Report: The Future of Auditing

"Keeping Capital Markets Efficient: Towards a National Strategy on the Future of Auditing"

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Research Report: The Future of Auditing

"Keeping Capital Markets Efficient:

Towards a National Strategy on the Future of Auditing"

EXECUTIVE SUMMARY

OVERARCHING COMMENTS

With the onset of the Global Financial Crisis, now more than ever the operation of the capital market has been put under pressure. A key objective of this research project is to make observations that may enhance and support the efficiency of the capital market through the information provided by auditors and its impact and influence. At the time of writing there have been few negative observations about auditors and their role in the Global Financial Crisis (GFC). While criticisms of bankers, regulators, directors and senior executives, advisory firms, hedge funds and other financial service organisations (amongst others) mounts, little concern has been expressed about the role of audit. To some this may be unexpected, but the presence of no news is to the eyes of some 'good news'. In some ways the GFC can be seen as a stress test of audit where the stress has not resulted in structural failure.

In essence, the aim of this project has been to put a 'window' on a number of issues in auditing and its operation in the capital market. The scale of the project from the outset was large and has grown substantially. It is acknowledged that the data collection for this project predates the GFC and readers are warned of this limitation. However there are many instances where the underlying core issues existed before and will continue to exist during and after the GFC. Even now, the project is not comprehensive, but it is of sufficient scale to allow the opportunity to explore quite specific issues and gain considerable insight into the views of participants in the market for audit services in relation to those issues.

While the authors have provided a list of conclusions, policy issues, and recommendations on actionable items, this is by no means comprehensive. We have sought to list actionable items that need to be considered by the relevant respective organisations and for these items to be considered generally in the context of a public policy debate. This list is not endorsed by the Australian Research Council or the Linkage partners. The authors have not attempted to be definitive or comprehensive but have simply summarised the positions that were observed in the market and sought to bring them into focus so that those charged with decision making might appreciate this synthesis of information as having utility.

This Report not only contains information that is survey generated but also includes the direct words used by many players in the market for audit services in face-to-face interviews and inferences drawn from those words. We have given over much of this Report to direct quotations from these participants as the power and authority of much

of what we describe is best conveyed we feel in the participants' own words. We have, however in each chapter tried to synthesise these quotations into a more efficient summary for those who might desire a more concise summation of these views. The authors note that while there are summaries that precede the chapters and summaries within the chapters, there is no doubt that for an understanding of the issues, the reader needs to read in depth the parts of the Report that are relevant to them. To aid this, Chapter 1 includes various directed pathways that will assist particular types of stakeholders (Users, Purchasers, Suppliers and the like).

There is no doubt that this project could not have been undertaken without the contribution of a large number of individuals and organisations. The Australian Research Council is this nation's premier research funding body across many fields of inquiry and its participation in this project has been crucial. Also, of importance has been the role played by two of the major professional bodies within the business community, the Institute of Chartered Accountants in Australia and CPA Australia. Their respective contributions, both financially and in terms of expertise, are recognised. All four of the major audit firms, Deloitte, Ernst & Young, KPMG and PricewaterhouseCoopers, have also made important contributions. These institutions and numerous individuals within them have played a significant role and we would like to formally acknowledge our appreciation for their contribution. In addition, there were the many individuals representing various stakeholders' views, including Users, Purchasers, Suppliers, Standard Setters and Regulators, who contributed to the statements contained in the Report and to the overall depth and richness of the materials that have been presented. We would like to thank each of these individuals; we are appreciative of the time and expertise they gave so generously. There is also a number of staff within the authors' respective institutions who have contributed in different ways and at different times and their contribution is acknowledged also.

Considerable care has been taken in compiling this Report which has involved seeking comments from certain key individuals and organisations over the past several months. However, any remaining errors and omissions remain the responsibility of the authors. Any comments or observations can be made by contacting the research team at ancaar@anu.edu.au.

In that connection, please be aware that we have used directly the words from a range of stakeholders in the various quotations included in the Report. We note specifically that the perceptions, beliefs and even representations of facts that are described in the Report and attributed to stakeholders are those of the participants and not the authors. Some of these observations may be thought of as factual by those who made them, but in reality they may not be factual. The authors do not necessarily agree that all assertions made are true in fact. The authors remain responsible for the other components of this Report which are described as summaries, issues and implications, concluding remarks and recommendations. It is important to note that none of the industry partners to the ARC Linkage grant has had a right of veto of the recommendations nor are these recommendations included at their request. The recommendations come as a consequence of the information gathered in the study and have been crafted by the research team.

We have attempted to ensure that no person has been or is able to be individually identified and no organisation has been named where there could be an adverse

outcome from that identification. There are a few instances where specific firm and company names are referred to, however this occurs in circumstances where we do not believe there will be any negative consequences for those organisations and generally these are a matter of public record. We trust that this Report and any further papers and publications and public discussion of its contents will contribute positively to the market for audit services and as a consequence of that to the efficiency of the capital market. Others will judge its utility and the efficacy of its recommendations, and of the report more broadly.

Summarising, the study can be characterised as exploring issues within certain major themes:

1. *Expectations Gap/ Informativeness of the Audit Opinion;*
2. *Staffing, Skills and Social Impacts;*
3. *Public Policy Implications;* and
4. *The Audit and Assurance Service.*

A brief discussion of the inferences we draw from participants' responses under the above themes follows. A chapter by chapter summary of issues raised in participants' responses and their implications, together with suggested actions to address these issues, follow this brief executive summary.

1. Expectations Gap/Informativeness of the Audit Opinion

From the responses of participant stakeholders we conclude that the external financial statement audit is valued and that there is no call for change to its mandate. We note that in the context of the Global Financial Crisis, its role becomes even more important to confidence in the capital market. As a starting point this is a clear positive for the future of audit. On a less positive note however, the audit expectations gap continues to exist (Chapter 3). Further, in our view it is not possible that this gap can be 'closed'. This is so for a number of reasons including the perceived complexity of financial reports which is a function of accounting standards and for which auditors cannot be held responsible. The wide disparity between retail and more sophisticated investors in terms of understanding of financial and related reports is another reason for our view that the audit expectations gap is not closable. Hence, we conclude that efforts to minimise the gap should not focus only on retail investors since the likelihood of success with this group is low, although we do explore ways in which auditors might make more of their process and work known to a general audience (Chapter 4). Rather, efforts should be focused on specific topics our research has led us to believe as contributing to misunderstandings by even the more sophisticated stakeholders in the market for audit services. In particular, we observe a concerning expectations gap between Suppliers and Regulators and, in our view, this gap can be minimised given the common interests of these groups, and suggestions are made as to how this might be achieved.

In our view, the standardisation or 'commoditisation' of the audit and its expression through virtually identically worded audit opinions may have contributed to the

expectations gap and to an undervaluing of the financial statement audit in the market for information. We suggest that those relevant stakeholders in the market for audit services give consideration to amended audit report wording and reporting formats to address this issue.

We infer from participants' comments that some audit committee members and even directors exhibit less than complete understanding of matters relating to the external audit and we make recommendations for ways that these cohorts might be better alerted to correct this. In particular, the issue of 'materiality' as this term is used in an audit context appears to be poorly understood and a whole chapter (Chapter 5) is dedicated to this important issue.

2. Staffing, Skills and Social Impacts

Many of the participants' comments, including from many junior auditors themselves, highlight the perceived 'menial' nature of much of the work of audit staff. We note that many of these individuals see themselves as stereotypical of 'Gen Y'. We infer from their comments that this issue has been exacerbated by recent changes to the auditing regime in terms of documentation requirements, checklists, and reduced opportunities to vary work by providing secondments at clients or engaging in non-audit service work for clients. The GFC may mask the implications of any decrease in the attractiveness of audit as a career in the short term but the underlying image of auditing as a career option, intersecting as it does with the expectations of Generation Y in terms of seeking a challenging and varied work role, needs to be addressed in our view. These issues and the issue of developing business acumen and client and industry knowledge are explored in Chapters 6, 7, 8 and 9 and suggestions made to address the underlying issues that emerge.

3. Public Policy Implications

In terms of the conduct of audits, our findings reveal at the time of the interviews a common concern amongst Suppliers about the increased level of prescription of audits accompanying the revised Auditing Standards and inspections by the regulator (Chapters 11 and 12). There is recognition that audit documentation quality has improved. If the changes introduced to the auditing regime as a result of 'CLERP 9' were made with a view to decrease the likelihood of unsignalled corporate collapse or to increase confidence in financial statement credibility, then there is little evidence that stakeholders perceive that they have succeeded. However, there is consensus among stakeholders that these changes have added to costs (Chapter 10). Statements from those in the market provide a view that audit partner rotation and some of the constraints on auditor provided non-audit services, often self-imposed by companies, are not maximising economic efficiency and suggestions to relax requirements in these areas are made (Chapter 9). In terms of competition in the market for audit services, many participants express concern about the potential consequences should one of the existing Big 4 not survive (Chapter 13). Suggestions for dealing with this potentiality are made.

