



# FAR CONFERENCE 2022

## Inside Out and Outside In

Report of the seventh Conference of  
the Foundation for Auditing Research

FOUNDATION FOR  
**AUDITING**  
RESEARCH

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## Colofon

This report contains the summaries of the presentations held at the fifth physical conference of the Foundation for Auditing Research (FAR). The summaries in this conference report should not be viewed as a formal research publication. The report should be read as an account from an audience member’s perspective.

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## **FAR Conference 2022: ‘Inside out and outside in’**

On June 20-21 2022, the fifth physical conference of the Foundation for Auditing Research (FAR) was held at Nyenrode Business University. The theme of the conference was ‘Inside out and outside in’. This theme allowed for a broad array of sessions that took issue with the influence of internal (e.g., audit teams) and external (e.g., regulators) factors on the quality of auditing and assurance and attracted an audience comprised of practitioners, academics, regulators, standard setters and journalists. The majority of the more than 100 participants were practicing auditors (45 percent). Given FAR’s objective of using academic knowledge to improve audit quality in practice, this is a satisfying figure.



During the conference, ample attention was paid to the ecosystem of the reporting and assurance chain and the role that academic research can play in the ecosystem. The discussions referred to the collaboration between academia and practice, the desired increase of diversity within audit teams, the increasing complexity of the audit, the role of culture and the increasing appreciation for auditor's professional judgment.

As every year, the conference consisted of plenary sessions, so all attendees followed the same program. The number of discussions on the practical applicability of the research findings seemed higher than in previous years, which was probably caused by consciously reducing the focus on methodological and statistical issues.

The kick-off took place by Henriëtte Prast (chair of FAR and (supervisory) board member) and Olof Bik (at the time of the conference: Business University Nyenrode, managing director of FAR and also chair of the conference). They sketched a picture of the past, present and future of FAR. Currently, 9 audit firms are affiliated with FAR and FAR research projects are conducted at 30 universities worldwide. Prast and Bik emphasized the three pillars of FAR: facilitating research on audit quality drivers, building a community, and sharing academic knowledge. They talked about the 'sowing time' of FAR, overcoming thresholds, data challenges, hurdles taken

and the harvest time that has now started. From now on, even more attention will be paid to presenting and sharing research results in an accessible manner and involving stakeholders in discussions about audit quality.

The conference consisted of two keynote speeches, two discussion sessions and five presentations of FAR research. The discussions after the research presentations were led by young professionals from the audit firms involved in FAR.

In this pdf-booklet, we proudly present the summaries of the conference presentations and selected Q&A's from the Q&A-sessions after each presentation. The summaries also include links to the conference presentations (videos and slides).

We hope you will enjoy reading the summaries and viewing the presentations and Q&A's, and we are looking forward to meeting you again 2023.

**Prof. dr. Olof Bik RA**

(Academic Board Member and Managing Director FAR)

**Prof. dr. Jan Bouwens**

(Academic Board Member and Managing Director FAR)



## DAY 1 – MONDAY 20 JUNE 2022

- 12:30 – 13:30 Registration and lunch**  
Central Hall in the Main Building (Albert Heijn / De Rooij)
- 13:30 – 13:40 Welcome and opening speech**  
*Henriëtte Prast, FAR Chair*
- 13:40 – 14:00 Plenary 1 – Foundation for Auditing Research: past and future**  
*Olof Bik (also conference chairperson), Managing Director of FAR*
- 14:00 – 14:20 Plenary 2 – Keynote speaker – The AFM examination into fraud**  
*Hanzo van Beusekom, board member of the Netherlands Authority for the Financial Markets (AFM)*
- 14:20 – 14:30 Q&A Audience
- 14:30 – 15:00 Afternoon tea break**  
Central Hall in the Main Building (Albert Heijn / De Rooij)
- 15:00 – 15:30 Plenary 3 – How is auditor commercialism related to audit quality and efficiency?**  
*William Ciconte, University of Illinois*
- 15:30 – 15:40 Discussant  
15:40 – 15:50 Q&A Audience
- 15:50 – 16:20 Plenary 4 – What makes audit partners and their engagement teams successful?**  
*Jere Francis & Lena Pieper, Maastricht University*
- 16:20 – 16:30 Discussant  
16:30 – 16:40 Q&A Audience
- 16:40 – 17:10 Break and snack**  
Central Hall in the Main Building (Albert Heijn / De Rooij)
- 17:10 – 17:50 Busy Season Talks – On making sure that audits deliver on expectations**  
Hosts: *Charlie Groen and Hakan Koçak*  
Panelists: *Auke de Bos (EY the Netherlands), Therese Grohnert (Maastricht University) and Mark Peecher (University of Illinois)*  
Moderator: *Jan Bouwens*
- 17:50 – 18:10 Plenary 5 – Bankruptcy and auditor’s reporting in the Netherlands**  
*Tjibbe Bosman, Program Manager FAR and PhD student UvA*
- 18:10 – 18:20 Discussant  
18:20 – 18:30 Q&A Audience
- 18:30 – 21:00 Dinner and evening drinks**  
Plesman Building

## DAY 2 – TUESDAY 21 JUNE 2022

**08:15 – 08:45 Registration**

Central Hall in the Main Building (Albert Heijn / De Rooij)

**08:45 – 08:55 Welcome and opening day 2**

*Olof Bik - conference chairperson*

**08:55 – 09:15 Plenary 6 – Keynote speaker – Regulation and audit firms**

*Yasmine Chahed, Visiting Research Fellow, Alliance Manchester Business School*

09:15 – 09:30

Q&A Audience

**09:30 – 10:15 Panel discussion – The organization of the audit: external expectations**

Panelists: *Chris Fonteijn (Quarter Master future accountancy sector), Edo Kienhuis (Board Member IAASB), Agnes Koops (Chair Assurance Board PwC the Netherlands) and Marlies de Vries (Quarter Master future accountancy sector)*

Moderator: *Jan Bouwens*

**10:15 – 10:45 Morning coffee break**

Central Hall in the Main Building (Albert Heijn / De Rooij)

**10:45 – 11:15 Plenary 7 – Culture controls in audit firms**

*Jasmijn Bol, Tulane University*

11:15 – 11:25

Discussant

11:25 – 11:35

Q&A Audience

**11:35 – 12:05 Plenary 8 – The loss of talent – a threat for audit quality?**

*Frank Moers, Maastricht University*

12:05 – 12:15

Discussant

12:15 – 12:25

Q&A Audience

**12:30 – 13:00 Closing reflections**

**13:00 – 14:00 Lunch**

Central Hall in the Main Building (Albert Heijn / De Rooij)



# The AFM examination into fraud

**Keynote speech by:**  
*AFM chairman*  
*Hanzo van Beusekom*

## **Abstract**

In his keynote speech, Van Beusekom discussed the recently published AFM position paper *Audit firms' approach to fraud and fraud risks at audited companies*. Van Beusekom emphasized that fraud is a significant social problem, the danger of which will increase further in the future due to developments in, for example, digitization, sustainability and internationalization. This potentially has major negative consequences for individuals as well as for the integrity of our financial system. All parties involved bear their own responsibility and everyone can contribute to the fight against fraud. Obviously, auditors play an essential role and the time is right to put energy into a more effective approach to fraud. According to Van Beusekom, the auditing sector is not yet sufficiently developed in the field of detecting fraud and dealing with fraud risks. There are three reasons for this. Firstly, the required knowledge, competences and experience are not always sufficiently available. Secondly, auditors often still rely too much on the good intentions of the client and are subject to judgment biases (just like everyone else). Thirdly, the internal culture at audit firms sometimes provides insufficient incentive for reporting fraud. Improving the auditor's gatekeeper role in the field of fraud will be a core theme of the AFM's supervision of audit firms in the coming years, also concerning corruption, tax evasion and money laundering. The auditing sector must invest in both hard skills (knowledge, competences and expertise), including in the field of fraud risk analysis and standards, and in soft skills, including in the field of developing the right mindset and recognizing judgment biases. Like other speakers, Van Beusekom notes that the challenges ahead will only make the profession more attractive.



### **Fraud is an important social issue**

I would like to focus on fraud and more specifically on the firm's approach to fraud and fraud risks at audited companies. This is of paramount importance, because fraud is a broad social issue and can have serious impact. Fraud can cause sizable losses for investors, loss of jobs and can cause serious harm to confidence in the financial system, as well. While the responsibility for fighting and preventing fraud lies primarily with the audited company, identifying and following up on fraud and fraud risk is a vital responsibility for auditors. As gatekeepers, auditors have a duty to serve and protect the public interest. Admittedly, this task is becoming more and more difficult. The problem of fraud is expected to become even more widespread, due to developments like sustainability and related green washing, technological developments and the digitization make it more difficult -but also more possible- to detect fraud. And the internationalization of business which makes it more difficult to protect against and to detect fraud.

### **Junior auditor enthusiasm**

Now, think for a second about a junior auditor during an audit who encountered an invoice that raises some alarm bells. It's for a large round amount and has a vague circumspect description and it's paid to a private person with a foreign bank account. This junior auditor is

new at the firm, just out of school, highly critical and very aware of the auditor's societal gatekeeping role. Furthermore, she finds a possible case of fraud, corruption, or bribe very exciting. She mentions her finding to her more experienced team members, who are less excited than she is. They think she's overreacting and say they've been auditing the company for years and that they can be trusted. Some simply tell her they don't have the time to do the extra research. She goes one level up to her team lead, to address the issue. He's also not very excited. He can already picture the hassle this would cause. As team lead, he would have to approach the client, a trusted long-standing client, and start asking some rather difficult questions, which are uncomfortable. He really doesn't want that confrontation. Also, the audit report is due shortly. What if it cannot be finished on time, especially when they do investigate the issue further, but her suspicion proves unfounded? The company will be unhappy, and quite rightly so. Investors will start asking questions about why the audit report isn't on time. And what repercussions will it have for the audit firm. Will they lose the client? And what if there is fraud, and the firm is accused of not detecting it sooner in previous years when it was already there. The team lead experiences a lot of pressure. Eventually, he asks the junior auditor to forget about the invoice and select another one and include that one in the file.

You might think I'm exaggerating, but this is what we regularly find during our work as regulators and supervisors. You can ponder over what you would do when she would come to your desk sooner or later, because she will come. She will come! If this is the difficult problem

we all are tasked with, what do we as the AFM expect from auditors? We recently published a paper which sets out our position. The core is identifying and following up on fraud and fraud risk in the statutory audit of audited companies is a vital responsibility of the statutory auditor. The auditor serves the public interest. This is so self-evident that I nearly had stricken it from the report, because who could be against this? But every time I post it somewhere I have about 15 people on LinkedIn who are contradicting me. So, as long as there are at least one or two contradicting me I will repeat posting it.



**Auditors often still rely too much on the good intentions of the client and are subject to judgment biases**

### **Root causes of insufficient development regarding fraud**

The second part of the position paper concerns the fact that the audit sector as a whole seems to be insufficiently developed in detecting and following up on fraud risk – although this isn't an objectified picture. More investments are needed. Also, the NBA, the Dutch professional body for auditors recently published an insightful report along similar lines. We have identified three potential root causes:

1. Knowledge, competence, and expertise are not always sufficiently available. Specific bottlenecks include inadequate fraud risk analyses, insufficient knowledge of the client, the sector and environment the client operates in, and a lack



of experience with fraud cases, sometimes specifically regarding group audits of internationally operating companies.

2. The auditor's role perception, attitude, and mindset may be inadequate when it comes to the detection of fraud and fraud risks. In general, the auditor's default position is to trust the company, rather than having a healthy distrust, and may be inattentive to signs of bad behavior. Confirmation bias can come into play here: the auditor unconsciously looks for confirmation of what he or she expects.
3. The internal culture at audit firms may be an impediment. Specific bottlenecks here include internal disincentives, like time pressure, capacity, a tendency to 'minimize' cases, lack of a safe space to address possible fraud, and compliance pressure.

In short, we feel and expect auditors to better fulfil their gatekeeping role with regard to fraud and fraud risks. And at the AFM, we will make this a key theme in our activities in the coming years when it comes to our supervision of audit firms.

### **How to better fulfil the gatekeeper role?**

A key question here is: what should auditors do to better fulfil their role as gatekeepers? Because that's the million-dollar question: how do auditors and audit firms translate this crucial responsibility into their daily professional activities? Clearly, that is not easy, and it makes for a challenging journey. Let me elaborate on that in three points.

