledge of the business and its risks for the audit to be effective“ (Grant Thornton).

"Audit quality could be enhanced for large, complex multinational clients if the period of rotation was 7 years rather than 5 years since it can take a considerable period of time for a partner to fully understand the client’s business and complexities“ (KPMG).

However, while accepting that skills and experience are fundamental drivers of audit quality, the majority of the respondents objected to a fundamental review of the qualifications and training requirements for auditors. The respondents expressed the view that the current qualifications and training requirements are sufficient and appropriate.

Overall, the majority of the respondents in this area support on the important of quality of people on audit quality. Analysis of the responses shows respondents were inclined to highlight concern with unfavourable impact of current regulatory environment to expertise and judgement of the auditors.

4.2.3 The Effectiveness of the Audit Process

The FRC asserts that factors such as characteristics of the audit team, technical support, audit methodology, auditing standards and quality control procedures contribute to the effectiveness of the audit process. Analysis of the responses shows that the respondents were fully in accord with the assertions. The majority of the respondents also emphasised the important role of the audit client and audit committees for an effective audit process. Other factors that influence the effectiveness audit process include application of business risk audit approach in an audit and experience of the audit partners.

"We think that the paper identifies most of the factors that contribute to an effective audit process. However, we would add to these the relationship that an auditor has with the board of directors, the audit committee, the financial management and elements of the operational management. A close, robust and challenging relationship with these parties will improve the effectiveness of the audit. A distant, difficult and uncooperative relationship will create significant barriers to audit quality“ (PWC).
“We are concerned that too much regulation risks auditors becoming overly mindful of compliance with process, which may detract from the thoughtfulness of audit work that is required” (PWC).

Eighteen respondents expressed deep concern about the effect of excessive and overly complex standards and regulation that shift auditing from principles to rules based approaches. As a result, some respondents believed that as the audit approach becomes more prescriptive that promotes compliance exercises rather than the use of professional judgement, and that this would significantly affect the effectiveness of the audit process and the overall assessment of the financial statements, thus delivery of high audit quality. In response to that issue, fifteen respondents took the view that, regulators should promote and support the principles based audit approach in their initiatives and projects in the audit arena to ensure high audit quality.

“Audit effectiveness and quality will inevitably suffer if auditors are faced with an increased administrative burden in order to demonstrate compliance in a regime that is in danger of becoming essentially rules-based with little or no tolerance for the exercise of professional judgment” (ICAI).

“The FRC and its operating bodies have a crucial role to play in shaping these developments, for example in liaising with the European Commission and other regulators, and in making the case for the importance of principles-based standards and the use of professional judgement. More work might be needed on the nature of professional judgement which is distrusted by some non-UK regulators but which we believe is crucial to high quality audit work, and therefore needs to be better understood internationally” (ICAEW).

Overall, one pertinent issue that emerged from the analysis concerning the effectiveness of the audit process is in relation to impact of various factors such as regulation, audit client, audit committee, individual auditors and firm’s policies and procedures on the effectiveness of the audit process to achieve audit quality.

4.2.4 The Reliability and Usefulness of the Audit Report

The FRC identified reliability and usefulness of audit reporting that command confidence as one of the key drivers of audit quality attracted many comments from the institutional investors. Analysis shows that the respondents generally viewed concept of audit quality is closely linked to the accuracy and credibility of the audit opinion that enhances quality of financial statements. As such, they suggested that the audit report should be accurate and the auditors should be seen as an independent professional entity. For example:
“The judgment of the auditor in confirming truth and fairness of financial statements may, in turn, make important demands on both his professional faculties and integrity. This process is key to ensuring audit quality” (Association of British Insurers).

“The value of the audit opinion is strongly linked to the usefulness of the accounts” (Coal Pension Trustee).

Some other comments that put forward by the commentators concerning factors that affecting confidence on audit opinions include greater information from audit firms regarding their process and policies, and reputation of audit firm and audit profession. In comparison, some of factors that identified could reduce confidence in audit opinion are related to format of the audit report (length and legalistic wording) and prescriptive audit approach in audit.

### 4.2.5 Other Factors Affecting Audit Quality

On the whole, the respondents supported the significant contributions made by the management of the audit client and audit committees to audit quality. The London Society of Chartered Accountants, for instance, pointed out the important role of the audit client for audit performance. Similarly, audit firms identified that the culture of the audited company and the skills and personal qualities of its board and executive management could enhance the effectiveness of the audit process.

“*The culture of the audited company and the skills and personal qualities of its board and executive management are very important drivers of audit quality*” (EY).

“*...to these the relationship that an auditor has with the Board of Directors, the audit committee, the financial management and elements of the operational management. A close, robust and challenging relationship with these parties will improve the effectiveness of the audit*” (PWC).

In a similar manner, other respondents such as Deloitte, the ICAEW, Investment Management Association and Confederation of Business Industry recognised the important role and responsibilities of the members of audit committees for audit quality. There was a consensus among the audit firms that the important role of audit committee in the auditing and financial reporting process. PWC noted that based on their experience the audit committees had become stronger and more questioning of what auditors do. Deloitte observed that the recent regulatory changes have resulted in increased communication between the auditors and audit committees. The audit firms also acknowledged the influence of the audit committees on the culture and conduct of their audit. Several audit firms also stressed the important role of the audit committees in enhancing the confidence of
the users of financial statements. These were illustrated by the following quotations:

"The responsibilities audit committees have undertaken in relation to the audit process can give confidence to shareholders that the auditor/client relationship is sufficiently independent and that sufficient attention is being paid to audit quality" (Deloitte).

"Enhancing the direct disclosure between audit committee and shareholders and/or making the formal communication between auditors and the audit committee more readily available, would go some way to improving confidence in the audit opinion" (BDO).

"...we also recognise the very important role of the audit committee in being involved and overseeing relationships between companies and their auditor, and in monitoring the company’s financial reporting and internal control systems and the audit process“ (Confederation of Business Industry).

As a result of the function of the audit committee, the majority of the respondents agreed that the committees discharge adequate roles and responsibilities in relation to the audit. The audit firm respondents acknowledged the increasing quality of communication between them and audit committees. Further, they recognised the critical role performed by audit committees in the auditing and financial reporting process. The audit firms, in general, suggest that additional dialogue between the audit committee and shareholders would enhance confidence about the audit profession. They also believe that detailed evaluation of audit guidelines would assist audit committees to function more effectively. On the other hand, investors requested more disclosure about the work performed by audit committees that enhances users’ confidence on audit quality.

4.2.6 Other Issues

In general, the respondents expressed a high degree of support for the initiative and the audit quality framework proposed by the FRC. In particular, almost all respondents were in favour of the attempt of the FRC to recognise a broad set of significant issues relating to audit quality through identification of drivers and threats that could enhance and undermine the audit quality. It is clear that the discussion paper succeeded in recognising wider factors that may influence audit quality in practice. Opinions often emerged as part of the covering letters attached by the respondents. A number of respondents commented on the positive effects of discussion paper in promoting and ensuring confidence in the value and quality of audit opinions. Some of the respondents commented on the positive contribution the discussion paper made, which enhanced their understanding of the complex topic in a systematic way. Others indicated that the discussion paper provided
constructive input to understand better what constitutes audit quality in practice. For example:

"We support the contribution of the paper to achieving greater and more consistent understanding of audit quality, and we consider the paper has successfully identified the principal drivers of quality" (PWC).

"We believe the discussion paper generally draws together the relevant issues surrounding audit quality” (CBI).

While acknowledging the positive contribution of the discussion paper, some respondents expressed adverse comments. For example, a few respondents referred to the lack of relevant and empirical evidence to support the assertions stated in the discussion paper. For instance, the comments of the CBI and KPMG included the following:

"There is also a need to underpin and inform any future review with appropriate supporting evidence or research, which is lacking in the current discussion paper...an assessment of the relative importance and completeness of the indicators identified would benefit from some relevant empirical data” (CBI).

"In some places the FRC discussion paper implies that there are significant concerns with audit quality. We do not consider that these are supported with sufficient research or evidence” (KPMG).

Three of the audit firm respondents had significant criticisms of some of the threats to audit quality identified in the discussion paper. For example, one of the audit firms pointed out that some of the factors that were identified as threats to audit quality were unsubstantiated because of a lack of concrete evidence that it would have an adverse effect on quality:

"A number of issues have been identified that could be threats but the paper seems to imply that they are threats. We do not see that there is any evidence to suggest that there is a flaw in the 'pyramid structure’ or in the training provided. Partners and managers are heavily involved in the key risk areas of an audit and staff members are adequately briefed, trained and supervised on the roles that they are assigned to” (KPMG).

The audit firm respondents also argued that the discussion paper failed to recognise the commitment of the audit firms to the quality of audit. For example, PWC noted that the discussion paper fails to appreciate the very real interest that audit firms themselves have in obtaining the highest quality. The respondents also expressed deep concern about further proposed regulations that might result from the discussion paper. Twelve respondents took the view that although the framework
had identified the main drivers of audit quality, it failed to recognise other critical drivers such as auditor independence and audit regulation.

"Our overall view is that it is a well timed and considered discussion paper in the light of the continuing need to ensure confidence in the value and quality of audit opinions. What is less clear is how the feedback you get will be used; however, from this firm’s perspective we would wish any approach derived from this to be measured, and not to result in the further creation of more prescriptive standards; there needs to be some time given to bedding down the large number of new auditing and financial reporting standards implemented over the years” (BDO).

"However, we believe that you have missed one key driver, the impact of regulation. Whilst this is highlighted in a number of areas (especially in chapter 7) it has not been highlighted as one of the main drivers” (KPMG).

"Qualities of independence in the audit and the auditor are crucial but this is a dimension that receives insufficient attention in the paper“ (ABI).

Overall, most of the respondents welcomed the initiative and project in the audit arena in the name of understanding and enhancing audit quality. However, there are limited comments from the respondents that provided any detailed analytical assessment of the concept and definition of audit quality. Only two of the respondents to the discussion paper sought clarity about the definition of audit quality. For example, the corporate respondent, The Hundred Group of Finance Directors suggested that audit market constituents such as auditors and audit committees should define more clearly the meaning of audit quality by providing qualitative and quantitative measures that could be used to assess the quality of the audit.

Another respondent, the ICAEW, raised concern about the imbalance in the definition of audit quality and its drivers as proposed by the FRC. The professional body claimed that current work in the audit arena focuses too much on the regulators rather than the broader view of the definition of audit quality. They proposed four broad perspectives on the definition of audit quality. These were i) market quality – quality in the eyes of principal stakeholders; in the case of shareholders as a class this arises from the stewardship role, but there are also other external stakeholders who might use information for decisions and this element of quality should aim to satisfy the public interest in the audit; ii) service quality – quality in the eyes of client management and those charged with governance; iii) operational quality – from the firms’ perspective in order that the provision of audit services is sustainable; and iv) compliance quality – quality in the eyes of regulators, notwithstanding the regulators’ clear interest in market quality
and the interest that they should arguably also have in service and operational quality.

Issues relating to the effect of changes in audit regulation were significant features of almost all responses to the discussion paper. Although the changes are aimed at enhancing audit quality, several of the respondents expressed adverse opinions. Thirteen respondents mentioned resource concerns arising from the current audit regulations. For instance, five of the audit firms referred to the increased time and cost needed to fulfil various regulatory requirements. Increased oversight activities have caused additional workload for the audit firms because more staff are needed to spend time in meeting the regulatory requirements. For example:

"...many ISAs are unnecessarily detailed, prescriptive and inflexible. Thus there is a significant risk that they could result in additional costs to firms and their clients (particularly smaller entities) without any corresponding improvement in audit quality" (IMA).

"Rapid change in auditing and reporting standards with the corresponding oversight requires internal departments of audit firms, who [are] responsible [for] training, quality and risk management, to make, on occasions, significant demands of audit teams. These teams then have to spend more time completing documentation and compliance forms. This can create an extra challenge to delivering audits and, for some, additional pressure” (EY).

"There are now significant pressures on audit firms to complete audits as quickly as possible to meet various reporting deadlines imposed on companies. In addition, major changes in requirements of regulatory standards, applicable to audits and audit firms of all sizes, have resulted in auditors spending a large quantity of their audit time demonstrating compliance with such standards. This ultimately has the potential to have a negative impact on audit quality” (ICAI).

The above statements manifest the changes in regulation that have created additional tasks for the audit firms. The firms need to stretch their resources to meet the regulatory and clients’ requirements as well as to fulfil other stakeholders’ needs. The respondents voiced significant concerns about the availability of staff to perform the additional work demanded by the current regulations. Analysis suggests staffing and cost becomes a major concern to the firm. In the light of the ongoing debate about the benefits of new regulation, it seems worth investigating the costs and benefits of the oversight function to audit firms and overall audit quality.
4.3 Questions for Consideration

This preceding discussion has reported a documentary study based on the thirty-nine responses submitted to the discussion paper *Promoting Audit Quality* published by the FRC. The chapter presents a snapshot of a small part of the audit quality debate, through the eyes of those who responded to the discussion paper. This study did not intend to draw specific generalised conclusions about the research topic from these responses but, the study was felt necessary to provide an additional information source to draw out areas that are potentially relevant for further investigation and that can enhance our knowledge about audit quality in practice. A number of questions and areas for further investigations arise from analysis of the data and are discussed in this section.

**Interpretation and Understanding of Term of Audit quality**

The discussion paper proposed a framework of audit quality that comprised of drivers and threats but without a clear definition and concept of the audit quality. While there may be advantages to understand the term audit quality based on its drivers and threats, however, the relationship between audit quality and the factors in the new audit environment remains unclear. While questions of how audit quality is defined and understood by professional practitioners are indeed important (Schroeder et al., 1986; Carcello et al., 1992; Duff, 2004), analysis of the responses draws attention to the lack of a practitioners’ construct of the meaning of audit quality. The expression ‘high audit quality’ featured in the responses but its meaning is unclear. What is audit practitioners understanding of audit quality and its impact on the audit performance? The meaning of the term of audit quality remains implicit rather than clearly articulated. The practitioners said relatively little about ‘true quality’ or ‘technical’ definition of audit quality in terms of what it means. They had more to say that they being committed to have high quality that relate to issue such as expertise, skills, professional judgement and culture of the audit firm.

Audit quality is a concept that needs to be clearly understood, thereby allowing greater understanding of the link between the meaning of audit quality and auditors’ evaluation and delivery of quality work. Similarly, understanding of the term of audit quality from the perspective of other audit market constituents such as audit committees and quality inspectors may provide further evidence on their role in commissioning and evaluating what sort of audit is delivered to them and on behalf of society.
The Commercial Culture of the Audit Firm

Identification of culture as one of the key drivers of audit quality may indicate considerable concern for the regulator concerning ‘commercialised professionalism’ that promote a culture of client-centred services (Hanlon, 1994) that may be viewed as detrimental to audit quality. As the AIU (2006, p. 13) points out, commercial considerations and measures continued to be a driver of performance measurement in the audit firm rather than audit quality. The investor respondents in this study voiced concerns regarding the commercial business approach of the audit firm that had contributed to decline in audit quality in recent years. In like manner, some prior research has shown deterioration of the culture of professionalism causes conflicts in values and practices within the audit profession that affect audit performance (Wyatt, 2004; Baker, 2008).

Previous research in auditing examining the impact of culture on audit quality is relatively scarce. There is a lack of understanding of what culture means for the auditors and how it relates to audit quality. In addition, there is insufficient information concerning how culture is measured or is capable of being monitored in the firm. Finally, it is unclear how the current auditing environment negatively affects the culture of the audit firms as claimed by the respondents to the discussion paper issued by the FRC. Recent corporate scandals have called into question whether accounting firms have nurtured cultures that emphasize an appropriate level of professionalism and commitment to serving the public interest (Jenkins et al., 2008, p69).

Expertise and Professional Judgement

Quality of people – expertise and professional judgement is the traditional sphere in auditing. Central to this claim, the audit firms and professional bodies argued that the changes in audit regulation may bring a threat to that core value of the audit profession. In general, analysis of responses highlighted concern of the respondents on the impact of the changes in the audit regulation that may devalue of a core area of expertise through and argued that changes in the nature of audit practices that more to do to tick box approach in audit performance are detrimental to professional judgement. While accepting potential negative impacts of the changes in audit regulation on the quality of people, the responses provided by the audit firms and professional bodies can also be seen as an important defence against the imposition of more prescriptive regulations that may be detrimental to market dominance, power and social status, and jurisdiction of their work. Analysis of responses showed there is a considerable tension around regulation and concern of
the audit firms concerning further regulation that might be proposed as a result of
the debate around the discussion paper. Given this context, responses from audit
firms on this issue can be viewed as an objection towards development in the audit
regulation and eventual independent oversight and direct regulation of the audit
profession. As such, an emphasis on expertise and professional judgement is
to be expected as it reflects an aspect of firm self interest. Attributes of
professional claims to special knowledge and expertise are necessary to sustain and
legitimate professional status and the related social and economic rewards
(Richardson, 1987). For this reason, professionalism often involves a traditional
stance against regulation.

Overall, professional audit firms always emphasised the importance of quality
people to audit quality. Does emphasis on this give firms more freedom to argue
they have good quality? Clearly, it is much more difficult for the regulators to
regulate ‘individual quality’ or to measure the quality beyond the threshold of
qualification and experience. Could focuses on professional judgement through the
quality of individuals relate to certain regulations that they found constraining to
the profession? The audit firms also suggested the important of the selection and
training procedures in the audit firm to advance knowledge and skills of the
auditors to achieve high audit quality. One of the limitations with this explanation is
that it does not explain how the quality of people is used in controlling perceived
and actual audit quality. Further, what sort of skills or professional behaviour that
are promoted by the audit firms towards achievement of audit quality in practice?

In relation to the quality of people, one significant issue that emerged from the
analysis of the responses is the importance of auditors’ professional judgement in
maintaining and promoting high audit quality. Hatherly (1999, p.54) describes
professional judgement as the interaction of the individual auditor’s reasoning
facility, experience, personality traits, and internal and external factors in the audit
environment. For example, auditors need to decide what is considered as
‘appropriate’ and ‘sufficient’ audit evidence to support the audit opinion. They are
also interacting with other members within the audit firm and with the other key
participants in the auditing system and this may influence their judgement. One
question that needs to be asked is: if the quality of audit does depend
fundamentally on the auditors’ professional judgement, what effects do changes in
audit regulation and interactions with other key participants in the auditing system
have both on auditors’ professional judgement and overall audit quality? Another
issue that needs to be addressed is whether the emphasis on professional
judgement provides a platform to object to direct-regulation of the profession and
demand more freedom for the profession? Moreover, what are the implications of the changes (regulation of the auditors that is independent from the professional bodies) for audit quality? Traditionally, the quality and consistency of audit performance has been assessed by fellow professionals.

The Role of Audit Committee

This study has shown that most of the commentators acknowledged the important role of AC as part of key participants in the audit process and audit quality. This is in line with the changes in the corporate governance framework – the UK Corporate Governance Code has now outlined more explicit responsibility of the AC in overseeing external audit function and evaluating audit quality. The new framework has also put greater emphasis on the importance of communication between the external auditors and the AC towards the achievement of audit quality in practice. Prior research shows mixed results concerning the effect of audit committees on audit quality (Carcello & Neal, 2000; Abbott et al., 2003a; Abbott et al., 2003b; Lee & Mande, 2005; Piot & Janin, 2007). Further, these archival studies failed to document the processes involved between the auditors and audit committees members and its impact on audit quality. Hence, this provides an opportunity to investigate further how audit committees understanding of the concept of audit quality influence their operation and process and its effect on audit function and audit quality in the new auditing environment.

The Role of Regulation and Discussion Paper

The audit firms and professional bodies tended to view regulation as one of the key drivers for audit quality, but on the other hand they also mentioned regulation is complex to deal with and potentially undermines audit quality. This shows some internal inconsistency or contradiction from the respondents and leads to questions as to the extent to which this kind of submission and document represents an expression of ‘true feeling’ and the extent to which it is a kind of political response. Therefore, it is important to note that the nature of documentary records is not purely a set of objective comments; it is part of a participatory process in which the participants that is the commentators have self-interests and motivations. Their responses would be aligned to their self-interest, particularly the audit firms but also other interested parties. Does the content of the responses carry real weight or is the process of discussion more important as a way of managing the credibility and legitimacy of various participants in the auditing setting?
4.4 Summary

One of the more significant findings to emerge from this study is the breadth of ideas that the participants to the discussion paper perceived as associated with audit quality. The concept of audit quality is dynamic and has to be seen in the context of a range of interwoven regulations and guidance, the cooperation of executive management, participation of the AC, individual auditors and the effectiveness of the audit firm’s procedures and policies, all of which promote high audit quality. The results of this investigation suggest that audit quality is influenced by various elements within and outside the audit firm. However, the overall impact that these various elements have had on audit quality is subject to further examination. Therefore, the study of the consultation around the FRC discussion paper has made a considerable contribution in selecting issues to emphasise in the interview. Details of the impact of various elements gathered from the interviews are provided in the following three chapters.
Chapter 5

Audit Partners’ Perceptions Concerning Audit Quality in Practice

5.0 Introduction

The purpose of this chapter is to set out the results of the interviews that were conducted with audit partners to elicit their views concerning the meaning of audit quality, factors that influence the construction of that meaning and the representation of that meaning in practice. The background to and structure of the interviews and the methodological approach to the analysis of the evidence collected were described earlier in the thesis (see Sections 3.2 and 3.3.1.2 respectively); this chapter presents and comments on the views expressed.

This chapter is structured as follows. Section 5.1 addresses research question 1, and describes multiple meanings audit partners associate with audit quality in practice. Section 5.2 discusses factors that shape and influence the construction of the meanings of audit quality, thus addressing research questions 2 and 4. Section 5.3 how the meanings of audit quality are represented in the operation of the audit partners, which is the subject matter of research question 3. Section 5.4 presents empirical evidence that highlights the existence of quality conflicts in practice. Section 5.5 addresses research question 5 and discusses the impact of the AC on the external audit function. Section 5.6 provides a summary discussion of the findings and the conclusions of the chapter.

5.1 Meanings of Audit Quality in Practice

The thematic analysis of the responses demonstrates that the audit partners predominantly frame their meanings of audit quality around three important constructs. First, the notion of audit quality is associated with the concept of the professionalism of the external auditors. Second, audit partners place great emphasis on compliance with internal and external quality requirements in operationalising the meaning of audit quality in practice. Finally, the concept of audit quality is connected with the construct concerning the commercial values of the audit firm. The discussion that follows will show that the three elements serve to give structure to the meaning of audit quality in practice.
5.1.1. Professionalism

A first aspect to the audit partners’ understanding of the meaning of audit quality relates to what may be called ‘professionalism’. This meaning is connected to a range of potential individual attributes and values that can have an impact on the conduct of the audit, such as professional judgement, providing an independent challenge to management, experience, knowledge, competence, professional scepticism, independence and objectivity. Analysis suggests that audit partners’ sense of meaning of audit quality is related to some extent, to the background that they possess, which is consistent with their status and expected role as a member of a professional occupation.

“Audit quality...I think it is a combination of knowledge and technical competence, with an appropriate state of mind about bringing independent and professional scepticism to what we do” (AP7).

“You have independence and integrity and those two things are more important than anything else. So, if your clients were to ask you to do something, you have to behave with integrity and independence even if it costs you money basically. That is the difference between being a professional and not. I have a much higher standard of ethics that is an old fashioned view” (AP11).

When discussing the meaning of audit quality, audit partners expressed the view that relates people to the element of audit quality. The quotations below illustrate the importance of people and refer to the auditor’s professional attributes to audit quality. Frequently during the interviews, the audit partners argued that auditors’ knowledge, experience and skills influence various audit tasks such as risk assessment, planning decisions and evidence evaluation to arrive at an audit judgement. Consistent with the dominant audit quality discourse (as discussed in section 2.1.1.) and with the two other groups in the study (AC members and quality inspectors), the quotes below assume that audit quality is achieved through the use of auditors who have the ‘right’ level of knowledge, competence and experience, which shows that characteristics related to individual auditors are generally perceived as an important determinant of audit quality. For example, when discussing the meaning of audit quality, several audit partners mentioned that the strength of the auditor’s professional attributes, such as judgement and experience, provided ‘comfort’ as to the fulfilment of appropriate audit quality. Here, quality of audit is articulated by way of how auditor’s experience and knowledge play a part in the identification and resolution of significant key risk areas that could affect the audit opinion or judgement. The audit partners appear to believe that having the ability to understand and identify the risks of a particular audit client, makes them...
better able to carry out work on a specific risks issue (for example, impairment of assets) that reflects audit quality. The importance of risk as part of construction to the meaning of audit quality is also shared by the AC members in the study. Therefore, it appears that professional attributes may generate feelings of confidence not only for the auditors but also the others about audit quality, which possibly affects their performance during the conduct of the audit (e.g. being more confident may translate into asking more challenging questions during the conduct of the audit and being more critical during evidence evaluation).

"I think the firm’s internal message about audit quality is actually people quality... audit quality is very much about the people we have and the way in which they understand what they are doing” (AP5).

“Audit quality is about doing the right thing at the right time, involving the right people, having the right set of reviews, doing the right amount of work, and resolution and application of judgement in matters arising” (AP3).

The audit partners viewed auditors’ professional attributes as a manageable input and seemed to argue that the more professional the auditors, the more likely that the auditor will produce quality work. Consequently, the underlying notion of professionalism is an important aspect of audit practice and are used by all audit partners to provide structure and meaning to the quality of work that they perform. Such rationales provide support for the claims of auditors to knowledge bases that portray auditors as an expert group and equate quality with auditors’ professional characteristics.

5.1.2 Compliance Obligations

Again, consistent with the dominant audit quality discourse (as discussed in section 2.2), it was apparent during the interviews that all of the audit partners strongly associate the meaning of audit quality with satisfying the requirements of the standards and guidelines during the course of the audit. The quality inspectors in the study also view compliance with standards and guidelines as important to audit quality. For example, in the first quote below, the audit partner emphasised that high audit quality is linked, to some extent, to his/her meeting the requirements of standards and guidelines. The next quote provides a picture of how the auditing standards were operationalised to give meaning about audit quality in the day-to-day audit practices, where standards are regarded as a ‘rulebook’ that govern the conduct of auditors. Further he/she suggested that compliance obligations with the standards and guidelines play a key role in providing assurance about audit quality, not only in the eyes of the audit partners but also to outside people.
“...I think, in a sense, quality audit is expected to be high quality from a compliance perspective...” (AP3).

“I do not mean going over and above the standards, we have a rulebook as such, which is the suite of auditing standards and we have to comply with that in every audit that we do. So, to my mind, producing the quality audit is to make sure that we comply with those standards and that the outside world has confidence in what the audit product is” (AP4).

Some of the audit partners viewed performing the audit beyond the requirements of the standards as important to demonstrate that they have performed a high quality audit, that is, at a level that exceeds the minimum acceptable level of quality. They suggested that the development of regulatory inspection (the AIU) has had an impact in recent years and has caused increasing emphasis on performing the audit in a manner that goes beyond the standards. In contrast, some partners expressed the view that because the auditing standards are set at a high level, compliance with the standards would actually be sufficient to indicate that they have performed a high quality audit. These conflicting views about the current level of the auditing standards and the extent to which they reflect an appropriate expression of audit quality are illustrated by the following quotations:

“(If) we do not get good quality audit works we will get a negative finding from the regulators report. The AIU reports are now publicly available. There is an increased need to make sure that what we do is demonstrably beyond the minimum standards” (AP2).

“Well, the auditing standards themselves, I think it is wrong to say well this is like a minimum standard because I would say they are quite a high standard anyway...” (AP4).

The regime of inspection also marks another aspect of these compliance obligations of audit quality as expressed by the audit partners, which refers to the importance of producing sufficient audit documentation to satisfy the assessment of quality carried out by the AIU. It was evident that documentation standards were one of the main focuses of the auditors as a means of ensuring high ‘compliance’ quality. The following comment summarises the views of auditors on this issue:

“...the audit process or the audit documentation process. I think that is influenced by regulatory factors because from a regulatory perspective, for example, the AIU have a general rule, which is commonly known, ‘if it is not documented it does not exist’. Therefore, I think there is an appropriate focus within our firm to ensure that there is appropriate audit documentation... I think the audit documentation is part of the audit quality equation. It is not the full equation” (AP7).
The above quotations suggest that the auditing standards and the activities of regulators are seen as relevant in determining what constitutes high audit quality, by influencing the extent of audit work and the required level of quality. Here, the regime of inspection has established another discourse around the notion of audit quality in practice among the audit practitioners. Compliance quality is give meaning by doing enough to satisfy the quality assessment carried out by the AIU. Nonetheless, only a small number of audits will actually be inspected by the AIU and, therefore, the partners’ approach might represent a reaction to the threat of inspection rather than the actuality, as expressed by the following audit partner:

"I would say the minimum standard has increased over the last ten years because anybody who wants a licence to audit has to adhere or meet certain minimum standards to keep it...Quality is the overarching requirement. Yes, it is in part a response to the regulator. To demonstrate to the regulator how we embedded quality in everything that we do, however, overtime it impacts on the way people behave day to day and they do strive for better quality. Increasingly, these days, if you do not execute it well you might lose your job. Really, that is the most brutal driver of all” (AP2).

Some respondents did discuss another way in which they perceived compliance with the standards and external inspection as useful, namely as a legitimating tool to gain wider public acceptance that audits are conducted with suitable quality. This is important to gain wider acceptance from society at large (audit clients, shareholders and other stakeholders) about the quality of audit services offered by public accounting firms. The benefit derived from external regulation provides the comfort that the public need concerning audit quality.

"So, to my mind, producing the quality audit is to make sure that we comply with those standards and that the outside world has confidence in what the audit product is” (AP4).

"It gives me some comfort and I think it should give investors more comfort that there is a regulator there, that there is a regulatory body looking at and challenging the auditors and their approach to the audit ...” (AP9).

As noted above, the construction of audit quality can also be explained as reflecting the issue of the auditors’ need to gain social acceptability and credibility. The auditor’s work arrangements and procedures are structured and conditioned by their institutional arrangements. It is important for them to be seen as adhering to such arrangements in order to gain legitimacy. Consequently, it can be argued that compliance obligations are an important legitimating vehicle for the individual audit partner, audit firms and the audit profession as a whole. To some extent, it demonstrates the auditors’ desire to maintain wide societal acceptance of their role, to enhance survival and the stability of the profession. This is perhaps important to
the audit firms because audit quality is difficult for people external to the process to observe directly.

Another new set of discourse and ideals around audit quality relates to the audit firms’ monitoring and micro-quality control. The meaning of audit quality is connected to meeting requirements of internal quality review and other quality control procedures within the audit firm. As implied in the first quote, the audit partner stated that compliance with the internal quality standards would ensure a sufficient level of audit quality by way of ensuring sufficient challenge to the management and appropriate audit judgement, as illustrated by the audit partner concerning the application of a monitoring tool - professional standards review within his/her firm. The following quote provides insight into how monitoring and micro-quality control are used to justify how ‘right’ or ‘appropriate’ audit quality is achieved during the conduct of the audit.