4. The Audit and Assurance Service

In terms of the provision of audit and assurance services, we observe from participants' comments mixed views on whether differential auditing standards based on listed/non-listed auditee status should be introduced (Chapter 14). We observe also that the value of internal audit is generally understated and that although opportunities for increased liaison between internal and external audit exist, there is little appetite by external auditors to undertake the incremental work necessary before the work of the internal auditor can be relied upon (Chapter 15). We observe also from participants' comments in relation to the potential for provision of assurance on information outside the scope of traditional financial statements that there is extensive demand but little willingness to supply (Chapter 16). In terms of the provision of levels of assurance other than 'reasonable' as pertaining to financial statement audits, evidence of some demand but an inability to supply under the current international assurance framework (Chapter 17) is observed.

Concluding Remarks

A detailed reading of this Report will result in an uninformed reader concluding that there are many challenges and sub-optimalities of audit. This would not be a sound conclusion. While this Report documents many opportunities for improvement, it is the case that auditing and other such professions rarely see the benefit of a 'good news' story. When, for example would we expect to see a newspaper article with the headline 'Auditor Does good Job', or an investigative television report finding that an audit meant that shareholders were protected? The best auditing and other experience goods can hope for is the absence of bad news. This Report needs to be read in this context.

SUMMARY OF REPORT CHAPTERS

1.0 Introduction

Many challenges for the profession of auditing are presented in this Report, but we can conclude that the 'future of audit' is a positive one with considerable ability to contribute to economic well being. The Report makes a number of recommendations across a range of issues. Some of these challenges are relatively simple to implement but others need deep consideration and long time periods. Several of the issues and recommendations are not original to the current authors. There have been other examinations of auditing and the authors acknowledge the work of those others and their ideas which have been implemented. Nevertheless, it is hoped that this comprehensive study of the perceptions of stakeholders in the market for audit services can contribute to debate and policy making about the external audit.

When the project commenced, there was no Global Financial Crisis (GFC); it had not even been imagined. The size of the project and therefore length of the time it has taken to complete this Report has been a major challenge. As a consequence some of the issues and underlying circumstances of the market for audit services in Australia have changed. The presence of the GFC however does not change the underlying challenges facing the audit profession. It might change the timing of some of the issues coming to fruition, but it does not eliminate the issues. Notwithstanding changes to the employment market created by the GFC, it appears that the nature of the work of auditors is becoming less attractive, especially to Generation Y, and the greater prescription around maintenance of auditor independence, audit documentation, regulatory inspections and legal backing for auditing standards is working to deplete the image of auditing as a career. Whilst the GFC might mitigate the consequences of these events and occurrences in the short term, there are some aspects of our findings that at the least require deep consideration by the relevant stakeholders.

The next section of this Summary of Report Chapters describes the research method used, very briefly, before provision of an overview of each of the remaining chapters and the issues and recommendations that flow from the content of those chapters. The Summary concludes with a table that provides an overview of each recommendation reference number classified according to likely stakeholder interest.

2.0 Research Method (Chapter 2)

This research project uses the voices of participants in the market for audit services to explore the current state of that market and gain insights to its future. It uses multiple methods (preliminary focus groups to focus the survey questions and interview protocols, telephone and mail surveys, face-to-face interviews, and focus group interviews with more junior auditors) to elicit qualitative evidence of the perceptions of stakeholder representatives. The stakeholder representatives accessed include those who use auditor's reports (Users such as shareholders), those who purchase audit services (Purchasers such as CFOs and audit committee members), those who supply audit and other assurance services (Suppliers), those who set auditing

standards (Standard Setters) and those who regulate the market for audit services (Regulators). The timing of the project coincided with the first year of administration of the legally enforceable auditing standards and other changes to the regulatory regime as a result of the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (CLERP 9) that were by then well entrenched.

The responses elicited from participants in interviews, which make up a large part of this Report, were coded and grouped according to themes using a qualitative software analysis tool and reported, along with the survey results, within these themes, grouped according to the category of the stakeholder. 'Summaries' of responses by each category are provided by the authors, together with sections on resulting 'Issues and Implications' and 'Concluding Remarks'. In summary, the following issues and recommended actions arising as an outcome of this research project, can be found in the Chapters to this Report.

3.0 Understandability of the Audit (Chapter 3)

3.0.1 Inferences from Survey Findings

Suppliers believed there is a substantial value add in the audit, but this was rarely replicated by other participants in the market for audit services. When asked about whether the auditor has a good understanding of the business, again Suppliers provided a positive response whereas Purchasers and Users were more mixed in their views. A large proportion of Users believed that the audit provided a form of guarantee about the truth and fairness of the financial statements.

Users, Purchasers and Suppliers all reported self-rated understanding of financial statements as above the median. Both Purchasers and Suppliers indicated that it was actually the external auditor's responsibility to detect material fraud. Users, Suppliers and Purchasers all recognised that the auditor has responsibility to detect material error. There was a shared view that the auditor has responsibility to warn the audit committee about early signs of risk. There were mixed views about whether the auditor should act as a whistleblower to an appropriate regulatory body. Big 4 Suppliers were the only respondents who strongly indicated they disagreed that the auditor has responsibility to provide direct assurance about the adequacy of the internal control system.

From these survey findings there is evidence that assurance is valued and there is no case to remove or limit the existence of an audit as it is currently known to the market.

3.0.2 Inferences from Interview Findings

Users report checking whether an audit report exists, that it is provided by a brand name auditor and is not modified. Such a simplistic categorisation may cause Users to miss statements of emphasis of matter. Another implication is that the audit report is perceived as a 'commodity', which is simplistic, standardised and fails to recognise the diversity of expertise held by some Users.

Purchasers perceive auditors to be doing "the right thing" but some concern exists that the amount of regulation and bureaucracy is a distraction from the main objective of providing assurance on the financial statements. Suppliers are concerned that audit

has suffered because of the complexity of accounting standards and believe that there is scope for enhancing what is communicated in the audit opinion.

What also emerges from all stakeholders is genuine concern about the level of complexity and information load jointly contained in the financial reporting and auditing disclosures, for which auditors cannot be held responsible, but which limits what can be done to enhance the understandability of the audit and audit process.

Issue 3.1
Perceived complexity of financial reports limits potential for communication solutions for auditors.

Suggested Action 3.1
Policy maker recognition that enhancing the readability and understandability of financial reports is a multifaceted, multi-agency responsibility with no single body taking overall responsibility for monitoring more than technical compliance with accounting standards etc. A body, likely the Financial Reporting Council (FRC) , should take on explicit responsibility for monitoring aspects of the quality and understandability of financial reports.

Issues 3.2 and 3.3
Audit report wording is standardised/commoditised which hides the degree of auditor judgement involved in relation to a specific auditee, ignores the diversity of the audience in terms of motivation for and capability of understanding of audit outcome information and uses terms that can be misconstrued (eg material misstatement, test basis).

Suggested Action 3.2
Amend audit reporting standards to encourage more nuanced and auditee-specific audit reports in order to encourage reading by target audience. Perhaps this should be in the form of appendices to a standardised report.

Suggested Action 3.3
While audit reports need to fulfil minimum legal requirements, there should be positive encouragement by regulators to allow auditors to include nuanced and subtle explanations and observations in a way that adds value to the report for interested readers.

3.1 The Audit Expectations Gap (Chapter 3)

3.1.1 Inferences from Interview Findings

The vast majority of participants acknowledged the existence of an expectations gap or gaps. Users, primarily large professional users, commonly perceive the existence of an expectations gap between themselves and Suppliers but also between regulators and auditors. Purchasers too observed multiple gaps, including a gap between auditors and regulators. Some Purchasers were critical of regulators in their inspection and oversight functions. Other Purchasers indicated that the audit expectations gap arises mostly in the presence of business failure and yet in a free market economy there will always be the presence of business failure. A number of Suppliers indicated that they did not believe the expectations gap was closable, with several acknowledging there were different sorts of gaps with different participants in

the capital market. In particular, retail investors were uninformed and probably uninformable. There were observations by many Suppliers of an expectations gap between auditors and regulators. There was criticism by Non-Big 4 Suppliers that audit expectations developed by regulators are based on their observations of the Big 4. Another observation was that the presence of a stronger regulatory environment actually has added to the expectations gap. Suppliers observed that it is not well understood that materiality means that the audit is undertaken at reasonable cost to give reasonable assurance.

There were few suggestions for resolving the gaps. One comment was that the scope section of the audit report describe more fully that which is undertaken by the auditor and that which is not. One Standard Setter observed that much of the expectations gap is caused by regulators who may choose to deflect blame and negative market sentiment from themselves and on to the accounting profession. None of the Regulators interviewed indicated that legally enforceable auditing standards would actually help solve the expectations gap, narrow it or manage it. In terms of policy implications, the authors observe that much has been done to encourage participation by investors in the Australian capital market, yet there has been no parallel public policy support mechanism to help educate and inform those participants in the capital market.