First. It's important that the audit sector applies a broad perspective and maintains a broad gatekeeping role. So not only focus on fraudulent

financial reporting, but also focus on risks such as corruption, tax evasion and money laundering. That broad role does justice to enhanced public expectations, and to the fact that the issue of fraud will extend to a wide range of areas in the future. Clearly, this requires a lot from auditors, in terms of knowledge, skills, and diversified teams. Allow me to make a comparison with my own profession, the supervisory community. We travelled a similar route. In the 'old days', a supervisor was an economist, lawyer, or auditor. Then came the financial crisis in 2008. It revealed serious weaknesses within the supervisory profession. The IMF summarized it nicely: 'Supervisor did not adapt to the changing environment. And supervisors did not focus on the risks building outside their regular areas of focus.' The message was clear, we needed to broaden our scope, and look beyond our safe and standard perimeters. This considerably changed our profession. Corresponding to our broadened role, we are now more than economists, lawyers, and auditors. We are also data scientists, behavioral scientists, and psychologists. The audit sector and audit firms should accept their broad gatekeeping role, and act accordingly.



### **Improving the auditor's gatekeeper role in the field of fraud will be a core theme of the AFM's supervision of audit firms**

Second, audit firms need to invest in hard skills: in knowledge, competence, and expertise. This means improving the quality of

fraud risk analyses, creating detailed knowledge of your client, their sector and environment, as well as more awareness of behavioral and cultural signals within audited companies. But also acquire more in-depth knowledge of regulations and standards with regards to fraud. And, equally important: make sure audit teams contain sufficient diverse experience, including with forensic auditing.



### **Audit firms also need to invest in soft skills**

Third, audit firms also need to invest in soft skills. When it comes to the detection of fraud, auditors need to improve on their role perception, attitude, and mindset. This entails, among other things, the issue of confirmation bias. A tendency to overestimate your own abilities can also play a part, for example by thinking 'I know my client, I am bound to notice fraud.' However, targeted fraud risk detection and follow-up requires an attitude and mindset on the auditor's part that is fundamentally different. There are ways to improve that. This might include the creation of more debate and checks and balances in the audit in case of fraud signals. There could be increased attention for contra-indications and contradictory audit information. A specification of risks, in particular regarding management override of controls – where can company management commit fraud? And there can be an even greater emphasis on quality control reviews within audit firms.

### **De-biasing strategies**

Now, such behavioral challenges are not unique to auditors. In fact, supervisors have also been known

to have their fair share of biases. Over the years, there has been ample academic and – unfortunately – practical evidence that supervisors are, like most human beings, prone to confirmation, anchoring, over-confidence, availability biases. To this end, at the AFM we have developed and implemented various de-biasing strategies. This includes a formal ‘contradiction team’. This is a group of people from different teams who engage with colleagues on difficult cases, ask tough questions, and pose challenging hypotheticals. The aim is to prevent tunnel vision, and to make sure that every consideration, opinion, and dilemma is adequately addressed.



### Identifying and following up on fraud and fraud risk is a vital responsibility for auditors

Despite having them internally, with colleagues, these sessions are usually not ‘fun’ talks, of course. They can be uncomfortable or even a little painful. But then, that’s often the point. Ideally, the structure of the audit sector and individual audit firms should be such that it gives a positive impetus to detecting and addressing fraud risks. Unfortunately, this is not yet the case in the current structure. For instance, the auditor is being paid by the entity he or she is auditing. This entails the risk that the auditor will operate too much on autopilot, and that the financial and personal relationship with the company makes it inherently more difficult to discuss fraud signals.

#### Alternative structure models

There are currently various trials underway with alternative

structure models. This includes the intermediary model, where an expert third-party, the intermediary, is directly involved in selecting and monitoring the auditor. This would contribute to the independence of the auditor regarding the audited company. Next to that, there should be strong and independent countervailing powers within audit firms themselves – such as the supervisory committee and the internal quality system. These remain of utmost importance to ensure that the public interest is placed above the client interest.

With these three points, we believe that auditors and audit firms can improve their gatekeeping role with regard to fraud and fraud risks. Hopefully, we’ll see improvement on their part in the analysis of fraud and fraud risks, and in the audit procedures they perform in this respect. Now, this conference isn’t merely attended by auditors. There are also a lot of academics in this room. And we have a call to action for you as well.



### The supervisory community travelled a similar route

#### Avenues for research

How can further research help auditors better fulfil their gatekeeping role? We propose possible avenues for further research that can help the audit sector and audit firms better fulfil their gatekeeping role. I will name three.

1. A recurring question we get is: what is the target on the horizon? What is the long-term aim, and when will the audit sector and the AFM be satisfied with the auditor’s role in respect of fraud? In other

words, what does good fraud detection look like? While this may be impossible to answer in any definitive form, it’s useful to develop some key fraud metrics. That will allow us to discuss this matter with a certain degree of objectivity. Now, many metrics are inherently flawed. Think of the number of frauds that are reported. Is a high number a good sign? This is difficult to answer, because you don’t know how many frauds go undetected. Similarly, is a low number a good sign? This might simply be the result of an auditor having cleaned up his client portfolio, getting rid of all clients with a potentially high fraud risk. So there lies an interesting research question.

2. A second research question lies in the behavioural field. What can be effective de-biasing strategies within audit firms? How can you create adequate countervailing powers within an audit firm or an engagement team?
3. In the Netherlands, there is a lot of discussion on transparency. What should auditors report on fraud risks? Should they report their activities or their findings? An interesting research question would be: what would be the effect on the quality of fraud risk analyses by auditors if they had to report on their findings in their audit statement? These, and surely other lines of research would help the audit sector and audit firms in their approach to fraud and fraud risks. And it would give us, as supervisor, an even greater understanding of the challenges in dealing with this issue.

### **Closing statement: we can all contribute**

While we have different responsibilities, we can all contribute to combatting fraud. As a supervisor, the AFM is committed to promoting fair and transparent financial markets. Fraud is, by definition, unfair and non-transparent. It is a significant social issue, which is expected to get worse, and potentially disastrous to many people, as well as to the integrity of our financial system. It is therefore incredibly important to deal with it appropriately. For us, this is a key issue. And it should also be one for the auditing sector. There haven't been many large accounting scandals in recent years, but the risk of fraud is increasing. So now

is the time for audit firms to invest time and energy into an effective approach. After all, it's better to prevent a fire than having to put one out. To finish, think about our junior auditor again. Instead of working in a system that works against her, she should be able to access the proper tools, and be able to speak openly about her suspicions. Instead of succumbing to tunnel vision and biases, she should be challenged to look at it her case from all directions. Instead of having to find a different invoice, she should get the help and support she needs to investigate properly. My final question to you is: how will you react when she turns up with difficult questions at your desk?

“

**The problem of fraud is expected to become even more widespread**

Selected Q&A's from the discussion are included below.



**More attention has been asked for fraud risks repeatedly, but it has led to almost predetermined significant fraud risk in all programs, like management override and completeness of revenues. Doesn't this imply a rigid checklist approach?**

'We see that with the measures you mentioned, the attention for fraud has increased over the last couple of years and I think this is a good development. We are moving in the right direction, but I'm worried that it's too little and too late. I worry about the fact that in two to five years from now, when the economy has turned again, we look back and say we haven't done enough. The checklist mentality that you mention is an important issue. This may lead to boilerplate answers. We are fiercely advocating to go the 'content route' as an auditor, not only say that you have done something regarding fraud risk but say what you have done and what the findings are. The first rule for the auditor is that the audit happens in the public interest, and the public is not interested in that you looked at fraud but in what you found.'

**What implications should your story have for the educational curriculum of auditors?**

'I see the auditing curriculum moving in the right direction. There is a wider range of topics and there is more attention for soft skills now than five or ten years ago. I've seen that the discussion about ethics has returned, which I think is tremendously important. I'm also a fan of the Busy Season Talks. Hence, there are green shoots, as Barack Obama would say. My speech contained many warnings, but there are already great initiatives being employed. This also makes the auditing profession more interesting.'

**I found it noteworthy that most of the barriers that you discussed were at the individual level, concerning biases and behavior. Isn't the problem more at the systemic level, relating to incentives and pressures? What are your recommendations, given the structure model we are in.**

'Indeed, there are structural impediments which make it difficult to do the right thing. It is the combination of advice and audit, but also the commercial incentives an auditor faces. This all could influence fraud. This is tremendously difficult. Therefore, I always stress that at the end of the day an auditor is not there for the client, but for the public. And audit firms can suffer badly from not detecting fraud. The reputation and litigation effects are getting larger. The main three areas we focus on are culture, structure -if we ever get to that- and incentives in the long run.'

**The recording of the conference presentation (including the complete Q&A- session) can be found here:**

[https://youtu.be/BhlnCzq5U\\_o?t=2592](https://youtu.be/BhlnCzq5U_o?t=2592)

**The slides can be downloaded here:**

<https://foundationforauditingresearch.org/files/2-hanzo-speech-far-2022-slides.pptx>



# How is auditor commercialism related to audit quality?

**Presented by:**

*Marleen Willekens (KU Leuven), co-authored by Will Ciconte and Justin Leiby (both at the University of Illinois Urbana-Champaign)*

**Abstract**

Marleen Willekens presented the study *How is auditor commercialism related to audit quality*. The data for this study are currently being collected via FAR. The study examines the age-old contradiction between commerce and professionalism that the auditor has to deal with. According to the literature, the more hours are spent on commercial aspects, the more important these activities are considered to be within the audit firms. The basic idea is that commerce is essentially the enemy of professionalism and therefore bad for audit quality. Willekens called this field of tension a ‘taken for granted assumption’, which is embedded in the standards as well as in the literature. But is that justified? Willekens and her co-researchers expect to find that a stronger commercial focus leads auditors to focus more on quality controls. This will likely negate the negative relationship between commerce and audit quality, and possibly lead to a positive relationship. After all, excessive commercial efforts without adequate quality control will potentially lead to reputational damage. The bottom line of the study is: going commercial isn’t necessarily bad for audit quality. But the data will tell.



#### Disclaimer

*The study is in its final stage of receiving the data, so we have not been able to analyze them. During this presentation, only the expected findings will be discussed.*



## Activities that an auditor devotes time to are deemed to be important tasks

### Why is this an important project?

We know that a double institutional culture exists within audit firms. On the one hand, auditing is a professional activity. On the other hand, audit firms have commercial motivations that are often viewed as being potentially conflicting with *professional* motivations. When we are thinking about professional motivations of auditors, we think about acting in the public interest. Whereas, when we think about *commercial* motivations, we think about the auditor as potentially aligning with the client, or even about the auditor as a businessperson, who is maximizing audit firm and/or auditor wealth. These two sets of motivations seem to conflict with each other. So, when we are thinking about activities that would fit into the arena of a professional, we think about performing audit tasks, following education, and mentoring staff members. Whereas, when we think of activities that belong to the

commercial set of audit activities, we think about practice development activities like entertaining clients or developing sales proposals for potential new engagements.