"Part of the concept of quality is addressed by something that we call professional standard review, which is a hot independent review of any opinion that the firm is issuing in relation to auditing, accounting and financial reporting matters. We also have various compliance functions, which are manifested in something called an audit quality partner dashboard, whereby there are various quality and compliance procedures that partners have to comply with...I would say the concept and the approach are an independent challenge/ review of the judgment and documentation of the engagement teams and compliance with external and internal standards” (AP1).

In general, it is evident that compliance obligations are important as a key aspect to gain acceptance or legitimacy about what the audit firm and auditor are doing to promote and achieve audit quality in practice.

5.1.3 Commercial Values

The partners’ views also revealed the importance of commercial values to the meaning of audit quality in practice. Analysis indicates that commercial considerations influence the idea of audit quality in the minds of the audit partners, as the concepts of service quality was very prominent in most interviews. During the interviews, the attribute of audit quality involved frequent references to the added value or additional benefits that audit clients expected from auditors. This attribute was widely considered as an integral feature of audit quality, in which most of the audit partners make sense of the concept by relating it to improving a client’s business operation and financial performance. The importance of this aspect of ‘service quality’ is also shared by the AC members in the study.
“We are a client service practice so we have to provide our clients with a service in a way that the client expects the service to be delivered” (AP5).

“The other part of audit quality is where clients get the benefit of the auditor’s input in terms of improvements to the business, improvements in efficiency and more effective controls...” (AP9).

Quality, as value for money, reflects the auditor’s concern about providing quality audit services to the audit client at a reasonable cost. In the interviews, most of the audit partners drew attention to the intense competition in the audit market, which exerts pressure on them to offer a better service by providing better outcomes or return to the audit client at a given cost. This is also important for them to retain their audit clients, as suggested by Beattie and Fernley (1995); value for money is an important consideration for companies in selecting external auditors. As such, this notion of audit quality is important because providing quality through value for money is important in meeting client’s expectations. This leads to a satisfied client that can lead to client retention and profitability.

“...certainly in the current economic environment it is really important for us to retain our existing client base and the easiest way of doing that is doing a good job and making sure that the client is really happy with the service...we are not seeing as many of our clients coming out for re-proposal... the economic downturn comes and clients start thinking whether they are getting good value for money from this...if they are not getting good value that is when they maybe decide to test the market. I mean that is a whole other area of quality in terms of what the client is seeing as a quality audit” (AP3).

The audit partners also suggested that audit quality is reflected in the way they maintain quality relationships with the audit client. This attribute of quality is important for them, because, as a client service firm, maintaining a ‘good’ relationship with the management and keeping them happy is crucial. As suggested by Behn et al. (1997), the quality of the relationship is a key determinant in satisfying the client.

“Audit quality is all about the people we have...the way in which they interact with the client. I think that is the key message and what we would say is the people that drive quality and how they react to the client’s situation” (AP5).

“I think, in a way, it is very difficult for our clients to assess the quality of the work that we are doing, I think they form a perception and an impression based upon their relationship with us, the interaction they have with us” (AP3).
Commercial values also relate to the way in which notions of efficiency and effectiveness are reflected in the audit partners’ comments and how they appear to give meaning to the concept of audit quality in practice. The notions of efficiency and effectiveness are highly related to commercial considerations over pressure for cost reduction and profit maximization. The following quote illustrates how efficiency and effectiveness are used to justify that ‘sufficient’ audit quality is achieved in practice. In that sense efficiency and effectiveness focus on the content of the actual evidential processes and procedures that comprise the audit, as discussed by the following audit partner:

"Fees are a feature of the market so, at times, there is a lot of pressure on fees. You then work out what the job is going to cost and that should drive the budget...you can challenge the audit effectiveness by getting proper involvement of the partners at the planning stage. For example, ensuring that they use their experience of the job...to focus the work on the right areas, on the risk areas, make sure you do not do too much work in the wrong areas, waste time, you can make sure it is efficient in terms of the longer a process is drawn out the more leakage points there are in it in terms of downtime and inefficiency so you can plan the audit in conjunction with the client...there is a huge issue around project management and an efficient close down of the job at the end to make sure that it is closed down in an efficient way” (AP10).

The importance of creating value to auditing in the perceptions and expectations of the audit client was evident in the interviews. The audit partners’ views suggested that quality in practice was always being looked at from the perspective of their client. As argued by Jeppesen (1998), the management is perceived as the client by the auditors. Some of audit partners even described success in re-tendering for an appointment or the length of tenure in retaining the audit client, which reflect management satisfaction with the audit, as offering one important piece of evidence of audit quality, as illustrated by the following quote:

"It is only fair to say that from the firm’s point of view, the centre or the key focus for us in terms of what is great, is the clients... the client is at the core of it and when we look at audit quality from the client’s point of view, you have a number of outputs, which will be how long you can keep the client for and your success on re-tendering and these sort of things...” (AP6).

"So again, you might say that the heart of the audit quality is that the auditors should never be in a position where the people that they potentially criticise can sack them, which is what you have. I am not saying that inhibits people’s behaviour but it can influence people’s behaviour” (AP2).

The majority of the audit partners believed that audit quality is not only about meeting the various requirements of the standards and guidelines (compliance obligations) but also about meeting the expectations of the audit client (the management). In the following quotes, it is evident that audit partners want to be
regarded as more than a company’s auditor and wish to provide valuable audit service that can be beneficial to the audit client. In this light, the client expects the auditor to be a business partner rather than a ‘police officer’. The second quote illustrates that the audit partner believed that audit quality is something that cannot be measured and he/she thought that what is considered to be quality is closely related to the ‘value’ that the audit services can offer to a particular audit client.

"what does audit quality mean to me? Well, on the one side, it means compliance with the strict accounting standards and auditing standards, and on the other, it means in terms of the client’s perception what is the quality of the audit, has it been a beneficial experience for them and that it is more than just compliance with the standards...we are trying to do more than just a purely compliant audit because, ultimately, I do not think you are ever going to exceed your clients’ expectations if all you are doing is ticking the boxes in respect of compliance; audit quality is very important to us as a practice... hopefully we can get to the stage of being a trusted business advisor, which is a bit more than just being the auditor” (AP3).

"An audit is not something you can necessarily say this is high, medium or low quality, it is not a service in that sense, it is either valued or it is not valued...So, in that sense, it is actually easier for the client to recognise what you do for them...you hope they will continue to use you because it is a valued experience” (AP11).

In general, from the analysis of the interview evidence it can be deduced that audit partners perceived audit quality as having multiple meanings. Interestingly the interviews suggest that commercial interests, that is, profit maximizing and reducing cost, play a role in giving meaning to audit quality in the eyes of the audit partners. Consequently, providing value added services and meeting the expectations of audit clients become important constructs for the meaning of audit quality perceived by the audit partners.

The above analysis shows different elements and attributes of the concept of audit quality held for the audit partners interviewed, specifically professionalism, compliance and commercial values, and illustrated how these elements featured in the partners’ comments. The discussion below relates those elements to the broader regulatory, societal and economic factors that influence the construction of practical meaning for the concept of quality. The concepts of role expectations and self-image are also considered in the assessment of the interaction process that shapes and influences the construction of meanings of audit quality.
5.2 Factors Influencing the Construction of Meanings of Audit Quality

Intrinsic to a discussion of the meanings that audit practitioners ascribe to the concept of audit quality is a consideration of how the meaning is made. This section attempts to answer the second research question, that is, to look at factors that influence the process of construction of the meaning for audit quality. In particular, it explores the influence of broader societal, regulatory and economic forces and the concepts of role expectations and self-image on the meanings of audit quality. In so doing, the discussion below directs specific attention towards understanding the competitive, commercial and professional factors that underlie what audit quality means for day-to-day audit practice. This section also discusses the potential impact of the AIU on audit quality, thus addressing research question 4.

In the interviews, three key elements of audit quality were identified that give meaning to audit quality – professionalism, compliance obligations and commercial values, which are closely related to two underlying facets of auditing. First, professionalism and compliance obligations are two elements that stem from the concept of auditing as a profession. These elements of audit quality emerge when the audit partners perceive that their role should adhere to the standards of the professional or expert group of which they are members (Burns and Haga, 1977; Miner et al., 1994). From this perspective, to understand audit quality one needs first to understand that auditing is a professional service that concerns the possession of knowledge or expertise and the display of appropriate behaviour (Grey, 1998). As a result, how auditors perceive their roles will be likely to have an effect on what they consider as legitimate and useful knowledge and, consequently, on their actions (Cooper and Robson, 2006). This perspective also requires recognition that auditing is an activity that involves the negotiation of a legitimate and institutionally acceptable knowledge base and practice (reflected in, for example, codified rules and regulations, education, training, audit methodology and quality control procedures), which influence the institutional significance of auditing and auditors (Power, 1996). From this perspective, audit quality primarily relates to professional attributes, values and appearance that individual auditors have such as judgement, expertise, competence, knowledge, interpersonal skills, ethics and independence, which it can be argued can influence their performance in executing audit responsibilities. In addition, audit quality is also about meeting the requirements of the standards and guidelines in the conduct of the audit. From another angle, compliance obligations also have some commercial aspect of it where if auditors fail to comply with those standards and guidelines it can expose
them to the threat of litigation, which could possibly, involve high cost and damage to their economic reputation (Palmrose, 1988).

Second, commercial values stem from the concept of auditing as an industry, where, at the same time, auditors are also members of commercial professional service firms that are motivated by profit and capital accumulation, which is likely to determine their practices and actions (Cooper and Robson, 2006). This element of audit quality appears where the auditors perceive that their role is to fulfil the client’s (the management) expectations and the audit firm’s business objectives. From this perspective, to understand audit quality one needs first to understand that auditing is a commercial professional service that emphasises profit maximisation and cost reduction for supporting the business of auditing. Accordingly, representation of audit knowledge and practice should be consistent with economic pressure and client legitimacy. From this perspective, audit quality is primarily about client service, particularly providing value added service and satisfying the client’s needs and expectations.

The discussion which follows will show that the two concepts (audit as a profession and audit as an industry) serve to give structure and justification to the meaning of audit quality in practice. In other words, the concepts influence the construction and presentation of the meaning of audit quality.

Analysis of the interviews suggests that social factors influence the meaning of audit quality in practice through the concept of ‘professionalism’ of the auditors. In this context, professional self-image influences the way in which meanings are constructed and the circumstances in which the idea of audit quality is interpreted and given practical meaning. In the interviews, the audit partners affirmed these notions of professionalism and linked them to audit quality, most notably to professional judgement and expertise or knowledge. The impact of auditors’ self-image is also connected to values and behaviours that are regarded as an important part of auditors’ culture. As such, attributes, such as behaving in a professional manner, independence and integrity are significant in giving meaning for audit quality in practice.

"The essence of a profession is that people behave in a professional manner, which is not something you can ensure by only writing things down or by having other people review what you do. If you do not have it inside then it is not going to be there. So we train people and recruit people to actually be proper professionals, therefore, to have an ethos and a culture of professionalism and independence as well as having procedures to do that. However, I suppose that the first essential is that it should be from the inside out" (AP11).
During the interviews, the audit partners tended to express pride regarding their professional status, while simultaneously expressing feelings that the recent changes in the audit regulatory framework did not appear to regard them as such. To some extent, the audit partners’ comments suggested that more independent regulation of the audit profession invalidates their professional identity or questions their professional standing. Regulatory intervention might reduce their professional privileges and status in society. Considered from this perspective, it is not really surprising that the symbolism of professional values is strongly embedded among auditors. Not only did it confirm the auditors’ sense of themselves as professionals, but it was also seen as maintaining their professional identity:

"...I think audit quality is taken very seriously because it is the lifeblood of most firms and I think the profession is professional and is often misunderstood“ (AP10).

"So the fact that the AIU can come in, and I do feel very strongly about this, the fact that the AIU comes in and spends as much time reviewing a job as we spent doing it is just ridiculous and they can come up with just hundreds of questions as to "why did you do this, how did you do that, why did you not do this“ it is just ridiculous...” (AP3).

From the institutional perspective, the auditing profession established its role and responsibility for the public interest in order to gain legitimacy. As contended by Hall (1968), a belief in social obligation requires an individual to recognize the importance of their work to society, and the fact that their work benefits not only the organisation and individual, but the public as well. The profession also creates professionalism as an ‘image’ in order to attain social acceptability and credibility. Public interest becomes the ‘ideology’ in providing a socially integrative function and ensures wider societal acceptance of the profession, as explained by one of the audit partners:

"I think, ultimately, that audit quality means that the recipient of an audit opinion can place reliance on the fact that the opinion is right and, hence, that helps the stability of capital markets and helps people to make informed decisions on the basis of the accounts on which the opinion is given. So that is probably why we have audit opinions, therefore, why audit quality is important“ (AP10).

The construction of quality through compliance obligations can be partly explained as having occurred through the influence of regulatory forces. As other authors have noted, in the context of the auditing profession regulatory pressures could affect the behaviour and structure of the audit firm (Dirsmith et al., 1997; Covaleski et al., 2003; Humphrey et al., 2009). This is because audit firms, as suppliers of the audit services, operate in an environment where connections to
professional associations and regulatory bodies are important for their reputation and legitimacy and have the potential to exert a significant influence on the design of their audit work, procedures, processes and practices. The interviews provide evidence that the interaction between the auditors and the regulator, in particular the AIU, influences the behaviour of the auditors and changes that are made in audit practice to reflect the expectations of the regulator. Similar to Nagy and Cenker (2007), recent changes in regulatory framework introduce pressure that influences audit firm procedures and practices.

"What you see through the AIU is more emphasis on file review, it is documentation quality certainly. Fundamentally, people are much more thoughtful now when somebody looks up the file. Most people have their file review by the external regulator now. It is around documentation, making sure it is documented and has appropriate support on files. So, I would say the biggest area where the regulator has changed things recently" (AP2).

In respect of the impact of the AIU on the process of the conduct of audit, the evidence shows that the regime of inspection has had a significant impact on the process of documentation of audit work. Specifically, it has influenced the audit firms’ monitoring and control procedures in relation to file review and the use of formalised electronic support systems that enhance audit quality through compliance with the auditing and documentation standards. Most of the partners indicated a rigorous process of review on closing down the audit files, which reflected a greater focus on the quality of documentation to satisfy the expectations of the regulator. Some of them mentioned the use of computerised audit systems to ensure compliance with the documentation requirements within the firm. Consequently, a number of the audit partners revealed how meeting the expectations of the regulator has created an additional challenge to them, which highlights the struggle of the practitioners to attain a balance between spending time on documentation rather than the audit itself. Further, the majority of the audit partners were apprehensive about the impact of the AIU on cost and the benefits associated with the inspection. They suggested that they need to spend considerable time and provide the necessary staff to meet the requirements of the AIU, which affects the cost of the audit. The situation has created additional pressure on audit firms because increases in audit fees do not always correspond with the audit costs. The following quotation illustrates the views concerning this issue:

"You start in the area concerning audit fees for the audit work and the associated costs. The balance between spending enough time on something to make sure it is documented, every last detail...The client is prepared to pay a fee, which will not necessarily cover all the time costs associated with
it. In the market, at the moment, we can see very aggressive pricing for some firms to win work...clients would have a fixed idea of what they would prepare to pay for that. They will try to get it as cheap as possible. It is true that in many cases you will not get a different audit opinion if you document it any less or you document every single conversation with the auditors down to any degree. You might be able to give them a better fee” (AP7).

Frequently, during the interviews, the audit partners expressed deep concern that the current efforts undertaken by the AIU are moving away from principles to a rule based audit approach that might emphasise tick box compliance at the expense of their professional judgement. Findings from interviews with auditors in the US by Nagy and Cenker (2007) support the claim that the changes in audit regulation influence the nature of audit that become more procedural to reflect regulatory compliance. This expression of discomfort by the audit partners may be also construed as the effect that regulation has in diminishing professional judgement of auditors or the ‘de-professionalization’ of the audit profession that is related to the value of an audit. As mentioned by the following audit partners:

"It does overly encourage teams to focus upon the process and documentation at the expense of appropriate judgment. I think it is just a kind of side effect of the influence of the regulators and sometimes there is a perception with the audit teams that we have to do this because of the regulator. However, it should not be just a process and should not remove the fundamental need to apply audit judgment, because, if it does, you come back to your first question in terms of what counts in terms of an audit. The auditors will not be providing the appropriate challenge to clients and providing appropriate reporting if it is just a tick box process” (AP1).

"There is greater and greater emphasis on what is written down rather than what is actually done and the judgments that are formed” (AP11).

Several views on the role of the AIU were expressed by the interviewees. In general, most of the audit partners tended to voice feelings of unease when discussing the inspection process. The AIU’s approach was perceived to be burdensome and highlighted overwhelming workloads resulting from such inspections. Some of the audit partners felt that a lack of beneficial feedback was given in the review. The audit partners also commented on the unpleasant experience of working with the AIU. The audit partners also believed that the regime of inspection does not have a significant impact on the attributes of commercial values in relation to their audit client. The following quotations illustrate the partners’ views on the above issues

"It is a pretty onerous experience and it is a pretty unpleasant experience to be reviewed by the AIU and I am not sure that is actually how it should be. I fully acknowledge they have got a job to do and I do not think anybody would want them to not be on the side of high quality audits, however,
equally I think they ought to be coming in from the perspective that you are innocent until proven guilty rather than “actually this is a bad audit and now you have got to prove that it’s a good audit”, which, personally, I think is the wrong way to come at it” (AP3).

"Regulators... whether it has actually improved the quality of audits, I am not sure that it has. I think we do good quality audits anyway, if we do not we get sued... I do not think it will necessarily improve the quality or indeed that it will help the clients get a better service...” (AP11).

Another significant concern of the audit partners in relation to the regime of inspection is the impact of public reporting, that is the AIU public reports on the perception of the users’ concerning the audit quality. In particular, they were concerned that the public would misinterpret the information published in the report, which might affect public confidence and trust concerning the quality of the services that they offer. This might also affect the business of the audit firm.

"My concern is that the man on the Clapham Omnibus may see some issues as being more severe than they really are in practice if they are misunderstood in a report...I do think that if people misunderstand things it might just be some documentation around something, quite a small matter could be perceived by an external reader thinking "oh my gosh, you know x, y or z firm does not know how to do this" so if it is not well written or the issue is not clearly understood it could be very detrimental to the firm’s market position” (AP9).

Despite concerns about the negative impact of the inspection, some of the interviewees accepted the important role of public reporting to enhance confidence and provide additional comfort to the users of the audit report about the level of audit quality offered by the audit firms. A small number of respondents viewed the inspection as having a positive impact on the audit profession by promoting greater transparency concerning the conduct and control of audit quality in practice. The views expressed about these issues are illustrated by the following quotations:

"Obviously we have external regulators who come in and assess audit quality, and obviously that is one of the changes that I have seen over the last ten years. They come in and make an assessment of quality. If that is what is needed to give the external world further comfort about the adequacy of the quality, then I suppose that is where one has to be” (AP8).

"I think it is forcing discipline amongst the players, which must be a good thing, so it is forcing everyone to demonstrate how to do things, so the control processes are there in place. So my personal view is that it is improved audit quality and processes across the board, I think what is undeniable is that it is giving more assurance to the public that someone is looking at audit quality and someone is making sure it is happening” (AP6).
The use of a construct of commercial values to give meaning to the concept of audit quality can be understood by looking at the nature of the market of auditing services. The audit market is subject to active competition and pressure on the fees for audit services (Humphrey, Moizer and Turley, 2007). As a result, there has been increasing need for audit firms to retain their client base through both creating and promoting perceptions of the value of the audit. This effort can also reflect the firms’ objective to enhance profitability. In the interviews, commercial values were represented by comments referring to quality attributes such as value for money in the delivery of the audit, attempts to promote a view amongst clients that the audit represents a value added service and the importance of meeting the expectations of customers (i.e. client company management). Commercial values are part of the culture within a firm in which audit partners emphasise delivering services that are valued and expected by their clients. This establishes the fundamental importance of serving the client by the audit firm. During the interviews the majority of the audit partners made comments referring to the importance of these attributes and connected them to the overall objective of audit quality, as illustrated by the following quotations:

"I think what works for us in the long term is clearly a culture that encourages our people to be really engaged with clients...delivering and bringing value to the clients. I mean, ultimately, we are a service industry" (AP3).

"... there are four strong players, it is going to be competitive, it will be competitive. We know that if we do something wrong for one of our clients, if we do not deliver the quality that the client expects or the service the client expects then we are not going to be there for very long, so it is a very competitive market" (AP7).

The importance of commercial values also fundamentally relates to the economic nature of the auditing services and the manner in which audit appointments are made and contracts negotiated. The audit involves an independent examination of a set of financial statements prepared by the company management. In economic terms, the audit service relates to the monitoring costs borne by shareholders to ensure that the management acts in their best interest. In this economic arrangement, the auditors are accountable to the shareholder, however, in practice they are paid and appointed or selected by the company management. This arrangement signifies the interdependence of economic interests between the auditor and the management (Simunic, 1980). The arrangement has also substantiated the imbalance of power between the auditor and the management, for the reason that the power to hire or fire the auditors as well as the determination of audit fees and scope reside with the management. The
asymmetrical power can create a conflict in the auditor and client relationship when the dependence of the auditor on the client is much greater than the dependence of the client on the auditor (Nichols and Price, 1976). Some audit partners’ comments explicitly refer to how the commercial and contracting arrangements for audit appointments influence the meaning of audit quality in practice:

"The heart of the matter is that we are been paid by somebody to give an opinion on their accounts. There is an element of interdependence. Although you could say it will always be there regardless of the regulation being in place, it is always the commercial pressure that you are under...I am not saying that inhibits people’s behaviour but it can influence people’s behaviour” (AP2).

“The auditors’ fees are theoretically set by the shareholders, however, in practice they are set by the directors and one of the auditor’s prime responsibilities is to check what the directors have been doing, so, by definition, there is in built tension” (AP11).

The idea that differential audit quality is not observable to those on whose behalf the audit is conducted, nor to those monitoring the delivery of the audit, and that differential quality can be signalled to management, reinforces the notion of the importance of satisfying client expectations to achieve appropriate audit quality. To understand audit quality from this perspective, it is of course relevant to note the nature of audit firms as commercial enterprises operating in a competitive market. Commercial pressure and the interdependence between the auditor and the client management may shape the meaning of audit quality and how it is made operational in practice. One critical issue here is whether task interdependence and commercial pressure create a conflict of interest that might result in the independence of the auditor and the technical quality of the audit being undermined and the auditors not acting in the best interests of the owners to whom they report.

"I think it is very difficult for our clients to in a way assess the quality of the work that we are doing. I think they form a perception and an impression based upon their relationship to us, the interaction they have with us. I think as a big four firm and the biggest professional firm they would expect our quality to be absolutely tip top and that is just a general expectation and it gets back to the point that that is a fundamental attribute that we are expected to fulfil is a top quality audit” (AP3).

The construction audit quality –efficient and effective audit, that is, quality in the design and conduct of the audit procedures and processes reflects considerable regulatory and economic pressures facing the audit firms. Hatherly (1999) suggests that regulatory and fee pressures could influence the audit firm’s efforts to be more efficient and effective. The economic climate may impose significant pressure on
the firms to ensure profit and survival and, consequently, minimizing cost is deemed important.

"I think what we are particularly focusing on at the moment is that it is really important that we get the audit planning right and that really means, among other things, that this is an area where there needs to be significant input from senior members of the audit team including the audit partners who have the judgment and experience...They are going to tell you before they start the audit what the issues are. Now, that is not to suggest you should not be doing the detailed audit testing, but it is to recognise where the productive areas of an audit are” (AP1).

The above analysis shows that the construction of the meanings of the audit quality in practice is influenced by interactions – role expectations, self images, regulatory, social and economic factors in the auditing environment faced by the auditors. The audit environment is constituted by an array of factors and actors that interact with one another, which can be said to influence and shape the perceptions of audit quality.

5.3 Representations of Audit Quality in Practice

This section answers the third research question: to document the different representations or symbols associated with the meanings of audit quality in practice. A first dimension to the interviewees understanding of the meaning of audit quality connected to what may be called ‘professionalism’ that associated with a range potential individual attributes that can have an impact on the conduct of the audit, such as professional judgement, skills, experience, knowledge, competence and expertise. Analysis of the evidence from the interviews demonstrates that various symbols are brought into play to represent and communicate that meaning in practice. All of the audit partners believe that audit quality is largely determined by the quality of the people. The audit firm creates explicit mechanisms to operationalise this meaning through entry prerequisites, professional examinations, institutionalized programmes of academic education, work related training and experience. Auditors use these strategies to establish that credible intellectual knowledge – ‘professional expertise’ – underlies their practices, which gives some indication or signal concerning the quality of work performed by its members, which, in itself, is difficult to observe not only by the outside people but also for the audit practitioners themselves.

Consequently, certain representations were emphasised by the audit partners to signify the meaning of audit quality. For instance, people quality is represented through the rigorous recruitment process of the audit firm and the academic
qualifications of the individual auditor. They emphasised that these are critical to ensure they have the ‘right’ people of the appropriate calibre doing the audit. Furthermore, the skills, competence and knowledge of the auditors are associated with the training they attend that keep them up to date with various aspects of accounting, auditing and business issues, which is important to reflect the level of competence and expertise that they have, as illustrated by AP3 in quotations one. In the last quote, the audit partner elaborates on how job training on various industries could enhance the professional experience of individual auditors, which might possibly affect their performance during the conduct of the audit by asking more challenging questions or posing a sufficient challenge to the audit client (the management). This quote and several others also imply the beneficial impacts of training concerning the ability of the auditor in assessing and resolving significant audit issues during the conduct of the audit that could affect the auditor’s opinion or judgement.

"We invest hugely in our people over the first three years in terms of getting their skill and competence raised to a reasonable level, lots of training, either classroom based training or on the job training, lots of coaching and, ultimately, we have a feedback and appraisal mechanism to ensure that the quality of the work that people are doing is of the right standard and that people are rewarded and appraised on that basis” (AP3).

"We try to give our people at the beginning of their career as broad an experience as possible...they can be working one day in insurance and one day in the media sector, one day in the manufacturing sector and I think it exercises their brain, helps them challenge how people do things. Because if you always work in the same sector, you tend to be used to how people just do things in that sector, but if you have had experience of other sectors, you can bring a fresh perspective to things and ask different questions, more challenging questions“ (AP6).

The analysis shows that audit partners represent audit quality by emphasising the need for coaching and the involvement of audit partners or seniors during various stages of the audit to achieve high audit quality. In particular, the audit partners emphasised the importance of their involvement in the audit planning by way of ensuring that audit efforts are concentrated on the right areas, as illustrated by the following quotes.

"...it is just getting the right coaching, the right seniority of people involved at the right time of the audit. It is right up front in the planning stage of an audit, really getting the input from the people that have been there before...if you get the quality right, then you ask all the right questions at the right time, you plan it properly, you have had someone on site making sure it is working correctly” (AP5).
The majority of the audit partners identify consultation as being central for audit quality and this representation of quality appears to be believed in and shared by all the audit partners interviewed. The quote indicates that consultation is practised across the hierarchy of the audit while suggest that failure to consult with the technical department on high-risk audit engagements could lead to unfavourable consequences for the auditor. It is evident that considerable formal and informal consultation has been practiced throughout the audit firm and that it is one of the important features in the process of the conduct of the audit. This aspect of the process of the conduct of the audit is highly associated with the symbol of the quality of audit judgement.

"We encourage people to consult each other as much as possible, sometimes these are like information consultations. If you have got decisions and you are looking at something and you think 'oh, I am not sure about this' you will go next door and speak to one of the other partners, maybe informally and just say 'what do you think about this?' Then you have very informal consultations, however, then, if you think you have got an assignment where you are going to have a lot of issues, you would ask to have a second partner quality control reviewer to look at your judgements. Obviously, that is in any high-risk jobs. We also have a technical department that people can go to and ask if they are not sure, so consultation is actively encouraged where other people feel the need. When we come along and do the cold reviews, if we look at something and we think 'you did not treat this right' or 'you should have consulted somebody else' then they will get criticised for not following due process. It is actually written down in our policies and procedures” (AP4).

Analysis of the evidence from the interviews demonstrates the important role of internal quality reviews to operate and communicate compliance quality to various internal and external compliance obligations. For example, the review process is represented in practice to define compliance quality with the internal quality standards by way of ensuring that auditors follow firm-wide policies and procedures. The reviews are also symbolised to various attributes of professionalism and commercial values. For instance, it symbolises audit quality by way of ensuring a consistent audit approach or methodology across clients and increasing audit efficiency and effectiveness. The reviews also symbolise decision quality by having a quality review partner to assess the quality of audit judgements. In general, the internal quality review is one of the important symbols in constructing and attaining comfort that the audit partners achieve adequate audit quality.

"How do we ensure that we deliver good quality audits? We have a widespread internal programme of training for the staff and the partners. We have an internal audit licensing system where partners demonstrate that they have done sufficient training every year to keep that licence and they
are regularly reviewed by our own internal quality control and review programmes. If their work is not up to standard then they effectively get a conditional licence and if they continue to not be up to standard they cannot take audits” (AP11).

Answers were sought about the format and assessment of quality during the review. The audit partners mentioned that the format of the review consists of a detailed list of yes and no questions that cover areas such as compliance with the auditing standards and documentation standards. The audit partners generally insisted that the internal engagement quality review is extensive in terms of its focus. The review process also covers the scope of the audit process, including the appropriateness of the audit approach, which is linked to risk assessment, sufficiency of the audit work, and identification and resolution of various key auditing or accounting issues. In addition, the assessment also involves reviewing other important areas such as reporting and communication with the audit client and other relevant parties such as the audit committee.

“What our internal inspection does is much wider...things like quality deliverable, have we properly met the audit committees report” (AP2).

The following quotation illustrates the process of the internal quality review that supports the comfort of the audit partner concerning the level of audit quality. First, a quality review partner would be required for high-risk audit engagements. Then, a report will be prepared based on the review. The findings of the review will be fed back to the engagement team, where, if issues emerge, they are required to be resolved by the engagement team. Finally, the quality review partner will formally sign off the file for clearance before the engagement partner signs off on the audit report.

“Independent reviews by another senior manager, basically against a check list, to make sure that the team has done their job properly and that it is ready for me to sign off. So reviewers record their findings from that review on a form that goes back to the engagement team, the engagement team respond to that document and that gets formally signed off as being satisfactorily cleared by the quality review partner” (AP3).

The views collected from interviewees about the role of audit methodology tend to emphasise the importance of a risk-based audit approach to represent quality audits. The auditors pointed out the impact of a risk-based audit approach on audit quality in several ways. First, it assists in ensuring that sufficient audit work has been performed in the areas where there is a higher risk of misstatement. Second, the approach helps in facilitating an efficient audit by concentrating on the risk areas. The risk-based audit methodology is perceived as being important in
achieving an effective and efficient audit. The symbolic representation of efficiency and effectiveness links quality with the audit firm’s methodology, in that sense, the notion of audit quality focuses on the content of the actual evidential processes and procedures that comprise the audit. Perhaps not surprisingly, the emphasis on firms’ audit approaches on risk based auditing and the importance of planning in the conduct of the audit also appear to be significant in the way in which the quality of the content of the audit process is understood.