In summary, the audit expectations gap continues to exist, is complex and multifaceted (existing at least between Users and Suppliers, Purchasers and Suppliers and Regulators and Suppliers) and at the least is costly to the efficiency of the market for information within the capital market and may have many other costs associated with it. It goes without saying that the audit expectations gap should be minimised to the extent possible. However, there needs to be recognition that the audit expectations gap will never be closed and that eliminating differential incentives for a gap to exist and 'educating' all stakeholders is not possible. Focusing on stakeholders who are motivated and have the capability to have their knowledge and understanding of audit and its outcomes raised and focusing on specific topics known to be the subject of misunderstandings (eg materiality, use of term 'test basis') is the best strategy. Because of shared objectives and sophistication level, the gap between Suppliers and Regulators should be given the highest priority in terms of gap minimisation.

Issue 3.4
Generalised non-reading of the auditor's report – potential to miss emphasis of matter paragraphs.

Suggested Action 3.4
Consider the current guidance on location and highlighting of emphasis of matter paragraphs to ensure they are conspicuous.

Issue 3.5
The standardised audit report wording uses terms that can be misconstrued and hence which may contribute to the audit expectations gap. In particular, there is evidence of misunderstanding of the use of the terms 'reasonable assurance', 'material misstatement' and 'test basis'.

Suggested Action 3.5
Change wording within the auditor's report to minimise the audit expectations gap (eg 'This audit is a certification of the X percentage probability of the absence of misstatement in the financial report above an absolute aggregate dollar value of Y'….or 'We are X per cent confident that there are no misstatements in the financial report above an absolute dollar value of …..').

Issue 3.6
Several Suppliers' comments indicate that they do not understand that authorities in Australia view the external audit as a form of 'delegated regulation' (Knott 2002). In Australia, audit is privileged by a mandate in many cases (that is, is required by legislation), has the shareholder as its centre as the client, and always is the beneficiary of restraint of trade policies (that is, only appropriately qualified persons can sign an audit report). These aspects of the current framework are not well understood by some Suppliers.

Suggested Action 3.6
Creation and wide dissemination of an overarching, high level, educational piece on the role of audit in Australia's society, including content in plain English on for which types of entities audit is mandated, the audit process and for suppliers, a section reinforcing the privileged role that audits hold and the rights and responsibilities that level of privilege brings with it.

Issue 3.7
Regulators allegedly sometimes do not practice 'delegated regulation' in its purest sense, but instead dictate 'detail' to a point which interferes with audit efficiency, but even more seriously, with audit effectiveness.

Suggested Action 3.7
Despite acknowledged existing mechanisms for communication, greater communication between Regulators and Supplier representatives from both larger and smaller audit suppliers and wider dissemination of feedback to the population of audit suppliers is needed to enhance communication of what each party (regulators and suppliers) is seeking to achieve.

4.0 Communication of More of the Audit Process by Auditors and/or by Management (Chapter 4)

4.0.1 Inferences from Interview Findings

There was no support at all for management communicating more of the audit process to stakeholders; however there was wide support from Users and Purchasers for auditors doing more of this than is the current case. In a large difference from Users and Purchasers, Suppliers were more critical of this as a possibility and Standard Setters were mixed in their views. One Purchaser observed that the current process undertaken in an audit is opaque. A Purchaser and a Supplier observed that the language used in audit opinions tends to contain 'jargon' and is not easily interpreted. Many participants, particularly Purchasers and Users, perceived the audit opinion as a 'blunt instrument' conveying only whether the opinion is modified or not. That is, Suppliers seek the ability to exercise their professional judgement, but most of the

audit observables are standardised or 'commoditised'. However several observed that the audit report is currently not read, so any further disclosures would suffer the same fate, may add to confusion, and would be likely written with litigation risk in mind. One Supplier observed that those charged with governance sometimes do not want information about how the audit is undertaken because this might increase their own legal accountability. Others argued that encouraging confidence in the framework and professionalism of audit was more important than additional disclosures.

Issues 4.1-4.3
Many of the aspects of audit are not well understood by some Users and Purchasers.

Suggested Action 4.1
Provision of collaboratively written, widely available educative material about auditors' work and process, focused on Users as the audience, written in layman's language and spelling out important things like the fact that the work involves sampling, may be particularly risk focused, deals with substantive issues pertaining to that particular industry or entity, and describing what levels of materiality are used. For consideration is whether these descriptions should be specific to the company or might be more generalised for a particular audit firm.

Suggested Action 4.2
Provide educational materials in plain English in relation to use of the word 'material' and 'materiality' in an audit context.

Suggested Action 4.3
Consideration be given to a government funded public education campaign of the type administered to encourage understanding of the importance of superannuation contributions.

Issue 4.4
Information search costs for auditor's reports are high since these documents are currently available only by acquiring, and searching within, individual company annual reports.

Suggested Action 4.4
For listed companies, auditors' reports should be mandated as a separately filed Australian Securities Exchange (ASX) document (as well as located within the annual report) so that they can be searched in aggregate as publicly available information individually or for a particular class of company or type of report.

5.0 Materiality (Chapter 5)

5.0.1 Inferences from Interview Findings

The issue of materiality was raised in the preliminary focus groups used to provide input to development of the survey instrument and interview protocol as a major source of misunderstanding in the market for audit services. The desirability of having disclosure of the level(s) of materiality was expressed by Users and Purchasers, but was less welcomed by Suppliers, Standard Setters and Regulators. That the financial statements are barely read anyway or that the concept would be confusing were major reasons behind unenthusiastic comments. Standard Setters and

Regulators observed that misinterpretation, misunderstanding or miscommunication of materiality had not caused company failures. However, others acknowledged that even if a small minority of informed readers read and understood the disclosures, it would assist in making the market more efficient. Some Suppliers argued that fostering more confidence in the existing process and framework was the key rather than explicit disclosures.

Amongst Suppliers, Purchasers and some Users there was a view that providing disclosure of the existence of a materiality threshold influencing the audit represents a key ingredient in advising the market that the audit is not a 100 per cent guarantee. From Users and Purchasers there was a focus on the quantitative aspects of materiality. Suppliers invoked both quantitative and qualitative characteristics. Some Suppliers argued that at audit committee level it is common to have a discussion about materiality at an aggregate level, but when one discusses line items in the financial statements on the basis of materiality, occasionally the discussion can become 'heated'. Also, although not brought out in the interviews, disclosing materiality levels may facilitate fraud.

Issues 5.1-5.3
The concept of 'materiality' as it is used in an auditing concept is not well understood outside the profession and is a previously underemphasised part of the audit expectations gap. As such, costs are imposed on the market for information within the capital market.

Suggested Action 5.1
Apart from the inclusion of generalised information about materiality and its role within audits, create specific guidance for audit committees in terms of their need to inform themselves about audit materiality and their right to request disclosure by the auditor to them of the level of 'tolerable error' used in the audit.

Suggested Action 5.2
ASX to include in its Corporate Governance Guidelines and Recommendations a recommendation that audit committee members undertake structured education programs that include content related to the statutory role of audit, audit processes and audit outcomes and audit committee member rights and responsibilities in relation to these features. This could be a recommendation that such requirements be included in corporate audit committee charters.

Suggested Action 5.3
Consider the integration of audit-related concepts wherever relevant into subjects/units within tertiary and professional business qualifications (as many institutions do with ethics education).

6.0 Developing Business Acumen and Client and Industry Knowledge (Chapter 6)

6.0.1 Inferences from Survey Findings

In terms of the telephone and mail surveys, in response to a question as to whether external financial statement audits are of value because of "the specialist industry expertise of the auditor", 50 per cent of Suppliers, 46 per cent of Users and only 31

per cent of Purchasers responded affirmatively. Amongst the Suppliers there was a sharp differentiation between Big 4 and non-Big 4 Suppliers with 77 per cent of Big 4 Suppliers believing industry expertise brings value compared to only 42 per cent of non-Big 4 Suppliers. This difference may reflect the relevance of industry expertise across the levels of market capitalisation and across unlisted companies. In respect of agreement with the statement that 'an external audit is of value because the auditor has a good understanding of the business', 55 per cent of Suppliers, 33 per cent of Purchasers and 40 per cent of Users responded affirmatively. CEO/CFO respondents as a sub-group of the Purchasers were particularly denigrative of the value of the financial statement audit as that sub-group perceives it.

In response to questions about an audit being of value because of the 'business acumen the auditor brings to the audit', 45 per cent of Users, 33 per cent of Purchasers and 55 per cent of Suppliers responded affirmatively. Specifically in respect of audit partners, most Users and Suppliers saw the business acumen of audit partners as above the mid-point, with junior auditors not rated highly. Interestingly, overall Purchasers took a harsher view compared with Users.