Our position is that this conflict between the two is a sort of ‘taken for granted assumption’, also seen like that by supervisory bodies, policy makers and regulators. Researchers have been studying this dual role that auditors have and, in this respect, an interesting quote from a partner in an interview study is: *‘You know a manager cannot be promoted if he is only a good auditor, sitting most of the time in his office. The firm wants its partners capable of recruiting new clients and selling a variety of services to existing clients.’*

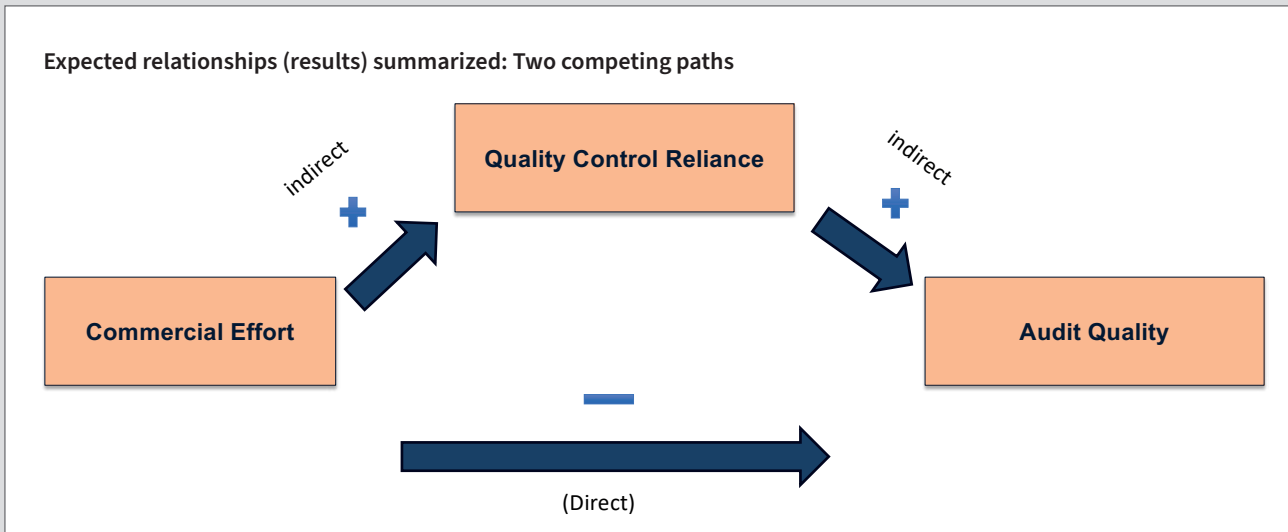
In the literature, we have seen that time management and time pressure are very important factors in the auditing setting. We have also seen that the activities that an auditor devotes time to are deemed to be important tasks. Hence, theory and evidence seem to suggest that allocating more time to commercial activities increases auditor’s beliefs about the importance of those activities and, ultimately, heightens their motivations to perform those commercial activities well. Therefore, time allocated to commercial activities means that they are important. The downside or the negative effect may be that commercial motivations may have an impact on audit quality, given the existing time pressure to complete audit engagements. There are studies that argue that auditors can never be independent and there is some ‘moral seduction’ inherent to the audit profession, since auditors earn money by providing this service that is supposed to be a service to society. If an auditor becomes more commercially engaged or

motivated, this could lead to a lower engagement effort and lower audit quality.

### Research questions

In this project, we address several research questions. The major question is whether auditor’s commercial effort decreases audit quality. Once we can analyze the data, we will also look at two other research questions. The first one of which is whether auditors’ commercial effort affects auditor compensation. Here, we expect a positive impact, as partners maximize the firm’s profits by attracting new clients and we know from previous research that compensation is at least partially based on fee income. The second additional research question is whether auditors’ commercial effort affects engagement effort. Here, we expect a negative relationship: when planning the engagement, the more the auditor is engaged in commercial activities, the less total staff time he or she will allocate to audit engagement effort for his or her whole portfolio.

It is important to evaluate whether such questions could be relevant for practice. Is commercial effort associated with lower audit quality? Is commercial effort associated with more access to quality control? Does quality control maybe mitigate the negative impact of commercial effort on audit quality? Based on our future findings, we can discuss whether regulators should seek to directly curtail commercial effort or focus instead on promoting stronger quality controls. If we find that quality controls can alleviate that concern, that may be an important route to follow.



**Expected relationships**

The expected relationships are depicted in the figure above. If we argue that commercial effort has a negative effect on the professional engagement effort, we expect a negative impact on quality. If, for example, there is a lot of commercial drive at the top of the audit firms, this might be picked up by team members, as well. This may lead to a negative relationship with audit quality. On the other hand, a commercial effort by partners could trigger the use of quality control reliance. We know from previous work that technically oriented partners are hesitant to ask for help, but we will be able to compare technically oriented versus more commercially oriented partners, since we will have data on the hours that partners spent on both audit engagement related work and on practice development related work. We expect that if partners are more commercially oriented, they will be less shy to ask for help. They will have an incentive to keep their reputations high, as compared to technically oriented partners would ask for help from quality control mechanisms. So, there are two competing parts: commercial effort

impacts quality negatively or there is an indirect route via quality control reliance. If there is more quality control reliance, that will also have positive impact on the audit quality.



**Excessive commercial efforts without adequate quality control will potentially lead to reputational damage**

**The data**

Our test variable will be commercial effort, measured at partner, director and senior manager level. Those are the levels that are engaged in the commercial activity. As two dependent variables we use audit quality and quality control, measured at the level of the partner’s portfolio. We measure commercial effort as the total number of hours an auditor spends on practice development activities. For audit quality, there are several metrics that we can use. The first metric is a review score that we will get for the engagements from the firms. We can also use the number of modified

opinions for the portfolio. And we are considering using abnormal accruals and restatements.

Regarding quality control measures we will use the total hours incurred by technical consultants for a given auditor’s client portfolio and the total hours of both voluntary and mandatory consultations. Furthermore, we can use the composition of the audit team by the partner. If a partner is not present very often, the partner probably might want to balance that by using more experienced people on the team. We measure that by using the ratio of the aggregate number of partner, director and senior manager hours in the portfolio of the partner divided by all hours (including junior level and intermediate level hours). This provides an indication of how senior the teams are on average for a partner’s portfolio. Of course, we will include several control variables, for example regarding professional effort (e.g., hours spent on learning), portfolio characteristics (e.g., client complexity and non-audit fees) auditor characteristics (e.g., experience and performance assessment scores) and audit office (e.g., office size).

### **Data collection**

We are collecting the data from the firm's management accounting information systems and hrmsystems. Also, some quality data are supplied anonymously and collected by the FAR-team. We will conduct the analysis as soon as possible, after the data collection is completed.

### **Contributions, implications and conclusion**

An important contribution to academic knowledge is that we will provide new insights on how commercial effort is related to audit quality. This could have a negative influence, but it may also be non-negative, because more commercially motivated auditors may use quality control reliance. The findings can also trigger new questions. For example: are there more effective or more efficient ways to design teams to balance the commercial and professional interests? There also may be other quality controls that can be put in place to safeguard audit quality. Another question could be whether a similar emphasis on quality control will mitigate the perceived negative impact of the joint provision of audit and non-audit services.

A potential conclusion maybe that more commercial effort does not necessarily lead to lower audit quality and that quality control appears to be critical to delivering and preserving audit quality. The data will tell.

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**Going commercial isn't necessarily bad for audit quality**



Q&A-session and discussion by Fabian Klar (BDO, also member of the Young Assurance Board). Selected Q&A's are included below.



**EY is currently discussing splitting up the advisory and auditing businesses. How does that relate to the commercial and professional motivations you are studying?**

‘We don’t have any results, yet. So, it is hard to already say something about whether (and how), for example, commercial effort triggers quality control reliance. But maybe later we could transpose the findings to the non-auditing-services context. And, from a personal perspective, I think a multidisciplinary approach has a lot of advantages, too.’

**What is the definition of commercial activities? Is it knowing your client, the making of risk assessments, understanding their needs?**

‘We asked for the practice development activities and the hours they spent on them. Examples of these activities are writing new proposals and engaging with the client. But having dinner with the client is not really going on that much anymore and it also isn’t what we are looking at.’

**Do you use hours spent as a measure of audit quality?**

‘It is important to mention that we measure hours at the portfolio level. We will check whether we can study potential over-auditing. In that case more hours do not necessarily lead to higher audit quality.’

**Couldn’t commercially oriented auditors have a positive effect on attracting good people? Furthermore, commercialism may also be linked to competition, which will also stimulate audit quality. You may also want to consider this.**

‘The first question is an excellent suggestion for research. We don’t currently study that. Your second remark is a very fair point, which deserves further attention.’

**The recording of the conference presentation (including the complete Q&A-session) can be found here:**

[https://youtu.be/BhlnCzq5U\\_o?t=6322](https://youtu.be/BhlnCzq5U_o?t=6322)

**The slides can be downloaded here:**

<https://foundationforauditingresearch.org/files/3-far-conference-presentation-2022-ciconte.pptx>

**For more information regarding the project, please refer to:**

<https://foundationforauditingresearch.org/en/research-publications/projects/2017b06-how-is-auditor-commercialism-related-to-audit-quality-and-efficiency-prof-ciconte/>

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**The major question is whether auditor’s commercial effort decreases audit quality**



# What makes audit partners and their teams successful?

## Presented by:

*Jere Francis (Maastricht University and FAR research chair) and Lena Pieper (Maastricht University), co-authored by Murray Barrick (Texas A&M), Olof Bik (Nyenrode Business Universiteit, at the time of the conference) and Ann Vanstraelen (Maastricht University).*

## Abstract

Jere Francis and Lena Pieper presented their research *What makes audit partners and their teams successful?* They look at the influence of personality characteristics of partners and managers on performance (ratings). The characteristics studied are the well-known 'Big 5' personality traits (kindness, carefulness, emotional stability, extraversion and openness to experiences), the so-called 'dark triad' (Machiavellianism, narcissism and psychopathy) and 'bravery'. The basic idea is that the auditor characteristics are directly related to the performance as well as indirectly via the skills (commercial, technical and leadership skills). The findings show that personality characteristics are related both directly and indirectly (through the skills) to the performance of audit managers and partners (as measured by their internal performance ratings). Extraversion shows the strongest positive relationship with performance. Carefulness and emotional stability have a positive effect on performance, while the direct effect of kindness on performance is negative. In short: personality matters. The second part of the research project concerns the cooperation ('dyad') between partners and managers. What effect does this shared leadership have on the effectiveness and performance and viability of the audit team? The research team examined the effect of two leadership behaviors of partners and managers, namely initiating structure and individualized consideration. They find that the best performance is achieved when both leadership behaviors are present with the partner. However, there is also a complementary effect. The best effectiveness of the team is achieved when the skills are divided: when one leader scores high on initiating structure and the other on individualized consideration, and vice versa. The findings suggest that audit firms should strive for team diversity in terms of personality characteristics and leadership styles.

## Purpose of the project

The purpose of our project is to investigate what makes audit partners and their teams successful. We consider a number of different dimensions of success: individual performance of partners and managers, how well a team does work together and engagement level audit quality outcomes. We rely on organization behavior and psychology research and study our question at three different levels. The first level, which is also the focus of today's presentation, looks at the audit partners and the managers individually. We want to investigate what personality characteristics affect their overall performance. Of course, we acknowledge that the partner and the manager lead the audit engagement team together. We refer to this as a 'dyad'. At this second level, we want to investigate how these partners and managers work together and when they function best. At the third level, we examine how this dual leadership jointly influences the engagement team. We view all these elements as different puzzle pieces that come together to shape audit quality. We hope that we can provide you with novel insights regarding each of these puzzle pieces and how they fit together to affect audit engagement teams and their performance. Ultimately, our goal is to provide different scientific insights that can be used to manage and compose audit teams in a more scientific way.

## Personality (characteristics) and job performance

In the first study, we look at the personality of audit partners and managers. Specifically, we look at how personality affects their overall job performance. We know from prior audit research that audit quality varies across individual auditors, but we do not really know

why this variation arises. Other academics have studied several characteristics and demographics, but these don't seem to explain a lot of the variation. This suggests that there are more deeply rooted factors that are connected to individual behavior that affect the auditors. We build on organizational behavior and psychology literature to study the role of personality. Personality comprises individual traits and patterns that make us who we are and affect how we behave. Those traits are constant across situations and across time. From the psychology literature, we know that personality is predictive of performance. We also know that different personality traits matter across different professions. For example, a police officer requires different personality traits than a teacher. Therefore, we chose to study the role of audit partners and managers personality traits. We basically say that personality can affect performance both directly and indirectly (through different skills).

In the psychology literature, the most well-known personality model is the five-factor model, which includes five traits that are assumed to determine overall personality: agreeableness, conscientiousness, emotional stability, extraversion and openness to experience. An agreeable individual is tolerant and likes harmony. A conscientious individual is someone who is very diligent and hard working. Emotionally stable means that a person is secure, calm and not ill-tempered. Extraversion is the degree to which a person is open and outgoing. And openness to experience is the degree to which a person prefers change over routine and is creative and imaginative. We also look at the so-called 'dark triad', which indicates the dark side of someone's personality,

encompassing Machiavellism, narcissism and psychopathy. Finally, we look at bravery, which we believe to be one important trait for an auditor because it captures the inherent willingness to raise issues, even when facing opposition.