“Well I say audit quality we have a phase, which is risk and quality. I mean we tend to sort of have the two very much allied together...Well I think they are pretty good bed-mates... our audit approach is very much designed to focus on risk, risk in the business and identifying significant risks and focusing our audit work on the areas of key risk and higher risk and, therefore, I think addressing those key risks adequately should lead to a good quality audit. Then clearly you need to do all the compliance bits around the edges, however, if you are addressing the key risks within the business and as long as you have identified the key risks correctly to start with then I think that should sort of lend itself to fundamentally moving down the path of the high quality audit” (AP3).

From the interview comments, it can be deduced that various representations are negotiated, developed and sustained within an audit firm in constructing the meaning of audit quality in practice. This highlights the significance of the various symbols in constructing social realities and in impacting behaviour and action. The meaning of audit quality, as articulated by the audit partners includes such symbols such as comments through references to the way auditors carry out the audit and policies and procedures established and implemented within the audit firm.

For instance, academic qualifications, trainings, recruitment process, internal quality reviews, audit partners, coaching, business risk auditing, audit planning and consultation within the audit firm are some of the important aspects of behaviour and ‘objects’ that were discussed in the interviews as representing audit quality.

**5.4. Quality Conflicts in Practice**

Having identified a number of elements concerning the meaning of audit quality to practitioners, it should be recognised that these elements cannot easily be ranked or placed in a hierarchy of importance or influence. Rather, there are likely to be tensions and conflicts between the activities necessary in order to deliver the competing elements and consequently potential choices in the conduct and content of what is done in any individual audit engagement. Auditing is not a unitary phenomenon and can mean different things to different people (Humphrey, 1997) and, similarly, audit quality can hold different meanings for different constituents.
because of their divergent interests and expectations. To the extent that the elements of the meaning of audit quality for the audit partners interviewed reflect attention concerning the varying interests of different constituents, then emphasis on specific elements will affect audit practice. The interview comments provide evidence that auditors recognise the diverse expectations of other constituents in the audit setting regarding audit quality and the associated perception gaps that can create role conflicts for auditors and the profession (Mills and Bettner, 1992). As implied in the quotes below, auditors perceive that different roles are expected by various constituents in the auditing environment. Consequently, some of the audit partners recognise the expectation and perception gap concerning their roles.

"My guess is that the public has a very ill considered view of what audit quality is, audit quality is a lack of failure in a quoted company.....from a client’s perspective, I guess the feedback we have is that a lot of quality issues from a client’s perspective are due to financial reporting actually rather than audit quality. Again, their view is that what goes out in the public domain is the set of accounts and then sometimes they are more interested in whether the accounts comply with the accounting rules rather than the quality of the audit and the challenge.....if you talk to all the committees, there would have to be a challenge from the auditors to the management and I think the quality seen at that level is the degree of challenge. In addition, probably because people are very practical, I think it is just the way in which the audit is done, it is very much seen as the quality of the audit, so just the effectiveness of the process, the relationships built up and just looking at your timetables" (AP5).

"I think there is still this huge perception gap between what the public at large think an audit involves and actually what it does involve and I mean I think the public expect us to be sitting there adding up lists of numbers and checking every invoice that the company has issued and they have no real idea and, maybe, they do not want to know. I mean they would be surprised in a sense that where you have a strong control environment how little detail testing sometimes actually goes on and you obtain your comfort elsewhere...” (AP3).

Audit quality in practice will frequently be viewed from the perspective of the audit clients. For this reason, public or regulatory interests may be in conflict with the auditors’ and clients’ financial interest. The quotation below highlights one auditor’s view about the potential conflict between compliance obligations and commercial values, that is, between the different interests of satisfying the expectations of the regulator and other objectives (e.g. profit maximisation) of the audit firm. The commercial and competitive forces that affect the audit market may create conflicts in practice, in particular, concerns about the cost of audit (either from the point of view of client management or the audit firm itself). A quality conflict arises because auditors are faced with practical choices about providing high quality services at a reasonable price (Mills and Bettner, 1992).
“...and then, I suppose the other thing is the commercial pressure, in a time of recession, profits are lower, people are trying to do more with the time, people are trying to do more in the time they have got available, are you getting things right from that perspective? In a recession, it can give rise to more challenge to audit quality” (AP5).

“The two main levels to make more profit on an audit, first it is the amount you spend on the audit and second there is the seniority of the people you put on the audit... so I think there is clearly a conflict there between making a significant profit and good quality audits” (AP6).

The analysis also suggests possible tensions in various areas of audit between the audit regulator and the audit practitioners. For instance, the following quotes highlight possible tensions concerning the appropriateness of the audit opinion as well as the sufficiency of the audit work and the adequacy of audit documentation during interactions between the audit partners and the regulator.

“There was probably less emphasis on file completion 15 years ago. Certainly, if the partners felt that there was enough evidence on the file, then that was pretty much enough really. Now it is the perspective where we have a very stringent control over closing down of files. We have a files review to see whether we got the right things on file from a completion point of view. Have we got the right sort of approach documents on file and that is done with the regulator in mind. That is what I would say drives what quality of audits now. As we provide better opinion, are the accounts more accurate now than they were 15 years ago? I am not convinced to be honest” (AP2).

“I think we probably are more regimented in documentation...I think the standards are very demanding and if you look at the audit inspection unit’s approach to reviews, sometimes they seem to want even more documents than we think is necessary” (AP5).

During the interviews the auditors also made reference to a potential conflict between what has been described here as the element of compliance obligations and that of professional values. For example, comments indicated that a tension between these dimensions is reflected in the procedures through which audit engagements are evaluated within the firms themselves. As suggested by Curtis and Turley (2007), in the audit firm setting there is tension between the practitioners and the firm’s ‘administrator’, that is the managerial control part of the firm. Most commonly, this idea is present in views complaining about a potential emphasis on completing checklists – that there is a conflict between ensuring that the audit involves the exercise of professional judgement and ‘box ticking’ to satisfy internal and external compliance obligations. In the words of one audit partner:

“One of the frustrations of the audit partners within this firm is that sometimes we come down on the side of quality evaluations that end up being basically a huge check list, tick what have you done, have you done
these 900 things on your audit ...and it is basically yes or no and for every no answer you justify why it is a no answer and if you have got lots of no answers then potentially that becomes an issue as to whether you have done a quality audit...” (AP3).

Generally, the auditors interviewed regarded attaining high audit quality from the perspective of their clients as their highest priority. That perspective may give rise to a further conflict between the desire to fulfil commercial values and the auditors’ perceptions of what is appropriate in terms of professional values. As stated by one interviewee:

"You will always get a partner and if it is a relatively small, or what appears to be a relatively small client, that partner can get too close to an audit client. They can get sucked into a position whereby they will do something out of a desire to provide client service and they will see it as a client service objective and, like I say, we are a client service firm and they will not see the difference between a client service and audit quality. I think that is a very difficult thing because we preach message to the staff that we must provide good client service, you must do a good quality audit and they are not always the same. And being able to identify and being able to ensure that our partners can identify where there is a conflict, is important. So, in a way, is something that worries me. I suppose the other thing is the commercial pressure, in a time of recession, profits are lower...In recession, it can give rise to more challenging audit quality” (AP5).

Collectively, the existence of these conflicts suggest that for the individual audit practitioner the process of attaining what he or she considers to be an audit of suitable (high) quality is likely to be complex and may involve considerable tradeoffs between conflicting pressures. In that sense, the ‘process’ of audit quality is more multifaceted than simply the presence of certain signals or attributes associated with the inputs supplied to the audit engagement or the characteristics of the financial statements after completion of the audit.

### 5.5 Perceptions Concerning the Impact of the Role of the Audit Committee on Audit Quality

This section reports on comments made by the interviewees regarding the extent to which interactions between auditors and the AC influence audit quality in practice, which addressing research question 4. First, each partner was asked a question about their general view with respect to the overall role of the AC. On the whole, the majority of them agreed that the role of the AC has strengthened in the last few years. Some of the partners indicated that the AC was now seen as being more rigorous and critical in their approach than had previously been the case. For example, the AC was taking an active role in their oversight activities through questioning, challenging and discussing critical accounting and audit issues, the
audit approach and the results of the audit with the audit partners. The AC sometimes asked for additional reporting or further detail on the auditors’ work but there is little evidence of the AC having a direct influence on the design of the audit work. Others noted the important role of the AC regarding matters such as auditors’ fees and enforcing additional pressures on management concerning difficult issues that emerge during the course of the audit that can facilitate the process of conducting an audit.

"They are demanding more from the auditors and the auditors are acknowledging their central role... Increasingly I am seeing that audit committees are taking a robust position, which is very noticeable...in terms of influencing or changing procedures, my answer will be no, on the assumption that there is no reduction on procedures. Would they sometimes ask us to do additional work in relation to that in addition to what is required to the audit. Sometimes, not the norm but sometimes when there are specific issues that really everybody knows are on the table from day one, only sometimes would I say they actually request additional work" (AP1).

"the audit committee has been very supportive of us in terms of the approach that we want to take in respect of that audit and to the point where they basically, even though I mean naturally we are under sort of fee pressure in the current market place, they have said "we want you to go and do a good, thorough audit of that and we are really interested in what your findings are” and in a sense, well keep an eye on the cost but do not worry about the cost because we want you to go away and do a good audit which is a slightly different message than you get from the FD because yes she wants a good audit but ultimately she wants to tie us down to a fee as well..... So, I think there are lots and lots of areas where you can have good sort of robust but educative and informed debate with the audit committee, which then actually does have a sort of positive impact rather than just trying to sort of agree with the FD” (AP3).

Most of the audit partners also took the view that the effectiveness of the role of the AC was very much dependent upon the individual characteristics of the chairman of the committee. The audit partners regarded the knowledge and understanding of the chairman concerning auditing, financial reporting and the client’s business, experience and their judgement to be an important part of the characteristics for the AC to be able to fulfil its role and its responsibilities effectively. At the same time, the audit partners perceived that the approach of the AC was varied and that it was very much influenced by the chairman of the AC. They also perceived that the chairman would be likely to influence the type of working relationship that existed between the auditors and the AC.

"It varies on the personalities involved on the non-executive side. They will ask detailed questions of the auditors and have a very good understanding of the accounts. Others will be much more hands off, they do not particularly want to see any report from the auditor. Others will be
challenging in terms of the information that they get from the auditor, in terms of the approach, in terms of the planning approach, the result of the work. It usually manifests itself in a way, I do not understand that number or that area in the accounts, can you explain that and deep-deep down that way. It does come down to the individual” (AP2).

Although there was a general agreement among the audit partners that the role of the AC has strengthened over the years, there were mixed views in relation to the impact of the role of the AC on audit quality and content or conduct of the audit. Some of the partners believed that the role of the AC influences the knowledge of the auditors by enhancing the auditors’ understanding of the client’s business. They believed that discussion with the AC on various business issues enhanced audit quality. Others mentioned the greater need to show that they posed sufficient ‘challenge’ to the company’s management in accordance with the expectations of the AC. As implied in the above quotations, there is evidence to suggest some impact from the AC on the content and conduct of an audit where there are instances in which the AC asks for additional work or detailed reports, questioning and challenging the work of the external auditors. In contrast with Cohen et al. (2002), the interviews evidence suggests active roles of the AC in their interactions with the external auditors.

Nonetheless, some partners viewed the role of the AC as being more related to the quality of financial reporting, that is, the output of the audit rather than the ‘process’ of audit quality. They mentioned that a great deal of interaction and discussion with the audit committees focuses on the financial reporting and business issues rather than audit issues or the procedural aspects of the audit engagement. Several of the partners opined that there was little contribution of the AC with respect to the conduct of the audit. The following comments summarise the divergent views of partners on this issue:

"I think having a good understanding with the Audit Committee will enhance audit quality because if you have an Audit Committee member who is close to the business you can share ideas and very often they can give you their perspective and their insight of what is happening...I think that enhances the auditor’s understanding of the business and the business issues” (AP9).

"I think the existence of audit committees and the quality of those audit committees has been a huge benefit. It has been very beneficial in terms of improving the quality of audit financial reporting, and, therefore, by definition, the audit opinion. I would say audit committees are more attuned to financial reporting obligations and the financial reporting requirements than they are of audit regulations, so you will have far more discussions with audit committees around accounting issues than you would around audit issues” (AP8).

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Analysis of the evidence from the interviews demonstrates greater interaction and communication between the auditors and the AC over the years. For instance, beyond the formal business of the regular meetings, significant informal interactions occur between the chairman of AC (e.g. informal meetings and telephone conversations) and the auditors. The auditors have regular informal one-to-one contact with the chairman of the AC. During these informal interactions, the chairman expects the auditors to keep him/her informed of emergent accounting or business issues and this informal discussion also aims to brief the chairman about reports to be formally submitted to the committee. Informal interaction also provides an opportunity to discuss potential conflicting issues before meetings or solving problems in advance of AC meetings. Further, these informal interactions are an important aspect of the relationship between the AC and the auditors. In this respect, auditors can be open and honest about the difficult issues that unfold during the conduct of the audits or answer sensitive questions concerning the competency of the management. Several partners perceived their relationship with the AC as interactive, productive and effective. However, there were also comments that reflect a more passive relationship.

"I have informal meetings before every audit committee meeting I will have an informal meeting with the audit committee chair... maybe a call or a catch up so there will be interaction between myself and the audit committee chair before each key meeting and then during the year end audit we will be in contact once or twice a week and we will probably have a lunch or an informal meeting once or twice during the year so quite a lot of interaction" (AP9).

"[If] you have got a good relationship you pick up the phone to the chairman of the audit committee and just make sure they are aware of any issues, so they can put pressure on management to address it. They have the opportunity to engage and get themselves up to speed on the issues before the relevant meeting...a good relationship is where you can have an open, honest relationship with the audit committee and they do not immediately turn round and just go back and tell senior management what you have told them, they use their experience and judgement as to how to present it back or whatever, so you would expect the formality of the meetings and then you would expect some sort of informal contact as well to ensure that there are no surprises and you can both use them as it were to help" (AP10).

The evidence from the interviews also suggests that more detailed reports are prepared for the AC. In terms of the content of the reports, a significant part of the reports concentrate on highlighting key audit issues that emerge in the performance of the audit. The interviewees also stated the importance of showing that they are challenging the management on those audit issues.
"I think the time devoted to audit committee report preparation content is much greater than it was. In terms of the style of reporting in the final report we increasingly focus on the key audit issue” (AP1).

From the analysis of the responses, it can be deduced that there were mixed views about the beneficial impact of the AC in promoting audit quality. Nonetheless, most of the auditors acknowledged the effective role of the AC in achieving financial reporting quality rather than audit quality. The audit partners also recognised greater interaction and communication between them and the AC, which they perceived as being beneficial to the audit quality.

5.6 Summary and Conclusions

This study adopts a symbolic interactionist perspective that offers an alternative framework to examine multiple meanings and various symbols of audit quality, the influences behind the construction of those meanings, and potential quality conflicts in practice. Primarily, this study suggests that audit quality can simultaneously hold different meanings for individual auditors. Three key concepts of audit quality in practice are identified. First, the concept of audit quality is related to the professionalism of the individual auditors. Second, concepts of audit quality concern the compliance obligations of the practitioners to the relevant auditing and accounting standards, and the related aspects of internal and external quality assessment. Finally, commercial or entrepreneurial values influence the practitioners’ notion of audit quality. The study also reveals that commercial values are far more influential than others, such as compliance obligations, to the way in which notions of meaning of audit quality in practice are understood and the way audit is carried out in practice. Further, these multiple interpretations of meanings emerge from the different ‘roles’ played by the auditors.

The empirical evidence on the perceptions of audit quality by audit partners provides some interesting insights. The general pattern based on the responses indicates that the auditors attach different meanings to audit quality, which are influenced by various expectations, interests and concerns by different constituents in the auditing environment. This is consistent with Turner et al. (2010) who view auditing as a multi-service activity that serves different types of customer groups that judge quality differently, for example, the compliance obligations and professional values as a result of public, regulatory and normative pressures (DiMaggio and Powell, 1983) in the auditing environment underpinned by the need to legitimise the conduct of the auditor to build and maintain the trust and confidence of the public at large concerning the quality of their services.
Compliance obligations are important for the auditors to legitimise their own standards and overall audit methodology and processes to the outside constituents, as argued by Scott (2001); legitimacy relates to social acceptability and credibility.

The auditors’ professionalism, reflected in factors such as professional judgement, competence and independence is represented by symbolic representations such as academic qualifications, training, technical guidance and consultation. These features were frequently described in the interviews and constitute a major part of the production of quality in practice. Further analysis shows that the auditors make these recommendations based on their claim to expertise and knowledge, which becomes one of the fundamental concepts that gives audit its value. As suggested by Richardson (1988), auditors’ claim to have knowledge that is important for the protection of professional privileges and autonomy of power that is enjoyed by the audit profession. In this respect, the compliance obligations and professional values concepts of audit quality are important to reflect the audit as a profession that is connected to the value of an external audit.

The analysis suggests that commercial values influence how auditors perceive audit quality and this reflects the business of auditing (Power, 2003). The competitive and commercial pressures on the audit market significantly affect the profitability and survival of the audit firm. As a result, to increase profit, meeting client’s expectations and providing value added services drive the idea of the concept of audit quality in practice. The results show that the commercial interests become the audit firm’s organisational values system that influences the production of ‘quality’ and the commercial concerns affect every aspect of auditing (Sikka et al, 2009).

Further reflections on this issue reveal that the power asymmetry and task interdependence may put additional pressure on auditors to deliver the ‘quality’ that is expected by their audit clients. The auditors’ appointment and re-appointment and determination of the audit fees are decided by the client’s management (Gavious, 2007). This condition has important implications for the concept of audit quality in practice, thus showing the importance of the concept in relation to the audit as an ‘industry’.

Overall, the analysis indicates that the concepts of audit quality in practice are changing and moving as they are subjected to social, regulatory and economic pressures. Auditing practices are interacting with the internal and external pressures for quality in the auditing environment that constantly change practical
framed of meaning of audit quality for the audit practitioners. In a sense, audit quality is subjectively constructed and changes with context.

It is notable that the audit partners’ configuration of meanings are reflected to some extent by symbols and the construction of the notion of audit quality that focuses on the inputs and processes of the audit rather than the outcome. Regarding the input of an audit, the audit partners emphasised that the quality of people is key in the production of a quality audit, in which various quality symbols – codified rules, auditing standards, professional examinations, training, coaching and consultation - are reinforced and recognised as giving some dimension of audit quality in the auditor’s mind. These symbols are important to establish and legitimise abstract audit knowledge.

Concerning the processes, the audit partners emphasised audit judgement, asking challenging questions, internal quality review, audit planning and risk analysis as essential for comfort in ensuring production of audit quality. These processes and procedures provide the representations of audit quality, that is what audit partners see as tangible indications of quality in the absence of more observable features of audit quality. Overall, the meaning of audit quality in practice is operationalised through various representations in the inputs and the audit process for the members in practice and to other external constituents with whom they interact.

This chapter also argues that audit quality in practice is more appropriately envisaged as a set of persisting conflicts and tensions, which result from the mutually related and competitive dimensions of audit quality. There is conflict between practitioners’ values and institutional demand for acceptable representation of audit quality. The first tension is between compliance obligations (in particular, external compliance obligations) and the professional values of the audit practitioners. Observation from analysis of the interview comments highlights that this tension is an important issue, as there is a continuous battle between the practitioners and the regulator (the AIU) in controlling who can lay down the parameters of the work that the auditors do. In the UK the introduction of the AIU by the FRC has introduced a prominent actor in the auditing system that might have a different conception of what audit quality is.

It appears that the regulatory changes regarding what constitutes quality translate into anxiety and unease in the audit partners’ understanding of the concept of audit quality. To her/him, recent regulation removes the ‘status quo’ in the audit, which implicitly undermines the professional judgement, expertise and knowledge
possessed and claimed by the auditors. The effort is sometimes viewed as de-
professionalizing the audit profession through removing the status of the public
accounting firm as a ‘profession’ and the professional power that is perceived as
threatening the core existence and survival of the audit profession. These feelings
were articulated during the interview when the auditors voiced their concerns about
changes in the nature of audit practice – the change from using professional
judgment to audit practice that is prescriptive.

In general, the overall impression that emerges from the interviews discussed in
this chapter is that what is considered as ‘quality’ in practice, as perceived by the
auditors, is without doubt the outcome of social relations, which is consistent with
the argument offered by Power (1996; 2003) contesting the dominant view that
‘quality’ is objectively constructed by following relevant standards and applying
appropriate auditing techniques. This study argues that audit quality in practice is
socially constructed. This shows that the meanings of audit quality represent
diverse issues including legitimacy, image management, role conflict and the
survival of the audit profession.

In conclusion, this chapter shows that: (i) the audit partners perceive multiple
meanings of audit quality in practice, (ii) the perceptions of the audit partners
concerning audit quality are influenced by internal and external factors, such as
commercial and regulatory factors in the audit environment, (iii) various symbols
are operationalised and communicated to signify meanings in practice to gain
legitimacy and ensure survival of the audit firm, (iv) quality conflicts exist because
of multiple roles performed by the external auditors, (v) the AIU influences the
meaning of audit quality in practice, and (vi) the AC has minimal impact on the
content and conduct of an audit.
Chapter 6

Audit Committee Members’ Perceptions Concerning Audit Quality in Practice

6.0 Introduction

The purpose of this chapter is to set out the results of the interviews that were conducted with AC members to elicit their views concerning the meaning of audit quality, factors that influence the construction of that meaning and the representation of that meaning in practice. The background to and structure of the interviews and the methodological approach to the analysis of the evidence collected were described earlier in the thesis (see Sections 3.2 and 3.3.1.2 respectively); this chapter presents and comments on the views expressed.

The chapter is structured as follows. Section 6.1 addresses research question 1, and describes multiple meanings AC members associate with audit quality in practice. Section 6.2 discusses factors that shape and influence the construction of the meanings of audit quality, thus addressing research question 2. Section 6.3 examines how the meanings of audit quality are represented in the operation of the AC, which is the subject matter of research question 3. Section 6.4 addresses research question 5 and discusses the impact of the AC on the external audit function. Section 6.5 provides a summary discussion of the findings and the conclusions of the chapter.

6.1 Meanings of Audit Quality in Practice

The thematic analysis of the responses demonstrates that the AC members predominantly frame their meanings of audit quality around four important constructs. First, the notion of audit quality is related to the characteristics of the audit firm. Second, the idea of audit quality is associated with the concept of professionalism of the external auditors and includes professional attributes, values and the reputation of the external auditors. Third, AC members place greater emphasis on external auditors’ own assessment and discussion of risks in operationalising the meaning of audit quality in practice. Finally, the concept of audit quality is connected with a construct concerning the credibility of the financial information that is produced by the management. The discussion that follows will show that the four elements serve to give structure to the meaning of audit quality in practice.
6.1.1 Characteristics of the Audit Firm

The first meaning of audit quality expressed by the AC members concerns the attributes of the audit firm, thereby linking audit quality with the size, reputation and industry expertise of the firm. Consistent with the dominant audit quality discourse (e.g. DeAngelo, 1981b; Knapp, 1991) the majority of the AC members interviewed associate audit quality with the size of the audit firm. The interviewees perceived that Big Four audit firms or larger firms can provide a better audit service because they have adequate resources in terms of people, systems and processes to provide a high quality of audit service.

"Most of the companies that I have been involved are large companies, very large and some of them are international. Sometimes the issues been dealt are complex and difficult. I think another aspect that important is the experience of the auditor who has well place to be able to deal with all aspects of the audit issues that might arise. Perhaps a large audit firm would be better to deal with a large complex company. That would be my opinion. If the company is international and global then I would think that the type of the auditor that to be used should also international and global. They have access to expertise, knowledge and resources” (AP1).

The AC members expressed the view that the larger audit firms can attract more highly skilled employees and that the Big Four firms have sufficient capacity to hire and train the best people. As a result, they believed the big firms have sufficient resources in terms of quality people, their competence and experience to carry out the audit. The Big Four firms are also believed to have strong quality control systems connected to the audit process and a strong audit methodology or approach that is associated with higher audit quality. Furthermore, the AC members believed that the big size audit firms have strong policies and internal procedures in place that monitor and facilitate the audit process.

"First of all I think you want to make sure you are dealing with an audit firm that has a very strong worldwide reputation...we are working with the Big Four. There has been a lot of debate recently, in which I have participated, about whether public companies could use non Big Four auditors to a certain extent. While I would not rule that out I think you would feel a lot more comfortable with one of the Big Four because they have strong internal control procedures themselves and they have back up partners who review the work on the audit” (AC5).

The AC members also emphasised that larger audit firms can provide high audit quality because of their reputation, industry specialisation and experience. During the interviews, the AC members emphasised that the special skills and knowledge of the audit firm concerning a particular industry can bring greater in-depth understanding to the unique audit risks that will be reflected in audit quality. The
larger audit firms are also perceived to have greater ‘international’ experience and better practices, which are important and beneficial for international and complex companies.

“If you are choosing between those Big Four...experience of your industry. That is one place where the firms will differentiate because they have different strengths in different industries” (AC10).

It was apparent that the perception of the AC members concerning the meaning of audit quality depends upon observable features of audit quality such as size, reputation and industry specialisation of the audit firm. In general, the characteristics of the audit firm as a construct of audit quality is important to signal audit quality through selection of credible and high quality auditors.

6.1.2 Professionalism of Individual Auditors

Another construct reflected in the comments expressed by the AC members links audit quality to the professional attributes, professional values and professional appearance of the external auditors. Similar to Schroeder et al. (1986) and also to the evidence obtained from the other two groups (audit partners and quality inspectors) in this study, analysis of comments suggests that AC members perceived the professional attributes of the audit team or individual auditors to be an important construct of audit quality. All of the AC members identified competence and knowledge and experience in the industry or with the client to be critical attributes for auditors to be able to deliver appropriate audit quality. For example, experience and knowledge are essential for the auditors to understand and identify risks and issues faced within a particular industry. These attributes allow auditors to identify strengths and weaknesses in the processes and procedures of the audit client’s internal control and accounting systems. The AC members also elaborated upon the importance of the technical skill of auditors - sound understanding of accounting standards that reflect audit quality because of the financial reporting regulatory requirements.

“I would be very concerned if I thought there were close personal relationships between the audit partners and our auditors and the senior executive...I think that is very important, and I think when it comes to failures, it will very often relate to the judgement of an individual auditors” (AC6).

The quotation below implies that the appearance of professionalism and the behavioural and interpersonal skills of auditors are very important attributes when AC members reflect on the meaning of audit quality. In this light, the AC members expressed the view that auditors’ interpersonal skills are important for them to feel
comfortable and confident that the auditors are delivering a high audit quality. In
other words, the AC members felt that the auditor should be able to demonstrate
his/her ability to identify, describe and articulate issues during interactions and
communication with the AC. The auditors should also be able to demonstrate the
ability to listen and respond to questions. The AC members also referred to the
importance of auditors’ behavioural skills – gestures, the ability of auditors to
interact, relate and respond during interaction and communication with the AC
members and with others (such as the management and the internal auditors), as
reflecting audit quality. In general, most of the AC members considered the
interpersonal and behavioural skills of the auditors to be very important for
perceptions about audit quality.

“They (external auditors) also need an interpersonal chemistry...an ability to
listen...somebody who is highly competent technically but cannot talk to
people in the factory or the office is not going to be as productive. I am
interested in the interpersonal skills of the auditor because that is the way
they collect a very large amount of their knowledge. Therefore there is an
element of chemistry and behaviour and then if you couple that with
technical knowledge and ability to talk about the subject, to reciprocate in
some ways. Then you hear him talking about it and you will think he knows
his job and you will feel more comfortable” (AC8).

Overall, the above analysis indicates that the auditors’ professionalism, comprising
professional characteristics, values and appearance, is important for audit quality,
and dominates the idea of meaning of audit quality for AC members. Whether the
auditors have delivered sufficient audit quality is related to the extent to which the
AC is persuaded by their ‘presentation’ of the audit rather than detailed knowledge
of the process of the audit itself. This may not be surprising because the AC
members are not in position to examine the process and conduct of the audit in
detail. This finding is in line with Carrington (2010) who identifies the appearance of
professionalism as a construct of audit quality in the absence of a clear relationship
between inputs (the external auditors’ professional attributes and values) and the
process of the audit.

6.1.3 Risks Orientation

In the interviews, the AC members generally saw the auditors’ presentation and
discussion in the area of risks as giving structure and meaning to the concept of
audit quality in practice. The AC members believed that external auditors’
understanding and assessment of risks can enhance audit quality in two ways. First,
the identification and assessment of risks by the external auditors will be likely to
influence audit planning and approach, which can influence the sufficiency of the
audit work in the conduct of the audit and the resulting outcome of the audit. Second, it would ensure that the external auditors focus and challenge the management on the right key issues and make certain that they form their judgement on the right key areas. This finding highlights that the ability of the auditors to present and communicate on business issues and in particular risks are important to convey an impression of their expertise, knowledge and competence and will be taken to reflect their ability to deliver audit quality.

“So audit quality is that the risks to the enterprise are being managed effectively. The AC is really looking at the risks to the enterprise, more important than are they adding up the numbers correctly” (AC4).

“What does audit quality mean to the Audit Committee? Well it is ensuring that when the plan is originally devised it focuses on the right things, that it is cognisant of the key risks in the business and that it is focused on ensuring that there are the right controls in those areas. In addition, the judgements that the audit focuses on are the ones that are critical to the risks in the business. Therefore, audit quality is about that sort of mapping between the business and its risk profile, the environment in which the business is in” (AC6).

In general, the area of risk is important for the AC members to be comfortable with the quality of the work performed by the external auditors and is one of the important features in the discourse of audit quality among the AC members. This finding is consistent with Gendron et al. (2004, p. 166), who identified external auditors understanding, assessment of risks and associated audit planning as being an important part of the perceptions of AC members concerning audit quality. In like manner, the first group (audit partners) in the study also expressed views about the importance of ‘risk’ in delivery of high audit quality. In this context, the presentation and discussion about risks by the auditors gives structure to the AC members’ attention and directly guide their conception of the meaning of audit quality.

6.1.4 Financial Reporting Orientation

During the interviews, the AC members strongly associated financial reporting quality with the meaning of audit quality. The interviewees connected attributes such as compliance with the accounting standards and accuracy of the financial information to the dimension of financial reporting quality. It was apparent during the interviews that the majority of the AC members strongly associated audit quality with the reported numbers on completion of the audit and the resulting outputs, which is the audit opinion. In general, they regularly mentioned the
important role of external auditors to ensure the credibility of the financial figures
produced by the management, which reflect audit quality.

"I want to know the company’s results that we present to the outside twice a
year, the figures that we are presenting and what we are saying about those
figures, an accurate and fair representation of what is actually
happening...are the disclosures that we are making the disclosures that we
should be making...there is integrity in the numbers, the profits of the
company are being fairly and accurately stated...that’s what I’m looking for,
that is what I think about audit quality...integrity of results” (AC11).