6.0.2 Inferences from Interview Findings

Purchasers' expectations were low in terms of the business acumen of auditors yet differentiation between expectations of senior and junior auditors is present. The lack of stability in audit teams, causing lapses in client knowledge is acknowledged by Purchasers.

It is acknowledged amongst Suppliers that junior staff do not have the business acumen or the maturity of more senior staff and so may ask clients the 'wrong' questions. However, there is also realisation that 'dumb' questions can be very useful in uncovering audit issues. Less reliance on substantive testing compared with prior periods may have limited the opportunity of junior staff to become deeply familiar with how businesses operate. Suppliers make frequent observations that inexperience is evident not only amongst junior auditors but also common amongst client staff. Regulators observe that business acumen is not necessarily one of the core attributes of a successful and competently completed audit. Comments on the size of the market in Australia as a constraint on gaining industry expertise in particular industries were received.

The issues relating to junior auditors and their ability to develop experience and acumen, requiring elements of 'emotional intelligence', useful in a business career remains and perhaps has implications for tertiary education.

One interesting insight that emerged from focus group interviews with more junior audit staff was the presence of remuneration schemes which reward client accounting staff based on the number or extent of audit adjustments. The authors note that these schemes could usurp the role of the audit committee and encourage conservative accounting rather than accounting that reflects economic reality.

Issue 6.1

The personal attributes of maturity, tenacity, self-assertiveness, resilience and integrity, many of which feed into the notion of 'emotional intelligence', may be as important to successful audit outcomes as technical auditing skills, yet are seldom

targeted explicitly as graduate attributes by tertiary institutions and beyond in their teaching and learning programs.

Suggested Action 6.1
Collaboration between relevant parties to assess the best way to build the development of key personal attributes into subjects/units and courses.

Issues 6.2-6.6
Based on participants' comments, the present audit business model in some practices is under stress. It is seen in some instances as heavily pyramidal, tending to overly rely on junior staff, least likely to possess the ideal 'personal emotional intelligence' attributes, at the interface between the client and the auditor and depends on retention of staff with the appropriate personal and technical skills for future leadership.

Suggested Action 6.2
Consider whether the current widely used audit business model is sustainable and optimal in the longer-term.

Suggested Action 6.3
Consider whether audit practices' current recruitment techniques test appropriately for the personal skills required to be a successful auditor.

Suggested Action 6.4
Consider developing more effective systems and processes for the management of client–specific knowledge and ensuring its continuity despite changes in audit team membership.

Suggested Action 6.5
Consider developing more effective workplace flexibility practices to retain staff at points of major change in their personal lives.

Suggested Action 6.6
Alter recruitment policies to encourage hiring of many more accounting Honours graduates (and others with higher level analytic skills).

Issues 6.7-6.8
A number of stakeholders noted that opportunities for development of business acumen and industry knowledge in junior auditors has become more limited with increased independence requirements.

Suggested Action 6.7
Consider development of a national database divided by industry groups and also geographic distribution including data that relates to audit, governance and risk issues relevant to auditees within the Australian market for audit services.

Suggested Action 6.8
Enhance the adequacy of the teaching of auditing at tertiary level and in continuing professional education by developing high quality, realistic multimedia and case-based teaching and learning materials.

Issue 6.9
Remuneration schemes which reward client accounting staff based on the number or extent of audit adjustments exist and can usurp the role of the audit committee and encourage conservative accounting rather than accounting that reflects the economic reality.

Suggested Action 6.9
Include in the ASX Corporate Governance Guidelines and Recommendations a recommendation that audit committee members be advised if client staff are, in part, remunerated based on the number of audit adjustments and how the scheme operates.

7.0 Attracting and Supporting Staff (Chapter 7)

7.0.1 Inferences from Interview Findings

Issues that were raised in the context of audit firm attraction of staff include the image of the auditing profession, the work/life balance preference of 'Gen Y', the fact that the CA Program no longer has to be completed within a public accounting firm, the attractiveness of other employers – especially organisations such in banking and finance, the comparatively low initial salary scale, the increasingly prescriptive and regulated nature of auditing, the available pool of graduates from which to recruit and questions over the continued attractiveness of achieving partnership.

Purchasers saw no threat to attracting appropriate talent to the profession, although they acknowledged the then competitiveness of the employment market. Some Purchasers, had reservations as to whether the pool of graduates has, in relative terms, declined while others observed that the CA in Commerce Program has affected the prior near monopoly recruiting position of the Big 4. That is, accounting graduates entering other occupations are not necessarily lost to the accounting profession, although the Big 4 may well have lost its relative position. One Purchaser observed that recruitment to chartered accounting via the CA in Commerce Program may be more attractive in view of the level of external oversight and inspection attached to public practice. Repeatedly the observation was that the accounting firms simply do not remunerate adequately.

In respect of Suppliers, more questioning ensued about the total pool of graduates available for recruitment. Frequently observations were made that the total pool seems to be either small or at a 'tipping point'. Auditing is still seen as a good training ground but there was also a perception it holds less glamour and prestige than it once did. One of the attractions of the larger employers was put forward as their multidisciplinary nature that can provide alternative careers to ambitious accounting graduates who seek diverse employment opportunities. Suppliers questioned the number of accounting graduates completing their degrees eligible for employment in Australia and their often limited knowledge of auditing. The pedagogy of teaching auditing is lamented if it is procedural in nature as opposed to thematic. Also, because auditing is often taught late in degree programs, applicants for graduate positions tend to have little or no understanding of the nature of auditing. The authors note that universities are under similar competitive employment pressures for staff as are accounting firms.

Standard Setters observed that accounting does not have the glamorous profile it once had and that the prestige of accounting is declining. As observed by a Standard Setter: 'It is no longer possible for the auditor to be the trusted advisor.' There was also acceptance that many of today's generation are seeking multidisciplinary careers that are diverse and challenging. Questions arise about sole use of Year 12 scores as university entrance criteria. The authors observe that other professions have broadened their criteria and that university entry scores are affected by factors that affect both supply and demand. If public accounting firms were more willing to take more graduates from universities without such high entry scores, and more willing to recruit international students whose working visas are yet to be processed, then perceptions of too few willing graduates might dissipate. One Standard Setter questioned whether firms track their selection choices at entry point to evaluate those who survive, prosper and contribute to the auditing profession in later years.

Regulators shared the view that accounting is not as glamorous as other employment opportunities and, as a consequence, suffers.

Issues 7.1-7.3
Many participants' comments indicate that in their view higher levels of prescription have lead to more 'menial' work for junior auditors.

Suggested Action 7.1
Consider greater use of mechanisms other than year 12 score for entry to university accounting degrees (eg as has been done for entry to Medicine) since the competitive forces to maintain university entrance scores as high as possible may not create circumstances for suitably disposed students to enter into Accounting degrees.

Suggested Action 7.2
Conduct research into whether the presence of alternative pathways (to CPA Segments and CA Program) have a negative effect on entrance standards and the quantity of accounting graduates entering or exiting universities in Australia. If there are other alterative pathways then what would be the likely consequences?

Suggested Action 7.3
Consider whether the 'best and brightest' really represent optimal audit firm recruits for the majority of appointments.

Issue 7.4
Auditing is perceived to have an 'image' problem and to have become less attractive as a career than it once was. The GFC may mask this fact in the short-term, but it will resurface as an issue.

Suggested Action 7.4
Consider how the profile of auditing as a career can be made more widely known as an attractive career option.

8.0 Retention of Staff (Chapter 8)

8.0.1 Inferences from Interview Findings

From the focus group interviews with junior staff, completion of CA and time commitments relating to fee reimbursement or when promoted to manager were frequently cited as trigger points for departure of staff. By and large remuneration was not a key driver in the decision to leave. Often the departure of a colleague seemed to trigger departure. Perhaps after the interpersonal connectedness issue was work life balance and in particular the changing nature of the work which was repeatedly described as either "documentation" or "admin".

Again from the focus group interviews with junior staff, (1) having someone who played key role model for them, (2) the quality of people and colleagues working around them and the level of friendliness and the functionality of that group and (3) having good quality clients emerged as reasons to stay. Opportunities for secondments, especially overseas, were also seen as reasons to stay.

In terms of the face-to-face interviews, Users do not see audit firms as premium employers. Purchasers question the recruitment from outside public practice to partner as undermining the traditional business model for staffing an audit firm. Another level of criticism by Purchasers of the audit firm business model is the relatively low pay, high hours of work, and a disconnect in lifestyle for modern-day, younger staff. Purchasers also acknowledge that much of the work undertaken by junior staff is 'menial' and that this provides industry with the opportunity to recruit people who are experienced in business, especially at the completion of CA or promotion to manager trigger points. Purchasers see a short term monetary gain for an audit firm employee to move to industry, but less clarity about long term financial rewards.