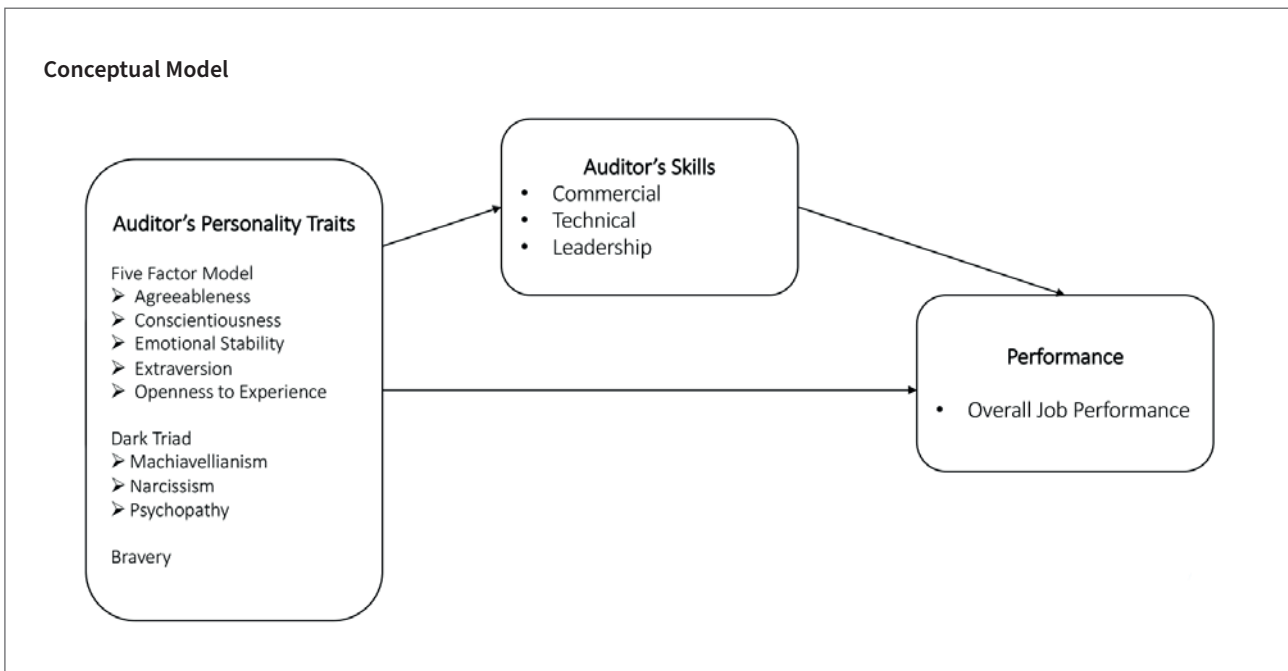
Of these personality traits, we consider a direct and indirect link to performance. For the indirect link, we know that an auditor's job involves different tasks that relate to three broad skills areas: commercial, technical and leadership. The commercial aspect is about generating income. The technical part concerns the ability to complete an audit effectively. Leadership involves the team orientation: does the leader spend time on mentoring and guiding the team? It is not difficult to imagine that to be good at commercial or leadership skills, it probably pays off to be extraverted and to be open to the team, whereas for the technical skills we believe that, for example, conscientiousness (the degree to which a person is detail-oriented and hard-working) could be beneficial.



## In short: personality matters

### Data

We collected survey and internal audit firm data. The survey was used to assess the skills and the personality characteristics. For performance, we used the audit firm's internal performance assessments. The total the sample consists of 1618 auditors, collected from all the audit firms that participate in FAR. The average professional experience is 16.1 years. We focus on the manager to (equity) partner levels. We categorize salary partners and associate partners as directors.



**Findings**

In general, we find that auditors at Big4 firms are more outgoing and open to new experiences. They also, on average, are more diligent and thorough, as captured by a higher degree of conscientiousness. They are also more agreeable, and they assess themselves higher on technical and leadership skills. This could be due to a different focus in the culture. Regarding the non-Big4 firms, we see that, on average, they score higher on the Dark Triad factors. This is most pronounced for the partners. We also find that auditors at the non-Big4 firms are more committed to and satisfied with their job. They assess themselves higher on commercial skills. Looking at the results across the function levels, we see that auditors become more and more similar the higher they are up in the hierarchy. We don't know whether this is good or bad, but it is an important finding. In addition, we find that certain personality traits become more pronounced, the higher they are in the hierarchy. For example, audit partners are on average more extraverted and more open to new experiences, which can be beneficial for the commercial side

of the audit. For conscientiousness (how thorough and diligent auditors are), we find a very high level for all function levels, which is not surprising given the nature of the auditor's work. Furthermore, what really differentiates partners from auditors at the other function levels, are the leadership (team oriented) skills and the commercial skills. Last but not least, satisfaction and the commitment towards the organization and the profession also increases with function level.



**From a technical point of view, you need to be grumpy but careful**

The big question is whether these differences actually matter: do personality traits affect the different skills? We indeed find that different personality traits matter for skills. For commercial and leadership skills -which can be characterized by a larger degree of interaction, either with the client or with the team- we find that factors like extraversion and the degree of agreeableness are

positively related with these skills. Remarkably, we also find that the dark triad factors are associated with higher commercial skills. Concerning the technical skills, we find that being conscientious (detail-oriented and hard-working) and open to new experiences are beneficial for the technical aspect. It is interesting to see that agreeableness has a negative relationship with technical skills.

If we put everything together to see how personality affects skills and performance, we find the following. Both the relationship through skills, as well as the direct link are predictive of performance. Initially we thought that all three skills would be rewarded in the performance measure, but we only find that the commercial and technical skills are rewarded in the performance measure. However, this changes for audit partners. We find that what differentiates a good partner from a bad partner are the leadership skills.

While agreeableness is positively associated with the commercial and leadership skills, it has a direct negative relationship with performance. So, being very

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## Auditors at Big4 firms are more outgoing and open to new experiences

caring about others and striving for harmony seems to hurt the performance of an auditor. Being an auditor means that you sometimes must face confrontations. We find that extraversion is the strongest predictor of performance. It has both an indirect effect through the skills as well as a direct positive effect on performance. In addition, conscientiousness (being hard working and diligent) as well as emotional stability also have a positive effect on performance.

### What can we learn from this?

The findings suggest that personality matters. This might be intuitive, but what we clearly find is that auditors with certain personality traits are inherently different and may be inherently better at certain skills. Interestingly, we see opposite signs between the personality traits. For example, extraversion and agreeableness are positively related to the commercial and leadership skills but agreeableness has a strong negative effect on the technical side of the audit and on the overall performance. Also, the dark triad has a positive effect on commercial skills, but a negative effect on the overall performance. Hence, there is a tension between the different personality types in the audit firm and some people have better commercial than professional skills, just because of their personality. This is something that audit firms can work on further.

To be a good auditor from a technical point of view, you need to be grumpy but careful.



Agreeableness doesn't help and conscientiousness helps. But if you're on the commercial side, it's okay to be a little grouchy, it's okay to have some elements of the dark triad. These skills seem to coexist and play a role. Auditors are not homogeneous, they have these multiple skills. The firm needs all these skills and managing them is a real challenge for the organizations.

### Brief outlook on dyad study

Audits are kind of unique in that there are two senior people who co-lead the engagement. In a related study, we look at the leadership behaviors of the manager and partner and the effects this has on the performance of the audit team. There are two distinguishing features of leadership behaviors that lead to team success. One is called 'initiating structures'. Initiating structures are laying down the rules of whose responsibility is it to do what. In the audit, we typically think of that as being done by the partner, but it might not be exclusively so. The other leadership function involves 'consideration skills', for example showing the team that you care for their well-being and listen to them. We find that these two skills are indeed very important and that the result is mediated through so-called 'team efficacy'. Efficacy simply means 'do you feel capable of doing the audit?' It is a team assessment of how capable the team feels. As the team feels more capable to

do the audit well, then that flows through to the outcomes that we look at. The outcomes in that study are: completing the performance deadlines in a timely manner and whether the team wants to work together again.

The leaders of the team need to provide structure for the engagement through their leadership. But they also have to exhibit consideration leadership behaviors, so that people know the leadership cares, they are interacting with them, and they are interested in them. The findings show that it doesn't matter necessarily which leader has the skills, but you need to have both skills. These dyads perform more effectively, meaning the teams feel like they would like to work together again, and they feel they meet the deadlines in a timely manner. The best performance of all occurs when the partner has both skills.

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## Audit firms should strive for team diversity in terms of personality characteristics and leadership styles

Q&A-session and discussion by Marnix Pouw (Deloitte). A brief summary of the discussion and selected Q&A's are included below.



In his elaborate discussion, Marnix Pouw wondered what he would change in practice, based on the research results. The topics are summarized in the table below. For example, the resource planning of teams is predominantly based on industry knowledge, experience and availability. The presented study shows that different skills are necessary and that they are related to different personality traits. This should be taken into account, but poses the challenge of resource scarcity. Another issue Pouw mentioned was the finding that there is an increase of similarity between auditors when they move up the hierarchy. That may not always be a good thing, since a changing audit environment requires different skill

sets. Pouw encourages building in more room for unique characters into the performance evaluation and personal development systems.

**Selected Q&A's**

**Are personality characteristics stable? Can they be changed?**

'Personality traits have been shown to be relatively stable by the time a person is in their 20s. As you get older maybe things change a little bit, but in a long period of a working career they are pretty stable over time. Therefore, we can't change the way people are. It is more a question of recognizing what people are and figuring out how to best manage them.'

**Perhaps the required personality of successful partners changes as board members of clients become more diverse?**

'It is very well possible that the characteristics of partners change as clients get more diverse. Unfortunately, we don't have the data to test this. It would be very welcome, though.'

**You focus on the big five personality traits model, but you also see a trend towards adding honesty-humility, which is the tendency to be genuine and fair. This seems especially important in a team context. Did you consider including that as well?**

'We did include it in the survey. But our data clearly show a five-factor structure. The honesty-humility factor doesn't have any explanatory power. So, we stuck with the traditional model. Of course, we talk about this in the paper. We were surprised. It would have been a nice story to tell if honesty was positive. Fortunately, we also didn't find that dishonesty is good.'

**The conference presentation (including the complete Q&A-session) can be found here:**

[https://youtu.be/BhInCzq5U\\_o?t=9184](https://youtu.be/BhInCzq5U_o?t=9184)

**The slides can be downloaded here:**

<https://foundationforauditingresearch.org/files/4-far-conference-presentation-2022-francis.pptx>

**If I was the leader of an audit firm, what would I change based on the research results?**

Topic	What is my experience?	What would I change?	Which challenges do I foresee?
<b>Team composition</b>	<ul style="list-style-type: none"> <li>Resource planning based on industry knowledge, experience and availability</li> </ul>	<ul style="list-style-type: none"> <li>Resource planning focused on complementary skill sets</li> </ul>	<ul style="list-style-type: none"> <li>Resource scarcity</li> </ul>
<b>Training</b>	<ul style="list-style-type: none"> <li>Focus is on job level</li> </ul>	<ul style="list-style-type: none"> <li>Targeted training</li> <li>Training on the job</li> </ul>	<ul style="list-style-type: none"> <li>Balancing generic and targeted training</li> </ul>
<b>Collaboration and habits</b>	<ul style="list-style-type: none"> <li>We like working with people who have similar characteristics</li> </ul>	<ul style="list-style-type: none"> <li>Using an objective model to eliminate bias</li> </ul>	<ul style="list-style-type: none"> <li>No practical model (yet) available (?)</li> </ul>
<b>The "traditional audit partner"</b>	<ul style="list-style-type: none"> <li>Future readiness</li> <li>Performance evaluation system</li> </ul>	<ul style="list-style-type: none"> <li>More room for unique characters in performance and development systems</li> </ul>	<ul style="list-style-type: none"> <li>Objectivity</li> </ul>

**For more information regarding the project, please refer to:**

<https://foundationforauditingresearch.org/en/research-publications/projects/2019e01-what-makes-audit-partners-and-their-engagement-teams-successful-prof-dr-francis/>

## BUSY SEASON TALKS LIVE

During the conference, a special edition of the popular Busy Season Talks took place, for the first time with a live international audience. Presenters Hakan Koçak and Charlie Groen (both working at PwC) interviewed Therese Grohnert (Maastricht University), Auke de Bos (EY and EUR) and Mark Peecher (University of Illinois).