"It is very clearly laid out what the auditors are expected to do, so the audit
quality...It has to be seen at the level of what work has to be done in order
to form a clear, coherent, definitive picture of the company’s finances”
(AC7).

The AC members mentioned that they are very interested to receive some in-depth
discussion about half year and full year financial results from the external auditors
to give them comfort about the quality of their work. The AC members also pointed
out that discussion between the AC members and external auditors are normally
centred on the application and resolution of accounting issues or standards, such as
impairment, revenue recognition and interpretation of new accounting standards,
which might have an impact on the reported financial results of the company. It is
evident that most of the AC members are concerned that there is ‘no surprises’ or
any potential threat of audit qualification because of the management’s accounting
choice. Accordingly, audit quality is connected to the ability of the external auditors
to demonstrate that they pose ‘significant challenge’ to the management about
various accounting issues related to the company as expressed by the following AC
members:

"The way numbers are presented, the accounting standards actually give
you quite a lot of scope in terms of net income, profit and all that sort of
thing, the way numbers are manipulated as opposed to just the straight
operating cash flow which is the really hard number. I think the quality you
look for in the external auditors is really whether they can go a little further
than the management can go and say what about this, what about that”
(AC4).

"What do I see as audit quality?...I would expect there to be what I call a no
surprises environment...to be open about issues and get to them early and
get the auditor engaged in them, this is what I mean by issues; how are we
going to approach impairment this year? How are we going to tackle this
new accounting standard? How are we going to get on with revenue
recognition? (AC3).
In this context, the underlying rationale is that the AC members want the external auditors to keep them out of trouble, so therefore, the auditors are expected to object to or challenge the management on accounting policies that might lead to problem in the future.

"The sort of thing that really cheeses off the executive is when external auditors change their mind about something, very close to our half year reporting time. What you always want is that the external auditors sign off and give you a clean bill of health on the accounts. The last thing you want is to have queries being voiced publicly. So what we do not want is that things change late on in the piece. It is very important that if external auditors have got concerns that those are flagged to the management and the AC early, so actions are taken to resolve the concerns” (AC4).

In general, the AC members emphasised a notion of financial statement quality where the focus is on the validity of the reported numbers and compliance from an accounting perspective. The quality of the financial statements dominated the AC members’ perceptions of audit quality rather than a technical interpretation of the quality of the audit process. This perhaps reflects the unobservable nature of audit quality and the AC’s focus on the output of the financial reporting process.

Having identified different constructs and attributes of the concept of audit quality held by the AC members interviewed, and illustrated how these constructs featured in the members’ comments, the discussion below relates those constructs to the broader regulatory and societal factors that influence the construction of a practical meaning for the concept of quality.

6.2. Factors that Influence the Construction of the Meanings of Audit Quality

This section attempts to answer the second research question, that is, to look at factors that influence the process of construction of the meaning for audit quality. In particular, it explores the influence of broader societal and regulatory and the concepts of role expectations and self-image on the meanings of audit quality. It is relevant to recognise that AC reform has resulted in tighter standards and regulations that have demanded greater roles for the AC to oversee the external audit function. The AC is now required to approve the appointment and remuneration of the external auditors. They have also been given responsibilities to review auditors’ independence and the effectiveness of the audit process, and to approve commissioning of non-audit services from the incumbent audit firm. At the same time the collapse of businesses has brought about criticism of the role and effectiveness of the AC as a control mechanism in the governance structures and
has threatened their legitimacy. For these reason, there is an increased need for ACs to demonstrate the legitimacy of their behaviour to conform to their role expectations and maintain their credibility. The discussion that follows will show that role expectations and legitimacy influence the meaning of audit quality, as perceived by the AC members.

One element influencing the AC members’ sense of meaning for audit quality derives from their own monitoring responsibilities. To some extent this can be seen as consistent with the present regulatory approach, which emphasises the role of ‘those charged with governance’ for making auditing and financial reporting effective. Accordingly, how the AC perceives their role will be likely to shape and influence the meaning, operation and representation of audit quality which should be consistent with the concern for high standards of corporate governance. For instance, the UK Corporate Governance Code (C.3.2) outlines that the principal roles of the AC include monitoring the integrity of the financial statements, reviewing significant reporting judgements and reviewing risk management systems. Frequently during the interviews the AC members mentioned these features as attributes of audit quality. The quotations below show how the expected role of AC members in reviewing risks influences the construction of the meaning of the audit quality. For instance, the auditors’ reports, presentations and discussions in the area of risks seem to dominate the AC members’ perceptions concerning meaning of audit quality. As implied in the quotations, the AC members perceived that their role is centred on monitoring of the business’s risks and believe that one important function of the external auditors is to support that role. Some of the AC members also believed that the value of the audit comes from the ability of the auditors to assess the risks of the business and their impact.

"If I think of the role of the AC and the role of the external auditors, the whole process revolves around risk, that is the key word” (AC11).

"I would say there is not a great value to the audit other than there is one exception, from my point of view, the auditors can highlight risk that I have not picked up through the normal channels. I am particularly interested in the auditors’ assessment of risk or any information that helps me to assess risk” (AC9).

The AC members also emphasised that to some degree comfort about audit quality is related to his/her financial and auditing background. Frequently, during the interviews, the interviewees felt that their experience is significant for them to fulfil their oversight responsibilities because assessment of audit quality involved considerable judgement. Similar to DeZoort (1997), the evidence from the interviews indicate that the perceived oversight role of the AC of the external audit
is related to the background of the members and their knowledge and experience in the financial, auditing and business sectors, which is consistent with regulatory recommendations (The Smith Committee Report, 2003; The UK Corporate Governance Code, 2010). One of the interviewees compared the nature of their work to the external auditors, which involved gathering information as evidence to support their judgement. A number of the AC members described a process of triangulation of information that is gathering of various information provided by the external auditors, the management and the internal auditors to assess audit quality.

“The chair of the AC is likely to have been a finance director himself with financial and auditing experience and it is therefore reasonable to assume that he will have a fairly good eye as to whether the job is being done technically to a reasonable standard” (AC11).

“I am a professional accountant and know about auditing so that contributes an important part to the discussions that I have with the audit partners and the audit manager” (AC5).

Nevertheless, the interview evidence suggests that the expected role of the AC to monitor audit quality is somehow challenging and problematic for the AC themselves. As suggested by Roberts and Dietrich (1999, p. 981), for the purchaser of professional services, assessing performance of services can be problematic due to an information problem: that the attributes of quality service are not identifiable and the activity of the producer of the services is unobservable. In the case of audit services, the notion of audit quality is obscure, the characteristics of ‘good audit’ are not known and the AC has a limited capacity to observe the conduct of the auditors or the process of producing the audit.

For example, analysis shows that the perception of the AC members about size and audit quality is based on a ‘taken for granted assumption’ about the processes of and inputs to the audit services because of the unobservable nature of audit quality. The following quotes illustrate the importance of that assumption for the AC members to feel comfortable with the audit quality; the reason being because of the limited ability of AC members to examine the audit process and procedures of audit firms.

“I think if you are working with the Big Four auditors the honest truth is that you take the general systems for granted...You do not go and study the details of their procedures...one of reason for having one of the Big Four as your auditors is that you can take their internal control procedures for granted” (AC5).
"I think the basic assumption is any one of the Big Four they have got the skills... the assumption that their audit approach is good and it meets all the standards,...you are making this assumption, I think it is a valuable assumption because I cannot go and test it" (AC3).

Analysis further suggests that the AC members are to some extent struggling to define the right concept because audit quality is not immediately or directly observable and is difficult to measure. For these reasons, the AC members use proxies such as the quality of the relationship, auditors’ reports on the audit and their discussion of issues to demonstrate they have reasons for being satisfied about audit quality. Importantly this suggests that the perceptions of the AC members concerning audit quality are largely influenced by and dependent on the external auditors themselves, as illustrated by the following AC member:

“What does audit quality mean to you? [Interviewer] It does not have a meaning, I cannot give you one. One of these papers say there is no definition of audit quality and I agree with that...If I can say straight away, the ACs are meant to assess audit quality and the effectiveness of audits. I think that is not a job that they should be given. The reason is that auditing is a highly technical skill, no member of an AC is likely to have that skill and even if they have they will not see the product, which is the audit paper. So all ACs use proxies and my discussions with external auditors say they all do the same. So what do they look for, they look for relationships with the partners in the external firm because that is all they see, you know how well a paper is presented, do they reach the main issues, are there any repercussions for the audit and the FRC, and if so, are they important or are they ‘nit picking’, do they highlight issues in advance, do they keep to their audit programme, all those things they can do directly” (AC10).

Furthermore, evidence from the interview comments suggests that some of the AC members may not have the technical expertise and knowledge to discharge of their expected roles effectively (see, for example, Knapp, 1991; DeZoort, 1997; Lee and Stone, 1997). In consequence, they put reliance on the external auditors for technical and specific aspects of accounting and business issues because of their own limitations of knowledge and expertise in those areas. The AC members also emphasised that their indirect involvement in the day-to-day operation of the business and consequent information asymmetry requires them to rely on external auditors to provide an overview about the conduct and activities of corporate management. Accordingly, the AC members tended to stress the importance of professional characteristics such as technical knowledge, competence and experience for high audit quality. As noted above, the knowledge base and process of the audit is difficult for the AC members to observe. For this reason, the appearance of professionalism of the auditors also becomes an important construct of the meaning of audit quality that is influenced by the interaction between the AC members and the auditors. This is in line with a more general perception that audit
practitioners tend to promote a professional appearance or behaviours in relation to their work rather than increasing knowledge of relevant parties that they interact because of the abstract nature of auditing knowledge (Anderson-Gough et al., 2002; Carrington, 2010).

“ACs are not the auditors and the ACs are not expert auditors themselves and they have not been trained as an expert auditors, in addition they depend on the auditors professional knowledge, for particular technical aspects. The ACs cannot be expected to be as technically competent as the auditors themselves. Each party has to understand the role of the other. Quite frankly if the auditor says something, the AC has to rely on his knowledge that he is right even though it may be sometimes illogical or hard to understand” (AC9).

“I came across another nice expression the other day, when somebody presents to you or when somebody talks to you, you do not actually remember most what they say what you remember is how they make you feel, that is quite an important distinction to draw. I do not remember most of what the audit partner says about the audit I will be quite honest with you I do not remember most of it, I do not even find a lot of it very interesting or engaging, I find a lot of it reasonably tedious but I do remember how he makes me feel. Does he make me feel that things are okay, does he make me feel that things are on track and does he make me feel that he's got to grips with things” (AC11).

The AC members’ construction of the meaning of audit quality through constructs such as the characteristics of the audit firm is influenced by their own need to create a credible image for legitimacy with the external parties (for example, regulators, shareholders and other stakeholders) in relation to their roles and responsibilities in monitoring audit quality. The AC members believed that engaging with a credible audit firm reflects high audit quality that can add an aura of credibility to their own work. Such ‘image management’ is especially important as a source of legitimacy for the AC members and to manage public perceptions concerning the level of audit quality. Hence, to fulfil the need for legitimacy, the AC members’ emphasis the size, industry expertise and reputation of the audit firm to signal high audit quality.

“First of all I think you want to make sure you are dealing with an audit firm that has a very strong worldwide reputation. We are working with the Big Four. There has been a lot of debate recently, which I have participated in, about whether public companies could use non Big Four auditors to a certain extent. While I wouldn’t rule that out, I think I feel a lot more comfortable with one of the Big Four and that the outside people has more confidence because they have strong internal control procedures themselves, they have back up partners who review the work on the audit and so on” (AC5).
It appears that the perception (of size and quality) exists because it may generate feelings of comfort and confidence about audit quality not only for the AC but also the wider public. Additionally, the perception is also influenced by the limited exposure of the AC to different size audit firms. The AC members perceived that the non-big four firms are unlikely to be able to deliver the required audit quality. In contrast to the viewpoint of the above interviewees, however, a small number of the AC members perceived that there is no real audit quality difference between the size of the audit firm, but the perception still exists that there is a threat of being criticised if the AC fails to discharge its roles and responsibility effectively if a non-big four firm is appointed, as illustrated by the following comment:

"I would expect that the top ten audit firms are all capable of doing a good job for you, would all be technically competent...I expect that they would be capable of doing a perfectly acceptable job. Do I think that the bigger plc's are going to go on using the Big Four? I expect they will because they will be worried about criticism if something went wrong and they had not" (AC11).

Thus, the constructs of audit quality that relate to audit firms’ characteristics and the professionalism of the individual auditors can be argued to be connected to the issue of legitimacy for the AC. This perspective is particularly relevant in the AC context where legitimacy is linked to engaging high quality external auditors. This aspect of audit quality is also crucial in managing the impression of others (such as shareholders) because credible audit is to some extent is important to the AC’s own credibility.

The construction of audit quality can also be described as reflecting the AC’s need to provide assurance to outsiders, in particular the shareholders, that financial information provided by management is legitimate. Here, the concept of audit quality is related to efforts to enhance the legitimacy of the financial reporting process and at the same time to assist AC members discharge their formal roles, functions and activities to relevant parties.

"I am one of the people that is responsible for ensuring that when you as an investor in that company see the company’s results that those results represent a fair view of the company’s performance, that the company is and will continue to be a going concern and that the results you are seeing, based on all of the knowledge that is available to us, are likely to be sustainable. That seems to me to be a very important responsibility. Secondly it is my job as a member of the board to be confident that the company has a strategy for the future that is targeted upon increasing value of the company in the interests of the shareholders and other stakeholders... the role of the external auditors is to make an effective contribution to the board being satisfied that its overseeing of those two key things is being done as well as you possibly can. That is what I think the AC is there for" (AC11).
Overall, the above analysis shows that role expectations of the AC and interactions between the AC and the external auditors can be said to influence and shape the AC members’ perceptions of the meaning of audit quality in practice. The next section provides further evidence about acts and objects that are used as symbols to communicate and represent meaning of the audit quality in the process and operation of the AC.

6.3 Representations of Audit Quality in Practice

This section answers the third research question: to document the different representations associated with the meanings of audit quality in practice. Analysis of the interviews evidence shows that various symbols are identified in the operation of the AC members in order for them to obtain a sense of comfort in the quality of work performed by the external auditors. In this case, both formal and informal interaction and communication, namely AC meetings, external audit reports and external auditors’ presentation and communication are important acts and objects in deriving comfort about audit quality (see, for example, Gendron et al., 2004). The evidence here is consistent with Power (1997) who suggests the importance of formal audit reports, presentations of auditors in meetings and informal communications as representations of comfort in the process of verification. Similar to studies by Gendron et al. (2004; 2006) and Beasley et al. (2009), the analysis indicates that these various representations are internally developed, sustained and promoted in the operation of the AC, and serve to make members comfortable concerning the quality of the work of the external auditors.

The interviews suggest that formal reports that are prepared by the external auditors become a key object in signifying audit quality in the eyes of the AC. For example, in the following quotes the AC members signified audit quality through his/her assessment of the content of the auditors’ reports. The AC members explained that the external auditors prepare various written reports at different stages of the audit. For example, before the first AC meeting, at the beginning of the audit, the external auditors prepare a detail report that outlines the scope of the audit including the audit plan, technical accounting issues to be addressed and the key risk areas that they would be focusing on in the conduct of the audit. The AC then has the opportunity to read the information prior to the meeting. Here, the AC members stated that they get comfort about audit quality through examining the content of the report by ensuring that the auditors identify and concentrate their work on the right key areas, which means that the audit plan reflects the key
risk areas of the business. The content of the report also influences the subject of discussion of certain issues in the AC meetings.

"You do expect a pretty detailed report from them (external auditors) and it is really about making an assessment of the quality of those reports...The assessment of the committee as a whole about the quality of the work done will be based upon the written reports submitted to the board and the verbal explanation that is given to the committee" (AC11).

"The external audit will present to the AC a report showing the key areas that the external auditor believe needs to be examined. The key issues in their mind as they design the external audit procedures - the key accounting issues, the key system issues, the key concerns that they may have, and discuss those with the AC in advance of the audit and reach an agreement on that. It is quite a comprehensive report and would go in advance of the audit, from the external auditor to the AC. After the completion of the audit, a very detailed report would go to the AC from the external auditor, setting out the findings as a result of the audit in relation to the factors that have been previously reviewed by the AC and discussed with them in advance. The audit partner or perhaps one of the audit staff will come to the AC and discuss the findings, in the detailed report with the AC, face to face in the audit meeting. Of course, all of that would also happen separately with the management of the company" (AC1).

The AC members have a high interest in risk matters, not least because risks underlie the external auditors approach in the audit but also they rely on this subject to develop their own understanding of audit quality. For example, the reports are used by AC members to develop expectations about the conduct of the audit. Thus, some sense of comfort about sufficient audit quality would be derived when the AC members find that the performance of the external auditor is in line with their expectations. It appears that such reports shape AC members interpretive schemas by providing them ‘ideal’ features that the AC members should be focusing on when assessing audit quality. The finding highlights about how content of the report is used to operationalise or give meaning to audit quality for AC members, influencing their focus on the work of the external auditors. This reinforces the central role the external auditors play in influencing the AC members’ understanding of audit quality.

"Clearly one of the things that audit committees have to do is to approve at the beginning of the financial year the audit scope that they (external auditors) are going to carry out...you would expect them to identify what they see as the particular risks that year. Therefore, to some extent you are ensuring they do have a good understanding of what are the particular risks because of the economic environment. Therefore, it is important to make a judgement about whether they have identified the right ones and understood the right ones...Demonstrating they have completed the audit scope they have said they would complete, reporting back on their findings, obviously their overall findings but particularly around those key risks” (AC3).
"...you hear him (external auditor) talking about risks and you will think he knows his job and you will feel more comfortable...the auditor has to convey their views and they have got to do that in a way which is going to encourage a response. The auditor has to make certain the AC hears it, understand it and responds to it. So they have to coach and push along...” (AC8).

It is also evident that reports that are prepared by other parties such as management, internal auditors and the regulator are an important source of information for the AC when seeking comfort about the quality of the work of the external auditors. For example, some of the AC members described how they used the internal audit report on risk analysis to evaluate whether the external auditors have incorporated key risks in the audit plan and have examined the right key risk areas during the conduct of the audit.

"The internal auditors report to me as chairman of the AC so I can get an independent view from them. So I go into the meeting with a view of the problem myself and then I find out whether the external auditor has looked at the same issues and analysed them in a kind of sensible way and I understand where he is coming from” (AC5).

The report that is prepared at the beginning of the audit also gives them an opportunity to examine the profile of the audit team members. In particular, the AC members will examine the experience of the partner and manager who will be involved in the audit. The interviewees acknowledged that they are using the information in getting comfort that the audit firm is using the right quality people - individuals that demonstrate the necessary knowledge and expertise in the company’s business as well as having sufficient knowledge of technical accounting issues.

As shown in the above quote, at the end of the audit, the final report that is produced by the external auditors will predominantly highlight the key audit findings. For the AC members, this report is very useful to make certain that the auditors have carried out the audit according to the scope that has been agreed at the beginning of the audit. They also want to ensure that the auditors have carried out sufficient audit work on the key risk areas, which they feel will have an impact on the quality of the financial reporting and audit quality. In general, reports that are prepared by the external auditors are considered to be an important working instrument for the AC members to assess and gain comfort about audit quality.

Analysis of the evidence shows that presentation and communication by auditors in AC meetings are important symbols that signify meaning for audit quality. The AC members stated that these symbols are important for them to assess audit quality.
The majority of the interviewees described the importance of the professional image: inter-personal and behavioural skills of the external auditors, communication, responsiveness and body language during the meetings, as providing a sense of comfort for them on audit quality. This finding is consistent with the finding of Sarens et al. (2009, p. 15), who found that auditors’ interpersonal and behavioural skills act as a source of comfort for the AC. Therefore, an interesting aspect of the AC members’ approach to the evaluation of the adequacy of the audit, and by implication their construct of audit quality, concerns the manner in which the external auditors communicate to the AC and the auditors’ presentation during the AC meetings.

“I came across a rather nice expression the other day, when somebody presents to you or when somebody talks to you, you do not actually remember what they say so much as how they make you feel, which is quite an important distinction to draw. I will be quite honest with you I do not remember most of what the audit partner says about the audit. I do not even find a lot of it very interesting or engaging, I find a lot of it reasonably tedious. However, I do remember how he makes me feel. Does he make me feel that things are okay, does he make me feel that things are on track and does he make me feel that he has got to grips with things” (AC 11).

“I think it is just as important through their presence at the audit committee and through dialogue with them to get a sense of how on the ball they are, I think you want to feel they have got a very clear decision making process around, you want to feel that that is a good sound process that is also an efficient and fairly slick process. Frankly, I think most of it is around the softer stuff rather than the harder stuff, how they conduct themselves, as I say ‘are they on the ball?’” (AC3).

More specifically, the AC members signified audit quality by assessing the extent to which the external auditors are able to communicate about risks and the company business to convey an impression of quality: knowledge, expertise and competence of the external auditors and the conduct of the audit. Thus, ‘risk’ becomes a meaningful symbol signifying audit quality which is communicated during interaction between the AC members and the external auditors. Some of the AC members also mentioned that in the AC meetings there is considerable discussion with the auditors in relation to financial reporting issues, such as application of new accounting standards and their impact on the financial statements.

The informal channel of communication and interaction is also part of the important act to operate meaning of audit quality whereby the AC members perceived that continuous discussion plays an important role in building openness and trustworthiness with the external auditors to give them comfort about audit quality. The AC members consider this informal process as a strength that helps them to raise and discuss ‘difficult’ matters with the external auditors. For example, the AC
members perceived that private meetings between the AC members and the external auditors provide a venue for the AC members to ask difficult questions, for example regarding the cooperation and integrity of the management, or to discuss sensitive matters or concerns that cannot be done during the formal meetings. They believed that the external auditors are more willing to express things openly about various issues during informal discussion. In general, the majority of the AC members perceived that these informal interactions and contacts were an essential aspect of the relationship between the AC and the external auditors.

"The key things that you are looking for are openness and trustworthiness...do you trust them, do you respect their judgement, and are they capable of having a dialogue with you. So can they discuss a problem with you or are they very defensive. The less able you are to have a dialogue with them and the more defensive they are, the less you trust them...you are assessing situations and people” (AC7).

"In many ways I think the important meetings are the ones I have privately with the auditors because as a professional accountant I can talk to the external auditors on an equal basis and I can ask them to be quite frank with me about how they feel about things and they always are. Whereas in the committee the external auditors may be a bit more careful in how they say things. When I have a private meeting with them they just tell me what they think and that is very important for me to know” (AC5).

In general, the evidence discussed above suggests that a significant aspect of the AC members’ approach to audit quality is what may be called ‘relational’. That is, their interpretation of the quality of audit delivered in practice is dependent mainly on symbols (acts, objects and words): their relationship with the auditor, views about personal qualities, external audit reports, presentations and communications, rather than by any kind of technical assessment of the quality of the content of the audit process itself. Accordingly, the meaning of audit quality is signified, created and communicated through the use of symbols – meetings, auditors’ presentations and documents used in interactions between the AC members and the auditors.

### 6.4 Effects of the Audit Committee on the External Audit

It is also important to consider precisely how the AC impacts upon the work of the external auditors. Accordingly, the discussion below gives specific to the effects of the AC on three aspects of auditing: the audit process, auditor appointments and remuneration, and auditor independence. In practice the AC members’ impact on the scope and conduct of the audit is very limited because it is not very easy for the AC to deal with something that is as technical and specific as an audit and to influence or change the audit approach. The external auditors’ audit plan is considered by the AC at one of its meetings. In that meeting, the AC members
contribute to the discussion about the scope of the audit, but do not make decisions with regards to the audit plan and approach. Hence, the audit plan is really reported and presented to the AC for authorisation or consideration with a minimal input from the AC. In the AC meetings, questions and discussion tend to be concerned with risks and business aspects of the audit client rather than the content of the audit process itself. There have been instances where, after reviewing the audit plan, the AC has asked the external auditors to do a bit more in certain areas or to include certain things in its plan. Nonetheless, the level of questioning and probing into matters is not ‘intense’. In a typical situation, the AC would look at the audit plan and ask, ‘are there any matters that you would like to bring to our attention?’ to which the external auditors would reply there were no matters. In this context, the limited role of the AC in specific matters dealing with auditing and accounting matters may be explained because of their lack of detailed knowledge and expertise in those areas. However, the lack of critical assessment by the AC can also be perceived as a consequence of the AC being able to trust and get comfort from the external auditors on those areas.

"I think they have correctly assessed the risk areas which of course they have done with management before they come to the AC. Sometimes we have asked them to give more emphasis to certain areas but we have never changed their approach and I would regard that as a really bad sign if we had to..." (AC10).

The AC is not always passive however. There is some evidence of the extent of the AC members questioning and challenging the auditors’ work during meetings. For instance, on a couple of occasions the AC members referred to having asked the auditors to perform additional work or provide further details in matters of concern as a result of the AC seeing and reviewing their reports. There is also some evidence concerning the impact of the AC on the audit process. For example, one of the AC members mentioned that he sometimes asks the external auditors to increase the sample size or to adjust the level of materiality being used as a result of matters of concern to the AC. Nonetheless, overall the AC members mentioned that changes to the external audit plan as a consequence of AC enquiries are rare and subject to consideration by the auditors themselves.

"When I sit there with the audit partner, if there are particular concerns that the audit committee have got in connection with the company...I can raise those with him and ask him to add those to his procedures or ask him to be careful in certain areas... we would be saying to the external audit firm, we are potentially worried about this particular division, could you perhaps increase your level of testing in that particular business, perhaps increase your sample sizes, or reduce your materiality levels, each year you agree a
materiality level with the external audit firm, perhaps you would ask them to go beyond that” (AC1).

“What happens in this company’s case is there is a pre audit meeting with the auditors in which they go through all their plans and those plans are discussed, and if we feel that there is something deficient in the plans, then it is the AC’s job to actually highlight those and discuss them. Maybe they would not be incorporated in the plan and if there was something the auditor was doing that we did not feel relevant we would tell him. Nonetheless, at the end of the day it is the auditors’ decision” (AC9).

The AC members’ comments in interview also imply that the AC members have a rather limited impact on hiring and firing and on setting the remuneration of the external auditors and regarded this as a matter primarily for the management. For instance, any dissatisfaction with the work of the auditors that leads to a proposal for a change of audit partner or audit firm would come from the management but the AC would generally be involved in the process of tendering. Some of the AC members described the audit tender process as a ‘beauty parade’ where a number of audit firms would come and present to the management and the AC, but selection of the external auditor is normally subject to considerable influence from the management.

"Occasionally you will find that they (the management) want to change a partner, even change a firm, more frequently change a partner in a subsidiary jurisdiction, occasionally they are dissatisfied with the quality of the team but all of those come through management and there is no real way of the AC doing other than accepting that” (AC10).

"We have a tender process which is called a beauty parade. If the management really believe the auditor is the best person against the other firms then they (the management) will come to the AC and say we actually think this firm has the best people “ (AC8).

One of the AC members opined that the role of audit quality in the selection and appointment of the external auditors by the AC is rather limited because audit quality is difficult to measure and quality differentiation between audit firms is unobservable. For this reason, selection of external auditors is normally based upon observable features such as reputation, industry specialisation and size of the audit firm. Some of the AC members mentioned that change or selection of audit firm may not necessarily be based on consideration of audit quality but it may also be related to the costs of the audit. Most of the AC members acknowledged that the management is always under pressure to cut down costs including the cost of the audit. As a result, appointment of the external auditors is very much driven by considerations such as whether the management think they get value for money from the external auditors. This may suggest that appointment of the external auditors is influenced by costs rather than audit quality.
"I don’t think ACs are in a good position to judge but I think they could accept that the Big Four all have very high standards and the difference between them in terms of standards is not something that they can measure. If you do a beauty parade although that is theoretically out on the table it is not something you are going to be able to judge” (AC7).

"I mean here for example we did change auditors probably five or six years ago. Always one of the concerns of the company is the cost of the audit and whether you feel you are getting value for money. So things can change purely on economic issues, nothing to do with the personalities... So the mere fact of going to tender always reduces fees, not necessarily quality either” (AC9).

Although the AC members do not make the decision concerning audit fees, they are particularly concerned that the fees are not significantly reduced by the management to an extent that would impact on the work of the external auditors or that put them in a situation of having to ‘cut corners’. The AC members also expect to be fully informed about additional work undertaken by the external auditors that gives rise to additional fees or that create potential sources for disagreement between the management and the external auditors.

"Most companies are looking at costs much more carefully and they are seeking to cut costs everywhere, and of course the auditors are rightly challenged around their costs. From an AC point of view you need to make sure that the external auditors fees are not being hit so hard that maybe they would not do as much work as you would like them to do. I think you have also got to be a little bit careful making sure that the management is not cutting down too heavily on the audit fees and then the auditors might think of cutting corners“ (AC3).

"The only area where potential disagreement may be would be if additional problems arise which end up giving rise to additional fees which were not in the original budget. I think if that happens the audit partner should be warning the AC chairman as soon as he can see that costs are going to be higher than they were originally expected to be” (AC1).

Similarly, the AC members are made aware of any non-auditing services provided by the external auditors. The decision in determining types of non-audit services and fees are normally decided by the management, but the AC members are required to give their approval on these matters. Most of the AC members mentioned that certain types of non-audit services such as valuation of intangible assets and improvement of accounting systems or any work that would result in the external auditors ‘verifying’ their own work should not be performed by the external auditors. On the other hand, a majority of the AC members expressed the view that certain services like tax, due diligence reviews and work related to mergers and acquisitions is not likely to impair the auditor’s independence. Most of the AC members mentioned that those types of non-audit services are better provided by the auditors because of their in-depth knowledge of the business.
“[If] there is a large non-audit fees involved, the AC has to give its consent and if it goes over a certain proportion of audit fees they also have to give their consent. So the monitoring is quite straightforward” (AC10).

The interview evidence also suggests that the management decision to select the external auditors to perform non-audit services is influenced by cost considerations. For the management, appointing another firm to perform non-audit services will normally cost more. As a result of the economic pressure (from the point of view of client management), the AC is generally willing to accept the management recommendation to appoint the external auditors to perform the non-audit services although it may perceived to impair independence.

“By using somebody else it costs you more and you have to educate the other party, so you can argue that actually it is not effective for the organisation. That is true, so we pay a higher price but we believe that is just something that has to be done in order to keep our auditors objective. Our auditors would not agree with that, they say they will always be objective and independent, it does not matter how much other business we give them. For us we just think, well it is much better not to have any doubt about the objectivity” (AC6).

Overall, the AC interviews provide evidence about the limited effects of the AC on external audit (see, for example, Turley and Zaman, 2007). The impact of the AC on the audit process is minimal, but is also limited with respect to auditor appointment, remuneration and independence. Similar to Spira (1999), this suggests that with respect to many of these aspects of the system of auditing, the AC role is largely for ritualistic and ceremonial purposes and in many cases may lack substantive purpose.