Suppliers see the real challenge as being around retention, having in mind generational expectations and structural changes in the nature of the work brought about by regulatory reform and the perceived lessening of professional judgement as a key part of the job. There is a lack of empathy by some with 'Gen Y' expectations in regard to the desired rate of change in their working environment. The authors note that perhaps the audit business model cannot facilitate this desired variety of tasks, but then it comes to the point of recruiting the appropriate staff and managing their expectations. Some Suppliers recognise the need for constant change and innovation in the working lives of 'Gen Y' junior auditors and seek to be proactive in providing this. Some Suppliers recognise that the traditional incentive structures, in particular the prized goal of partnership, are no longer the attractions they once were. Suppliers repeatedly lament that the nature of oversight of the profession has degraded it, with the high level of regulation and scrutiny having consequences for job satisfaction, employment and retention.

Standard Setters are somewhat cynical that what is happening is anything but a desired outcome. There were very penetrating comments from a Standard Setter that even at partner level, there is a serious threat by attrition, which has system-wide implications, especially for highly specialised industry groups.

There was an observation that suggested some partners and managers belonged to a "previous generation" and were not empathetic with 'Gen Y', especially about

changes to documentation requirements. While some of the participants of the focus groups suggested that documentation was one reason to leave the profession, there were also some positive advantages to better documentation seen.

Issues 8.1-8.4
Widespread observations by participants at the time of questioning result in the conclusion that retention of staff is becoming more of a challenge than in the past.

Suggested Action 8.1
Make sure human resource performance systems work optimally to reward merit and potential.

Suggested Action 8.2
Consider secondments to regulators (and others such as 'policy' officers) since secondments to clients are no longer as possible, presuming any potential conflicts of interest can be eliminated or adequately managed.

Suggested Action 8.3
Inform staff not just about employment opportunities and career development that exists within their firm but also give benchmarked objective comparators to other alternative employment.

Suggested Action 8.4
Engage with audit firm alumni not just as potential clients but also as potential returning employees.

9.0 Auditor Independence (Chapter 9)

9.0.1 Inferences from Survey Findings

In terms of a survey question 'Are you aware of the following specific changes that have occurred in the regulation of audit services in Australia: reforms pertaining to auditor independence', 57 per cent of Users 79 per cent of Purchasers and 92 per cent of Suppliers were aware.

9.0.2 Inferences from Interview Findings – Auditor Provided Non-audit Services

In the face-to-face interviews with stakeholders, generally Users saw a balance between the advantage to auditor independence of more prohibitions placed on auditor provided non-audit services (APNAS) and the loss of knowledge from the joint supply of several services. It was observed that there is much cynicism on the part of the public about the issue and there was a very clear need to be independent and be seen to be independent.

Of the Purchasers, there was scepticism about the efficacy of 'Chinese Walls', whilst also speaking of the potential loss if there was a blanket ban on any form of joint supply of services. Purchasers wanted a framework or systems to make choices about service provision from the incumbent auditor.

Suppliers questioned whether the current situation with regard to auditor provided non-audit services was optimal. A number of Suppliers, particularly those with small

to medium range clients, spoke of the advantages and efficiencies of joint supply as being substantial and lost in the current environment. It was common for Suppliers to comment on the expertise they brought, otherwise deficient within the client and that efficient and cost effective joint delivery was in the best interest of all. This includes start-up companies with a preference for a 'one-stop shop' including capital raising, tax advice and financial reporting expertise to be supplied from the one source. One of the Suppliers indicated a concern with the differential investment behaviour of audit and non-audit staff. The authors note that this may be a deterrent to retention within audit divisions. One observation from Suppliers was that tax services delivered are so integral to the audit that the distinction between the two can be artificial.

Standard Setters varied in their belief as to whether the current regulatory system is tuned optimally. One Standard Setter raised concerns that the independence debate has been 'hijacked' arguing that what is sought to be achieved is objectivity rather than independence.

The authors note that the issue of joint supply of non-audit services by an auditor is a classic example of where public policy and personal interest conflict. The objective of Regulators and regulations is to protect business from the potential negative outcomes of possible independence threats, whereas the role of individual boards of directors and auditors is to provide an efficient and effective supply of relevant services to enhance the financial and business outcomes of clients.

Issue 9.1
Discouraging auditor provided non-audit services (APNAS) for all sizes of clients creates inefficiencies and costs for shareholders.

Suggested Action 9.1
Apply the ethical rules covering auditor provided non-audit services APNAS differentially to different sizes of company or according to some other criteria such as listed company size.

Issue 9.2
Companies' disclosures regarding non audit service fee categories is inconsistent hence reducing comparability.

Suggested Action 9.2
Provide guidance as to appropriate detailed services that fit within specific APNAS classifications.

Issue 9.3
Audit division staff have reduced freedom with respect to investment opportunities compared with other public practice staff, but generally may not be as susceptible to losing employment in economic downturns because of the mandated nature of audit.

Suggested Action 9.3
Investigate whether stability of employment characteristics compensate for foregone investment opportunities, and if not, compensate accordingly.

Issue 9.4
Although members of the three professional bodies in Australia (CPAA, ICAA and NIA) are bound by the IFAC-compliant APESB's APES 110, there remain Registered Company Auditors who are not members of those bodies and hence who are not necessarily bound by an ethical code based on IFAC's code through membership of a professional accounting body.

Suggested Action 9.4
Include ethical standards within the AUASB's legal mandate or else the FRC provide the AUASB with a strategic direction to issue ethical standards for auditors.

9.1 Inferences from Interview Findings -Rotation

The issue of mandated partner rotation is one of the few issues to achieve agreement amongst stakeholders. A large number of Purchasers and Suppliers as well as a number of Users, Regulators and Standard Setters articulated the desirability of having a 'fresh pair of eyes', a 'diversity of view' as audit partner rotation can bring. Purchasers notes that rotation was practices by many audit firms before the current regulatory framework, but that the time period was typically longer than five years. Purchasers also expressed some degree of uncertainty about the quality of any partner rotating in. Amongst the Purchasers representing companies within the top 50 or so listed companies on the ASX there was deep rooted concern about the speed of rotation. Purchasers also expressed concern that when senior partners rotate off, the next logical client could be a major competitor in the same industry.

Suppliers also agree with the principle of rotation but have concerns. Suppliers noted a significant trade-off between independence, both real and perceived, and the erosion of client knowledge. It was common to suggest that a five-year period is too short, particularly for large, complex or highly regulated (particularly APRA regulated) companies. One Supplier noted there is no similar requirement for directors to rotate off. Suppliers to larger clients observed that large clients feel they have the power to demand any particular partner of their choice. Consequently there is increased pressure on the most expert partners and less ability to train up more junior partners.

Some Suppliers made note that the five-year rotation was a 'tipping point' for clients in a decision to put the auditor to tender; it was also a tipping point for some individual partners to reconsider their own careers. Suppliers also noted the time and energy needed to manage the partner rotation process with the need for 'shadow' partners for some complex clients in the year or more before rotation. The authors note the anomaly of this situation in terms of bringing a 'fresh pair of eyes'.

Regulators, Standard Setters and Users agreed in principle with rotation but also acknowledged a substantial trade off between knowledge of the client and independence. Suppliers and Standard Setters recognised that, generally, the initial year audit quality is lower than the quality of an audit where the partner has been engaged with the client for three or more years. The authors note that the balance between engagement time and perceived independence may need to be crafted conditionally on the size, complexity or regulatory framework within which the auditee operates.

Issue 9.5
Five-year audit partner rotations are reported as creating problems for large, complex, highly regulated companies.

Suggested Action 9.5
Consider differential application of audit partner rotation requirements rather than a 'one size fits all' approach.

Issue 9.6
Several participant Suppliers commented on the point of audit partner rotation as being a trigger point for decisions regarding whether to leave or remain in the auditing profession. No data is available as to whether the point of partner rotation has increased the rate of exit from the profession.

Suggested Action 9.6
Conduct research into movements in Registered Company Auditors per capita both before and after the introduction of the five-year rotation requirement, controlling for other factors likely to affect these movements (eg retirements).