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### **It should be possible for auditors to ask questions, without being disciplined for not knowing everything**

Auditors are highly educated, motivated professionals who work in an uncertain and highly regulated environment. Therefore, Grohnert describes auditing as a very interesting research area. She is particularly interested in the role that learning culture plays, and can play, in the field of auditing. Grohnert argues that it should be possible for auditors to ask questions, without being disciplined for not knowing everything. It is also essential that such behavior is being encouraged. This all starts with exemplary behavior by the managers. Furthermore, occasionally a time-out in the decision-making process should be taken. This ‘reflexivity’ turns out to be very valuable, according to Grohnert. She also advocated a more intensive cooperation between academia and auditing practice. Practice must be continuously involved, also in the development of the research questions and the research design: “Throwing thousands of questionnaires over the fence is sub-optimal. Consultation is important in conducting meaningful and accepted research”.

De Bos highlighted the positive development that the role of all audit supply chain participants in the reporting and assurance process is currently being more explicitly discussed. Also, when pilot testing innovations, collaboration with these chain partners is essential. It leads to a sustainable contribution to audit quality. Moreover, De Bos identified three important factors at the audit firm

level: digitalization, sustainability, and diversity. Diversity is a theme that was mentioned regularly during the conference and also De Bos thinks it is important that people with diverse backgrounds work together in auditing. Based on various experiences with hospitals - where an explicit time-out takes place before an operation starts - De Bos also advocates inserting time-outs during the audit process, for example before the issuance of the auditor’s report.

Peecher praised the unique situation in the Netherlands concerning the collaboration between academia and audit practice: “There is a vigorous attempt by academics, practitioners, regulators and FAR to try to get to real answers.” He said that the data collection is very well organized and coordinated by FAR. He also indicated that, in the field of auditing research, practical relevance is taken into account above average, when compared to other scientific fields. However, Peecher did warn against relying on the results of individual studies. Practicing auditors should always interpret research findings in the context of the existing literature and what they already know from their own practical experience.

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### **It is important that people with diverse backgrounds work together in auditing**

The last question of the session remained unanswered, but it certainly makes one think: which activities and procedures that the auditor performs can be omitted? ‘What can we stop doing?’ Peecher concluded with survey results that show that the auditor is in the top 5 most trusted professions, and he encourages to strive for keeping the profession in this highly ranked position.

**The recording of the session can be found here:**

[https://youtu.be/BhInCzq5U\\_o?t=14055](https://youtu.be/BhInCzq5U_o?t=14055)



# Bankruptcy and auditor's reporting in the Netherlands

**Presented by:**

*Tjibbe Bosman (Universiteit van Amsterdam and Program Manager FAR), co-authored by Merel van de Kuip and Wim Janssen (during their appointment at FAR).*

**Abstract**

Tjibbe Bosman presented a study on Dutch bankruptcies and the related audits in the years 2012-2020. Only 0.3 percent of the organizations under a statutory audit regime went bankrupt during this period. However, it is important to realize that a small number of large bankruptcies do cause the greatest social damage. Bosman notes that fewer annual accounts and audit opinions are filed in the years preceding a bankruptcy. This problem increases as the bankruptcy date approaches. In the filed annual reports, management does not signal continuity risks in more than 70 percent of the cases. And in most cases, the auditor's reports do not contain a going concern opinion, while these organizations do go bankrupt afterwards. According to Bosman, the economic enforcement agency should enforce the Dutch filing obligation more strictly and the chamber of commerce should make access to the information easier. Audited organizations are often concerned that a going concern opinion will lead to bankruptcy, as a self-fulfilling prophecy. Based on the data examined, this fear appears to be unjustified. In 99.3 percent of these audit reports issued, the company is not yet bankrupt 12 months after this balance sheet date and 92.2 percent still exists after 36 months.



## What can bankruptcies teach us about auditing?

This study analyzes bankruptcy and auditor reporting in the Netherlands, based on publicly available data. What can bankruptcies teach us about auditing? Well, at least the Pincoffs' bankruptcy scandal stimulated the start of the auditing profession in the Netherlands, in which we view the auditor as the trustee of the general public. An important question is whether auditors live up to that expectation. Does the general public benefit from the auditor's role in society? The Dutch statistics agency (CBS) estimates the damage from bankruptcy at 4.4 billion euros each year, which is about 0.7 percent of GDP. Going concern is also an important and recurring topic on the policy debate, in which the question is whether continuity should get a bigger and more recognizable role in the audit. However, improving or extending the scope of the audit and the responsibility of the auditor is a potentially very expensive measure.

### Relevant data

But how do auditors perform in this area? How many GCO's are being issued? How many bankruptcies are present, how did these entities file prior to bankruptcy and how did management disclose discontinuity risks? Also, what audit opinions were filed prior to this bankruptcy? This relates to the fundamental criticism on the auditing profession: if a company goes bankrupt, why didn't

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**The economic enforcement agency should enforce the Dutch filing obligation more strictly**

the auditor warn for that? And how many entities with GCO's eventually go bankrupt? And furthermore: what is the societal damage from these bankruptcies that are under mandatory audit regimes? An issue in practice with issuing a GCO is that some auditees consider this to be a self-fulfilling prophecy and that for example the bank will lose faith in the company and as a result it will go bankrupt. We can check how likely that is, based on macro data. We collaborated with several parties (among which are Company.info, Bureau Van Dijk, CentERdata and the NBA) to collect data for more than 208 thousand organizations in the Netherlands.

### Findings on bankruptcy and filing

We have analyzed the percentage of statutory audit opinions with a GCO from 2012 to 2021. We see a GCO-peak in 2020-2021, which is very likely due to the COVID-19-crisis. In 2021, in about 18 percent of the audit opinions the auditor warned for material uncertainty related to going concern. But also before the crisis, there was an increase in the number of GCO's that auditors were issuing.

Among the organizations under mandatory audit regime that we studied, we found 572 bankruptcies. That's 0.3 percent of all yearly statutory audits during the period 2012-2020. Mainly, companies in the manufacturing, construction and retail industry go bankrupt.

One year before bankruptcy, publicly available data are hardly available from those entities. Also, three years prior to bankruptcy, we already see that only 64 percent comply with the filing and regulation requirements. One of the big issues in the Netherlands is that we do not enforce filing of mandatory financial statements and audit



opinions. The publicly available information decreases as bankruptcy approaches. There is a cost attached to filing financial statements, because competitors also read the financial statements. Therefore, firms generally do not like to disclose everything.

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**The publicly available information decreases as bankruptcy approaches**

Interestingly, we also looked at the files of the insolvency collector who dissolved the bankrupt entities. We find that many companies disclose that the main reason that they were not able to file audited financial statements is that the auditor raised issues. This may be a good message for the auditing profession. Unfortunately, this type of data is unstructured, which makes it difficult for stakeholders to find this information. And some of it is not publicly available, but is, for example, included in the management letter.

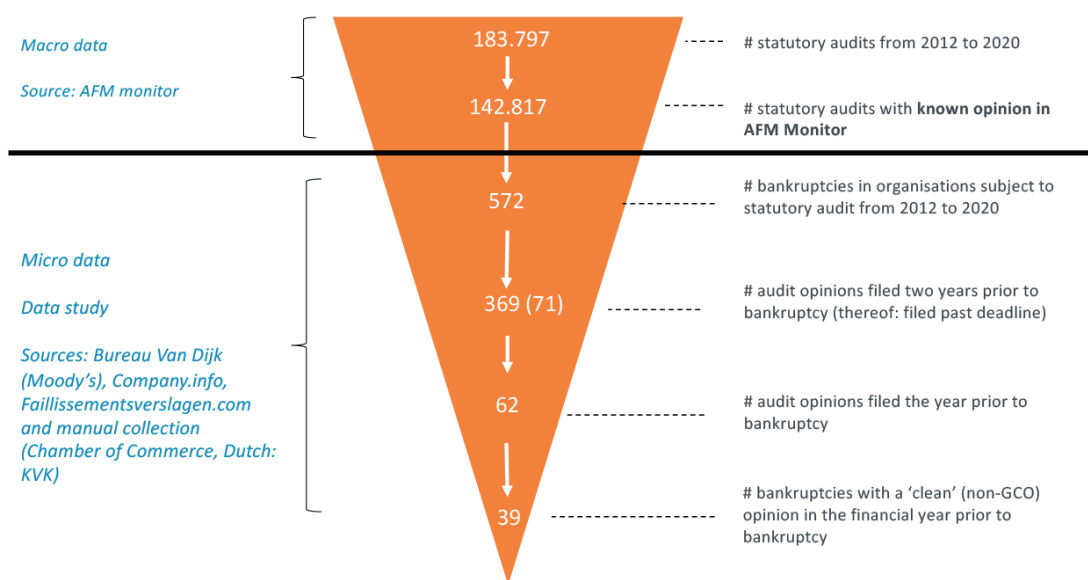
### Disclosure of continuity risks and audit opinions

Our sample consists of companies that eventually go bankrupt. In nearly 80 percent of the cases, *management* discloses no continuity

# 1. Descriptive Results: Which audit opinions were filed?

## Data

Research Method: Statutory Audit Opinions issued in 2012-2020



risks in the filed financial statements three years before bankruptcy. This decreases somewhat to 70 percent one year before bankruptcy.



### 88 percent of the organizations that go bankrupt do not file audited financial statements before the legal deadline

There were nearly 184,000 statutory audit opinions issued in 2012-2020 (see figure). Based on data from the AFM, we know the opinion of nearly 143,000 of them. We find 572 bankruptcies and we still find 369 audit opinions filed two years prior to bankruptcy. Just a year before the entity files for bankruptcy, we only find 62 audit opinions, out of the 572 that go bankrupt. And here is the (maybe) bad news for the auditing profession: of those 62 audit opinions issued, the majority (39)

did not include a warning relating to discontinuity. However, that is not necessarily wrong, since there might be information after balance sheet date that forces the entity to file for bankruptcy. But on the macro level this could be bad news.

#### Miscellaneous findings

For all bankruptcies, we collected information from the courts. At the courts, the insolvency collector needs to identify the debt affected by the bankruptcy, 11 billion euros related to the 25 largest bankruptcies in this period. If we look at the at the largest bankruptcy, the company did not even have a Dutch auditor. The trade register did not notice it and nobody enforced. The insolvency collector was the first one to flag it. We brought this phenomenon under the attention of the *Kwartiermakers*, at the European Commission and at the NBA. So far, there is no progress on the issue. If a company does not file obligatory financial statements in the Netherlands, the first one who will catch you is apparently the insolvency collector.

Another interesting question is how many entities that have received GCOs actually go bankrupt. In 99 percent of the cases in which a GCO was issued, 12 months after balance sheet date the company did not end up in bankruptcy. In 23 cases in which a GCO was issued, bankruptcy proceedings were opened within 12 months after balance sheet date.

Also interesting is the fact that the GCO is invisible in the standard financial statement product at the trade register.

#### Main conclusions concerning the descriptive study

The legal obligation to provide data is not complied with by organizations in many cases.

88 percent of the organizations that go bankrupt do not file adopted and audited financial statements (or a 403-statement) for the year prior to bankruptcy, before the legal deadline. This percentage is 44 percent for two years before the

bankruptcy and 36 percent for the three-year period.

Furthermore, essential information provided by management is missing from financial statements. 71 percent of the filed financial statements in the year prior to bankruptcy do not contain a disclosure by management of the going concern risk or situation.



### **A small number of large bankruptcies cause the greatest social damage**

And in 88 percent of bankruptcies, the audit opinion is missing for the financial year prior to the year of bankruptcy. The majority of filed audit opinions are non-GCO and do

not include a voluntary disclosure. But for the majority (63 percent, or 39 instances out of 62) of audit opinions issued for the fiscal year before the insolvency, the auditor did not include a material uncertainty relating to going concern (GCO) in its audit opinion.

#### **Subsequent hypothesis testing**

The question is what bankruptcy can teach us about auditing? The Netherlands decided to use the highest EU thresholds for the mandatory (statutory) audit requirement. An important question is whether mandatory audit requirements are associated with lower bankruptcy damage. I expect that a mandatory audit requirement is associated with lower debt by insolvencies. The expectation is that there is an important preventive effect from the need to hire an audit.

Insolvency debt data were collected for companies just above and also below the mandatory thresholds. The results show that the year before bankruptcy no company voluntarily hires an auditor, or at least files an audit opinion. Based on the data, the general public seems to benefit most from a statutory audit requirement.