6.5 Summary and Conclusions

This chapter has provided empirical evidence on the process of making meaning for audit quality from the perceptions of the AC members. It has provided some interesting insights into factors that influence the construction of the meaning and the AC members’ approach to the evaluation of the adequacy of the audit, and by implication their constructs of audit quality. As discussed in the theoretical framework chapter, individual’s understanding of audit quality is formed through interaction between various constituents in the auditing environment and influenced by various environmental factors. Thus, the meaning of audit quality is socially constructed and has to be created, signified and communicated through various symbols.
For the AC members, their perceptions of audit quality are relevant to understanding the operations and effects of AC in relation to external audit. It is notable that AC members’ construction of meaning concerning the concept of audit quality involved significant reference to aspects of their relationship with the auditor and to whether or not they feel comfortable about the audit quality that is delivered in practice. While it may be appropriate that AC members look for evidence of personal and professional qualities in the auditor, there could also be a concern that this opens up an ‘image management’ aspect to audit quality in practice. It should also be noted that the study identifies the struggle of the AC members in defining the term of audit quality, which has contributed to the minimal impact of the AC members on external auditing. From the process of constructing meaning of the audit quality discussed in the chapter, it can be seen that the AC members have difficulties in defining the concept of audit quality because it is difficult to measure and observe, and the AC members may not have sufficient knowledge and expertise to handle something that is specific and technical like auditing. Rather than having their own clear point of reference of what audit quality is based on, the AC members are taking some of the concept of audit quality from the external auditors themselves as a frame of reference. An example of this is the influence of the auditors’ reports, and their presentation and communication concerning risks which become an important source of discourse concerning audit quality for the AC members. The external auditors help to bring about a ‘schema’ of audit quality for the AC members. Thus, AC members are depending on external auditors for their understanding of audit quality and their conception of its meaning is very much influenced by the external auditors themselves.

Similarly, the indirect nature of the AC’s observations of audit quality have caused AC members to rely on ‘proxies’ of audit quality involving a combination of measures linked to audit inputs and outcomes related to audit quality, such as characteristics of the audit firm, professionalism of the external auditors and the quality of the financial statements in defining meaning of audit quality. The AC members identified the quality of the financial statements, which are the output of the financial reporting process, as a construct of audit quality rather than a technical interpretation of the quality of the audit process. Likewise, perceptions of the AC members about the meaning of audit quality is associated with the ‘input’ factors such as characteristics of the audit firm (size, industry specialisation and reputation) and professionalism of individual auditors (characteristics, values and appearance) that indicate high audit quality.
Analysis of the ‘input’ factors from the interviews evidence also provides some interesting insights into the perceptions of the AC members concerning the meaning of audit quality. For example, professional appearance: the interpersonal and behavioural skills of the external auditors during interactions are significant for the AC members in constructing meanings of audit quality in practice. The findings show that the presentation of the external auditor during interaction and communication with the AC members become an important means for assessing audit quality and are important for the AC members to derive comfort about audit quality. The findings suggest that the perceptions of the AC members concerning audit quality go beyond the technical skills of the auditors, thus, suggesting that relational rather than technical aspects of external auditors are more important in influencing the perception of AC members about audit quality.

This study suggests that the various constructs of audit quality are important for the AC members to show that they are having an acceptable basis for concluding there is appropriate audit quality, which is important for their legitimacy. Internally, the AC members legitimise their roles and responsibilities by reviewing of external audit reports and asking questions, and assessing the external auditors’ responses during the formal and informal meetings. Externally, the AC members legitimise their roles and responsibilities through engaging with a reputable and specialist audit firm that has individuals with the ‘right’ quality and possess the required skills and knowledge to indicate high audit quality.

This study also provides some interesting evidence on AC effects. The interview evidence shows that the AC has a rather limited influence on the work of the external auditors, in particular the external audit process. The evidence provides limited support concerning the effects of the AC on the content or conduct of an audit. The role of the AC is often restricted to the approval of scope of the audit. Similarly, the formal responsibilities of the AC members in auditor appointment and remuneration, and provision of non-audit services (auditor independence) are rather minimal and often restricted to the approval without much enquiry. This evidence suggests that the role of the AC members is rather for ceremonial purposes and casts doubt about the effectiveness of the AC in monitoring quality of the external audit.

In conclusion, this chapter shows that (i) the perceptions of the AC members concerning audit quality are influenced by societal and regulatory factors, such as the expected roles and responsibilities of the AC in the corporate governance arrangements, (ii) the AC members’ conceptions of meaning of audit quality is
influenced by the external auditors, (iii) assessment and comfort about the quality of work of the external auditors is substantially influenced by the interpersonal and behavioural skills of the external auditors during interactions and communications with the AC, and (iv) the roles of the AC in relation to external audit are rather a ceremonial feature where the impact of the AC to external audit is minimal.
Chapter 7

Quality Inspectors’ Perceptions Concerning Audit Quality in Practice

7.0 Introduction

The purpose of this chapter is to set out the results of the questionnaire survey that was conducted with quality inspectors to elicit their views concerning the meaning and standing of audit quality, and the influence of external and internal factors in the auditing on that meaning. The structure and analysis of the questionnaire survey were described earlier in the thesis (see Section 3.3.1.3). The results of the interviews that were conducted with two representatives from quality inspections and public reports published by the AIU were also used to gain further insight into this study and amplify the questionnaire survey findings.

The views of the quality inspectors concerning audit quality are potentially important for three reasons. First, their views may provide some indication about how good or bad auditing is in practice because the quality inspectors have the opportunity to assess and form judgement on external auditors’ performance through records of the audit that is not available to any other group other than the auditors themselves. Second, an interview and questionnaire survey may provide evidence about quality inspectors’ conception of meaning of audit quality and their perceptions on the potential impact of internal and environmental factors on the quality of work on individual audit assignments and their conception of the meaning of audit quality in general. Finally, the quality inspectors are a corporate safeguard as they monitor the external audit and publish their judgement based on their assessment; their opinions may influence the practices implemented and quality achieved within the audit firm.

It is important to note that due to the limit of the sample in this study, analysis of results is primarily descriptive in nature, and discussion of the results has to be impressionistic. In consequence, a caveat should be stated about the interpretation of the evidence from inspectors. When there is a strong consensus from the twelve responses, it is indicative of a widely held opinion but when there are variations, there are limits to the strength of conclusions that can be drawn. The sample is relatively small and does not allow for further statistical analysis, such as testing for differences within the sample (such as experience in practice, educational qualifications, etc.). It is also important to note that the study does not aim to test
any hypothesis or examine cause and effect. Nonetheless, within these limits, this study is interesting and relevant to look at because it provides some evidence of audit quality inspection, a part of the overall audit system that is not easy to penetrate and which has not been extensively covered in prior research.

The chapter is structured as follows. Section 7.1 presents a descriptive profile of the quality inspectors participating in the questionnaire survey study. Section 7.2 describes the attributes quality inspectors associate with audit quality in practice, which addresses research question 1. Section 7.3 addresses research question 2 that primarily concerns the perceptions of the quality inspectors on environmental factors that influence the concepts of audit quality in practice. This section also discusses the internal factors that influence the quality attained on individual audit engagements. Section 7.4 presents some evidence that highlights the existence of quality problems in practice. The final section, 7.5, provides a summary discussion of the findings and concludes the chapter.

7.1 Profile of Quality Inspectors

This section provides details on the characteristics of the respondents surveyed. All respondents were asked questions about gender, age, educational and professional qualifications, job title and experience. Tables 7.1, 7.2, 7.3, 7.4 and 7.5 present the frequency results for these questions. A small majority of the respondents (58%) are male. As shown in Table 7.2, 33%, 33% and 25% of respondents are aged between 28-37 years, 38-47 years and 48-57 years, respectively, whereas only one of the respondents is aged more than 57 years (9%). Most respondents in the sample have as their highest education level achieved a first university degree (75%) and 25% have a master’s degree. All the respondents (100%) have a professional qualification.

Table 7.1: Gender of Quality Inspectors

<table>
<thead>
<tr>
<th>Gender</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Male</td>
<td>7</td>
</tr>
<tr>
<td>Female</td>
<td>5</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
</tr>
</tbody>
</table>
Table 7.2: Age of Quality Inspectors

<table>
<thead>
<tr>
<th>Age</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>18 – 27</td>
<td>-</td>
</tr>
<tr>
<td>28 – 37</td>
<td>4</td>
</tr>
<tr>
<td>38 – 47</td>
<td>4</td>
</tr>
<tr>
<td>48 – 57</td>
<td>3</td>
</tr>
<tr>
<td>Above 57</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
</tr>
</tbody>
</table>

Table 7.3: Educational Level and Professional Qualification of Quality Inspectors

<table>
<thead>
<tr>
<th>Educational Level</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bachelor degree</td>
<td>9</td>
</tr>
<tr>
<td>Master degree</td>
<td>3</td>
</tr>
<tr>
<td>Doctoral degree</td>
<td>-</td>
</tr>
<tr>
<td>Others</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Professional Qualification</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>ICAEW</td>
<td>12</td>
</tr>
<tr>
<td>ICAS</td>
<td>-</td>
</tr>
<tr>
<td>ACCA</td>
<td>-</td>
</tr>
<tr>
<td>Others</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
</tr>
</tbody>
</table>

As for job title, the largest group of the respondents described themselves as members of the inspection team. The rest of the respondents are either leaders (25%) or both leader and member (25%) of inspection teams. According to Table 7.5, 17%, 33% and 17% of the respondents have auditing experience of between 5-10 years, 11-15 years, and 16-20 years, respectively, whereas 33% have auditing experience of more than 20 years. Five of the twelve respondents (42%) have more than 5 years experience in audit inspection, while 33% and 25% have 3-5 years and less than 3 years experience in inspection respectively. In interview, one of the interviewees described the knowledge and experience of quality inspectors as follows:

“They (quality inspectors) have all conducted audits of a similar complexity to those audit engagements that we are asking them to review...we are using good people and experienced people....I would say that our top person is the equivalent of the top person auditing Barclays Bank; I am sure from a technical point of view” (R1).
Table 7.4: Position of Quality Inspectors

<table>
<thead>
<tr>
<th>Current position</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leader of inspection team</td>
<td>3</td>
</tr>
<tr>
<td>Member of inspection team</td>
<td>6</td>
</tr>
<tr>
<td>Both leader and member of inspection teams</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
</tr>
</tbody>
</table>

Table 7.5: Working Experience of Quality Inspectors

<table>
<thead>
<tr>
<th>Auditing Experience</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 5 years</td>
<td>-</td>
</tr>
<tr>
<td>5 to 10 years</td>
<td>2</td>
</tr>
<tr>
<td>11 to 15 years</td>
<td>4</td>
</tr>
<tr>
<td>16 to 20 years</td>
<td>2</td>
</tr>
<tr>
<td>More than 20 years</td>
<td>4</td>
</tr>
<tr>
<td>None</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Experience in the Audit Inspection</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 3 years</td>
<td>3</td>
</tr>
<tr>
<td>3 to 5 years</td>
<td>4</td>
</tr>
<tr>
<td>More than 5 years</td>
<td>5</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
</tr>
</tbody>
</table>

Respondents were asked about the types of audit firm and types of audit engagement they had inspected in the previous twelve months. Tables 7.6 and 7.7 show the frequency for responses to these questions. About 67% of respondents claimed that they spent more than fifty percent of their time reviewing the Big Four firms in the last year of inspection. As for the proportion of time spent on the type of audit engagement, 92% of respondents spent less than fifty percent on FTSE 100 companies. About equal time was spent by the respondents on other listed companies. The respondents spent less than fifty percent of their time on inspecting other public interest entities.

Table 7.6: Proportion of Time in Different Types of Audit Firms

<table>
<thead>
<tr>
<th>Type of audit firm</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Big four firms:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>More than fifty percent</td>
<td>8</td>
<td>67%</td>
</tr>
<tr>
<td>Less than fifty percent</td>
<td>4</td>
<td>33%</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
<td>100%</td>
</tr>
<tr>
<td>Other firms:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>More than fifty percent</td>
<td>2</td>
<td>17%</td>
</tr>
<tr>
<td>Less than fifty percent</td>
<td>10</td>
<td>83%</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
<td>100%</td>
</tr>
</tbody>
</table>
Table 7.7: Proportion of Time in Different Types of Audit Engagement

<table>
<thead>
<tr>
<th>Type of audit engagement</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>FTSE 100 companies:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>More than fifty percent</td>
<td>1</td>
<td>8%</td>
</tr>
<tr>
<td>Less than fifty percent</td>
<td>11</td>
<td>92%</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
<td>100%</td>
</tr>
<tr>
<td>Other listed entities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>More than fifty percent</td>
<td>5</td>
<td>42%</td>
</tr>
<tr>
<td>Less than fifty percent</td>
<td>7</td>
<td>58%</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
<td>100%</td>
</tr>
<tr>
<td>Other public interest entities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>More than fifty percent</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Less than fifty percent</td>
<td>12</td>
<td>100%</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
<td>100%</td>
</tr>
</tbody>
</table>

This section has presented a detailed profile of the personal backgrounds of the respondents to the questionnaire. In general, it shows that the respondents are generally experienced in the current positions, are educated and have considerable knowledge about auditing and experience of a range of inspection assignments both leading and participating in those inspections. Overall, it is felt this profile represents a representative group from which to gather evidence of audit quality as viewed within the inspection system.

### 7.2 Meanings of Audit Quality in Practice

In this section, an analysis of the inspectors’ views on the meaning of audit quality is presented. In other words, this section aims to understand attributes that the respondents are using in forming their judgements in assessing audit quality in the inspection engagements they undertake. Table 7.8 shows the rank (out of 22), mean and standard deviation for each attribute listed in the survey instrument. Overall, the majority, or fifteen of the attributes are rated above 4, which implies the importance of the attributes to reflect audit quality in practice.
### Table 7.8: Attributes of Audit Quality in Practice

<table>
<thead>
<tr>
<th>Id</th>
<th>Attribute</th>
<th>Rank</th>
<th>Mean</th>
<th>Standard deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>The auditor demonstrates an appropriate level of challenge to the management of the audit client</td>
<td>1=</td>
<td>4.92</td>
<td>0.39</td>
</tr>
<tr>
<td>2</td>
<td>The auditor does sufficient work to obtain sufficient evidence to support an audit opinion</td>
<td>1=</td>
<td>4.92</td>
<td>0.39</td>
</tr>
<tr>
<td>3</td>
<td>The work done in carrying out the audit is subject to review before the audit is completed</td>
<td>3</td>
<td>4.75</td>
<td>0.96</td>
</tr>
<tr>
<td>4</td>
<td>The auditor reports the correct audit opinion on the financial statements</td>
<td>4=</td>
<td>4.67</td>
<td>1.11</td>
</tr>
<tr>
<td>5</td>
<td>The auditor is technically competent</td>
<td>4=</td>
<td>4.67</td>
<td>1.13</td>
</tr>
<tr>
<td>6</td>
<td>The auditor is independent</td>
<td>4=</td>
<td>4.67</td>
<td>1.13</td>
</tr>
<tr>
<td>7</td>
<td>The audit is carried out in accordance with ethical standards</td>
<td>7</td>
<td>4.58</td>
<td>1.24</td>
</tr>
<tr>
<td>8</td>
<td>The audit work undertaken is based primarily on an assessment of the risks associated with the client’s financial statements</td>
<td>8</td>
<td>4.50</td>
<td>1.28</td>
</tr>
<tr>
<td>9</td>
<td>The audit is carried out in accordance with auditing standards</td>
<td>9=</td>
<td>4.42</td>
<td>1.24</td>
</tr>
<tr>
<td>10</td>
<td>The role of the audit partner is at the centre of the audit process</td>
<td>9=</td>
<td>4.42</td>
<td>1.24</td>
</tr>
<tr>
<td>11</td>
<td>The audit work is determined through an appropriate planning process</td>
<td>11=</td>
<td>4.25</td>
<td>1.41</td>
</tr>
<tr>
<td>12</td>
<td>The auditor maintains effective communication and interaction with the audit committee</td>
<td>11=</td>
<td>4.25</td>
<td>1.11</td>
</tr>
<tr>
<td>13</td>
<td>The audit meets the quality standards applied internally by the audit firm</td>
<td>13=</td>
<td>4.17</td>
<td>0.92</td>
</tr>
<tr>
<td>14</td>
<td>The auditor maintains a high level of documentation in the completed audit files</td>
<td>13=</td>
<td>4.17</td>
<td>1.26</td>
</tr>
<tr>
<td>15</td>
<td>The audit is carried out in accordance with quality control standards (ISQC1)</td>
<td>15</td>
<td>4.08</td>
<td>1.32</td>
</tr>
<tr>
<td>16</td>
<td>The audit is valued by the audit client</td>
<td>16</td>
<td>3.67</td>
<td>1.13</td>
</tr>
<tr>
<td>17</td>
<td>The audit is completed in a timely manner</td>
<td>17</td>
<td>3.58</td>
<td>1.23</td>
</tr>
<tr>
<td>18</td>
<td>The auditor maintains a good relationship with the management of the audit client</td>
<td>18</td>
<td>3.17</td>
<td>1.65</td>
</tr>
<tr>
<td>19</td>
<td>The audit firm is free from negative findings in inspection reports</td>
<td>19</td>
<td>3.08</td>
<td>2.39</td>
</tr>
<tr>
<td>20</td>
<td>The auditor satisfies the audit client’s expectations</td>
<td>20</td>
<td>3.00</td>
<td>2.56</td>
</tr>
<tr>
<td>21</td>
<td>The auditor provides good value for money to the audit client</td>
<td>21</td>
<td>2.33</td>
<td>1.34</td>
</tr>
<tr>
<td>22</td>
<td>The audit firm provides additional services in association with the audit</td>
<td>22</td>
<td>1.42</td>
<td>1.24</td>
</tr>
</tbody>
</table>

Notes to table:

1. Factors are shown in decreasing order
2. Response scale is: 1. Little or no importance, 2. Unimportant, 3. Undecided, 4. Important, 5. Very important
3. High consensus (standard deviation ≤ 0.85 shown in bold) low consensus (standard deviation ≥1.25 shown in italics)
There is a strong consensus among the respondents that high audit quality should be reflected through adequate challenge to the management (mean 4.92), which is connected to sufficient audit work that supports the audit opinion or judgement formed by the external auditors (mean 4.92). The respondents also connected adequate documentation in the completed audit files to the attributes of audit quality (mean 4.17), which was also mentioned as a key feature of by the audit partners interviewed in the study. The AIU emphasises the importance of challenge, adequate audit work and documentation for the auditors to support auditors’ judgement to form ‘correct audit opinion’ (mean 4.67) as key attributes of audit quality, as stated in its public report:

“The AIU’s review of individual audits place emphasis on the appropriateness of significant audit judgements exercised in reaching the audit opinion, as well as the sufficiency and appropriateness of the evidence obtained. The AIU’s inspections include, but are not restricted to, an assessment of compliance with the requirements of relevant standards and other aspects of the regulatory framework for auditing” (AIU, 2008, p. 4).

The survey results show that the respondents see a strong link between audit quality and compliance with the ethical standards (mean 4.58), auditing standards (mean 4.42) and quality control standards (mean 4.08). The respondents also expressed strong support for the influence of internal standards within the audit firm and audit quality. For example, they perceived that ‘the work done in carrying out the audit is subject to review before the audit is completed’ (mean 4.75) and ‘the audit meets the quality standards applied internally by the audit firm’ (mean 4.17) as evidence of a high audit quality.

In like manner, all of the audit partners interviewed in the study associated the meaning of audit quality with meeting requirements of standards and guidelines in content and conduct of an audit as well as how quality control is applied within firm. This is in line with the focus of the assessment carried out by the AIU on firms’ compliance with the regulatory framework for auditing, and application of policies and procedures within audit firms to attain a high audit quality. As stated in the AIU Public Report (2010, Appendix A):

“The AIU monitor firms’ compliance with the regulatory framework for auditing, including the Auditing Standards, Ethical Standards and Quality Control Standards...The AIU’s inspections of the major firms comprise a review of the firms’ policies and procedures supporting audit quality...”
Frequently, during the interviews, the interviewees argued that although their focus in the assessment of audit quality includes auditors’ compliance with audit regulation, their focus of assessment is more to do with the issue of the ‘quality of the challenge’ of the auditors to the management. For example:

“The auditor has to make judgments and the inspection teams make an assessment of whether those judgments were done in an appropriate fashion...whether they do sufficient in order to get sufficient reliable evidence...whether they robustly challenge the management...our criticism on quality will be on that challenge and not on did they actually follow the standards” (R1).

“...the fact that we were given a responsibility for monitoring audit quality but nobody had told us what audit quality was. Therefore, we had to make an interpretation. The reality is that it is not only compliance with the audit regulations. To me, if it was merely compliance then all of the criticisms towards audit regulators would be valid because it then just becomes a tick box approach, but it is not only compliance with the audit regulations, which then brings in all the auditing standards and all the ethical standards...the auditor has to make judgments and we challenge the judgments...“ (R1)

As implied in the above quotation, one of the interviewees argued that some claims about compliance or the ‘tick box approach’ to audit quality in the inspection process are unsubstantiated because that is not the only focus of the inspection unit. In other words, the interviewees suggest that the auditors’ work performance in accordance with the standards is acceptable but that it is not sufficient in itself for audit quality. This may refer to possible inherent limitations of standards to equate entirely or codify completely what is necessary to form an opinion on the truth and fairness of the financial statements. It is possible that the criteria necessary to guarantee that the auditors do enough to form a suitable opinion at an appropriate level of assurance on the true and fair view would never be captured entirely by the procedures specified in a codified set of standards.

The questionnaire respondents perceived both the auditor’s technical competence, in terms of a high level of auditing and accounting knowledge, and objectivity as important for delivering high audit quality. The analysis in Table 7.8 shows the importance of attributes including the auditor’s competence (mean 4.67) and independence (mean 4.67) to audit quality (DeAngelo, 1981b; Knapp, 1991). This is also consistent with the views was expressed by the audit partners and AC members interviewed in the study on the relative importance of these attributes for construction of the meaning of audit quality in practice.
The questionnaire evidence also shows the respondents rated ‘the auditor maintains effective communication and interaction with the AC’ (mean 4.25) to be an important attribute of audit quality. The AC now has a primary role in communication between the company and the auditor and considerable emphasis is now placed on such communication (Turley, 2008, p. 218). As stated by the AIU in its first public report with regard to the importance of this attribute:

“The auditors’ communications with those responsible for overseeing the entity’s financial reporting process (normally an Audit Committee reporting to the full Board) is a key aspect of the audit process. A quality audit involves appropriate and complete reporting by the auditors which enables the Audit Committee and Board to properly discharge their responsibilities” (AIU, 2004/2005, p. 7).

The respondents expressed lower levels of agreement (a mean score of less than 4) with statements concerning seven possible attributes for audit quality that are mainly related to ‘service quality’ or attributes that relate to aspects of the auditor-auditee relationship. For example, the quality inspectors rated low ‘the auditor provides good value for money to the audit client’ (mean 2.33) and ‘the audit firm provides additional services in association with the audit’ (mean 1.42). This suggests less weight is given by the quality inspectors to the commercial aspects of auditing as a reflection of high audit quality. This is in significant contrast with the views of audit partners (as discussed in chapter 5) which suggested that their conception of audit quality is highly related to the construct of service quality.

To summarise, the responses of the quality inspectors to the survey questions show that they consider the aspect of what might be called ‘the performance of the audit process’ as the key construct of audit quality. The quality inspectors also considered compliance and technical attributes rather than service attributes as relevant concepts of audit quality in practice.

### 7.3 Factors Influencing Audit Quality in Practice

In this section, an analysis of the respondents’ views on the influence of environmental factors on the development of the concept of audit quality is presented. This section also provides analysis of the internal factors within firms that the respondents perceived as influencing the quality of a specific audit assignment.

Respondents were asked to answer questions regarding the impact of the business, accounting and auditing environment on audit quality. Table 7.9 shows the rank (out of 15), mean and standard deviation for each factor listed on the research
instrument. It is interesting to note that four of the higher ranked issues are related to factors on the business of auditing or the commercial side of auditing. The consensus amongst the inspectors is that competition in the audit market has had an impact on audit effort regarding: meeting expectations of the audit client (mean 4.00), delivering value for money (mean 4.00), the auditor-auditee relationship (mean 3.83) and providing value added services (3.67). Although these factors are not considered by the respondents as key attributes of audit quality as such, that is what the auditors should be focusing on to achieve quality (as discussed in section 7.2), the respondents seem to acknowledge the effect of economic pressures in the audit environment for the auditor to give attention to them in practice. In other words, the aspects of service quality that the quality inspectors consider are least important to the concept of audit quality are also exerting significant influence on conception of audit quality in practice. This position is supported by some of the respondents who believed that the approach and conduct of the audit in practice manifests the commercial aspects of the audit firms (see Table 7.10), as there is a greater need for the audit firms to focus on aspects of service quality to their audit clients because of intense competition, fee pressure and slow growth in the audit environment (Behn et al., 1997; Duff, 2004). One of the interviewees commented:

“...firms are under increasing fee pressure from their clients who want to reduce costs and the recession is effecting the firms...fewer clients, fewer transactions and that is potentially an issue” (R2).

The influence of economic pressures to the conception of audit quality in practice was also recognized by the audit partners interviewed in the study. The views expressed by both groups denote the way in which commercial pressures influence what the auditors do to demonstrate good auditing in practice. In consequence, it places pressure on what might be seen as the more public interest oriented role of the audit.

The respondents also rated as high the impact on audit quality of some aspects of the regulation of accounting and auditing factors. This emphasis is also supported by the fact that when asked about what general factor is most reflected in the conduct of audits the item highest ranked by the inspectors was the compliance aspects of the audit (see Table 7.10). For example (see table 7.9), it is notable that the most highly ranked factor influencing quality is the complexities of accounting standards on the technical expertise required of auditors (mean 4.08). The analysis also shows the agreement of the respondents concerning the impact of audit regulation on auditor independence (mean 4.00), audit documentation (mean 3.75) and the audit process (mean 3.75).
Table 7.9: Perceptions of the Impact of Business, Accounting and Auditing Factors Affecting Audit Quality in Practice

<table>
<thead>
<tr>
<th>Id</th>
<th>Factor</th>
<th>Rank</th>
<th>Mean</th>
<th>Standard deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Accounting standards requiring more estimation and judgements have resulted in greater need for technical expertise</td>
<td>1</td>
<td>4.08</td>
<td>1.48</td>
</tr>
<tr>
<td>2</td>
<td>Competition in the audit market has resulted in a greater focus on meeting client’s expectations</td>
<td>2=</td>
<td>4.00</td>
<td>1.28</td>
</tr>
<tr>
<td>3</td>
<td>Competition in the audit market has resulted in greater emphasis being placed on delivering good value for money to the audit client</td>
<td>2=</td>
<td>4.00</td>
<td><strong>0.43</strong></td>
</tr>
<tr>
<td>4</td>
<td>The framework of audit regulation has led to greater attention to factors related to the auditor’s independence from the audit client</td>
<td>4</td>
<td>3.92</td>
<td>1.66</td>
</tr>
<tr>
<td>5</td>
<td>Competition in the audit market has resulted in greater emphasis being placed on the auditor’s relationship with the audit client’s management</td>
<td>5</td>
<td>3.83</td>
<td>0.92</td>
</tr>
<tr>
<td>6</td>
<td>Competition in the audit market has resulted in greater attention being given to delivering value added services to the audit client</td>
<td>6=</td>
<td>3.75</td>
<td>1.11</td>
</tr>
<tr>
<td>7</td>
<td>Changes in the framework of audit regulation have led to increased emphasis on maintaining adequate audit documentation</td>
<td>6=</td>
<td>3.75</td>
<td><strong>1.42</strong></td>
</tr>
<tr>
<td>8</td>
<td>Factors in the auditing environment have resulted in greater reliance on consultation within the firm as part of the audit process</td>
<td>6=</td>
<td>3.75</td>
<td><strong>1.57</strong></td>
</tr>
<tr>
<td>9</td>
<td>The current business environment has resulted in greater reliance on risk based audit approaches</td>
<td>9</td>
<td>3.67</td>
<td>1.14</td>
</tr>
<tr>
<td>10</td>
<td>Changes in the framework of audit regulation have created a greater need for the auditor to demonstrate a challenge to client management</td>
<td>10</td>
<td>3.33</td>
<td>2.07</td>
</tr>
<tr>
<td>11</td>
<td>The current business environment has resulted in greater attention to audit planning</td>
<td>11</td>
<td>3.00</td>
<td><strong>1.48</strong></td>
</tr>
<tr>
<td>12</td>
<td>Factors in the auditing environment have resulted in extensive internal review of the audit engagements</td>
<td>12</td>
<td>2.92</td>
<td>2.33</td>
</tr>
<tr>
<td>13</td>
<td>The auditing standards are used by audit practitioners to justify doing less detailed audit work</td>
<td>13</td>
<td>2.83</td>
<td><strong>1.83</strong></td>
</tr>
<tr>
<td>14</td>
<td>The framework of audit regulation has led to increased focus on conducting an audit beyond the minimum requirements of auditing standards</td>
<td>14</td>
<td>2.75</td>
<td><strong>1.57</strong></td>
</tr>
<tr>
<td>15</td>
<td>The framework of audit regulation has resulted in less reliance on the auditor’s professional judgement</td>
<td>15</td>
<td>2.17</td>
<td><strong>1.48</strong></td>
</tr>
</tbody>
</table>

Notes to table:

1. Factors are shown in decreasing order
3. High consensus (standard deviation ≤ 0.85 shown in bold) low consensus (standard deviation ≥1.25 shown in italics)
This view about the important influence of compliance aspects to the concept of audit quality applied in practice was also evident in the interviews with the audit partners in this study. For example, as reported in Chapter 5, the interview evidence pointed to the importance of the quality of documentation, internal quality control applied within the firm to satisfy inspection and the assessment of audit quality carried out by the AIU.

Table 7.10: Rank Items Influence on the Conduct of Audits in Practice

<table>
<thead>
<tr>
<th>Item</th>
<th>Rank of order</th>
<th>Number (n=12)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>The approach to the conduct of audits in practice reflects the compliance obligations placed on the public accounting firm</td>
<td>1</td>
<td>5</td>
<td>42%</td>
</tr>
<tr>
<td>The approach to the conduct of audits in practice reflects the commercial values of the public accounting firm</td>
<td>2</td>
<td>4</td>
<td>33%</td>
</tr>
<tr>
<td>The approach to the conduct of audits in practice reflects the professional values of the public accounting firm</td>
<td>3</td>
<td>3</td>
<td>25%</td>
</tr>
</tbody>
</table>

In the discussions with inspectors about potential influence of the AIU on audit quality, the interviewees indicated that they see some positive impact from independent inspection on the quality of audit performance or on important attributes that they believe represent audit quality: challenge, evidence and documentation. This perception is illustrated by the following comments:

"What we do see is that when we go back and review an audit that we had previously reviewed the firm has addressed the points and it does not matter how challenging they were of the findings they do actually implement the recommendations we make...the firms are doing a better job and they are documenting their rationale or they are putting together their evidence in a better way and then they are more challenging and thinking historically. Therefore, I am pretty certain that we are doing better audits than we did 5 years ago" (R1).