10.0 Regulatory Reforms to Audit: Their Impact (Chapter 10)

10.0.1 Inferences from Survey Findings

Several survey questions were asked about the regulatory reforms and their impact. In response to questions as to awareness of the following specific changes that have occurred in the regulation of audit services in Australia, the percentage agreeing or strongly agreeing was:

	Users	Purchasers	Suppliers
• awareness of introduction of legally enforceable auditing standards	54%	77%	90%
• regulation will reduce the number of corporate failures occurring	28%	15%	15%
• responses to high profile corporate collapses have assisted in improving the general public's confidence in the capital market	21%	19%	20%
• responses to high profile corporate collapses have assisted in enhancing the credibility of financial statements	25%	21%	22%
• responses to high profile corporate collapses have assisted in enhancing the quality of an audit	33%	34%	42%
• responses to high profile corporate collapses have assisted in adding value to a company's business operations	37%	18%	20%
• in your opinion, complying with the additional mandatory procedures will increase the costs of conducting an audit	81%	90%	92%

10.0.2 Inferences from Interview Findings

Some Users took the view that as soon as a crisis emerges in what would otherwise be a free market; the political response is to increase regulation. There was concern about unintended consequences which may in fact damage what would otherwise be appropriate public policy settings. Some Users felt that broadly the market would not be well served by change to the status of auditing standards. In respect of engendering more confidence in the capital market, Users suggested that the market will continue to believe that auditors will undertake what they need to do to form their audit opinion. Others supported with a belief that the market would not see much impact of the changes. One respondent was somewhat critical of the profession's ability to enforce standards, implying that a high level of regulated enforcement will give rise to a higher quality outcome. In terms of audit quality, some Users praised the current regulatory requirements suggesting that they provide a floor level of quality. Various Users described the present regulatory system as giving rise to audits which are 'standardised', 'consistent', 'unbiased', 'objective', 'comprehensive' and 'methodical'. There seemed to be an implication in the minds of some that these requirements would give rise to higher quality auditing and took the view or belief that this would mean that the auditors would be better able to comment on the credibility of financial statements. A few Users suggested that the auditor needs to go beyond this and be inquiring and innovative in their understanding of a business and the risks that business faces.

Purchasers were split between whether or not legal enforceability was a positive initiative for the Australian economy. Some Purchasers suggested that it could be worthwhile; while others were concerned that legal enforceability will result in auditors withdrawing from offering opinions and judgments and moving to fulfilling compliance requirements. One Purchaser lamented the loss of intellectual property rights for the profession. This Purchaser also observed that the Government has no one else to blame but itself and its own processes if and when there is another round of corporate failure. Few Purchasers suggested there was a clear increase in confidence in the capital market and Suppliers too shared the scepticism that the market will be any different to that which has preceded it. In terms of audit quality, some Purchasers felt that while the audit may not change much of what is done, the current regulatory requirements add considerable robustness to the audit, which may not have been present before. A number of Purchasers suggested that fundamentally the audit they observe has not changed with recent amendments to regulatory requirements, however it has driven up costs. Few Purchasers were able to identify how the audit had been changed or that the auditors provided new and valuable insights into the business. Those who were able to make direct comparisons between Australia's current position and the Sarbanes-Oxley Legislation in the US spoke favourably of the Australian position and somewhat harshly of the more prescriptive and compliance driven US position.

Standard Setters took the view that legal enforceability was good because it would give rise to improved quality. One Regulator indicated that would give substance and support and a more clarified approach then had previously been the case.

Users, Purchasers and Suppliers all acknowledged that costs had risen as a consequence of these changes. For Users who are somewhat sceptical of the value adding capacities of an audit, these added costs only intensify the irritation.

Purchasers also acknowledged that costs have risen, but there appears to be some acceptance of these costs being passed on, at least in part. Suppliers have acknowledged increased costs and in some instances margins have been squeezed. While recognising there was going to be a cost gravitation upwards in respect of legally backed auditing standards, some Standard Setters commented that this came about because of changes in the international standards, which called for higher levels of documentation. One Standard Setter also made the observation that the change to legally enforceable auditing standards may in fact substantially increase the threshold costs of becoming an auditor to the corporate sector; thereby limiting competition.

Related to but not directly connected with the increase to operating costs of conducting an audit under the new regulatory environment is the issue of the costs or potential costs to auditors in respect of litigation risk. One Regulator who took the view that the presence of legally backed auditing standards will only change the environment in a relatively minor way - adding another legal pathway to enhance auditor accountability.

Issue 10.1
Increasingly prescription of audits is seen to 'distract auditors' from their tasks.

Suggested Action 10.1
Evidence should be gathered as to whether the regulatory reforms of earlier this decade have been cost beneficial.

11.0 Increasingly Prescriptive Audits: A Distraction for Auditors (Chapter 11)

11.0.1 Inferences from Survey Findings

Respondents were asked: 'In response to high profile corporate collapses, regulation now requires auditors to comply with additional mandatory audit procedures. In your opinion, complying with the additional mandatory procedures will distract auditors from the objective of a financial statement audit, which is to give assurance on the credibility of financial statements' and 19 per cent of Users, 27 per cent of Purchasers and 37 per cent of Suppliers either agreed or strongly agreed.

11.0.2 Inferences from Interview Findings

Users, Purchasers, Suppliers, Standard Setters and Regulators were all interviewed with a query as to whether the additional audit procedures required as a result of the reforms distract auditors from the objective of a financial statement audit. Many Users felt that the current regulatory requirements have shifted the focus of the auditor away from the need to spend time understanding the business and the risks of the business. Some Users took a different perspective, suggesting that the current regulatory requirements are not a distraction and that in fact an audit may be largely irrelevant anyway. Other Users praised the current regulatory requirements suggesting that they provide a floor level of quality. In terms of policy implication, the descriptors used ('standardised', consistent', etc) by Users might represent a necessary but not sufficient condition for there to be a high value audit that attests or gives assurance to the credibility of financial statements.

Purchasers were also split between those who believe that the current regulatory processes are a distraction and those who believe they are not. Those who were

critical of the current proposals suggested that for the audit to be of value it really needs to look at the substance behind the transactions and behind the documentation to provide value. Those who believe that regulation is not a distraction tended to share the view of Users that the current regulatory requirements are there to ensure an appropriate job is done and that they represent 'demonstrable compliance'.

A number of Purchasers suggested that, fundamentally, the audit they observe has not changed with recent amendments to regulatory requirements, however it has driven up costs. Those who were able to make direct comparisons between Australia's current position and the Sarbanes-Oxley legislation in the US spoke favourably of the Australian position and somewhat harshly of the more prescriptive and compliance driven US position.

One Purchaser questioned why auditors might find increased documentation requirements a negative development, alluding to an unwillingness to convey their 'true' beliefs. In view of this, when commenting on the increased requirements, auditors and audit firms need to be careful to explain the reasons behind their concerns and not give an incorrect impression of an unwillingness to commit their thoughts into writing. One Purchaser observed that the US jurisdiction is very focused on prescription with a rules-based environment whereas the UK is conceptually founded on a principles-based environment. The commentator observed that in Australia, regulatory agencies have gone on to interpret these principles to create guidance, which in turn is then interpreted as rules. This is not meant to be a criticism of regulatory agencies because sometimes they create this guidance at the behest of participants in the market to assist them. However, the commentator also observed that the difficulty with rules is that rules can become outdated as circumstances change or even irrelevant because of environmental changes. The second difficulty with a rules-based regime is that rules then can be used as a substitute for good judgment.

Similarly, Suppliers were divided between those who believe the current regulatory requirements are a distraction and those who believe that they are an enhancement. Those critical pointed to the ever increasing time spent on documentation which has distracted them from the time able to be committed to understanding the business whilst clients are reluctant to absorb substantially increased fees. Those who were critical suggested that some audit partners are becoming 'gun shy' of the possible penalties and that they have to change their approach to the less principles-based and reliance on judgment to being much more checklist oriented. Other Suppliers suggested a 'heightened regulation risk'. One Standard Setter observed that the whole debate of rules versus principles has not been helpful. Although Australia has come from a background of a principles-based environment, even principles-based standards have included an amount of prescription.

Standard Setters see the current regulatory requirements as a useful part of the quality control of an audit and not as a distraction from the actual ongoing operation of the audit. They observe that the requirements give rise to demonstrated evidence that a good job has been accomplished. One Standard Setter observed that although auditors call for audits to be judgement driven and principles-based, when interacting within professional bodies they seek greater 'clarity', which inevitably becomes something akin to a 'checklist'.

Regulators acknowledged that the current requirements may give rise to a loss of focus and audits may indeed get bogged down in some of the tedium. Given the scale of the change in the nature of the work, it has consequences for the working lives of many individuals of who might be attracted to and retained within the profession (refer Chapter 8).

Issue 11.1
There appears to be no agreed minimum documentation requirements between the regulator and auditors. It appears that, by default, PCAOB documentation requirements have been adopted by the Big 4 in internationalising their audit processes and applied to PCAOB and non-PCAOB regulated audits alike. In turn, Suppliers interviewed advise that they believe that this has been seen by Australian regulators as the minima and onerous when applied to both Big 4 and Non-Big 4 auditors in relation to the bulk of audits inspected.

Suggested Action 11.1
Greater dialogue between auditor representatives and regulator representatives should take place.

12.0 The Approach, Operation and Resources of the Regulators (Chapter 12)

12.0.1 Inferences from Interview Findings

Both Purchasers and Suppliers recognise the need for regulatory inspections and their benefits which provide quality control and potentially useful information to the capital market, albeit that the regulators' reports tend to highlight negatives only. Nonetheless, both Purchasers and Suppliers were sceptical about the inspection process. One Purchaser observed that there is never an opportunity to gain an understanding from working paper files of events as they unfolded in the real world. Both Purchasers and Suppliers provided criticism that inspectors did not have sufficient 'real world' auditing experience and that inspections were limited because of this deficiency.