Even though we don't have a lot of filings prior to bankruptcy, the good thing is that the insolvency collector needs to report on that. Remarkably, as also mentioned earlier, it might be the audits that were not finished that are beneficial to society.

Q&A-session and discussion by Marnix Kalkman (Mazars). Selected Q&A's are included below.



**Auditors need reliable information for providing the audit opinion. On the other hand, the general public only has access to company information from the chamber of commerce. What is the optimal balance between reliable and timely available information?**

‘For many companies that go bankrupt, the latest set of audited financial statements has been published years ago. And then the first thing after that is the bankruptcy filing, publicly available from the chamber of commerce. I think that is an issue. However, auditors get information and need to consider client confidentiality which might keep them from disclosing the information. Experimental research in this area may help us.’

**Is there a relationship between timely filed financial statements and a decrease of the social cost of bankruptcy?**

‘The assumption underlying legislation is that timely reliable public information helps markets with efficient allocation of capital. A real issue in Netherlands is the access to information. If we compare listed companies in the Netherlands to the companies in Germany, Belgium, the United Kingdom and the United States, the financial statement information is not that structured in the Netherlands. I think even in general, Europe would benefit from having one single EU trade register where xbrl is implemented. Xbrl is not fully implemented in Netherlands, yet. Many companies still just submit a very badly scanned document. Another issue is that the Dutch chamber of commerce claims property rights concerning information that companies file and requires a fee for acquiring it. From a societal perspective, this is a very inefficient solution, if you want to allocate capital efficiently.’

**The recording of the conference presentation (including the complete Q&A-session) can be found here:**

[https://youtu.be/BhlnCzq5U\\_o?t=16367](https://youtu.be/BhlnCzq5U_o?t=16367)

The slides can be downloaded here:  
<https://foundationforauditingresearch.org/files/5-far-conference-presentation-2022-bosman.pptx>

For more information regarding Tjibbe's projects, please refer to:  
<https://foundationforauditingresearch.org/en/research-publications/projects/2020b07-the-institutional-context-in-and-conditions-under-which-auditors-deliver-quality-phd-project-t-bosman/>



# Regulation and audit firms

**Keynote speech by:**  
*Yasmine Chahed (Alliance  
Manchester Business School)*

## **Abstract**

Yasmine Chahed was a member of the team behind the influential Brydon Review into the Quality and Effectiveness of Audit. In her keynote address, she discussed audit regulation from the UK perspective. In 2019, the Brydon report and two additional other commissioned reviews into the future of audit, featured more than 150 recommendations for reform. British critics are disappointed that there is still no clear plan for implementing the recommendations. There are, however, plenty of opportunities to tackle improvements that are not dependent on legislation. These opportunities derive from Brydon's absolute conclusion that any reform package starts with a clear vision of the social purpose of audit. Taking that view suggests that the scope and practices of audit cannot remain static. Audits should adapt to the needs of users, who want to have greater confidence in companies, their directors, and the information they report (including non-financial and forward-looking information). Auditors should not be endlessly busy with consultations to look for ideal solutions. Instead, audit reformers must create conditions for innovation, experimentation, validation, and competition to be focused on, and judged against, delivering the desired new audit future. Auditors should roll up their sleeves and practice what they can do differently and better serve the public. Importantly, working on a socially more valuable audit will certainly also increase the attractiveness of the profession.



### High-profile company failures

Many of you may recall the dramatic moment four years ago when a British MP told KPMG and Deloitte: ‘I would not hire you to do an audit of the contents of my fridge’. This damning remark came during a tense Select Committee hearing as MPs questioned the judgement shown by the two auditors at the center of the Carillion collapse. The firm went into receivership in early 2018, owing its creditors one billion pounds and over four billion pounds to its suppliers and pension fund, and leaving 18,200 people worried about their future employment. This debacle was just one of several high-profile company failures that highlighted how auditors failed at the most basic tasks, like counting cash, distinguishing assets from liabilities, or spotting large-scale fraud. It was an industry-wide problem. PwC was fined a record ten million pounds in 2018 for its audit of the collapsed retailer BHS. Grant Thornton paid more than two million pounds in fines for a ‘serious lack of competence’ in its audits of the cake chain Patisserie Valerie. And when Thomas Cook came down crashing later in 2019, the spotlight just shifted to EY. In their defense, most of the auditors usually gave an outpouring of commitment to do better, next time. But over the years, such weak responses, coupled with the failure of auditors to notice the warning signs of business collapses, precipitated a crisis of trust that led

to the Government, investors and other stakeholders calling for a root and branch review of the UK audit industry.



### Some say audit reform debate in the UK produced much ado about nothing

#### Reform is needed

Of course, crises of trust in audit are not new. But unlike before, in 2018, the UK Government was determined to take matters into its own hands. To drive reform, it commissioned not just one, or two, but three independent reviews to inform legislative changes:

- One on ‘the future of the audit regulator’.
- A second on ‘the statutory audit market’.
- And a third into the quality and effectiveness of the audit itself.

That third review was led by Sir Donald Brydon, an experienced FTSE 100 chairman from the city of London. As an academic and policy expert, I was invited to join the review team.

The three reviews took just under two years to complete and together they produced over 150 specific recommendations by the end of 2019. The sheer amount of those recommendations was already a stark reminder of the complexity of the entire ‘audit ecosystem’, covering not just audit but all areas of corporate governance and reporting. The recommendations were published in late 2019. Only last month, the Government belatedly responded by repeating its commitment to introduce holistic

regulatory reform. But commentators are disappointed because there is still no clear timetable for implementing legislation.

Does this lack of progress matter, you might ask? Not really, because none of the legislative proposals put forward in May 2022 directly addresses the need to deliver ‘better audits’. Instead, the Government has made it clear that it wants to use primary legislation to drive changes only in three areas directly related to audit:

1. The audit market by demanding FTSE 350 companies to hire a second auditor, a so-called challenger firm for at least parts of their audit.
2. The organization of audit firms, by giving the regulator the powers to enforce operational separation of audit and non-audit practices.
3. Through the creation of a new and more powerful regulator.

The next question is whether the Government’s proposed interventions can address the fundamental concerns that gave rise to calls of audit reforms in the first place, including concerns over auditors failing to challenge management effectively. Or insufficient competition and choice in the audit market. Or a lack of auditor concern with long-term resilience and complex fraud risks.

#### Split audit of the fridge

In my opinion, the earlier mentioned ‘audit of your fridge’, would under the legislative reform package be split between two firms, both with new government arrangements overseeing their strategy, pay and training, but one being most likely too short to get to the higher shelves of your fridge. The new audit would follow a highly documented process

that will undoubtedly confirm what you have in your fridge and certainly give reasonable assurance on use-by dates. But is this audit of your fridge any more informative than the audit you had before? Does it tell you whether you have everything it takes in terms of ingredients, skills, and equipment to produce a nourishing meal? Or whether you can pay for electricity to keep the fridge running in the longer term? In other words: the problem with the proposed legislative reform is that no amount of change to audit firm governance, the audit market, or regulatory oversight can deliver what is really required by society in terms of ‘better audits’.



### Working on a socially more valuable audit will increase the attractiveness of the profession

#### Much ado about nothing?

Some say four years of audit reform debate in the UK produced ‘much ado about nothing’. But I’m more optimistic. I see real opportunity in those parts of the Government’s response that do not require primary legislation. And that positive outlook is very much led by my experience on the Brydon Review. It was the Brydon Review’s absolute conclusion that any reform package starts with a clear vision of the social purpose of audit. I agree that the scope and practices of audit cannot remain static. This is especially true, as it is now widely accepted that the purpose of business in society evolves and with it the sources of risk and value are changing too, to become more non-financial, more outward-looking, and more long-term. Suppose an

audit was to match the redefined purpose of business in a stakeholder capitalism environment. In that case, you could think of practices reaching as far as carbon auditing and valuing nature. But let’s be honest, today’s audits are hardly any different to those performed 70 years ago. They are still narrowly focused on attesting to the truth and fairness of a backward-looking set of financial accounts. If audit is indeed a public interest function, then the scope of an auditor’s work in the 21st century must clearly go further. It must respond to what users need from an audit to give them confidence in the economic decisions they make.

#### A clarified purpose of the audit is needed

With this in mind, coupled with the results of an extensive stakeholder listening exercise, Brydon suggested that the definition an audit’s purpose should be reframed. It should be: *‘to help establish and maintain deserved confidence in a company, in its directors and in the information for which they have a responsibility to report, including the financial statements.’* I was happy when I saw the Government’s continued endorsement in its response of Brydon’s proposed purpose and that it should guide all regulatory work and all market activity, even if not formally enshrined in law. From my perspective, the adoption of such a clarified purpose of audit, led by real stakeholder needs, can produce the radical change needed to deliver the audit reformers’ vision for restoring trust in audit and corporate governance. Similar calls for rethinking the scope and purpose of audit have resurfaced at least over the last 30 years. So, starting from that perspective, I would say that maybe it is time to pick those ideas up.



### Audits should adapt to the needs of users

#### How to embark on the reform journey?

So, how do we embark on this journey of real reform? We can think of it as a dynamic process that follows along 5 Ps: Purpose, Principles, Practice, Profession, and Public Interest. Purpose comes first, because we need to adopt a broader purpose statement as an impetus for action that transforms the way we approach and think about audit and conceptualize what an audit is. Instead of constantly trying to fix a 70-year-old version of audit, we must examine why the audit matters to society, today and tomorrow. If you listen carefully, it is clear that society wants an audit function that indicates the ‘deserved confidence’ of the whole company. Next, to enact that broader purpose, we should support a principles-first approach. Principles allow us to think more creatively about what an audit could be and what wider judgments it should entail to deliver more confidence than standard procedures provide. After all, if auditors want to be seen as a true profession, they should seek opportunities to behave like one. And that also means embracing the uncertainty of change. A focus on actioning ideas in practice, the third P, should make that easier. Instead of having endless rounds of consultations, in which every party is pressed to present an ideal solution to a problem, we should give auditors an opportunity to roll up their sleeves and demonstrate, in practice, what they think they could do better or differently -given their current and potential skill sets- to serve the public interest.

For example, we could ask:

- What would an audit look like that increases directors' accountability on ESG, value creation, and impacts?
- How can an auditor play a role in detecting but also preventing complex fraud or greenwashing?
- Where can an audit support those who need to deal with the unavoidable uncertainty in assessing a company's long-term resilience?

Such a market for actioned ideas also invites more open-mindedness about who can be an auditor and who can help establish and maintain deserved confidence. This will involve embracing old and new suppliers of auditing and assurance services who can provide clients with the best solutions to confidence problems and create actual competition and choice in the audit market. And it has further implications for the profession. If we can embrace innovation around a broader concept of auditing, we can create a more vibrant audit profession, one that connects and integrates diverse skillsets and also boost the attractiveness of the profession to current and future talent. At least in my experience, graduates really want to know how our profession is making a positive contribution to society.

“

### **There are plenty of opportunities that are not dependent on legislation**

One step further, such purpose-led actions will also change the outlook on what it means to deliver audit quality in the public interest. In the UK Business Secretary's own words:

*'Effective corporate reporting and audit ensures investors and the public can assess the health of large companies. It is crucial to supporting confidence in businesses, encouraging investment and growth which in turn helps create jobs.'*

### **Be curious and experiment more**

Finally, I would like to see all of us spend more time being curious and experimenting. Other professionals already have well-established regulatory labs or sandbox-environments that help overcome persistent blockers of change by bringing all interested parties together to work out an actionable solution. Sometimes that can also mean defining what the problem is in the first place. In addition, such experimentation and road testing of ideas creates opportunities for regulators who are keen to oversee innovations, and their effective testing and diffusion. It is also an

opportunity for audit firms to be more proactive and show where society can get more value for money for an audit. And for Governments, a more experience-based approach to change can provide much needed evidence to get meaningful legislation drafted, and to get it over the line.

“

### **Any reform package starts with a clear vision of the social purpose of audit**



Selected Q&A's from the discussion are included below.