"We get feedback from people who say that inspection has made a difference to the way the audit firms’ work. I have had that feedback quite frequently that is rather sort of second hand or third hand from ex-partners of large audit firms or people working in companies. There is an example of where the auditors have been more robust because the auditors have used us as an excuse for not agreeing to things they did not want to agree with in the first place. For example, "we could not possibly agree to this, you must realise that nowadays our files are crawled over by the AIU and this is not an accounting treatment that I could countenance going along with" (R2).

The AIU has also acknowledged in its public report the impact of inspections on actions taken by the audit firms: ‘firms respond in a positive manner to its inspection findings by altering their policies and procedures supporting audit quality
or providing training to staff (AIU, 2009, p. 10). This shows some evidence of a positive impact by the AIU with regards to behavioural changes that it wishes to promote. Nonetheless, concerns have also been raised over the high level of recurring issues found in inspections (ibid). This issue is demonstrated by the lower level of support the respondents offered for the suggestion that audit regulation has led to an emphasis on going beyond the minimum requirements of standards or (mean 2.75) that environmental factors have led to extensive internal review (mean 2.92). The behavioural changes may be attributed to a reaction to the threat of the inspection rather than the actuality in practice. The interviewees explained some possible reasons for that:

"I want to do things to make sure I do not get a bad report from inspection". Auditors are probably doing it for a number of different reasons, the outcome of our inspection of their particular engagement does have an impact on their remuneration therefore "I am going to do that to make sure I do not get criticised". Equally, if they are criticised to a certain degree, particularly now the letters go to the audit committee chair on our findings on individual engagement. "I might lose the job if the inspectors actually criticise me for something" (R1).

"...audit firms tell us we are making a difference, well they might say that anyway because they fear that maybe something worse is coming along" (R2).

From the analysis of the survey questionnaires, the respondents do not indicate that they see evidence of potential negative impacts from regulation on the development and approach of firms and auditors to audit quality. For example, the respondents tended to disagree (rating below 3) with the statements that: ‘the auditing standards are used by audit practitioners to justify doing less detailed audit work’ (mean 2.83) and ‘the framework of audit regulation has resulted in less reliance on the auditor’s professional judgement’ (mean 2.17). This is in notable contrast with the audit partners interviewed in this study, who often drew attention to potential negative impacts of regulation on the quality of audit performance. For example, the audit partners frequently mentioned concerns with regard to changes in the nature of audit practice to a compliance or ‘tick box’ audit approach that undermines their professional judgement.

Overall, there is general agreement among the quality inspectors that the regulatory factors (both accounting and auditing) and the business aspects of auditing have an influence on the development and approach of firms and auditors with respect to audit quality. In particular, the impact of the economic factors, that is competition in the audit market, on the concept of audit quality in practice appears to be particularly strong.
Respondents were asked to answer some questions regarding their perceptions concerning how a large number of more specific behavioural, technical or relational steps affect the ‘actual’ audit quality that is achieved on individual audit engagements in practice. The results are summarised in Table 7.11.

**Table 7.11: Internal Factors Affecting Audit Quality in Practice**

<table>
<thead>
<tr>
<th>Id</th>
<th>Factor</th>
<th>Rank</th>
<th>Mean</th>
<th>Standard deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>The degree of involvement of the audit engagement partner during audit planning influences the quality of the resulting audit process</td>
<td>1</td>
<td>4.42</td>
<td>1.30</td>
</tr>
<tr>
<td>2</td>
<td>Technical and other consultations within the audit firm enhance the quality of judgements made during the completion of the audit</td>
<td>1</td>
<td>4.42</td>
<td>1.30</td>
</tr>
<tr>
<td>3</td>
<td>Technical and other consultations within the firm during planning influence the quality of the resulting audit process</td>
<td>3</td>
<td>4.25</td>
<td>1.11</td>
</tr>
<tr>
<td>4</td>
<td>Training within the audit firm enhances auditors’ technical expertise</td>
<td>3</td>
<td>4.25</td>
<td>0.96</td>
</tr>
<tr>
<td>5</td>
<td>Internal reviews within the audit firm enhance compliance with the technical requirements of auditing standards</td>
<td>5</td>
<td>4.17</td>
<td>1.26</td>
</tr>
<tr>
<td>6</td>
<td>Effective communication from the auditor to client management influences the quality of the resulting audit process</td>
<td>5</td>
<td>4.17</td>
<td>0.71</td>
</tr>
<tr>
<td>7</td>
<td>Interaction between the auditor and client management influences the quality of the resulting audit process</td>
<td>5</td>
<td>4.17</td>
<td>0.71</td>
</tr>
<tr>
<td>8</td>
<td>Training within the audit firm enhances the delivery of an effective and efficient audit</td>
<td>5</td>
<td>4.17</td>
<td>0.92</td>
</tr>
<tr>
<td>9</td>
<td>Audit software facilitates compliance with the technical requirements of auditing standards</td>
<td>9</td>
<td>4.00</td>
<td>0.43</td>
</tr>
<tr>
<td>10</td>
<td>Risk based audit approaches facilitate the achievement of an effective and efficient audit</td>
<td>9</td>
<td>4.00</td>
<td>0.43</td>
</tr>
<tr>
<td>11</td>
<td>Audit software promotes compliance with documentation requirements</td>
<td>11</td>
<td>3.92</td>
<td>0.71</td>
</tr>
<tr>
<td>12</td>
<td>Internal reviews within the audit firm improve compliance with documentation requirements</td>
<td>11</td>
<td>3.92</td>
<td>0.68</td>
</tr>
<tr>
<td>13</td>
<td>Audit software facilitates the achievement of an effective and efficient audit</td>
<td>13</td>
<td>3.83</td>
<td>0.84</td>
</tr>
<tr>
<td>14</td>
<td>Internal reviews within the audit firm enhance the quality of audit judgements made during the audit</td>
<td>13</td>
<td>3.83</td>
<td>0.92</td>
</tr>
<tr>
<td>15</td>
<td>Internal reviews within the audit firm ensure the delivery of an effective and efficient audit</td>
<td>15</td>
<td>3.75</td>
<td>1.23</td>
</tr>
<tr>
<td>16</td>
<td>Training within the audit firm improves auditors’ ability to challenge the management of audit clients</td>
<td>16</td>
<td>3.58</td>
<td>1.24</td>
</tr>
<tr>
<td>17</td>
<td>Internal reviews within the audit firm enhance auditor’s technical expertise</td>
<td>17</td>
<td>3.50</td>
<td>1.75</td>
</tr>
</tbody>
</table>
Table 7.11: Internal Factors Affecting Audit Quality in Practice (continued)

<table>
<thead>
<tr>
<th>Id</th>
<th>Factor</th>
<th>Rank</th>
<th>Mean</th>
<th>Standard deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>18</td>
<td>Audit firm methodologies and manuals improve the quality of audit judgement applied during the audit</td>
<td>17=</td>
<td>3.50</td>
<td>1.28</td>
</tr>
<tr>
<td>19</td>
<td>Interaction between the auditor and the audit committee is influential in determining the content of audit work undertaken</td>
<td>19</td>
<td>3.42</td>
<td>1.41</td>
</tr>
<tr>
<td>20</td>
<td>Risk based audit approaches help the auditor to provide value for money to the client</td>
<td>20</td>
<td>3.25</td>
<td>1.41</td>
</tr>
<tr>
<td>21</td>
<td>Audit firm methodologies and manuals enhance the auditor’s ability to challenge client management</td>
<td>21</td>
<td>3.08</td>
<td>1.32</td>
</tr>
<tr>
<td>22</td>
<td>Internal reviews within the audit firm ensure the auditor’s independence from the audit client</td>
<td>22</td>
<td>3.00</td>
<td>1.71</td>
</tr>
<tr>
<td>23</td>
<td>Risk based audit approaches help the auditor to provide value added services to the audit client</td>
<td>23</td>
<td>2.92</td>
<td>1.48</td>
</tr>
<tr>
<td>24</td>
<td>Performance appraisal systems within audit firms increase compliance with the technical requirements of auditing standards</td>
<td>24=</td>
<td>2.83</td>
<td>1.65</td>
</tr>
<tr>
<td>25</td>
<td>Performance appraisal systems within audit firms improve compliance with documentation requirements</td>
<td>24=</td>
<td>2.83</td>
<td>1.82</td>
</tr>
<tr>
<td>26</td>
<td>Interaction between the auditor and the audit committee facilitates the correct audit opinion being reported</td>
<td>24=</td>
<td>2.83</td>
<td>1.43</td>
</tr>
<tr>
<td>27</td>
<td>Performance appraisal systems within the audit firm enhance the auditor’s technical expertise</td>
<td>27</td>
<td>2.67</td>
<td>1.34</td>
</tr>
<tr>
<td>28</td>
<td>Performance appraisal systems within the audit firm improve the auditor’s independence</td>
<td>28</td>
<td>2.58</td>
<td>1.41</td>
</tr>
</tbody>
</table>

Notes to table:

1. Factors are shown in decreasing order
3. High consensus (standard deviation ≤ 0.85 shown in bold) low consensus (standard deviation ≥1.25 shown in italics)

The questions that are the basis for Table 7.11 were intended to provide an understanding of quality inspectors’ view about what differences they see in the specific practices and behaviours adopted between the audits they inspect that they perceive have an influence on the relative quality of those audits. Some of the items refer to things that may vary from audit to audit, even with the same audit firm or team, such as the degree of involvement of the audit partner, and others to things that may vary between firms, such as the nature of appraisal systems.
Overall, 18 of the 28 statements in the questionnaire were supported by the overall responses (mean score above 3.5) and suggesting that these factors were perceived by the respondents as having at least an effect on audit quality. The respondents perceived the role of the audit partner in the audit planning as having an important influence on the audit process (mean 4.42). The involvement of relevant staff within the firm through consultation etc. was also identified as influencing on the quality of audit judgements (mean 4.42) and, subsequently, the resulting audit process (mean 4.25). The respondents also strongly agreed with the influence of training, as they perceived the positive impact of training on the technical competency of the external auditors (mean 4.25) and the delivery of an effective and efficient audit (mean 4.17). This finding is echoed in the following comment by one of the interviewees:

"The people aspect is a significant concern, so there is quite a focus looking at the human resource systems and performance appraisals...the overall firm's approach to training and whether the firm is in compliance with continuing professional development...“ (R1).

The factor related to internal audit firm monitoring and micro-quality control, that is the firm’s quality review system, is also perceived as being influential in the conduct of an audit: for instance the statement that ‘internal reviews within the audit firm enhance compliance with the technical requirements of auditing standards’ was given considerable support by the respondents (mean 4.17). These factors (of planning, consultation, training and quality control) that have been highlighted above were also referred to as an important representations of audit quality by the audit partners interviewed in this study (see section 5.3).

Audit firm monitoring and micro-quality control are also perceived as influential concerning various aspects of the audit performance by the respondents. For example, the respondents perceived that internal reviews improve compliance with the documentation standards (mean 3.92), enhance the quality of audit judgements (mean 3.83), ensure delivery effectiveness and an efficient audit (mean 3.75), and enhance the auditor’s technical expertise (mean 3.50). Nonetheless, interview evidence highlights some concern about the effectiveness of the firms’ quality reviews on achievement of high audit quality, as pointed out by one of the interviewees:

"As regards to sort of comparisons of the way we are looking at quality and the way the firms are looking at quality. What the firms have generally done is they have designed audit systems to be compliant with auditing standards and then in doing their own annual quality review. What they have done is just said "has the firm’s system been complied with“ because if the firm’s
system has been complied with de facto this audit must comply with auditing standards because our system complies with auditing standards. So the amount of time they spend on doing a file review is very limited and is focused on whether all the requirements have been met and have things been completed in accordance with our system and does not drive down into did the work that the staff actually do meet the objectives of the particular audit test?...there is an issue as to whether the firm’s own quality reviews are sufficiently rigorous” (R2).

The respondents also recognised the impact of effective communication and interaction (both mean 4.17) between the external auditors and the client management on the quality of the resulting audit process. Consistent with other perception studies (Schroeder et al., 1986; Chen et al., 2001), this finding highlights the important role of the audit client in facilitating the achievement of an audit. Interestingly, although the respondents perceived effective communication and interaction between auditors and the AC as one of the key attributes of audit quality (as mentioned in section 7.2), the analysis of the responses shows low evidence of the actuality concerning the role of the AC in the achievement of audit quality in practice. For example, the respondents gave relatively limited support for the statements that 'interaction between the auditor and the audit committee is influential in determining the content of audit work undertaken’ (mean 3.42) and ‘interaction between the auditor and the audit committee facilitates the correct audit opinion being reported’ (mean 2.83). These views suggest only a slight effect of the role of the AC on the actual conduct of the audit whereas consistently a range of issues related to reporting and communication with AC are highlighted in the inspection reports (AIU, 2008; 2009; 2010). Overall, the findings suggest a minimal impact of the AC on the audit process, which is in line with the finding of Cohen et al. (2002) and Turley and Zaman (2007) who suggested that the AC has a weak influence on the audit process. In like manner, some of the audit partners interviewed in this study expressed views regarding the minimal impact of the AC on the content and conduct of the audit and achievement of high audit quality in practice. The analysis of the interview evidence collected from AC members, which was discussed in Chapter 6, also suggests limited effects of the AC on the external audit function.

Although one of the aims of the AIU is to promote behavioural change amongst auditors in relation to audit quality through the performance systems of the audit firm, as illustrated by the interview quotations below, the respondents did not express support for statements regarding the influence of performance appraisal systems in various aspects of the conduct of the audit. For example, low mean scores were shown for the impact of performance appraisal systems on: compliance
with the technical requirements of auditing standards (mean 2.83), documentation requirements (mean 2.83), auditor's technical expertise (2.67) and auditors' independence (2.58).

"If you look at how the key performance indicators or typical audit partner’s objectives that audit firms establish and this is an area which I am very keen on that we go further on. There will be and partly as a result of the work of the audit inspection unit and the firms are getting better at this. There will be some attempt to assessing an audit partner based on quality and these things have evolved from, in my day which I was conducting audits” (R1).

"We expect to see links between that annual quality review process and performance appraisals and we expect to see a link between performance appraisals and remuneration and these links are becoming more specific and clearer. We expect to see the results of our work reflected in performance appraisals and the results of the firm’s quality audit review reflected in performance appraisals certainly” (R2).

Overall, the top five factors that influence the performance of the audit engagement and potentially cause a variation of audit quality between audits, as rated by the inspector respondents, are related to audit partner involvement, consultations within the firm, training, internal reviews, and interaction and communication between the external auditors and the client management.

### 7.4 The Level of Audit Quality Attained in Practice

Having discussed the desired attributes of audit quality perceived by the respondents (section 7.2), and potential environmental and internal factors that influence the achievement of audit quality in practice (section 7.3), this section attempts to provide an analysis of respondents’ views about the current level of audit quality in practice. The analysis aims to identify the existence of problems with audit quality in practice.

In general, the majority (83%) of the respondents agreed that the current level of quality of audits in the UK is high indicating a high level of optimism regarding audit quality in practice (see Table 7.12). Most of the inspectors (67%) agreed with the statement that the quality of the audits has increased in the last decade, while 25% of the respondents expressed a neutral view about the issue and only one (8%) disagreed with the statement. Similarly, only 17% of the respondents agreed with the statement that the quality of the audits in the UK has decreased in the last decade, 58% of disagreed with the statement and 25% were undecided about the issue. In general, the respondents perceived that the level of audit quality in practice is appropriate, as the AIU put it, 'the AIU considers the overall quality of
major public company audit work to be fundamentally sound’ (AIU, 2009).
Nevertheless, the AIU also highlights that a high number of audits require
significant improvements based on their assessment in the recent public inspection
report (AIU, 2010, p. 3).

**Table 7.12: General Views about Audit Quality in Practice**

<table>
<thead>
<tr>
<th>Id</th>
<th>Issue</th>
<th>Quality Inspectors (n=12)</th>
<th>Mean</th>
<th>Standard deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>In general, the quality of auditing in the UK is high</td>
<td>-  1  1  10</td>
<td>3.75</td>
<td>0.947</td>
</tr>
<tr>
<td>2</td>
<td>The quality of auditing in the UK has increased during the last decade</td>
<td>-  1  3  8</td>
<td>3.28</td>
<td>1.231</td>
</tr>
<tr>
<td>3</td>
<td>The quality of auditing in the UK has decreased during the last decade</td>
<td>-  7  3  2</td>
<td>2.58</td>
<td>1.545</td>
</tr>
<tr>
<td>4</td>
<td>There is a high level of consistency between audits in the quality of auditing achieved in practice</td>
<td>2  4  5  1</td>
<td>2.42</td>
<td>1.408</td>
</tr>
<tr>
<td>5</td>
<td>There is considerable variation between audits in the quality of auditing achieved in practice</td>
<td>-  1  2  7  2</td>
<td>3.83</td>
<td>1.085</td>
</tr>
<tr>
<td>6</td>
<td>In general market participants perceive the standard of audit quality to be adequate</td>
<td>-  4  2  6</td>
<td>3.17</td>
<td>2.065</td>
</tr>
<tr>
<td>7</td>
<td>General concerns about audit quality in recent years are based on a proper understanding of the conduct of audits in practice</td>
<td>3  7  1  1</td>
<td>2.00</td>
<td>1.128</td>
</tr>
</tbody>
</table>

Notes to table:

2. High consensus (standard deviation ≤ 0.85 shown in bold) low consensus (standard deviation ≥1.25 shown in italics)

Perhaps of more significance is the fact that half of the respondents perceived that there is inconsistency between audits in the quality of auditing achieved. The majority of the respondents agreed (either agree or strongly agree) that there is considerable variation between audits in terms of the level audit quality attained in practice. This suggests a potential variation in audit quality in different audit engagements and audit firms inspected by the AIU.

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The inconsistencies and variation could possibly be caused by audit partners’ involvement in planning, technical and other consultations within the firm, training, internal quality reviews and other internal factors within the audit firm (as discussed in section 7.3, that is, all the factors commented on in previous section about causes of variation in quality of individual audit engagement). Different audit firms might have different resources in terms of people, policies and procedures, internal processes and systems that may influence the production of the audit and its quality. The variation may also be due to the inconsistency between the policies and procedures that are established within the firm and its application on the actual conduct of auditors, which may contribute to a deficiency in audit quality, as pointed out by the AIU:

"...major firms have policies and procedures in place to support audit quality that are generally appropriate...nevertheless, improvements to these policies and procedures have been recommended at all firms...the number of audits assessed requiring significant improvement at major firms (eight audits or 11% of audits reviewed at major firms excluding follow-up reviews) is too high. Firms are therefore not always consistently applying their policies and procedures on all aspects of individual audits” (AIU Annual Report, 2009/2010, p.3).

Only half of the respondents believed that the participants in the audit market perceived the standard of audit quality to be sufficient. Therefore, the current perceptions about auditing legitimise the role of an independent oversight body to restore trust and confidence of the users of audit services, in particular shareholders and other stakeholders, concerning audit quality. However, the majority of the respondents also believed that the concerns about audit quality in recent years are not based on a proper understanding of the conduct of audits in practice. One of the potential reasons for such a situation is because of the lack of users’ understanding of the audit function which can lead to unreasonable expectations of audit services (Humphrey, 1991). This issue possibly indicates a lack of understanding about how audit quality is achieved in practice, thus, highlighting the unclear connection between the auditors’ performance of work tasks in practice and the notion of audit quality.

The questionnaire responses provide some evidence about certain issues that the respondents have experienced during the process of inspections (Table 7.13). There is strong agreement among the respondents concerning the lack of challenge posed by the external auditors to their audit client. Ten out of twelve respondents stated that the issue frequently or always appeared during the inspection process. The respondents rated the quality of audit documentation the most common issue with all of the respondents indicating that the adequacy of documentation either
frequently or always occurs during the inspection process. This view from the inspectors is interesting to set alongside the comments of the audit partners regarding the role of, and possible focus on, documentation in the inspection process (see Chapter 5).

**Table 7.13: Issues Arising in the Process of Inspection**

<table>
<thead>
<tr>
<th>Id</th>
<th>Issue</th>
<th>Quality Inspectors (n=12)</th>
<th>Mean</th>
<th>Standard deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>How often in the process of inspection do issues arise concerning the adequacy of audit documentation?</td>
<td>-  -  -  6  6</td>
<td>4.50</td>
<td>1.28</td>
</tr>
<tr>
<td>2</td>
<td>How often in the process of inspection do issues arise concerning compliance with auditing standards?</td>
<td>-  1  2  6  3</td>
<td>3.92</td>
<td>1.27</td>
</tr>
<tr>
<td>3</td>
<td>How often in the process of inspection do issues arise concerning the adequacy of the auditor's 'challenge' to management?</td>
<td>-  1  1  9  1</td>
<td>3.83</td>
<td><strong>0.84</strong></td>
</tr>
<tr>
<td>4</td>
<td>How often in the process of inspection do issues arise concerning the sufficiency of audit work?</td>
<td>-  1  2  8  1</td>
<td>3.75</td>
<td>0.99</td>
</tr>
<tr>
<td>5</td>
<td>How often in the process of inspection are issues that arise resolved by discussion with the audit team</td>
<td>-  2  2  7  1</td>
<td>3.58</td>
<td>1.41</td>
</tr>
<tr>
<td>6</td>
<td>How often in the process of inspection do issues arise concerning compliance with ethical standards?</td>
<td>-  1  4  7  -</td>
<td>3.50</td>
<td>1.30</td>
</tr>
<tr>
<td>7</td>
<td>How often in the process of inspection do issues arise concerning compliance with international accounting standards (IAS)?</td>
<td>-  2  4  5  1</td>
<td>3.42</td>
<td>1.41</td>
</tr>
<tr>
<td>8</td>
<td>How often in the process of inspection do issues arise concerning the appropriateness of the audit opinion?</td>
<td>3  7  2  -  -</td>
<td>1.92</td>
<td>1.07</td>
</tr>
</tbody>
</table>

Notes to table:

2. High consensus (standard deviation ≤ 0.85 shown in bold) low consensus (standard deviation ≥1.25 shown in italics)
The majority of the respondents stated that issues regarding the sufficiency of the audit work arise frequently or always in inspections. Another significant area of potential disagreement between the inspectors and the auditors concerns compliance with auditing standards. Fifty percent of the respondents stated issues of compliance frequently or always occur in the inspection process.

Despite this evidence of areas where audit inspections regularly lead to potential doubts about aspects of audit quality, a large majority of the respondents indicated that issues concerning the audit opinion arise never or only rarely in inspections. This tends to suggest that the principal questions arise concerning aspects of the process by which the audit is conducted and recorded rather than the appropriateness of the final product in the form of the audit opinion issued.

The above analysis provides evidence of the areas of problem that arise in the process of inspection. There are potential quality conflicts or disagreements between the inspectors and the external auditors a variety of attributes of audit quality. This may indicate some problems in the quality of audit performance in practice. As stated in the recent inspection report published by the AIU (2010, p. 15) a significant improvement was required in some of the audits that they had reviewed. Some of the reasons identified by the AIU in the report were related to lack of evidence to support auditors’ key audit judgements and some of audit reports reviewed were signed before all the required work had been done. The evidence from the survey supports such concerns of the regulator regarding certain behaviours of auditors that could compromise audit quality.

The comments below, taken from the interviews with inspectors, provide some practical evidence of the above concerns in the AIU assessment process. One potential observation is that the regulator believes that a lack of challenge by the auditors, evidenced in, for example, acceptance of a weak explanation from the audit client, reducing the amount of work performed below what would be considered reasonable and reducing the amount of documentation (which have been identified as ‘quality threatening behaviour’ in the literature, as discussed in section 2.1.2) may potentially undermine audit quality. Surprisingly, one of the interviewees mentioned the regularity of such incidents found in the inspection process, which may suggest regular evidence of such behaviours in practice.

"Audit judgments are challenged and in that process we will raise queries for the auditors to answer. It might be something as basic as we could not find the bank confirmation letters or it could be something like the auditing standards require an assessment of risk but the auditors did not test the
design and implementation of the controls over those significant risks. That is again very common” (R2).

“I had another example yesterday relating to a goodwill impairment calculation for an organisation involved in property...we said “on what basis did you accept the client’s assertion that property transactions were going to double in 2009 and then double again in 2010?” The initial answer you get “there is no third party evidence that was the director’s view”...effectively they should be doing more audit work to support decisions made in the accounts. So all I am trying to say is that actually we can challenge the judgments but it is not an easy task” (R1).

This quotation below further implies some difficulty on the part of the AIU in promoting the behaviour they see as consistent with high quality (such as providing a robust challenge to the management and undertaking sufficient audit work) because it will always be contested by the audit firm. One of the interviewees gave practical evidence on the above issue, as follows:

“We often see very inconsistent conclusions being drawn by different people or by different firms and indeed different teams within the same firm. The number of shops that are visited in stock counts will differ markedly between one team and another. Now it will be very difficult for us to say “well one is right and one is wrong” especially as within that firm those responsible for the methodology and technical advisory and professional practice would argue that, would and more or less have to argue that both are right so we cannot say that one. It would be difficult for us to say one is right and one is wrong. So we challenge judgments made by the audit team, frequently those judgments are around the acceptability or lack of challenge relating to auditing and accounting issues and we aim to do that on all audits (R2).

In summary, the analysis suggests some evidence of disagreement between the regulator and the external auditors in what is regarded as an indication of audit quality in auditors’ work performance. In addition, the analysis provides some interesting evidence about areas where problems arise. Thus, suggesting some potential problems in the achievement of high audit quality in practice.

7.5 Summary and Conclusions

Semi-structured interviews and a survey questionnaire were employed to elicit evidence from inspectors who are part of the AIU within the FRC about what they consider important in evaluating audit quality and what level of quality is achieved in practice. This group is responsible for monitoring and ensuring the quality of the auditing services. They are therefore in a good position to provide information on the standing of audit quality and possible factors that influence the attainment and operationalisation of audit quality in practice. Although the strength of conclusions that can be drawn from the survey is limited by the small size of the group
surveyed and the number of interviews conducted, the study nevertheless provides some interesting evidence about the topic under research from an important group that has not previously been incorporated in research.

The responses obtained from audit inspectors provide, first, evidence of the existence of possible problems in the audit quality that is delivered in practice. The issues that create problems are the quality of the ‘challenge’ to management, evidence and documentation. These are areas that lead to debate between the quality inspectors and the auditors in the process of inspection. Potentially this highlights the continuing difficulties faced by the regulator in changing certain aspects of behaviour of the auditors and the content of audit work.

Second, the evidence suggests that the quality inspectors conception of the meaning of audit quality is mainly related to aspects of audit performance related to judgements and the conduct of audit work. Elements such as the adequacy of challenge by the external auditors to the management, the sufficiency of audit evidence that should be documented in the audit working papers and the concern about the impact of accounting standards which require greater judgement illustrate the importance of this aspect of the discourse of audit quality for the inspectors.

Finally, the findings from the quality inspectors confirm that the concept of and approach to audit quality in practice are influenced by economic and regulatory factors in the auditing environment. They acknowledged that there is variation and inconsistency in the quality of individual audits that they inspected and that this is also potentially influenced by various factors that are internal to the firm and the audit process such as audit partner involvement and the firms’ monitoring controls (through consultations, training and internal review).

In conclusion, this chapter shows that: (i) inspectors’ perceptions and assessment of the quality of auditors’ work is substantially influenced by the process aspects of the audit, (ii) concepts of and approaches to audit quality in practice are influenced by firms’ commercial interests and compliance obligations, (iii) the level quality attained on specific engagements is influenced by various internal factors such as the role of the audit partner, consultation and training, and (iv) there are a number of potential problems of audit quality in practice observed by inspectors and there will be continuing difficulties for the regulator to improve audit quality because their work is likely to be contested by the external auditors.
Chapter 8

Conclusion

8.0 Introduction

This chapter summarises and reviews the empirical evidence presented, makes comments concerning possible public policy implications arising from the study and makes suggestions for future research. The main body of the research that comprises this thesis is contained in the four previous chapters. In chapter 4, various issues relating to audit quality from comments submitted in response to the FRC discussion paper ‘Promoting Audit Quality’ were identified in order to draw out areas for further investigation in the subsequent elements of this study which were reported in chapters 5, 6 and 7. In these chapters perceptions of auditors, AC members and quality inspectors concerning audit quality in practice were explored.

This thesis extends previous studies on audit quality by broadening the theoretical and empirical approaches to understanding the meaning of audit quality. Rather than looking at indirect signals of the level of quality achieved, the research has focused on the meaning contained in how audit partners, AC members and quality inspectors talk about the concept of audit quality, that is, how these people internalise and make sense of the term ‘audit quality’. This thesis has sought to add to understanding concerning what factors influence the practical construction of the term audit quality and how the concept affects the content and conduct of auditors’ approach to audit engagements, and AC members’ and quality inspectors’ evaluation of audit quality on those engagements.

A review of the literature argued that most of the earlier research on this subject has employed a functionalist approach in investigating the topic of audit quality, which emphasises variables and hypotheses derived from agency theory to predict association between possible input and output signals that could be indicative of variations on audit quality and show possible cause and effect. Despite the important contribution of such research to the body of knowledge on audit quality, it provides limited information about what the term means to different actors (such as auditors, AC members and quality inspectors) and how organisational and social factors that exist in the auditing environment may shape and influence their understanding and operationalisation of the term ‘audit quality’, and therefore those actors’ actions. Since the basic contention of the thesis is that perceptions about audit quality in practice are shaped by various interrelated factors in the
audit environment, a theoretical and methodological framework that is capable of providing a richer and more meaningful way of exploring the concept’s meaning and identifying the factors influencing that meaning is needed. Therefore, a qualitative approach has been considered suitable in order to provide insights into factors that may shape the meanings and perceptions. A theoretical framework and a methodology capable of addressing the complex nature of the interactions of various factors that have shaped and influenced the meaning and perceptions of audit quality are necessary. For this reason, symbolic interactionism was chosen as a theoretical or analytical perspective and document content analysis, face-to-face semi-structured interviews and a survey questionnaire were employed to address the research subject for the thesis.

This chapter has three main sections. Section 8.1 provides a review of the findings of the study. The contributions to research and implications for public policy of this study are highlighted in section 8.2. Finally, section 8.3 outlines the limitations and suggestions for future research.

### 8.1 Review of Significant Findings

This section offers some reflections on the results of this study regarding understanding of the meaning of concept of audit quality by key participants in the audit process, the influence of various internal and external factors in the auditing setting on the meaning and representations of that meaning in practice. This section attempts to emphasise that the meaning of audit quality is context dependent and must be understood within its social, organisational and institutional context.