Supplier members of firms that had been inspected were mixed in their evaluation of inspections process and some were overtly negative. The non-Big 4 observed that the process had been contaminated by inspectors observing resources available to the Big 4 and expecting the non-Big 4 to operate at the same resource level. There was, in the view of one non-Big 4 Supplier, a lack of empathy for the fact that they do things differently.

Observations that the regulator is inadequately equipped to undertake inspections were made by Users, Purchasers and Standard Setters. One User expressed disappointment that there was a need to obtain greater interaction between practice and Regulators and to attain more practical experience for regulators from those in regulatory environments. One Purchaser observed that resources assigned to regulators are almost by definition inadequate for fully undertaking the task entirely entrusted to a regulator and that the efficient operation of a Regulator is to be selective and strategic about the work undertaken rather than attempt to be comprehensive. This Purchaser also noted the beneficial use of secondments and sabbaticals from

private sector Suppliers into Regulators, which is common in the US but until very recently rare in Australia.

One Standard Setter observed that audit is in fact an outsourced form of regulation but there is a potential disconnect between the outcomes of the audit and what the Regulator might ultimately wish to be reported. This is not the responsibility of the auditor *per se* but suggests a subtle re-engineering of regulatory objectives and outcomes.

It is interesting to observe that while participants in the market have their criticisms of audit documentation requirements, Users, Purchasers, and Suppliers and perhaps particularly Standard Setters, all observe that there is a benefit to enhanced levels of documentation.

Issue 12.1
There is evidence of tension and misunderstandings between Suppliers and Regulators at the time of the interviews. The authors note that current forums such as the Australian Securities and Investments Commission (ASIC) Chairs Committee and various taskforces, the Regulatory Discussion Group, APRA's Superannuation National Auditors Consultative Committee (SNACC), ASIC Accounting Liaison meetings, the Research Group and other informal as well as formal meetings and discussions did not all exist at the time.

Suggested Action 12.1
Establish a new forum or make more effective existing forum for communication between Suppliers and Regulators and create wider dissemination of outcomes of those communications to ensure transparency and a comprehensive understanding of these communications by the supply side of the market.

Issue 12.2
It is difficult to encourage communication between Suppliers and Regulators when there is no peak body for registered company auditors.

Suggested Action 12.2
Encourage formation of a peak body for registered company auditors.

Issue 12.3
It is noted that there has since been increased funding to ASIC, but at the time of the interviews several participant stakeholders perceived ongoing under-resourcing of ASIC both in monetary and expertise terms.

Suggested Action 12.3
Adequate resourcing of and training in audit related matters of regulatory inspection staff so they hold both relevant expertise and experience.

Issue 12.4
An alleged 'one size fits all' approach by ASIC to inspections.

Suggested Action 12.4
A more nuanced and informed approach to inspections which might include engagement with peak body for registered company auditors.

Issue 12.5
Reports on ASIC inspections tend to focus on negative aspects.

Suggested Action 12.5
A more balanced approach to ASIC reporting on inspections.

13.0 Competition (Chapter 13)

13.0.1 Inferences from Survey Findings

In response to the assertion that: 'For larger companies in Australia, there is a lack of competition in the market for audit services', 57 per cent of Users, 52 per cent of Purchasers and 55 per cent of Suppliers either agreed or strongly agreed. In response to the assertion that: 'An external financial statement audit is of value to you because of the brand name of the audit firm', 32 per cent of Users, 34 per cent of Purchasers and 30 per cent of Suppliers either agreed or strongly agreed.

13.0.2 Inferences from Interview Findings

A significant number of Users were concerned that with only four major audit firms there was a lack of competition. Users also observed that for a significant portion of the market, the Big 4 are the only potential suppliers and that certain investors sought out and gave preference to global brand names such as the Big 4. One User made the observation that the sheer scale of the Big 4 provided opportunity for training and skill development unmatched by the Non-Big 4, which created potential dominance and quality level implications.

Purchasers were more mixed in their views. A positive view was that the quality of the Non-Big 4 meant that sector could be turned to for specific advice on certain matters. Other Purchasers believed that for the big end of town the market was sufficiently competitive and that there is significant competition once one looks beyond the larger ASX listed companies. One of the more complex observations was that too much competition can drive down quality. Other Purchasers suggested that for some services the Non-Big 4 are stepping up and becoming more competitive. Purchasers noted that at the margin between the Big 4 and the Non-Big 4 there is considerable competition with the Big 4 establishing 'enterprise' or 'middle market' divisions that compete fiercely with Non-Big 4 firms. While some Purchasers believe that the market encompasses self-correcting mechanisms, other observations suggest the difficulty of another large audit firm developing through natural market forces. One observer suggested nationalisation of the audit industry given the low level of competition. However others observed that much competition exists, particularly at partner level rather than at firm level and that the Big 4 can move partners around the world.

Several Suppliers observed heavy price competition and that tender battles are intense. There are repeated suggestions of tight margins and considerable fee pressure. On the other hand, Suppliers recognise that Purchasers at the upper end are limited in choice. One Supplier commented that competition can be generated where

a large listed company may have an inner circle of three of the Big 4 in one way or another, but must have one not supplying it. Several Suppliers observed that for some clients the market comprises three rather than four large suppliers. Suppliers also recognise that some of the mid-tier is moving up and some of the Big 4 activity is moving down into smaller audit purchasers. One Supplier suggested that the presence of the Big 4 with work divisions which cater for middle market clients effectively creates a second brand name of the Big 4, with potentially different standards of both quality and cost structure.

Other Suppliers indicated that the Big 4 competes with consulting firms since divesting their own consulting arms which means less work for the Big 4, placing pressure on all parts of the organisation including pressure on staff retention and the ability to interchange between audit and non-audit work. Some Suppliers observed that more competition would mean some firms not having the expertise or skill set to undertake quality audits because of the pressure on recruiting qualified staff. Other Suppliers expressed concern that the regulatory environment and the expectations of the standards of quality for audits have meant that some suppliers are moving out of the market, thereby lowering competition. Related to that is that increased regulation has meant that the ability of each Big 4 firm to differentiate itself on quality terms is limited and in fact the quality differentiation comes at partner level not at firm level. This in turn represents a challenge due to mandated audit partner rotation requirements.

One Standard Setter also observed that in the 1980s audit firm fee competition was intense and initiated essentially by the audit firm in order to win consulting activity. Through regulatory change, this is now not possible but there is still considerable price pressure in fees driven this time by clients rather than audit firms. Their motivation appears to be the desire for cost efficiencies.

There were repeated comments about the moral hazard for regulators should another large firm fail. As economic circumstances adjust with the GFC, the potential moral hazard may be more real, at least in some jurisdictions around the world. One Regulator made the observation that the moral hazard problem has already occurred in Asia; where whilst one firm was subject to regulatory sanction, sufficient concessions were given such that it continued to trade. The authors observe that despite sometimes intense competition, the majority of Purchasers do not currently see financial statement audits as a value for money service provided to the market.

Issues 13.1-13.2

In the unlikely event that there was a failure of one of the Big 4 accounting firms, it is probable that there would be adverse effects on the market for audit services and particularly for competition in that market. Yet the ongoing viability of these partnerships cannot be observed and there appears to be no contingency plans by those who regulate this market.

Suggested Action 13.1

If not already in existence, and although unlikely to be needed, a contingency plan to deal with the threatened failure of one of the Big 4 should be established.

Suggested Action 13.2
Regulatory oversight, perhaps on a confidential basis, of the financial statements of the Big 4 accounting firms.

Issue 13.3
There is no single regulatory body responsible for oversight of the 'well being' (eg number per capita, level of activity of, level of maintained competence of) of the pool of registered company auditors.

Suggested Action 13.3
Establishment of body responsible for oversight of the well being (eg number per capita, level of activity of, level of maintained competence of) of the pool of Registered Company Auditors. Alternatively existing mechanisms could be adapted to deal with this matter. As a minimum ongoing Registered Company Auditor accreditation should be dependent on carrying an appropriate amount of professional indemnity cover, complying with minimum annual continuing professional education requirements and be subject to appropriate quality review processes.

14.0 Differential Auditing Standards (Chapter 14)

14.0.1 Inferences from Interview Findings

The notion of 'differential auditing' causes confusion in the minds of at least some participants and in particular, Users, who tended to confuse the issue of differential auditing standards with differential mandates. From Users there is a mixed view in regard to the advantages and disadvantages of differential auditing standards. Some of the motivation for the positive view comes from the perception that they will create cost savings. However, some Users were adamant that they would cause capital market inefficiencies by enhancing the attractiveness of remaining private as opposed to going public. Also, there is concern that differential auditing standards will cause decreased understandability and confusion in the capital market.