**You mentioned that some industries are further in using the sandbox approach. Can you share some insights on that?**

‘It’s a global phenomenon in financial services. It is good to consider what is being done in financial services, including regulation, to see how these regulatory sandboxes have been developed, how they bring together different players, and how they also create comfort for those providing those services. What we also have in the UK, but also at the European level, at EFRAG, the European Financial Reporting Advisory Group, is a so-called ‘lab environment’. This is, at the moment, mostly focused on corporate reporting. In that financial reporting lab, the idea is to create a safe space for companies and investors to work out ways of dealing with very complex reporting problems. As we all know, standards can be drafted in in very detailed form. But we might still not know what good looks like. So, the lab setting is an opportunity to figure that out, while having a feedback mechanism from the regulatory and policy discourse to learn what works.’

**Your presentation comes across as if, for example, detailed recommendations are less relevant, since it is quite clear what should be done?**

‘That is very well spotted. Many commentators said government was going about audit reform the wrong way, by starting with audit market and the audit regulator, and effectively it should have started with a concept of audit in the first place. We should first agree what we mean when we talk about an audit. What are we trying to achieve? Then we

can think about the reform. When you read the Brydon review carefully, it becomes clear that the whole report includes only one call for action and that’s the call to rethink the purpose of audit and make sure we all agree on that purpose. All the detailed recommendations are almost like a manual of all the areas you might want to look at as auditors, directors, legislators and investors.’

**Is that concept embraced by the UK government?**

‘Yes, in a way. That makes me very optimistic. If you read the government’s response, it has acknowledged the importance of thinking about the broader purpose of audit. It embraces the idea that there should be a wider audit. It is also very clear in saying that it is not up to the government to legislate or to mandate. It is up to the market to develop that, as you would develop new products in other markets as well.’

**It seems to me that somehow your presentation somewhat conflates the performance gap with the expectation gap?**

‘Brydon rejects the expectation gap as a starting point for the conversation. Instead of spending a lot of time conceptualizing the gap itself, the idea is to ask stakeholders what they expect from an audit. You get a hundred different answers, which also means there’s not “the” expectation gap. The different expectations point in a direction where you must think about how the audit can become more responsive to those different expectations. But we have to start with the broad purpose which is universally applicable.’

**The recording of the conference presentation (including the complete Q&A- session) can be found here:**

[https://youtu.be/aNSID\\_WZ6IU?t=721](https://youtu.be/aNSID_WZ6IU?t=721)

**The slides can be downloaded here:**

<https://foundationforauditingresearch.org/files/6-yched-background-slides-far-conference.pptx>

## PANEL DISCUSSION

# THE ORGANIZATION OF THE AUDIT: EXTERNAL EXPECTATIONS

Jan Bouwens (University of Amsterdam and managing director of FAR) chaired a panel discussion on the desirability of auditor conservatism, entitled *The organization of the audit: external expectations*. Panel members were Marlies de Vries and Chris Fonteijn (Quartermasters/'Kwartiermakers'), Edo Kienhuis (IAASB and PwC) and Agnes Koops (PwC).

Jan Bouwens asked the panel what form of conservatism an auditor should use to look after the public interest. He presented a choice of three attitudes that the auditor can (hypothetically) adopt: (1) a very critical and conservative attitude; (2) an essentially conservative attitude, but at the same time thinking along with the client when possible; and (3) a flexible attitude ('fully accommodating'). It became clear that none of the panelists saw any benefit in choosing one particular option.

“

### When auditors make mistakes: don't punish but learn

Kienhuis indicated that he would be 'a bit offended' when having to make a choice. An optimal option does not exist. For instance, estimates presented in the financial statements may stir a discussion between the client and the auditor. The updated version of Standard 540 (Auditing Accounting Estimates and Related Disclosures) explicitly considers the challenges that exist for the auditor and how to respond to them. Professional skepticism is important throughout the audit, but each auditor will apply skepticism as (s)he sees fit.

Also, Quartermaster Fonteijn stated that choosing one of the three options is not helpful. In some cases, conservatism is desirable, but there are also situations that require a more pragmatic attitude from the auditor: 'it is about being inquisitive, being independent, being pragmatic'. De Vries and Fonteijn emphasized the role of academic research in auditing. They elaborated on the role of the Quartermasters and the tasks they -and the profession- are facing. A lot of work is currently being done on the development of audit quality indicators and the research into structural changes.

“

### It is no longer always a bad thing to say goodbye to a client

De Quartermasters indicated that they now (more) allow the view that a high-quality audit is the responsibility of the entire chain and not only the responsibility of the auditors. And certainly not in the last place the responsibility of the audited companies. The entire ecosystem matters. The Quartermasters announced that they acknowledge in their forthcoming report that much work has been done, but that also a lot of work remains to be done. The progress is still going too slow, they think. "If you're in control, you're not going fast enough," said Fonteijn, referring to Formula 1 driver Mario Andretti. There should be more experimentation and more risk taking. De Quartermasters will argue for a closer look at the training of auditors and indicate that a complete redesign should be considered to better connect auditors and society.

Agnes Koops also saw little use for choosing one of the three options presented by Bouwens. According to her, auditors are increasingly aware that they work in the public interest. Audit firms should therefore also appreciate auditors for doing the right things. It is therefore not about picking one of the three options, but about working for the good cause and supporting the professional skepticism of auditors as a firm: 'we got your back'. Also, when auditors make mistakes: don't punish but learn. In addition, it is no longer always a bad thing to say goodbye to a client. That has really changed. Apparently, the sentiment of fear has become less necessary.

According to Fonteijn, there are two 'demons' that worry (young) auditors: the AFM and lawsuits. According to him, that fear is very unjustified. If you, as an auditor, substantiate your work and considerations well, then you have very little to fear.

**The recording of the session can be found here:**

[https://youtu.be/aNSID\\_WZ6IU?t=3379](https://youtu.be/aNSID_WZ6IU?t=3379)



# Culture controls in audit firms

**Keynote speech by:**

*Jasmijn Bol (Tulane University), co-authored by Mark Peecher (University of Illinois Urbana-Champaign), Isabella Grabner (Vienna University of Economics and Business) and Katlijn Haesebrouck (Maastricht University).*

**Abstract**

Jasmijn Bol presented the study *Culture controls in audit firms*. The study contains two related research questions. The first research question concerns the relationship between cultural values on the one hand and professional judgment and actions associated with audit quality on the other hand. And in particular: what cultural values are important for those judgments and actions? The second research question is: which determinants are associated with those cultural values? Two cultural values are being examined. The first is 'calibrated skepticism'. Well-calibrated skeptical auditors do not continuously display a conservative attitude and corresponding behavior, but only when they have to. The second cultural value examined is 'professional pride', a value that has been discussed a lot in recent years. The results show that the degree of calibrated skepticism of the participating auditors is statistically significantly related to their skeptical judgments and actions. Such a relationship is not demonstrated for professional pride (which does not mean that professional pride is unimportant for the profession). In the second part of the study, determinants of calibrated skepticism were examined. We looked at the influence of a 'facilitating culture' within the audit. Also, the culture regarding an independent attitude toward the client was examined. In addition, two personal values were examined: (1) valuing contributing to society; and (2) appreciating getting to the bottom of things. The results show that calibrated skepticism is positively influenced by the facilitating culture, by appreciation for social contribution and by wanting to get to the bottom of things, but not by the culture of independence. In sum, the study shows that calibrated skepticism is important for audit quality.



### Culture controls and improving audit quality

In this study, we are looking at organizational culture, which refers to the purpose and values that the organization and the employees share and that guide decision making and actions in domains where explicit rules and policies are difficult to define. We are specifically interested in the potential role of culture *controls*. How can we build an organizational culture that can help improve audit quality? To answer that question, we need to understand what the values are that guide desired behavior. We start by looking at the values that lead to audit quality. Then we ask how we can build a culture that can help internalize those values. In examining values, we specifically focus on assessing the risk of material misstatements. We are looking both at judgment and actions. In the second part of our investigation, we study the determinants of those values: what cultural characteristics would instill those values?



### You can't ask people to push back if they don't feel capable of doing so

#### Part one: Values

We focus on beliefs and actions that auditors take that are 'calibrated.' The idea is that if an auditor has a

questioning mind and is critical when looking at evidence, this doesn't mean that the auditor is always going to be more conservative. We think professional skepticism (i.e., pushing back and questioning) is important, but only when it is justified based on the understanding of the behavior and incentives of the client. We think this will lead to higher audit quality. In addition, in the media we heard more and more about the importance of auditor pride. But is there a direct connection between auditor pride and higher audit quality? To examine that question, we also examine two types of pride in our study. Firstly, we study 'enduring latent pride', which comprises stable ingrained values. And secondly, we examine 'primed pride', which is an 'in the moment' activated emotional state that affects auditors' judgment and actions.

In part one of our study, we examine whether auditors that perceive themselves as being calibrated skeptics and have high levels of pride think critically about audit evidence, when assessing the risk of material misstatement and while planning actions.

#### Data and method concerning part one

We collected data through interviews, experiments, and surveys. We used a measure that we call perceived skeptical calibration. For this, we asked survey participants four questions: how often do you ensure high audit quality by... (scaled from 1/never to 7/always): (1) pushing back to e.g., colleagues, your supervisor, the client; (2) following up with the client when appropriate; (3) being vigilant about things that are in the 'grey zone'; and (4) getting expert help if necessary.

Calibrated skepticism is about pushing back when appropriate, in the grey zone, if necessary. We are trying to get at applying professional skepticism in a well calibrated way. In addition, we measured enduring latent auditor pride.



### Calibrated skepticism is important for audit quality

In our experiment, we provided participants with an audit engagement team scenario and asked them to assess the reasonableness of management's assumptions. We divided people randomly into two groups. One group received a reasonable revenue forecast. The other group gets an unreasonable aggressive forecast. When the growth rate assumption is reasonable, pushing back will likely decrease audit quality. When the growth rate assumption is unreasonable, pushing back will likely increase audit quality. We were interested in whether the response of the two groups was different. Furthermore, the two groups were split based on priming or not priming professional pride. Thus, in total there were four experimental groups.

As said, we found it important to look at both judgment and action. Regarding judgment, we asked participants, based on the provided scenario: how comfortable are you with management's assumed revenue growth rate of X%?; do you believe that management's X% growth assumption is biased?; and how reasonable is management's X% revenue growth assumption? Concerning action, we asked: 'In this situation, should the audit partner 'sign off' and grant a clean audit opinion on the financial statements?'

### Findings regarding calibrated skeptics

People don't perceive themselves to possess the same calibrated skepticism. We see some people score very high and some people score very low on self-assessed calibrated skepticism. Most auditors score in the middle. Also, in enduring latent pride there is variation. In general, pride is quite high. Importantly, the results show that people who perceive themselves as well-calibrated professional skeptics are pushing back when it is reasonable to do so. Thus, they act in a way that enhances audit quality through their professional judgment. For pride, we don't find a direct relationship between high levels of pride and being skeptical in judgment and actions.



### Calibrated skepticism is about pushing back when appropriate

#### Implications of part one

We find that investing in a culture that increases the value of calibrated skepticism may be a valuable investment for audit firms. It seems to lead to better professional judgment. Investing in auditor pride, on the other hand, doesn't seem to have an impact on professional judgment. However, this doesn't mean that auditor pride is not very important and that we should not invest in it. Maybe it helps us to recruit better talent and helps us with retention.

#### Part two: determinants of calibrated skeptics

In part two of our study, we look at how management controls and organizational culture can cause calibrated skepticism to flourish.

An organizational culture where auditors perceive that audit firm leadership truly values auditors getting a deep understanding of the client's financial statements likely promotes calibrated skepticism. We call this a 'facilitating culture'. The focus is on auditors' *perception* of the culture because how they perceive the culture is what leads to the internalization of values. Also, the culture of independence seems important for calibrated skepticism: do the auditors really perceive that the management of the firm wants to be independent from its clients. Furthermore, two important personal values likely to be associated with being a calibrated skeptic are: contributing to society and getting to the bottom of things.

#### Data and results of part two of the study

Using the same survey already mentioned, we collected data on facilitating culture (for example on budget pressure), independence culture and personal values. We used several control variables. The results show that facilitating culture is important. The presence of the perception of a facilitating culture leads to higher levels of calibrated skepticism. Surprisingly, we don't find results for the independence culture. We do find strong evidence that personal values of importance to society and getting to the bottom of things help in creating calibrated skeptics. Also, auditors who feel more competent (this was a control variable) are more likely to



### Firms should focus on individuals that care about societal interests and want to get to the bottom of things

be calibrated skeptics. In addition, we found that the message of audit quality importance within the audit firm is not enough to increase calibrated skepticism.