In chapter 4, the comments of the 39 respondents to the discussion paper ‘Promoting Audit Quality’ made by the FRC were analysed in order to gain an understanding of the issues surrounding audit quality as perceived by parties sufficiently interested to submit comments. As illustrated in this study, the concept of audit quality develops dynamically and is influenced by many factors which are prevalent in the auditing setting. The process and impact of regulatory development may be significant, as are the economic environment and the influence of interactions between different parties (such as audit committee, regulator and audit client) with particular roles in the auditing system.
In chapter 5, 6 and 7 findings on perceptions of audit partners, AC members and quality inspectors concerning the meaning of audit quality in practice were outlined respectively. One general conclusion from this work is that the three groups have subtly different ways of constructing their perceptions of audit quality in practice. The first group of individual audit partners consider audit quality as resulting from the combined effects of parameters tied to client service, regulatory compliance, the technical process or methodological content of the audit, and individual auditors’ characteristics. The factors tied to client service are considered to be more critical than other factors. These factors include meeting client’s expectations and providing value added and value for money audit services. This aspect of audit quality was also recognised by the AC members who did refer to value added services to quality of communication and the relationship with the external auditor reflecting their interest in service quality. In contrast, although the quality inspectors acknowledged the influence of commercial aspects on the meaning of audit quality in practice, they did not consider aspects of service quality to be important and relevant evidence of audit quality.

For the audit partners, among the factors tied to compliance and regulatory factors that were perceived as influential to the notion of audit quality are the quality of documentation of the audit process and the quality control applied within the audit firm. This aspect of quality overlaps with the views of the third group (quality inspectors). An additional conclusion from the study is that it makes clear the influence of regulatory factors on the audit partners’ conception of audit quality. Finally, the audit partners also give high importance to factors tied to the individual auditor’s attributes, such as professional judgement, independence and competence to the construction of audit quality. This aspect of audit quality was also recognised by the other groups. This implies the importance of auditors’ professionalism to the meaning of audit quality in practice, which does have some connection to independence as one of the two attributes (together with technical competence) reflected in the explanation of audit quality most commonly cited in the research literature (DeAngelo, 1981a). Overall, audit partners have been shown to build conceptions of audit quality beyond the ‘technical’ or core aspects of the auditing profession to accommodate a large range of attributes such as the relationship with audit client, applied methodology, work processes and documentation. These factors are taken into consideration by partners in making their quality judgements. Most notably the partners’ understanding appears to place the audit client at the core of audit quality, which provides an interesting complement to other research
which has shown that finance directors rate aspects of service quality higher than the technical quality of auditors (Duff, 2004).

The second group represented by the AC members reveal quite a different view of audit quality from the other two groups of the study. An important first conclusion from this part of the research is that for AC members the notion of audit quality is mainly tied to the ‘relational’ rather than the technical attributes of individual auditors. In this case, professional appearance, which is a function of the interpersonal and behavioural skills of individual auditors during their interaction and communication with the AC, seems to play an important role in constructing the meaning of audit quality for the AC members. However, this group did also consider factors related to the attributes of individual auditors (such as competence, knowledge and independence) as important to the notion of quality, similar to the perceptions of the other two groups. In contrast, to the opinions expressed other two groups, audit firm attributes (size and industry specialisation) are also considered by AC members in forming their understanding and perceptions of audit quality. The study has showed that the AC members very much rely on such features in their conception of audit quality, partly due to their limited access to evaluate the detailed conduct of the actual audit engagement.

Finally, a significant finding from the work with AC members was that the quality of the financial statements dominated the AC members’ perceptions of audit quality rather than a technical interpretation of the quality of the audit process itself. This perhaps reflects the unobservable nature of audit quality and the AC’s focus on the output of the financial reporting process. It was apparent during the interviews that the majority of the AC members strongly associated audit quality with the reported numbers on completion of the audit or the resulting outputs. This emphasis reflects how the AC members strongly associated audit quality with the end product of the financial statements. This is in notable contrast to the position with audit partners, who emphasised compliance with the auditing standards in the conduct of the audit but rarely referred to the quality of information in the final audited financial statements as a signal of audit quality. In contrast, the audit partners placed emphasis on compliance with the auditing standards in the process of an audit rather than the financial statement output for their meaning of audit quality. In general, AC members appear to derive confidence regarding audit quality through factors mainly relating to ‘interpersonal’ aspects of the audit related to behavioural, presentation and interpersonal skills of external auditors than on the audit work itself.
The third group included in his study, quality inspectors who are the members of the AIU, exhibit quite a different view of audit quality to the other two groups. Notably, this group attached more importance to the conduct or content of an audit as key to the concept of audit quality. For this reason, the level of challenge to the management of the audit, the sufficiency of evidence and documentation are important to inspectors in constructing their perceptions of audit quality. Similar to the audit partners, this group also gives high importance to factors tied to quality control applied within the audit firm and various ‘compliance’ attributes of the notion of audit quality. The quality inspectors’ view also overlapped with those of the audit partners and AC members on the relative importance of auditor’s competence and independence to audit quality. However, there is a significant contrast between the quality inspectors and audit partners regarding the position of service quality attributes as key constructs for audit quality in practice. Overall, this study shows that inspectors build their meaning and perceptions on a range of attributes that relate to: audit process or content, internal and external compliance aspects, and individual auditors’ characteristics. Most essentially inspectors place the audit process and conduct at the core of audit quality, which might reflect the ability of the audit quality inspectors to, and their responsibility to, examine directly the content and conduct of individual audit engagements, in contrast to other non-auditor actors in the auditing system.

Taken together, the results from the research involving three important groups who have responsibilities for assessing audit quality in practice show the social meaning of audit quality and illustrate the socially constructed nature of auditing activity and the multifaceted meanings that can be associated with audit quality. This aspect of the evidence from this study supports the observations reached by Fischer (1996), who recognised the socially constructed nature of audit quality which derives from its unobservable nature.

From the interactionist perspective, Blumer (1969) and Charon (2007) have suggested that social meaning is best understood in terms of interaction between people and their environment and the role of various representations to signify meaning. The literature addressing audit quality in an organisational and social context (section 2.1.5) suggests role expectations, economic and regulatory factors may influence and shape the practices or performance of auditors. It also highlights how, in the absence of observable features on audit quality for both practitioners and users of audit services, audit practices and other ‘impression techniques’ are not only important to represent the technical audit function but it also for the legitimacy of auditors’ conduct and the knowledge base of audit. This study reveals
a variety of technical, compliance and service concepts attached to the meaning of audit quality, reflecting influences from internal and external factors in the auditing setting. Therefore, the contextual dependence of the meaning of audit quality and possible understanding of factors that influence and shape meaning and perceptions concerning audit quality have been made evident. For example, a notable finding arising out of the interviews with the audit partners was the apparent influence of commercial interests or client service on the meaning of audit quality and that the wider societal obligation had more limited influence on the meaning of audit quality. The issue of economic interdependence and imbalance of power between the management and external auditor have put pressures for the external auditor to deliver ‘quality’ that is expected by the audit client. This potentially opens up the issue of vulnerability to, and economic dependence on the demands of company management. Therefore, it resurrects the issue of expectation gaps that have long been associated with auditing.

In the case of AC members, their conception of the meaning of audit quality is greatly influenced by auditors’ presentations and communication during interactions. The external auditors seem to play an important role in AC members’ understanding and constructing meaning and perceptions of audit quality. Further reflection on this issue shows that the limits of the knowledge and expertise of the AC members and their need to demonstrate a credible image for the legitimacy on their role may shape and influence the meaning and perceptions of audit quality for this group.

The review of the research literature and also other policy documents that relate to audit quality points out that the concept of audit quality has a dynamic and context based aspect; different interpretations of audit quality may be held by different people and drivers or factors that influence audit quality may change over time (see, for example, Sutton, 1993; Rasmussen and Jensen, 1998; FRC, 2007). This perspective is consistent with the findings of this study which show in greater depth not just the existence of diversity but also the variety of constructs used to give meaning to audit quality. For example, the key construct for quality as understood by the audit partners is related to what is expected by the audit client and potentially is influenced by the commercial interests of the audit firm. At the same time, auditors are also expected to deliver audit quality that is expected by the AIU on behalf of the society or what the practitioners themselves believe concerning suitable technical audit quality that should be delivered in practice. This study suggests the variety of constructs of audit quality may potentially reflect subjective construction of the term resulting from interplay between various internal and
external factors prevalent in the auditing environment. Nevertheless, the manner in which these factors lead to real differences in specific audit practices remains an open question. One potential conflict identified by this study is that between client services and other constructs of audit quality.

Audit quality is connected to the value of audit services, yet there is no accepted authoritative definition of what it is and what constitutes a quality audit is not simple to answer. In the absence of such objective evaluation of what it is, it appears that all audit practitioners have to create and rely on various representations to signify or convey quality in their work: presentation, professional qualification, training, audit working papers or guidelines and standards in planning and executing audits. The identification of reliance on various representations to signify audit quality is well established in the literature (see section 2.1.5) and is consistent with observations made during the course of conducting this study. Further both extant literature and the evidence from this research suggest that representations are not only important to symbolise quality but are also important tools in practice to legitimise auditors’ actions and knowledge base, mobilise commercial interests and maintain the ‘social order’ of the financial and auditing systems (see, for example, Richardson, 1987; Richardson, 1988; Power, 1996; Power, 2003; Carrington, 2010). This study suggests that the notion of audit quality can be seen as a ‘language’ without ‘technicity’ that has been called upon by various audit constituents to give meaningful debate that there high quality auditing is being delivered. This is not meant to say that there is no high quality auditing but rather that the way in which the debate about audit quality is driven is partly to maintain legitimacy and convey certain impressions of what is done by various constituents in the auditing setting in the name of audit quality. Audit practitioners’ use of the term of audit quality and associated symbols can be understood as providing a socially integrative function for the auditing profession and also maintaining the legitimate authority of the profession with respect to auditing and financial accounting. For AC members, their understanding of the term of audit quality, and their function and operation in relation to external audit are very much influenced by the external auditors themselves. This highlights the potential ceremonial role rather than the substantive purpose of the AC. In a sense, the whole debate about audit quality has symbolic representations that help to maintain confidence that auditing is worth doing and that each of the significant parties in the system is aiming for high audit quality.

One concern of this research was to investigate the influence of ACs on audit quality and it is worth noting that all the groups in this study provided only limited
evidence on the impact of ACs on audit practice and the external audit function. This finding is consistent with studies such as Cohen at al. (2002) and Turley and Zaman (2007) which report a minimal impact of the ACs on audit process and external auditor activity. In comparison, the three groups provided mixed views concerning the impact of the AIU on auditor’s work performance.

8.2 Contributions and Implications of the Study

By adopting symbolic interactionism as a theoretical approach and employing a qualitative research design, this study attempts to contribute to the understanding and knowledge on audit quality by researching this issue within the organisational and social context of audit practices. This approach is relatively unrepresented in existing research but provides insight into the complex and dynamic interactions of factors such as economic interests, role expectations and regulations that impact on the meaning of audit quality and the practices of various constituents in the auditing setting. This perhaps has added a new dimension to the research in this field.

With regard to the audit quality literature, this study enhances the understanding of the nature of audit quality from the practical perspective of those who provide the audit services and those who are responsible for monitoring them. This perspective is also drawn from the context of auditing within the UK, whereas much of the prior research has been dominated by studies conducted with reference to the US environment (as evidenced in, for example, the surveys of Watkins et al., 2004 and Francis, 2004). In addition, much of the audit quality literature that attempts to investigate the association between some ‘input’ and ‘output’ measures of audit quality adopts a large-scale market-based approach or survey-based approach (Humphrey, 2008). These studies have tended to use competence and independence as a framework of analysis without seeking greater in-depth understanding concerning people’s thought processes and consciousness of what constitutes an audit of high or sufficient quality. The research reported in this thesis therefore complements existing research through opening up the rationales and potential behaviours which lie behind commitments to quality by those involved in commissioning, delivering and assessing actual audit engagements.

The current study has shown that the meaning of audit quality is situated within the context in which it applies, how it is influenced and shaped through the interaction between internal and external factors in the auditing setting, and what the meaning symbolically represents within audit firms and to the outside world. The study
suggests that to some extent audit quality means different things and serves different purposes in different places and different times, and that context is critical to an understanding of practice. Thus, this research highlights the importance of studying the meaning and construction of audit quality in its context and provides some insights into the meaning of the concept and some of the constructs employed to give it meaning. This finding has theoretical relevance, suggesting that the meaning of audit quality and its impact on audit practice and oversight process can be better understood by analysing it in relation to different interests, expectations and the sources of legitimacy of those involved.

In addition to insights into the meaning of audit quality and some of its concepts, this study advances the existing knowledge about the influence of interactions of internal and external factors in the auditing environment to the construction and representation of the meaning of audit quality in practice. The used of symbolic interactionism allows greater insights into the complex interrelationship of factors impacting meaning and perceptions of audit quality based on respondents' own experiences. For example, this study explains how economic and regulatory factors influence the notion of audit quality, and, in consequence, the operation and activities of audit practitioners. This study also reveals how acts (e.g., external auditors’ presentations and asking challenging questions) and objects (e.g., written reports, training and consultations) are used to signify and communicate audit quality in practice. In like manner, AC members’ meaning and perceptions of audit quality are very much influenced and shaped by their interactions and communications with the external auditors. This study shows the important role of the external auditors (in terms of auditors’ presentations and reports) in constructing and representing a meaning of audit quality for the AC members.

Audit quality is a complex thing and attempts to investigate its meaning as an influence on practice in the conduct of audit engagements and audit evaluations with reference to the broader societal and organisational context enhance our understanding of the process through which auditors, AC members and quality inspectors believe that appropriate audit quality has been achieved. It is hoped that the findings of this study will be of value to the regulators, audit practitioners, AC members, audit clients and other interested parties. A number of implications are identified from the findings in this study.

The concept of audit quality in practice highlights the inherent tensions between, and sometimes within, the elements of audit quality. From a practical point of view, it can be concluded that the auditors are searching for a difficult balance between
related and competing dimensions of audit quality. From the point of view of the audit profession and regulator, how to address the inherent tensions in auditing is particularly important. The study also shows the unintended consequences of the inspection process for audit quality. The implications relate to how policy-makers should be able to identify these tensions and position actions related to the promotion of audit quality accordingly. The role of the regulator should give appropriate consideration to the positioning of audit quality issues at the intersection of competing forces. The issue of regulatory policy in relation to audit quality remains a matter of active debate currently, as reflected in the European Commission Green Paper published in the autumn of 2010 (EC, 2010), and the discussion in this study shows how care is needed in using ‘quality’ as a means to justify or encourage acceptance of regulatory action.

For practitioners and firms there are issues concerning how choices are made when conflicts arise between, for example, meeting quality as required by their audit client and meeting their professional obligations and roles to the public at large. The research has shown potential tensions and conflicts in relation to audit quality because of various role expectations on external auditors by different parties with whom the audit practitioners interact, whether in terms of satisfying business demand for profits or their professional obligations. Considerable potential conflicts between the different meanings to audit quality were alluded to by both audit partners and quality inspectors. The drive for audit quality may, therefore, simply reinforce rather than resolve the issues about expectations and roles that have long been associated with auditing.

This study shows that the operations and processes of ACs in relation to audit quality include a ceremonial function and highlights the limited impact of the AC on audit quality and the external audit function. This may imply that AC members require greater understanding of their roles and need to acquire the appropriate type and level of skills and expertise to make them function more effectively. The significant efforts by regulators and legislative bodies in recent years towards greater codification of AC characteristics and operations may not necessarily enhance their governance contribution. Further issues can also be raised with regards to how to assess the quality of the governance contribution of the AC itself. One approach is to make AC processes more visible through more disclosures about the work performed by the AC with the introduction of public reporting by ACs.
This study identifies that the role for a technical specification of the concept of audit quality may be limited and suggests the rhetorical meaning and exploitation of the term ‘audit quality’ potentially limits what can be achieved for enhancing audit quality in practice. Inconsistent language is employed in claims or discussions of audit quality by key participants in the audit process. Therefore, calls from different parties to ‘standardise’ or enhance audit quality may potentially obscure or hide differences in perspective between participants in the audit process.

8.3 Limitations and Suggestions for Future Research

Whilst this study may have provided theoretical and empirical contributions in several respects, like any research, it is subject to certain limitations. Principally these relate to the scope of groups included in the research, the extent of coverage of these groups, the degree to which the evidence collected provides a picture of actual practice on real engagements and the limitations of the methods of data collection.

This study is exploratory in nature and only covers perceptions concerning audit quality from the perspective of audit partners, AC members and quality inspectors. Thus, one limitation of the study is that it excludes some key participants in the auditing system such as financial directors of companies, others in executive management, information intermediaries and institutional shareholders. Future research could focus on the perceptions of these participants to establish if they share a common understanding of the concept of audit quality with the groups covered in this research or use additional constructs to give meaning to the term. Such groups have been included in previous research in the general area of audit expectations, where differences between the views of auditors and others have illustrated the presence of an ‘expectations gap’, and it may therefore be productive to research further whether there is also a gap regarding understanding of audit quality. In addition, perceptions about audit quality from those who are directly involved in the detailed audit work such as audit managers, audit seniors and junior staff might add further insights about the practical operationalisation of audit quality.

A second limitation of the study is that the coverage of the groups included was constrained by practical issues concerning access to individuals and the time available and future research could attempt to expand the number of individual participants, possibly through wider survey methods. Interviews were chosen as the primary method of data collection to enhance the ability of the study to identify
constructs and symbols that individuals use to represent the general concept of audit quality. Further research could then take these constructs and develop research instruments to reinforce their significance by surveying their relevance to much larger groups of participants. As noted above, surveys have frequently been used to investigate expectation of auditor roles and responsibilities and similar methods could be employed in respect of audit quality based on the results of this project. Another possible fruitful line for future research would be to consider using laboratory type experimental research to examine the influence of the different constructs of audit quality by different people to audit performance or assessment of audit quality. Again there is a well-established literature looking at the psychology of auditors’ judgement and decision-making and the findings of the current study could be developed into experimental tasks with auditors and other groups.

An important motivation for this study was a concern to go beyond existing approaches to audit quality which focus on testing the association between certain available indirect signals of possible input and output quality and to ask questions about how the concept of audit quality is given real practical meaning by those involved in audit engagements; in other words to understand more about the process through which significant parties in the audit system determine that adequate audit quality is produced. However, it must be acknowledged that, although the study has involved direct contact with participants in the audit quality process, it still only offers indirect evidence of actual practice. The main data from the three groups were gathered through interviews and survey rather than direct examination of the content of audit work and its evaluation in actual audit engagements. It is felt that these methods of enquiry are still appropriate because the study is investigating perceptions of quality held by key groups and an objective scale by which to measure quality on specific assignments does not exist, but observation of auditors’ actual work assignments or quality inspectors’ work documents or the proceedings of AC meetings would also be relevant methods of study. It should be recognised, however, that such research would have to overcome significant obstacles regarding being allowed access to review the documents or attend the meetings. Although a study of audit quality in practice using interviews is restricted regarding what conclusions can be drawn from a small number of people, the objective of an interpretive approach is not wide generalisation, but to provide an enhanced understanding of the particular issues being researched. Another possible line of research to explore may be to use the
findings from this study to develop a framework which could be used to analyse behaviour in specific case studies of audit engagements.

Finally, another aspect of the research for which limitations must be recognised is the possible existence of various forms of bias, subjectivity and interpretation that are inherent in qualitative research (for example, personal bias and self-serving responses by interviewees). Careful attention was paid to the pursuit of a rigorous and comprehensive approach concerning the collection and analysis of data, as highlighted in Chapter 3, but such limitations are still possible. Limitations of research method affect all forms of research enquiry. In this study as in many others these do not necessarily undermine the validity of the research and its contribution to understanding of the subject of the enquiry but are characteristics which must be borne in mind when placing the study alongside the wider body of research to which it contributes.
Appendices

Appendix 1: Summary of Discussion Paper and Questions posed to the Respondents by the FRC

Appendix 2: Analysis of Comments submitted to FRC on Discussion Paper Promoting Audit Quality

Appendix 3: Letter to Interviewees

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Appendix 5: Survey Questionnaire
### Appendix 1: Summary of Discussion Paper and Questions posed to the respondents by the FRC

#### The culture within an audit firm

In ‘Promoting Audit Quality’ the FRC identified the following indicators of audit firm cultures that enhance audit quality:

- Leadership of firms emphasising the importance of auditors discharging their professional responsibilities.
- Respect for the principles underlying auditing and ethical standards.
- Partner and staff development systems that promote personal characteristics essential to quality auditing.
- Not letting financial considerations drive decisions with a negative effect.
- Promotion of consultation on difficult issues and providing sufficient resources to deal with issues as they arise.
- Development of an information infrastructure to support the audit function.

Possible threats to an audit firm’s culture:

- Audit leadership having insufficient input to the firm’s management decisions.
- Over-emphasis on winning and retaining audits.
- Excessive cost cutting in times of economic downturn.
- Insufficient importance placed on technical training.

and asked the **following questions**:

1. Are there other important factors of an audit firm’s culture that are not referred to above?
2. Are there pressures that could compromise the culture of audit firms that have not been identified above?
3. Are there any further steps that should be taken to build confidence in the culture of audit firms and, if so, what might they be and why are they needed?

#### The skills and personal qualities of audit partners and staff

In ‘Promoting Audit Quality’ the FRC identified the following key drivers of audit quality:

- The skills base of partners and staff.
- The training given to audit personnel.
- The approach to appraisal of partners and staff.

Possible threats to the skills of an audit team

- Failure to develop the necessary personal characteristics through effective mentoring.
- Failure to retain staff with the necessary experience and expertise.
- Allocating more capable staff on the basis of client prestige rather than audit risk.
- Insufficient or ineffective training.

and asked the **following questions**:

4. Do you agree that technical skills, personal qualities and practical experience are key drivers of audit quality?
5. Has this paper identified the issues that could result in an inadequately trained or skilled workforce for audit – if not, what other issues are there and why are they issues?
6. Should there be a fundamental review of the qualification and training requirements for auditors?
Appendix 1: Summary of Discussion Paper and Questions posed to the respondents by the FRC, continued

The effectiveness of the audit process

In ‘Promoting Audit Quality’ the FRC identified the following features of an effective audit process:

- The structure, experience and knowledge of the audit team is appropriate for the engagement and resources are sufficient to enable a considered response to issues that may arise;
- High quality technical support is available when the audit team encounters a situation it is not familiar with;
- The audit methodology is well structured and:
  - Provides a framework and procedures to obtain sufficient appropriate audit evidence effectively and efficiently.
  - Provides for compliance with auditing standards without inhibiting exercise of judgement.
  - Requires appropriate audit documentation.
  - Ensures there is effective review of audit work.
- The objectives of ethical standards are achieved, providing confidence in the integrity, objectivity and independence of the auditor; and
- Audit quality control procedures are effective, understood, applied and monitored within firms and across international networks.

Possible threats to effective audit process

- Increased use of computerised audit methodologies may distance auditors from the company being audited, reduce flexibility and result in time spent coping with the technology at the expense of evidence gathering.
- Over prescriptive auditing standards, regulation and audit methodologies can have adverse impacts such as:
  - Insufficient emphasis on tailoring audit procedures to specific circumstances
  - Inhibiting the exercise of judgement
  - A focus on producing documentation at the expense of performing audit procedures properly.
- ‘client capture’ where the relationship with the client is so close that objectivity is impaired

and asked the following questions:

7. Are there other factors that determine whether an audit process is effective?
8. Are there threats to the effectiveness of the audit process that have not been identified before?
9. Are there further steps that could be taken to counter the threats to the effectiveness of the audit process?
The reliability and usefulness of audit reporting

In ‘Promoting Audit Quality’ the FRC identified the following characteristics of reliable and useful audit reporting:

- The form of the auditor’s report is highly codified and standardised.
  - Key elements are specified by law and auditing standards
  - A clean auditor’s report operates as a signal rather than a source of new information
  - Confidence in the auditor’s report is inextricably linked to confidence in the presumed quality of the audit process.

- Good communication with audit committees. Benefits include:
  - Encouraging a dialogue about the scope of the audit.
  - Providing a forum to discuss the key risks identified and judgements made in reaching the audit process.
  - Discussing qualitative aspects of the entity’s accounting and reporting and potential ways of improving financial reporting.

Threats to confidence in audit reporting

- The FRC is conscious that some users and commentators have concerns about:
  - Whether the scope of the meaning of “true and fair view” was restricted following the introduction of IFRS. This is being addressed by the Companies Act 2006.
  - Whether auditors are properly fulfilling their legal responsibilities to consider the adequacy of a company’s accounting records.
  - Whether auditor’s reports should be more informative about key audit issues and

asked the following questions:

10. Are there factors that determine whether audit opinions command confidence?
11. Are there other reasons why users may not have confidence in the audit opinion?
12. Are there further steps that could be taken to reinforce the confidence in an audit opinion?
Appendix 1: Summary of Discussion Paper and Questions posed to the respondents by the FRC, continued

<table>
<thead>
<tr>
<th>Factors outside the control of auditors affecting audit quality</th>
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<tbody>
<tr>
<td>In ‘Promoting Audit Quality’ the FRC identified the following influences on audit quality that are outside the control of auditors:</td>
</tr>
<tr>
<td>The approach taken by management;</td>
</tr>
<tr>
<td>o Good corporate governance plays a major role in ensuring companies attach appropriate importance to corporate and financial reporting and to the audit process.</td>
</tr>
<tr>
<td>o Nevertheless, there will always be a risk that management may be motivated in some circumstances to obstruct the audit process.</td>
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<tr>
<td>The contribution made by audit committees;</td>
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<tr>
<td>o Although the auditor is responsible for the planning and scope of the audit, the audit committee can be of considerable significance in areas such as:</td>
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<tr>
<td>▪ Considering the scope of the audit and major risk areas</td>
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<td>▪ Being satisfied as to the appropriateness of the audit plan and audit resources.</td>
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<td>The role of shareholders and commentators;</td>
</tr>
<tr>
<td>o Support of auditors, where appropriate, by shareholders increases the likelihood that directors and management will comply with their obligations in relation to the preparation of reliable financial statements.</td>
</tr>
<tr>
<td>The role of litigation;</td>
</tr>
<tr>
<td>o The liability regime in the UK is being reformed in a way that is designed to ensure that exposure to litigation remains a stimulus to audit quality.</td>
</tr>
<tr>
<td>The approach of regulators;</td>
</tr>
<tr>
<td>o Regulators need high quality staff, able to assess whether audit firms have undertaken high quality audits in compliance with the principles of professional standards. For this to work, audit firm must also adhere to the principles.</td>
</tr>
<tr>
<td>The pressures caused by the accelerating reporting regime.</td>
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<tr>
<td>o Tight reporting deadlines limit the opportunity for detailed work by auditors after the reporting period and results in increased reliance on work performed before the end of the reporting period.</td>
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and asked the following questions:

13. Are there other external factors that have the potential to affect adversely audit quality?
14. Are audit committees discharging their responsibilities in relation to audit adequately, and if not, what further steps might be taken to make their role more effective?
15. Should the FRC develop more detailed guidance for audit committees in relation to the evaluation of audit effectiveness?
16. Should annual reports include a summary of the work undertaken by the audit committee to evaluate audit effectiveness?
17. Are there further steps that should be taken to reduce the risk that these external factors may adversely affect the audit process?
Appendix 2: Analysis of comments submitted to FRC on Discussion Paper Promoting Audit Quality

This section presents analysis of responses submitted to the FRC on the discussion paper for promoting audit quality. All of the respondents are listed in the accompanying table, together with an analysis of the responses on seventeen specific questions and others issues. Responses of the each respondent in respect of each of these issues are tabulated. Columns 1-17 provide and analysis of responses to the specific questions posed by the FRC, thus the major of respondents addressed these questions and a variety of opinions were expressed. An explanation of all columns is provided below.

The Culture within an Audit Firm

<table>
<thead>
<tr>
<th>Column 1</th>
<th>Q1</th>
<th>Are there other important indicators of an audit firm’s culture that are not referred to above?</th>
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<tbody>
<tr>
<td></td>
<td>A.</td>
<td>Level of partner involvement with audit client</td>
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<tr>
<td></td>
<td>B.</td>
<td>Greater transparency on governance and control of the audit firm</td>
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<tr>
<td></td>
<td>C.</td>
<td>Review from the inspection bodies</td>
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<td></td>
<td>D.</td>
<td>Ownership and control of the audit firm</td>
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<td></td>
<td>E.</td>
<td>Professionalism</td>
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<td></td>
<td>NC</td>
<td>No significant comment</td>
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<td></td>
<td>NA</td>
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<thead>
<tr>
<th>Column 2</th>
<th>Q2</th>
<th>Are there pressures that could compromise the culture of audit firms that have not been identified above?</th>
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<tbody>
<tr>
<td></td>
<td>A.</td>
<td>Effect of regulation and regulators</td>
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<td></td>
<td>B.</td>
<td>Commercialisation of the audit firm</td>
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<td></td>
<td>C.</td>
<td>Staffing - hiring and retaining of auditor</td>
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<td></td>
<td>D.</td>
<td>Audit fees set at level that is not adequately rewards the service provided/practice of low balling</td>
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<tr>
<td></td>
<td>NC</td>
<td>No significant comment</td>
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<td>NA</td>
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<th>Column 3</th>
<th>Q3</th>
<th>Are there any further steps that should be taken to build confidence in the culture of audit firms and, if so, what might they be and why are they needed?</th>
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<tbody>
<tr>
<td></td>
<td>A.</td>
<td>Greater transparency of the audit firm governance and control</td>
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<td></td>
<td>B.</td>
<td>Create dialogue or communication among audit market participants (auditors, regulators and investors)</td>
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<td></td>
<td>C.</td>
<td>Greater involvement of audit committees to support role of auditor</td>
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<tr>
<td></td>
<td>D.</td>
<td>Role of inspection bodies to recognise and emphasis positive aspects of the audit firm</td>
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<td></td>
<td>E.</td>
<td>Auditor legal liability</td>
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<td></td>
<td>NC</td>
<td>No significant comment</td>
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<th>Column 4</th>
<th>Q4</th>
<th>Do you agree that technical skills, personal qualities and practical experience are key drivers to audit quality?</th>
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<tr>
<td></td>
<td>A.</td>
<td>Respondents indicate agreement</td>
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<td></td>
<td>NC</td>
<td>No significant comment</td>
</tr>
<tr>
<td></td>
<td>NA</td>
<td>not available</td>
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</tbody>
</table>
Appendix 2: Analysis of comments submitted to FRC on Discussion Paper
Promoting Audit Quality, continued

The Skills and Personal Qualities of Audit Partners and Staff

**Column 5 Q5**
Has this paper identified the issues that could result in an inadequately trained or skilled workforce for audit – if not, what other issues are there and why are they issues?

