

Accountancy

Are auditors performing their role effectively?

Description	
Sub-category	Auditing
Research Type	Essay
Anticipated grade	Undergraduate
Grade level	2.1
Approximate word count	1,000

Introduction

Since the early 1990s there has been a continuing debate centred on assessing whether, within the confines of commercial pressure imposed on them, auditors are effectively carrying out their role and duties. This paper examines recent research and expert commentary related to this particular argument. It is concluded that generally, members of this profession are performing well. However, there remains significant areas of concern that need to be addressed.

The debate

“The debacle of Enron has shaken core assumptions about auditors and auditing.” (Kay and Carsberg 2002). This comment, and others containing similar sentiments, appeared in the Financial Times. Driven by the events that led to the collapse and failure of the Enron Corporation, and the global auditing firm Arthur Andersen, it was not surprising to find that the competency, independence and quality of the standards of auditing began to be questioned.

As a result of this and other high-profile failures, financial and auditing industry experts, including those identified in the quoted headline, called for auditing standards and supervision to be enhanced and significantly improved. It was in response to these demands that US legislators introduced the Sarbanes-Oxley Act (2002) and regulators in the UK published the Combined Code of Corporate Governance (2003). Both of these regulatory additions included stringent requirements related to the performance of the auditing procedure. At the same time, through its international organisation, the IFA¹, also responded by revising and improving its auditing standards, which have undergone a continuing series of subsequent amendments.

However, concerns have been raised regarding to objectives outlined in certain elements of these regulations. For example, in a parliamentary editorial (2006), objections were raised about the UK government's efforts to make certain aspect of auditing failure a criminal offence. In challenging this mover, representatives from larger auditing firms argued that it would not only be *“both costly and ineffective”*² but also *“inevitably lead to defensive auditing, which is not in the interests of the profession or clients.”*³

There is little doubt that auditing is a complex and demanding procedures, and this is particularly the case where the audit client is a listed corporation or one that operates in a transnational or multinational environment. Prior to its commencement, the appointed auditor and firm are required to undertake a significant amount of preparative work (Gray and Manson 2004). Among these tasks is the need to ensure the auditor has a comprehensive understanding of the client' firm operations and activities, has evaluated the potential risk areas, prepared a robust audit

¹ International Federation of Accountants

² Baroness Noakes, a former KMPG partner

³ An Ernst & Young spokesman

plan and agreed the fees to be charged with the client (Dassen et al 2004).

Based on the risk evaluation, the audit plan needs to be designed to ascertain the depth and breadth of the procedures required to ensure its effective completion. This includes determining the extent of the testing processes required, and that the actions identified and to be fulfilled by members of the team, in all areas of the audit are compliant with current codes, regulations and auditing standards. In this latter respect, it will be important to ensure they have accounted for recent amendments that may have been introduced into UK company law and combined codes and well and standards set by the IFA (Grey and Manson 2004).

Monitoring the auditor

In an effort to further enhance the quality of auditing, the UK government also set up an Audit Inspection Unit (2006). The objective of this unit is to randomly inspect the audits to ensure that they are being performed effectively, and of a quality that was required to be in accordance with currently prevailing standards and regulations. In the 2011/12 report (Audit Inspection Unit 2012: 7), it was confirmed that inspections covered a total of “84 audits”. Despite the report's overall conclusion that the quality of the audit performance had improved in over 90% of cases⁴, a few remaining areas of concern were still there were a few concerns highlighted and further improvements recommended. Among the most important of these was the fact that there appeared to be a focused on three main areas, these being impairment of goodwill and other intangibles, group audit considerations and auditor independence.⁵ Furthermore, it was noticed that some auditing firms were engaging in fee reductions which, in the Unit's opinion, was potentially having an adverse impact on audit quality.

Although previous review of the auditing profession have agreed that the quality of auditing have improved in recent decades, they have also highlighted another area of concern that is beyond the remit of the Audit Inspection Unit (2012). This issue is specifically related to the current level of competitiveness that exists in the auditing industry. In particular, this issue was raised by the Oxera Consultancy Group (2006). Following the demise of Andersen's (Kay and Carsberg 2002), this has left only four global auditing firms. The report highlighted the fact that this situation has not only led to an 11% increase in audit fees, but also reduced corporate auditor choice and increased the barriers for other firms to compete successfully in providing audit services the publicly listed corporations (Oxera Consultancy Group 2006). Fears were also expressed in this report that further consolidation in this sector of the auditing industry would serve to further exacerbate these problems.

⁴ See page

⁵ See page 5

Conclusion

It is concluded from the discussion presented in this paper that, although it can be argued that the quality and performance of auditing firms is achieving the required standards in most areas, there are areas where improvement is still required. In particular, it is considered that the most important of these are connected to the three issues raised in the Audit Inspection Unit (2012) report, namely goodwill and intangible impairment, group considerations and fee reduction practices. Equally, it is considered the issue related to competition in the auditing industry remains a problem. In this particular area, it is suggested that national and international governments need to reinforce the content of competition laws and seek to devise a process that will allow firms outside of the 'big' four to compete more effectively for public and international corporate audits.

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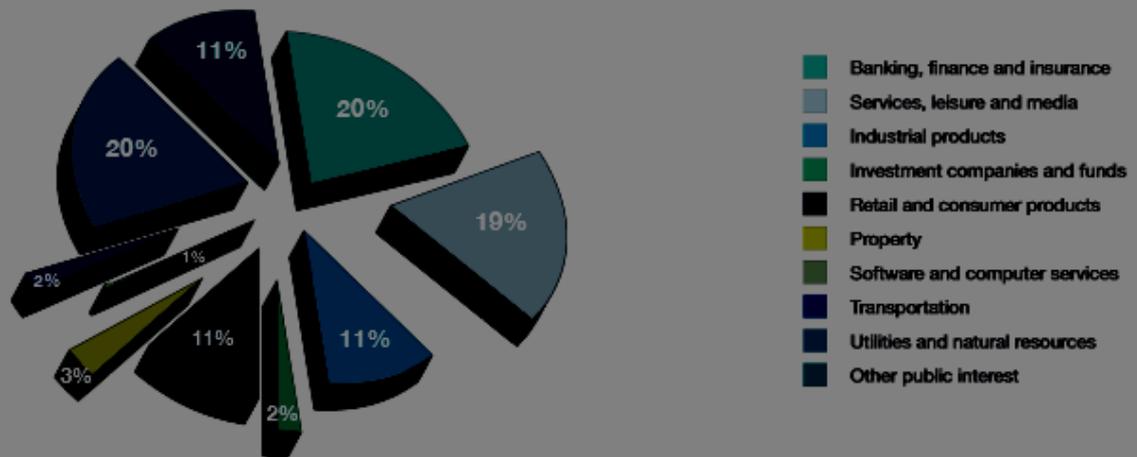
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Appendix 1

Audit files reviewed by sector 2011-12 (excluding public sector)



Audit Files reviewed by type of organisation 2011-12 (excluding public sector)