#### Implications for the audit profession concerning part two of the study

As an important implication, we think that audit firms can enhance audit quality by increasing the levels of calibrated professional skepticism of auditors. This can be done by building an action-oriented culture that makes auditors feel that audit firm leadership truly values auditors getting a deep understanding of the client's financial statements. Also, selection and promotion can help. Firms should focus on individuals that care about societal interests and want to get to the bottom of things. And that is not just about who the audit firm wants to hire but also self-selection into the audit firm (i.e., who wants to work for the audit firm). Furthermore, competence is needed. You can't ask people to push back if they don't feel capable of doing so.

Q&A-session and discussion by Robin Beijen (Baker Tilly).  
Selected Q&A's are included below.



**The conference presentation (including the complete Q&A-session) can be found here:**

[https://youtu.be/aNSID\\_WZ6IU?t=7746](https://youtu.be/aNSID_WZ6IU?t=7746)

**The slides can be downloaded here:**

<https://foundationforauditingresearch.org/files/far22-bol-final.pdf>

**For more information regarding the project, please refer to:**

<https://foundationforauditingresearch.org/en/research-publications/projects/2018b02-culture-controls-in-audit-firms-prof-bol/>

**We are promoting skeptical behavior during auditor education, but such behavior is often not stimulated under budget pressure in a real audit engagement. How can we handle this conundrum?**

‘It is critical to look at the culture being built from the top of the organization. Partners and higher firm leadership set the tone. Their message should flow through the organization. Awareness is important to make changes and research can examine the consequences of not creating the right culture of being skeptical when needed.’

**You argue that skeptically focusing on issues that do not require that focus can decrease audit quality. Why can being overly skeptical be a problem?**

‘The auditor must do so many things. If the auditor pushes on things that don’t need to be pushed, there’s just not enough time to do a proper audit. This relates to the question ‘what should an auditor not do?’. The answer, I believe, is: don’t push if not needed.’

**Cultural message was significantly negative. Why would this message have a negative effect on calibrated skepticism and the actions that auditors take?**

‘We were also puzzled by the negative impact. Although we have no direct evidence, this might have been caused by auditors negatively responding to hearing ‘the talk’ but not seeing ‘the walk’.

**How can we improve the audit quality culture to limit the enormous load of memos and review notes, which are not always necessary and often have to be dealt with under high time pressure?**

‘It’s not that checklists aren’t good, it’s the checklist mentality that is suboptimal. If we start thinking about what we define as well-calibrated skepticism, as mentioned before, this also implies thinking about audit activities that are not necessary. We should better focus the audit on where the pain is. Asking ourselves, as professionals, how we can be more calibrated is a first step in enhancing our well-calibrated skepticism and thereby audit quality.’



# The loss of talent

**Presented by:**

*Frank Moers (Maastricht University), co-authored by Isabella Grabner (Vienna University of Economics and Business) and Judith Künneke (Tilburg University).*

**Abstract**

Frank Moers presented a study on the loss of talent. In their performance evaluations, audit firms should value traits that are important for future leadership. However, the important question is whether that actually happens in practice. If not, this may imply that auditors who possess significant leadership skills will leave the office prematurely, since their talent has not been appreciated. This leads to the loss of talent. At the same time, auditors may move up the hierarchy while they don't (or to a lesser extent) possess the desired talent for leadership. In the study, so-called 'tacit knowledge' is examined. Tacit knowledge is all the relevant knowledge that cannot be formally trained and that can be separated from technical knowledge (which auditors learn during their education and on the job training). The importance of tacit knowledge increases as an accountant moves up the organizational ladder. Previous research shows that more experienced auditors (with more tacit knowledge) get better performance reviews. The current study demonstrates that partners with higher tacit knowledge achieve higher audit quality. Also, technical knowledge influences audit quality, but to a lesser extent (ratio between tacit and technical knowledge is 5:3). Tacit knowledge should therefore be an essential part of auditor's performance assessment. However, the assessment focus is still mainly on technical knowledge and skills. This could explain the loss of talent by audit firms. It is a cause for concern, but it also offers opportunities for improvement.



### Human input is critical

Financial auditing is a very interesting context to examine performance management, incentives, career issues et cetera. It doesn't matter how much artificial intelligence is implemented, at the end of the day the audit will always be based on human judgment. Hence, the human input is critical. We looked at what we call identification of talent or potential. The project is called *Loss of talent*, but talent is a difficult concept to grasp. People's potential is the most valuable asset the firm has. So, we are interested in how potential can be identified, how it can be managed, and how it can be prevented from leaving the audit firm. There is an increased shortage on the labor market in general, but certainly also within the field of auditing. Hence, it is important to keep the right people within the firm.



**Tacit knowledge should therefore be an essential part of auditor's performance assessment**

### Technical knowledge and tacit knowledge

The general research question is: to what extent is talent identified within an audit firm? Talent can be expressed in terms of the

potential to perform well in a more complex future role. So, it is not about how well an auditor is doing in the current position, but how well the auditor will potentially be doing, after growing to the next position within the organization. In this project, we distinguish two different types of knowledge. One is technical knowledge, which you get by instruction, for example by taking bookkeeping classes. Secondly, there is tacit knowledge, which is learned from experience and by learning from others. Tacit knowledge allows to apply technical knowledge in a better way. You can learn something in class, but making actual decisions and trade-offs is something you subsequently learn in practice. Some people are better at developing that knowledge and this is what might be driving the potential of employees. In our study, we show that the knowledge that is important in delivering high audit quality as an engagement partner is exactly what is being ignored when evaluating potential future engagement partners. This finding fits our expectations, but from an audit quality perspective it is not the conclusion we would hope for.

### The data

The data we are using are a combination of survey and archival data. We used a survey to measure technical and tacit knowledge. For the assessments of tacit knowledge, the respondents indicated how they would act in about 50 different scenarios. We benchmarked these responses with the responses by the scores of the leaders of the audit firm (15 senior partners). The assumption is that the more an auditor responds in line with the leadership of the audit firm, the higher the tacit knowledge is. And the more an auditor deviates from the leadership answers, the

lower the tacit knowledge is. This also implies that tacit knowledge is firm specific. If an auditor within the sampled audit firm would have high tacit knowledge, that same individual might not have the same high tacit knowledge after switching to a different big four firm.



**Partners with higher tacit knowledge achieve higher audit quality**

In addition, we have analyzed personnel files, containing tenure, performance evaluation on an annual basis, how many hours are worked on which engagement et cetera. It is important for our study that we have data on both how well auditors perform in their current position as well as on the potential rating they received in their evaluations. Furthermore, we have engagement data, including internal quality reviews, which we use as a measure of audit quality. This measure is also what the audit firms themselves define as audit quality.

### Is knowledge associated with audit quality?

The study has two main parts. The first part is about the extent to which an engagement partner's technical and tacit knowledge are associated with audit quality. By examining what matters for audit quality at the engagement partner level, we can highlight which knowledge is relevant for potential identification at lower hierarchical levels. The second part of the study is about the question whether knowledge that matters for audit quality is adequately assessed at lower levels in the hierarchy. If performance and potential assessments ignore aspects that matter at a later career



stage, then potential is inadequately assessed and thus inadequately identified. After identifying what matters at the engagement partner level, it seems important to include that in evaluating lower-level employees. Audit firms may want to evaluate these characteristics for these auditors, because they form the pool from which future engagement partners will be selected. If firms ignore that, then they are misidentifying talent.

### What do we find?

We find that technical knowledge matters. Being technically proficient is associated with a higher quality rating of the audit engagement. However, tacit knowledge appears to be a lot more important than technical knowledge (at a ratio of 5 to 3). This is consistent with previous research, which shows that if you move up the hierarchy, the technical knowledge will not become irrelevant, but other aspects become more relevant. However, we find that technical knowledge is the only thing that matters in both evaluating auditor performance and assessing auditor potential. Tacit knowledge is unrelated to both appraisals. This typically is the core cause of the so-called 'Peter principle'. Strictly speaking the Peter principle means that people get promoted to the level of incompetence, which implies inefficient promotion decisions. This is caused by evaluating things that are currently important, but don't matter that much in the future. A related problem is that if people possess required tacit knowledge, and are aware of that, they might be



**Tacit knowledge appears to be a lot more important than technical knowledge**

feeling undervalued by their leaders. In general, this is the number one reason why people typically leave organizations these days.

### Contributions to academic knowledge and audit quality

Prior research has shown that experienced auditors with higher tacit knowledge receive higher performance ratings. Our previous work found that this is partly the result of the fact that these auditors are better at developing their employees. In the current study we provide another reason, namely that auditors with high tacit knowledge deliver higher audit quality. Recent research shows that inherently subjective potential ratings, poorly predict performance after being promoted. We extend this literature by showing that this is not due to 'random inaccuracies' but due to systematically ignoring tacit knowledge, a form of knowledge that is of great importance later, and hence in assessing potential now. Of course, it is important to study further what causes this problem.



**To be able to identify potential, one must not only know what to look for, but also have the skills to see it**

### Contributions to audit quality

With people being the key driver of audit quality, having the right individuals in the organization is key. This implies that inadequate identification of potential may reduce audit quality. Our evidence suggests such inadequate identification. But how can this problem be tackled? We need to revisit the skillset that is required to advance and to be successful



**Too often, annual assessments are seen as taking time away from real work**

in the firm. We need to know what competencies an auditor needs later in the career and map those out as well as possible. This requires developing and carefully selecting supervisors and mentors. To be able to identify potential, one must not only know what to look for, but also have the skills to see it. And a good auditor is not necessarily a good supervisor and mentor. Furthermore, employees need to be provided opportunities outside of their current job function and should be allowed to make mistakes. They need to be challenged and to be offered room for learning, which also allows observing how well they do and whether they improve, and thus whether they are fit for a more complex future role. Finally, firms should treat the assessment of potential as a core activity of supervisors and mentors. Too often, annual assessments are seen as 'taking time away from real work'.

**Q&A-session and discussion by Kay van den Elzen (KPMG).**  
Selected Q&A's are included below.



**Did you find what kind of skills comprise the tacit knowledge?**

‘We haven’t studied that. But based on the presentations during this conference, what resonates with me the most is ‘calibrated professional skepticism’. That is something that cannot be taught in class and is probably an important part of tacit knowledge. It is something that you learn on the go, that you learn from your supervisors’ behaviors. And calibrated skepticism may be looked at to evaluate lower junior level employees on an annual basis.’

**In practice, most auditors work on several different teams, with different managers. How does that fit with the importance of mentoring you mentioned? How should an audit firm structure that?**

‘I think a mentor should not necessarily be the manager on the engagement. It probably resembles

academia, in which a researcher works on several research projects, but can still have a mentor that serves as a general guide. And, of course, an individual auditor has a responsibility to get the information from within the engagement teams on how well he or she is doing on the engagements.’

**You seem to focus on individuals which have an optimal profile in terms of possessing tacit versus technical knowledge. Couldn’t this needed knowledge be covered by several different roles within a team? People with mainly technical knowledge can also be valuable?**

‘We are looking at the engagement partner level. It could be the case that some of the tacit knowledge involves how to set up the engagement team. You can actually get people together with a different background. But you are probably aiming at the fact that at the junior level not everybody has to have tacit knowledge. Somebody could be more technical and still be of high value in the organization. Of course, the technical knowledge will always be relevant. But I think, on average, that tacit knowledge should be the most critical characteristic that an audit firm is looking for, in terms of potential. However, it could be that if the audit firms have perfect foresight, that they know what’s relevant right now for audit quality is not going to be relevant five years from now. This could be the reason why they don’t evaluate tacit knowledge in their own junior employees. But I don’t think this perfect foresight is a plausible perspective.’

**The conference presentation (including the complete Q&A-session) can be found here:**

[https://youtu.be/aNSID\\_WZ6IU?t=10850](https://youtu.be/aNSID_WZ6IU?t=10850)

**The slides can be downloaded here:**

<https://foundationforauditingresearch.org/files/8-far-conference-presentation-2022-moers.pptx>

**For more information regarding the project, please refer to:**

<https://foundationforauditingresearch.org/en/research-publications/projects/2016b01-the-loss-of-talent-a-a-threat-for-audit-quality-prof-dr-moers/>



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