A. Respondents indicate yes
B. Not - rapid changing, excessive and/or overly complex standards and regulations
C. Not – hiring and retaining audit staff
D. Not – inadequate wider business knowledge
E. Not – increasing internationalisation of companies
NC. No significant comment
NA. Not available

**Column 6 Q6**
Should there be a fundamental review of the qualification and training requirements for auditors?

A. Respondents indicate yes
B. Respondents indicate no
C. Should be left to the UK professional bodies
NC. No significant comment
NA. Not available

The Effectiveness of the Audit Process

**Column 7 Q7**
Are there other factors that determine whether an audit process is effective?

A. Auditor relationship with audit client
B. Auditor relationship with audit committees
C. Attractiveness of the audit profession – hiring and retaining staff
D. Effect of regulation and regulators
NC. No significant comment
NA. Not available

**Column 8 Q8**
Are there threats to the effectiveness of the audit process that have not been identified above?

A. Rapid changing, excessive and/or overly complex standards and regulations
B. Inadequate involvement of specialist
C. Lack of co-operation and support from audit client
D. Lack of co-operation and support from audit committees
E. Changes of partner rotation
F. Inadequate use of computer-aided techniques
NC. No significant comment
NA. Not available
Appendix 2: Analysis of comments submitted to FRC on Discussion Paper
Promoting Audit Quality, continued

Column 9  Q9
Are there further steps that could be taken to counter the threats to the
effectiveness of the audit process?
A. Respondents indicate no
B. Increase period of partner rotation from 5 to 7 years
C. Introduce joint audit for large listed companies
D. Promote and support principle based audit approach
E. Emphasising risk based audit approach
F. Introduce rotation of audit firm
NC No significant comment
NA Not available

The Reliability and Usefulness of Audit Reporting

Column 10  Q10
Are there other factors that determine whether audit opinions command
confidence?
A. Use principles rather than rules based approach in auditing and financial
reporting standards
B. Reputation of audit firm and audit profession
C. Role of inspection bodies or regulators
D. Greater information from the audit firm
E. Role of audit committees
NC No significant comment
NA Not available

Column 11  Q11
Are there other reasons why users may not have confidence in the audit opinion?
A. Moving away from principle to rules based approach
B. Lack of information on operation, governance and control of the audit firm
C. Understand ability - length and legalistic wording
D. “Audit expectation gap”
E. Poor communication between auditor and/or audit committees and users
NC No significant comment
NA Not available

Column 12  Q12
Are there further steps that could be taken to reinforce confidence in an audit
opinion? In particular, what changes to the form and content of the audit report
should be considered?
A. Gives consideration to suggestions made by the Audit Quality Forum
B. Report should be simplified
C. Review formats and style of report
D. Deserve separate and detail discussion
E. Enhance communication between auditors and/or audit committee and
shareholders
NC No significant comment
NA Not available
### Factors outside the Control of Auditors Affecting Audit Quality

#### Column 13 Q13
Are there other external factors that have the potential to adversely affect audit quality?
- A. Rapid changing, excessive and/or overly complex standards and regulations
- B. Increasing globalisation and internationalisation of business
- C. Culture of audit client
- D. Lack of consensus about definition of audit quality
- NC No significant comment
- NA Not available

#### Column 14 Q14
Are audit committees discharging their responsibilities in relation to audit adequately, and if not, what further steps might be taken to make their role more effective?
- A. Respondents indicate yes
- B. Not – FRC develop a means to apply pressure to company and/or audit committees
- C. Varies between companies
- D. Not – owner representation on the audit committees
- NC No significant comment
- NA Not available

#### Column 15 Q15
Q15 Should the FRC develop more detailed guidance for audit committees in relation to the evaluation of audit effectiveness?
- A. Respondents indicate yes
- B. Respondents indicate no
- C. FRC should discuss with audit committee
- NC No significant comment
- NA Not available

#### Column 16 Q16
Should annual reports include a summary of the work undertaken by the audit committee to evaluate audit effectiveness?
- A. Respondents indicate yes
- B. Respondents indicate no
- C. Up to the company
- NC No significant comment
- NA Not available

#### Column 17 Q17
Are there further steps that should be taken to reduce the risk that these external factors may adversely affect the audit process?
- A. Better understanding of roles between the participants in the corporate reporting chain
- B. Need to avoid initiative overload
- C. Maximise audit committee’s talent
- D. Examine regulators and quasi-regulators approach (FRC and other relevant parties - timely recommendations and outcomes delivered)
- E. Effective audit planning
- NC No significant comment
- NA Not available
Appendix 2: Analysis of comments submitted to FRC on Discussion Paper
Promoting Audit Quality, continued

Other significant issues

<table>
<thead>
<tr>
<th>Column 18</th>
<th>Discussion paper</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.</td>
<td>Welcomes references to discussion paper</td>
</tr>
<tr>
<td>B.</td>
<td>Sought about empirical evidence of the assertions and its impact to audit quality</td>
</tr>
<tr>
<td>C.</td>
<td>Insufficient attention to other dimension of audit quality</td>
</tr>
<tr>
<td>NC</td>
<td>No significant comment</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Column 19</th>
<th>Professional judgement</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.</td>
<td>Respondents stressed out about the importance of professional judgement in audit quality</td>
</tr>
<tr>
<td>NC</td>
<td>No significant comment</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Column 20</th>
<th>Quality of people</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.</td>
<td>Respondents suggested the imperative of quality of people to deliver audit quality</td>
</tr>
<tr>
<td>B.</td>
<td>Respondents suggested that the rotation of partner should be increased from 5 to 7 years</td>
</tr>
<tr>
<td>NC</td>
<td>No significant comment</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Column 21</th>
<th>Definition of audit quality</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.</td>
<td>Respondents suggested that there should be broad view of definition of audit quality</td>
</tr>
<tr>
<td>B.</td>
<td>Respondents stressed out about the importance of outset of audit quality</td>
</tr>
<tr>
<td>NC</td>
<td>No significant comment</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Column 22</th>
<th>Greater transparency of operation, governance and control of audit firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.</td>
<td>Respondents required more information about operation, governance and control of audit firm</td>
</tr>
<tr>
<td>B.</td>
<td>Respondents suggested more information on the audit report</td>
</tr>
<tr>
<td>C.</td>
<td>Respondents suggested that audit firm should be free to exercise their judgement in how best to make the transparency disclosure</td>
</tr>
<tr>
<td>D.</td>
<td>Respondents expressed concern the transparency reporting become standardised and become additional regulatory burden</td>
</tr>
<tr>
<td>NC</td>
<td>No significant comment</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Column 23</th>
<th>Commercialisation of audit firm</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.</td>
<td>Respondents expressed concern about commercialisation of the audit firm</td>
</tr>
<tr>
<td>B.</td>
<td>Respondents suggested that the provision of non-audit services would enhance audit quality</td>
</tr>
<tr>
<td>NC</td>
<td>No significant comment</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Column 24</th>
<th>Changes in auditing/accounting regulation and standards</th>
</tr>
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<tbody>
<tr>
<td>A.</td>
<td>Respondents expressed concern about the effect of the changes to the audit quality</td>
</tr>
<tr>
<td>B.</td>
<td>Respondents suggested that the changes have created additional resource concerns to them</td>
</tr>
<tr>
<td>NC</td>
<td>No significant comment</td>
</tr>
</tbody>
</table>
Appendix 2: Analysis of comments submitted to FRC on Discussion Paper Promoting Audit Quality, continued

**Column 25  Principles versus rules**
A. Respondents expressed concern that the changes in regulation and standards is moving away from principles to rules based audit approach
B. Respondents opined that the migration from the principles approach is not necessarily a threat to audit quality
NC  No significant comment

**Column 26  Role and support from audit client**
A. Respondents stressed out about the important role and support from audit client to audit quality
NC  No significant comment

**Column 27  Role and support from audit committees**
A. Respondents stressed out about the important role and support from audit committees to audit quality
NC  No significant comment

**Column 28  Value of audit report**
A. Informative report
NC. No significant comment

**Column 29  Professionalism**
A. Auditor should exercise professionalism (scepticism, integrity, ethical and serve the shareholders' and other users of account)
NC. No significant comment

**Column 30  Independence**
A. Independence as another driver of audit quality
NC. No significant comment

**Column 31  Effects of current initiatives and projects**
A. Enhance confidence to the audit quality
B. Concern about imbalance review by the regulators
C. Regulators should promote principles audit approach
NC. No significant comment

**Column 32  Effects to the audit process**
A. Express concern about prescriptive audit approach
B. Express concern about global audit standards initiative
NC. No significant comment

**Column 33  Documentation**
A. Express concern about requirement on documentation
B. Respondents express positive effects of high quality of documentation
NC. No significant comment

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## Appendix 2: Analysis of comments submitted to FRC on Discussion Paper
### Promoting Audit Quality, continued

### Column 34  Resource concern
- **A.** Express concern about inadequate time, costs and pressure created by the current initiatives and projects
- **NC.** No significant comment

### Column 35  True and fair view
- **A.** Respondents suggested that audit quality should support auditor true and fair view
- **B.** Respondents questioned whether true and fair view add value on the audit
- **C.** Respondents suggested that the principle approach is important to professional judgement to give true and fair view of the financial statement
- **NC**  No significant comment
Appendix 2: Analysis of comments submitted to FRC on Discussion Paper Promoting Audit Quality, continued

<table>
<thead>
<tr>
<th>Questions:</th>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
<th>Q5</th>
<th>Q6</th>
<th>Q7</th>
<th>Q8</th>
<th>Q9</th>
<th>Q10</th>
<th>Q11</th>
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<th>Q14</th>
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<td>4 Deloitte</td>
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Governance for Owners
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Dear

Research on Audit Quality

We are currently undertaking research to investigate the perceptions of key participants in the audit process concerning the factors that influence audit quality. This has been a subject of considerable debate over recent years and one that has attracted interest from the Financial Reporting Council, reflected in their 2007 publication Promoting Audit Quality. It is hoped that our research will both improve understanding of what steps have been taken to enhance audit quality and contribute to future policy making in this area.

The attention given to audit quality in recent years may have had a particular impact within audit firms where the quality of service provided to clients is clearly of great importance. In order properly to understand how this subject has been addressed within firms in the recent past, we are conducting interviews with a number of audit partners from the larger accounting firms and would like to ask if you would be willing to provide an interview to assist with this study. The interview would require one hour of your time and would take place at a venue that is convenient to you. More details concerning the intended topics for discussion will be provided if you are able to participate but the intended subjects will include the impact of regulation and how audit quality is promoted and evaluated within professional firms. The interview will be undertaken by Noor Adwa Sulaiman, a PhD student at Manchester Business School who is pursuing doctoral studies on this subject together, where the schedule permits, with me or another co-researcher. For those participants who are would like to receive information about the research findings we will also provide a summary of the findings of the study.

We recognise that giving up time to participate in a project like this is not easy but the subject of this research is an important topic in the modern business environment and we do hope you will be willing to contribute to the study. If you are not able to offer a face to face interview but would be willing to participate in a telephone interview then we would also be interested to hear from you. If you feel that another of your partners is closer to audit practice and may be better placed to contribute then please suggest this. Please respond to Ms Sulaiman (nooradwa.sulaiman@postgrad.mbs.ac.uk), to whom any queries may also be directed. Thank you for your consideration of this approach and your co-operation will be very much appreciated.

Yours sincerely

Stuart Turley
Professor of Accounting
Appendix 3: Letter to Interviewees, continued

Research on Audit Quality

We are currently undertaking research to investigate the perceptions of key participants in the audit process concerning the factors that influence audit quality. This has been a subject of considerable debate over recent years and one that has attracted interest from the Financial Reporting Council, reflected in their 2007 publication Promoting Audit Quality. It is hoped that our research will both improve understanding of what steps have been taken to enhance audit quality and contribute to future policy making in this area.

Their relationship, interaction and communication with a company's auditors place audit committee members in an important position to judge audit quality and form views about the factors that influence quality. Consequently, in order properly to understand this subject, we are conducting interviews with a number of audit committee members from UK listed companies and would like to ask if you would be willing to provide an interview to assist with this study. The interview would require one hour of your time and would take place at a venue that is convenient to you. More details concerning the topics for discussion will be provided if you are able to participate but the intended subjects will include the impact of regulation, the manner in which audit committees can assess audit quality and the extent to which they are able to influence that quality in practice. The interview will be undertaken by Noor Adwa Sulaiman, a PhD student at Manchester Business School who is pursuing doctoral studies on this subject together, where the schedule permits, with me or another co-researcher. For those participants who would like to receive information about the research findings we will also provide a summary of the findings of the study.

We recognise that giving up time to participate in a project like this is not easy but the subject of this research is an important topic in the modern business environment and we do hope you will be willing to contribute to the study. If you are not able to offer a face to face interview but would be willing to participate in a telephone interview then we would also be interested to hear from you. Please respond to Ms Sulaiman (nooradwa.sulaiman@postgrad.mbs.ac.uk), to whom any queries may also be directed. Thank you for your consideration of this approach and your co-operation will be very much appreciated.

Yours sincerely

Stuart Turley
Professor of Accounting
Research on Audit Quality

Recently I wrote to you to invite you to participate in a research project currently being undertaken on audit quality. This topic has been the subject of considerable debate and the project is concerned specifically with how quality factors influence practice in the conduct of actual audits.

I am writing again simply to emphasise the significant contribution that your participation can make to the research. It is of particular interest to us to be able to collect the views and insights of practicing auditors/members of audit committees. We would be especially grateful for your help because it is only by speaking to people with direct experience of audits currently that we can get an accurate understanding of audit quality in practice.

If you have not yet made a whether or not to assist with the research and participate in an interview, then I hope you will be able to respond positively to the request. (A copy of the text of my original letter is attached.) However, if you have already replied to the invitation then please accept my apologies for this follow-up letter which may have crossed in the post with your response.

Finally can I also just restate that protecting the confidentiality of participants’ views is important to us, and also to the University, and no information will be referred to in a format which could identify the respondent or firm without permission.

I appreciate your willingness to consider our request.

Yours sincerely

Stuart Turley
Professor of Accounting
Appendix 4: Interview Guide

Auditors:

Meaning and construction of audit quality:
1. What sort of attributes do you think people look for in an audit?
2. How do these reflect audit quality?
3. Do you think it is possible for people outside the process to assess audit quality?
4. How do you evaluate quality on the jobs you control?
5. What are the key characteristics or qualities you look for in the work done?

Factors constitute audit quality in practice:

Judgement and methods
1. How do staff deal with making audit judgement (like fraud risk assessment or determining nature, timing and extent of testing)?
2. How does the firm’s audit methodology help to support audit decisions or audit judgement?
3. What are the important aspects that could support good judgement?

Quality of people
1. How does the firm ensure the audit staff possess the required skills and experience?
2. What can be monitored?
3. How far does the firm rely on supervision of staff to promote quality?
4. How are varying skills and experiences of staff accommodated without affecting audit quality?

Governance and control
1. Where does quality fit into the structure of governance and control of the firm?
2. How does governance and control of the firm ensure high audit quality?
3. Is quality (review) the responsibility of particular individuals?
4. Is quality ‘measured’? If so, how?
Appendix 4: Interview Guide, continued

**Culture**
1. Can you describe how quality fits into the organizational values of the firm?
2. Are specific things done to promote those values and to encourage adherence?
3. Can you describe how the values are communicated to the employees of the firm?
4. What are the impacts of the values to the performance of the staff?
5. How could you monitor the values?

**Non-audit services and ethics**
1. How are safeguards applied to maintain quality if the firm is also providing non-audit services?
2. How the audit firm satisfy itself that any safeguards required are implemented?

Auditors are recognised as professional members that uphold ethics and professionalism.
1. What policies does the firm have?
2. How are these implemented?
3. How do ensure people don’t simply give lip service to these values and standards?

**Regulation**
1. How have the changes in audit regulation and corporate governance influence the way you carry out the audit?
2. In general, do you think the changes and reforms have affected the quality of work of the auditors? (Improved? Deteriorated? How? – can you give specific example?)
3. How the changes and reforms improve the quality of audit in your firm?
4. Do you think the impact of regulation on quality is different in your firm from others?
Appendix 4: Interview Guide, continued

In my analysis of responses to the Discussion Paper: Promoting Audit Quality issued by the FRC, several respondents highlighted some resource concerns in the audit firm created by the changes and reforms.

1. How the audit regulation creates such problem?
2. Can you describe how the firm handle this?
3. Is there any conflict between cost and quality?
4. How is this handled in the firm?

Auditor and audit committee relationship:
1. Can you tell me about the way you manage the relationship of your firm with its audit committee?
2. What has changed in time with regards to your relationship with the company’s audit committees?
3. How the communication and interaction influences the way you conduct the audit?
4. Does the audit committee ever have any influence on audit work?
5. Is that impact beneficial to audit quality?
6. Can you give specific examples?
7. How important is a good relationship with the ACs to doing a good audit?

Wrap up questions:
1. How as a partner you are comfortable that there is adequate quality to allow you to sign the audit report?

Audit committees:

Meaning and construction of audit quality:
1. What sort of attributes do you think people look for in an audit?
2. How do these reflect audit quality?
3. Do you think it is possible for people outside the process to assess audit quality?
4. How do you evaluate quality on the jobs performed by the auditors?
5. What are the key characteristics or qualities you look for in the work done?
Factors constitute audit quality in practice:

Judgement and methods
1. How do you satisfied that the auditors have performed good audit judgement?

2. In your opinion, how do the audit firm’s audit methodologies support auditors in handling the key accounting and auditing judgement?

3. What are the important aspects of the audit methodology that could support good judgement of the auditors?

Quality of people
1. In your opinion, how do skills and experiences of the auditors contribute to quality audits?

2. How do ‘quality people’ have any bearing in the selection process of the auditor?

3. How do ‘quality people’ have any influence when you assess the effectiveness of the audit performed by the auditor?

Governance and control
1. Where does quality fit into the structure of governance and control of the audit firm?

2. How does governance and control of the firm ensure high audit quality?

3. How information about governance and control of audit firm does influences the audit tender process (appointment, re-appointment or removal) of the auditor?

4. How does information about governance and control assist you in assessing the effectiveness of the audit process?

5. How would you comfortable that the audit firm’s governance and control will deliver quality audit?

Culture
1. How is organizational value important in the conduct of the audit?

2. How do the values of the audit firm influence your quality assessments of the audit firm?
Appendix 4: Interview Guide, continued

Non-audit services and ethics
Issue about the provision of non-audit services appears to be significant concerns than before
1. Can you describe about mechanisms available in safeguarding the auditor’s independence?
2. How does the audit committee satisfy itself that any safeguards required are implemented?
3. In your opinion, how do the provisions of non-audit services influence the audit firm’s performance?

Auditors are recognised as professional members that uphold ethics and professionalism.
1. In your opinion, how do ethics and professionalism influence the auditor’s performance?

Regulation
1. How have the changes in audit regulation and corporate governance changed your work with the company’s auditor?
2. In general, do you think the changes and reforms have affected the quality of work of the auditors? (Improved? Deteriorated? How? – can you give specific example?)?
3. How have changes and reforms improved the quality of audit performed by the company’s auditor?
4. Do you think the impact of regulation on quality is different in your firm from others?

Auditor and audit committee relationship:
1. Can you tell me about the way you manage the relationship of your firm with its auditor?
2. What has changed in time with regards to your relationship with the company’s auditor?
3. How does communication and interaction influence the way auditor conduct the audit?
4. Does the audit committee ever have any influence on audit work?
5. Is that impact beneficial to audit quality?
6. Can you give specific examples?
7. How important is a good relationship with the auditor to promote audit quality?

Wrap up questions:
1. How comfortable are you that there is adequate quality of work performed by the company’s auditors?
Appendix 5: Survey Questionnaire

A STUDY ON AUDIT QUALITY IN PRACTICE

Dear Mr/Ms

We are currently undertaking research to investigate the perceptions of key participants in the audit process concerning the factors that influence audit quality. This has been a subject of considerable debate over recent years and one that has attracted interest from the Financial Reporting Council, reflected in their 2007 publication Promoting Audit Quality. It is hoped that our research will both improve understanding of what steps have been taken to enhance audit quality and contribute to future policy making in this area.

The attention given to audit quality in recent years may have had a particular impact within audit firms where the quality of service provided to clients is clearly of great importance. In order properly to understand how this subject has been addressed within firms in the recent past, we are conducting a survey with a number of individuals (auditors and non-auditors) and would like to ask if you would be willing to assist with this study. The survey would require approximately 30 minutes of your time. The information you provide will be treated with strict confidentiality, and will not be used for any purpose apart from the research. In the case of publication, only aggregate information will be used without any specific reference to individual participants.

The questionnaire is structured in several parts covering possible attributes of audit quality, the impact of various factors on the conduct of the audit, how audit quality is achieved in practice and also some background information about yourself.

We recognise that giving up time to participate in a project like this is not easy but the subject of this research is an important topic in the modern business environment and we do hope you will be willing to contribute to the study.

Thank you in advance for your kind cooperation.
Appendix 5: Survey Questionnaire, continued

Section 1: Please provide some background information about yourself by ticking the most appropriate box in each of the following questions

1. Are you:  
   - Male  
   - Female

2. Which age group are you in?  
   - 28 – 37  
   - 38 – 47  
   - 48 – 57  
   - Over 57

3. What is your highest level of educational qualification?  
   - Bachelor degree  
   - Doctoral degree  
   - Master degree  
   - Other (please specify)  
   - …………………………………………………

4. What professional qualifications do you hold?  
   - ICAEW  
   - ACCA  
   - ICAS  
   - Others (please specify)  
   - …………………………………………………

5. What is your principal role in audit inspection?  
   - Leader of inspection team  
   - Member of inspection team  
   - Both leader and member of inspection teams  
   - …………………………………………………

6. What is your overall experience in auditing practice?  
   - Less than 5 years  
   - 5 to 10 years  
   - 11 to 15 years  
   - 16 to 20 years  
   - More than 20 years  
   - None  

7. What is your experience in audit inspection?  
   - Less than 3 years  
   - 3 to 5 years  
   - More than 5 years

233
Appendix 5: Survey Questionnaire, continued

8. In the last year, what proportion of your time has been spent in different types of audit firms in inspection of?

<table>
<thead>
<tr>
<th></th>
<th>More than fifty percent</th>
<th>Less than fifty percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Big four firms</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other firms</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

9. In the last year, what proportion of your time has been spent on inspections of different types of audit engagement:

<table>
<thead>
<tr>
<th></th>
<th>More than fifty percent</th>
<th>Less than fifty percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>FTSE 100 companies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other listed entities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other public interest entities</td>
<td></td>
<td></td>
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</tbody>
</table>
Appendix 5: Survey Questionnaire, continued

Section 2: The following statements refer to possible attributes of an audit which could reflect audit quality. Please indicate your personal view of the importance of each statement for high audit quality by circling one number on the scale. If you feel the attribute is of little or no importance for high audit quality, please circle the number 1. If you feel the attribute is very important for high audit quality, circle 5. If your feelings are less strong, please circle one of the numbers in the middle. (Please circle only one response per statement):

<table>
<thead>
<tr>
<th></th>
<th>Little or no importance</th>
<th>Unimportant</th>
<th>Undecided</th>
<th>Important</th>
<th>Very important</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. The audit is carried out in accordance with auditing standards</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>2. The audit is carried out in accordance with ethical standards</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>3. The audit is carried out in accordance with quality control standards (ISQC1)</td>
<td>1</td>
<td>2</td>
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<tr>
<td>4. The auditor satisfies the audit client's expectations</td>
<td>1</td>
<td>2</td>
<td>3</td>
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</tr>
<tr>
<td>5. The audit is valued by the audit client</td>
<td>1</td>
<td>2</td>
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</tr>
<tr>
<td>6. The auditor provides good value for money to the audit client</td>
<td>1</td>
<td>2</td>
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<td>5</td>
</tr>
<tr>
<td>7. The audit work undertaken is based primarily on an assessment of the risks associated with the client's financial statements</td>
<td>1</td>
<td>2</td>
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<td>5</td>
</tr>
<tr>
<td>8. The audit work is determined by a proper planning process</td>
<td>1</td>
<td>2</td>
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</tr>
<tr>
<td>9. The auditor does sufficient work to obtain sufficient evidence to support an audit opinion</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>10. The role of the audit partner is at the centre of the audit process</td>
<td>1</td>
<td>2</td>
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<td>5</td>
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<tr>
<td>11. The work done in carrying out the audit is subject to review before the audit is completed</td>
<td>1</td>
<td>2</td>
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<tr>
<td>12. The auditor reports the correct audit opinion on the financial statements</td>
<td>1</td>
<td>2</td>
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<td>5</td>
</tr>
<tr>
<td>13. The auditor demonstrates an appropriate level of challenge to the management of the audit client</td>
<td>1</td>
<td>2</td>
<td>3</td>
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<td>5</td>
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<tr>
<td>14. The auditor is technically competent</td>
<td>1</td>
<td>2</td>
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<td>5</td>
</tr>
<tr>
<td>15. The auditor is independent</td>
<td>1</td>
<td>2</td>
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<td>5</td>
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<tr>
<td>16. The audit meets the quality standards applied internally by the audit firm</td>
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<td>2</td>
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<td>5</td>
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<tr>
<td>17. The audit is completed in a timely manner</td>
<td>1</td>
<td>2</td>
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<td>18. The auditor maintains a high level of documentation in the completed audit files</td>
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<td>2</td>
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<td>19. The auditor maintains a good relationship with the management of the audit client</td>
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<tr>
<td>20. The auditor maintains effective communication and interaction with the audit committee</td>
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<td>21. The audit firm provides additional services in association with the audit</td>
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<td>5</td>
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<tr>
<td>22. The audit firm is free from negative findings in inspection reports</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
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</table>
Appendix 5: Survey Questionnaire, continued

Section 3: The following statements refer to aspects of the business, accounting and auditing environment which could have an impact on audit quality. Based on your own experience in auditing, please indicate the strength of your agreement with each statement by circling one number on the scale from 1 where you strongly disagree to 5 where you strongly agree with the statement. (Please circle only one response per statement):

<table>
<thead>
<tr>
<th></th>
<th>Strongly agree</th>
<th>Agree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly disagree</th>
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<tbody>
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<td>1.</td>
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<td>7.</td>
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<td>8.</td>
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<td>15.</td>
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</table>
### Appendix 5: Survey Questionnaire, continued

Section 4: The following statements refer to the manner in which audit quality is achieved on individual audit engagements in practice. Based on your experience in inspecting audit engagements, please indicate the strength of your agreement with each statement by circling one number on the scale from 1 where you strongly disagree to 5 where you strongly agree with the statement. (Please circle only one response per statement):

<table>
<thead>
<tr>
<th></th>
<th>Strongly agree</th>
<th>Agree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Audit software facilitates compliance with the technical requirements of auditing standards</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>2.</td>
<td>Audit software promotes compliance with documentation requirements</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>3.</td>
<td>Performance appraisal systems within audit firms increase compliance with the technical requirements of auditing standards</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>4.</td>
<td>Performance appraisal systems within audit firms improve compliance with documentation requirements</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>5.</td>
<td>Internal reviews within the audit firm enhance compliance with the technical requirements of auditing standards</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>6.</td>
<td>Internal reviews within the audit firm improve compliance with documentation requirements</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>7.</td>
<td>Risk based audit approaches help the auditor to provide value for money to the client</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>8.</td>
<td>Risk based audit approaches help the auditor to provide value added services to the audit client</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>9.</td>
<td>Effective communication from the auditor to client management helps to satisfy the client’s expectations</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>10.</td>
<td>Interaction between the auditor and client management enhances the degree to which audit services are valued</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>11.</td>
<td>Risk based audit approaches facilitate the achievement of an effective and efficient audit</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>12.</td>
<td>The degree of involvement of the audit engagement partner during audit planning influences the quality of the resulting audit process</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>13.</td>
<td>Technical and other consultations within the firm during planning influence the quality of the resulting audit process</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>14.</td>
<td>Training within the audit firm enhances the delivery of an effective and efficient audit</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>15.</td>
<td>Internal reviews within the audit firm ensure the delivery of an effective and efficient audit</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
</tbody>
</table>
Appendix 5: Survey Questionnaire, continued

Section 4: The following statements refer to the manner in which audit quality is achieved on individual audit engagements in practice. Based on your experience in inspecting audit engagements, please indicate the strength of your agreement with each statement by circling one number on the scale from 1 where you strongly disagree to 5 where you strongly agree with the statement. (Please circle only one response per statement):

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly agree</th>
<th>Agree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>16. Audit software facilitates the achievement of an effective and efficient audit</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>17. Training within the audit firm enhances auditors’ technical expertise</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>18. Training within the audit firm improves auditors’ ability to challenge the management of audit clients</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>19. Technical and other consultations within the audit firm enhance the quality of judgements made during the completion of the audit</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>20. Internal reviews within the audit firm enhance the quality of audit judgements made during the audit</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>21. Internal reviews within the audit firm enhance auditors technical expertise</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>22. Internal reviews within the audit firm ensure the auditor’s independence from the audit client</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>23. Audit firm methodologies and manuals improve the quality of audit judgement applied during the audit</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>24. Audit firm methodologies and manuals enhance the auditor’s ability to challenge client management</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>25. Performance appraisal systems within the audit firm improve the auditor’s independence</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>26. Performance appraisal systems within the audit firm enhance the auditor’s technical expertise</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>27. Interaction between the auditor and the audit committee is influential in determining the content of audit work undertaken</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>28. Interaction between the auditor and the audit committee facilitate the right audit opinion being reported</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>
Section 5: The following statements refer to possible issues that may arise in the process of inspection. Please indicate your personal experience of the occurrence of issues by ticking one number on the scale. If you feel issue never or rarely occur please tick the number 1. If you feel the issue always occur, tick 5. If your feelings are less strong, please tick one of the numbers in the middle. (Please tick only one response per statement):

<table>
<thead>
<tr>
<th></th>
<th>Never</th>
<th>Occasionally</th>
<th>Seldom</th>
<th>Frequently</th>
<th>Always</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. How often in the process of inspection do issues arise concerning the sufficiency of audit work?</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>2. How often in the process of inspection do issues arise concerning the appropriateness of the audit opinion?</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>3. How often in the process of inspection do issues arise concerning compliance with ethical standards?</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>4. How often in the process of inspection do issues arise concerning compliance with international accounting standards (IAS)?</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>5. How often in the process of inspection do issues arise concerning the adequacy of audit documentation?</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>6. How often in the process of inspection do issues arise concerning the adequacy of the auditor’s ‘challenge’ to management?</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>7. How often in the process of inspection do issues arise concerning compliance with auditing standards?</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>8. How often in the process of inspection are issues that arise resolved by discussion with the audit team?</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>
Appendix 5: Survey Questionnaire, continued

Section 6A: The following statements refer to general propositions about audit quality in practice. Please tick one number for each statement to indicate the strength of your agreement with that statement, where 1 indicates that you strongly disagree and 5 that you strongly agree with the statement. (Please tick only one response per statement)

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly agree</th>
<th>Agree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. In general, the quality of auditing in the UK is high</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>2. The quality of auditing in the UK has increased during the last decade</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>3. The quality of auditing in the UK has decreased during the last decade</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>4. There is a high level of consistency between audits in the quality of auditing achieved in practice</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>5. There is considerable variation between audits in the quality of auditing achieved in practice</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>6. In general market participants perceive the standard of audit quality to be adequate</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>7. General concerns about audit quality in recent years are based on a proper understanding of the conduct of audits in practice</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

Section 6B: Based upon what you have seen, heard, and experienced during audit inspections, please rank the following items according to their importance as influences on the conduct of audits in practice. Place a “1” next to the item that you consider to be most influential, a “2” next to the item that is next most influential, and so on. No two items can have the same ranking.

a. The approach to the conduct of audits in practice reflects the compliance obligations placed on the public accounting firm

b. The approach to the conduct of audits in practice reflects the commercial values of the public accounting firm

c. The approach to the conduct of audits in practice reflects the professional values of the public accounting firm

Thank you for answering this questionnaire.
References


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