Purchasers showed little support for differential auditing standards. They note that the criterion of listed versus unlisted is inappropriate with a size-based criterion seen as more functional. Suppliers describe concern about the ability to effectively communicate what level of assurance is being given. Standard Setters were also not supportive of differential auditing standards, although one drew a sharp distinction between differential auditing standards and differential accounting standards and suggested that the debate might be confused because of the intersection of the two. Regulators did provide some support for differential auditing standards. Much of the positive motivation focussed on the costliness of obtaining assurance. However, the case against focussed on the undesirability of large unlisted businesses being audited to a differential standard.

In summary, there was limited support for differential auditing standards and if there was to be a discussion around this issue, it should focus on the size-based criterion rather than listed/unlisted.

Issue 14.1
Entities that require what might be called 'micro audits' often are required by their Constitution or by legislation (eg Incorporated Associations) to be subject to an audit, when a review would suffice.

Suggested Action 14.1
Consider reviewing with a view to amending (often State and Territory) legislation so that the term 'review' rather than 'audit' is used, or indeed a choice between both, where appropriate.

15.0 Internal Audit (Chapter 15)

15.0.1 Inferences from Interview Findings

Many Users valued internal audit capacity whether outsourced or insourced, however saw little interaction between the work of external auditors and the role of the internal auditor. Additionally there seems little support for the proposition that Users value the internal audit as part of the value of a company. Purchasers do see a relationship between the internal and external audit functions. Purchasers also value internal audit as an important part of risk management. There is scepticism as to whether the capital market has a view on the role and value of the internal audit function at all.

Many Suppliers commented that not all clients maintain an internal audit function. Suppliers provide little evidence that external auditors rely on the work of internal auditors, but recognise that boards of directors, audit committees and management value of the internal audit function. Standard Setters do not support the proposition that external auditors rely on the work of internal auditors. Regulators do see external auditors as placing more reliance on the internal audit function, but they do not recognise that it is perceived as valuable to the market, probably because its work is not observable to the capital market.

Issue 15.1
Reliance by the external auditor on the internal auditor requires procedures to investigate the competence and level of independence of the internal auditor that tend to negate any efficiencies involved in reliance.

Suggested Action 15.1
Consider ways in which external auditor reliance on internal audit may be facilitated. This can emanate from both the internal or external audit side of the market.

Issue 15.2
It is difficult for the market to perceive the value of internal audit when present in a company.

Suggested Action 15.2
Companies should be encouraged or required to disclose detail about the internal audit function, what level it reports to, the type of work it engages in, the number of personnel involved, etc.

16.0 Other Assurance Services and Reports (Chapter 16)

16.0.1 Inferences from Survey Findings

Survey responses to questions about whether the external auditor is best placed to provide reports on various forms of non-financial information resulted in the following percentages agreeing or strongly agreeing:

Levels of support for auditor provision of reports on:	**Users**	**Purchasers**	**Suppliers**
• presence of material fraud in a company	81 %	66%	69%
• internal control procedures	80 %	79%	81%
• integrity of senior executive managers	50 %	33%	27%
• risk management approaches of a company	75 %	70%	63%
• performance of senior executive managers	34 %	14%	12%
• environmental and corporate sustainability perf.	44 %	31%	32%
• quality of corporate governance	77 %	74%	68%
• conflicts of interest of directors	74 %	74%	53%
• senior executive managers' projections	40 %	32%	30%
• reasonableness of non-financial information	48 %	49%	47%

16.0.2 Inferences from Interview Findings

Users particularly expressed the desirability of reports on material fraud, internal control procedures, risk management approaches within the auditee, quality of corporate governance and reports on conflicts of interests of directors, but even then responses were nuanced. Purchasers and Suppliers were not so enthusiastic, with positive responses in relation to reports on material fraud, internal control procedures, the quality of corporate governance and risk approaches of the auditee. It was observed that additional assurance around these disclosures might actually inhibit the provision of enhanced disclosure by directors and/or management. Users expressed scepticism about disclaimers that would accompany these assurances. Purchasers were concerned that they would result in 'second guessing of the board'. Suppliers were sceptical that Purchasers would be prepared to pay for these assurances. Questioning as to whether these additional assurance services would be well understood occurred. Standard Setters were more positive but suggested the need for universal reporting and a framework within which to report. Regulators were sceptical, questioning whether there is value in these assurance engagements other than in the unrealistic circumstance of provision of real time assurance, but were more positive in respect of additional assurance around the presence of material fraud. Regarding internal controls, again more positive than negative views were expressed and Suppliers saw a nexus between their current role and the provision of additional assurance around internal controls. Each specific type of potential report received comments, but the most universally disliked report was assurance over the integrity of senior management – generally seen as not possible when auditors worked so closely with management.

Issue 16.1

There is demand for assurance on various non-financial information types, much of which falls within a 'risk management' framework.

Suggested Action 16.1
Provide thought leadership by developing subject specific guidance for assurance on certain types of non-financial information within an overarching framework of 'risk management'.

17.0 Differing Levels of Audit Assurance (Chapter 17)

17.0.1 Inferences from Interview Findings

Users revealed some confusion about the level of audit assurance but did express a desire for higher levels of audit assurance. Suppliers were less enthusiastic observing that Users are not enthusiastic about even the current audit product repeatedly describing it as 'a necessary evil' or seeing it as a compliance commodity that is not necessarily high value adding. Additionally, legal liability associated with higher level assurance was raised. One Supplier observed that there may be circumstances where a lower level of audit assurance might be desired. Some Suppliers believed higher levels of assurance were possible but only if privately communicated to directors. The prohibitively high cost of higher than existing audit assurance was raised also. Generally, Standard Setters were not positive about differing levels of assurance, expressing that it was a challenge just to communicate adequately the current level of audit assurance. This viewpoint contrasted with one Regulator who believed that it was possible to have differential levels of assurance where those differential levels attached to different components of what is communicated to shareholders. In summary, in certain conditions differential levels of audit assurance may be possible but there was little enthusiasm for differential levels of audit assurance.

Issue 17.1
The Auditing Standards constrain the level of assurance to 'reasonable' even where there is client need for something above this level and where the circumstances exist where it can be delivered.

Suggested Action 17.1
Provide a framework whereby higher than 'reasonable' assurance can be given within Auditing Standards, in circumstances where there is client demand and an ability to deliver at that higher level. It is acknowledged that this suggestion would mean a departure from the present position of the assurance framework of the IAASB.

Issue 17.2
Agreed-upon procedures engagements cannot provide any assurance.

Suggested Action 17.2
Consider whether 'agreed-upon' procedures engagements should be able to provide a level of assurance. It is acknowledged that this suggestion would mean a departure from the present position of the assurance framework of the IAASB.

18.0 Conclusion

This Summary of Report Chapters provides an overview of the whole Report. It is not a substitute for reading the Chapters in full in order to examine the issues giving rise to its 53 recommendations. With this number of recommendations, some of which would be relatively easy and quick to implement and others of which need a longer term view, it might be helpful to consider which recommendations are likely to be of most interest to which set of stakeholders. The table below lists each recommendation and classifies it according to the authors' view of where the interest might lie. The concluding chapter, Chapter 18, includes a table which summarises all of the issues and recommendations and provides the authors' view of which party might best be given responsibility for implementation. It is important not to confuse the table below with author- perceived assigned responsibility, but rather to view it as the authors' attempt to assist stakeholders in focussing on recommendations most pertinent to them.

The reader may find of assistance also content towards the end of Chapter 1 which provides various diagrammatic pathways or 'roadmaps' to reading this Report, contingent on reader interests and motivations.

Summary of Expected Stakeholder Interest in Specific Recommendations

No.	Recom-mend-ation No.	Users	Purchasers	Suppliers	Std Setters	Regul-ators	Acad-emics	Legis-lators
1	3.1		√	√		√		
2	3.2			√	√			
3	3.3					√		
4	3.4				√			
5	3.5	√		√	√			
6	3.6				√	√		
7	3.7			√	√	√		
8	4.1	√	√	√	√	√		
9	4.2		√	√	√	√		
10	4.3							√
11	4.4			√		√		
12	5.1		√					
13	5.2		√			√		
14	5.3						√	
15	6.1						√	
16	6.2			√		√		
17	6.3		√	√				
18	6.4			√				
19	6.5			√				
20	6.6			√				
21	6.7			√	√	√		
22	6.8						√	
23	6.9		√	√		√		
24	7.1						√	
25	7.2						√	
26	7.3			√				
27	7.4			√				
28	8.1			√				
29	8.2			√		√		
30	8.3			√				
31	8.4			√				
32	9.1			√	√	√		
33	9.2			√	√	√		
34	9.3			√				

No.	Recom-mend-ation No.	Users	Purchasers	Suppliers	Std Setters	Regul-ators	Acad-emics	Legis-lators
35	**9.4**				√	√		
36	**9.5**			√		√		
37	**9.6**			√		√	√	
38	**10.1**			√		√	√	
39	**11.1**			√		√		
40	**12.1**			√	√	√		
41	**12.2**			√		√		
42	**12.3**					√		
43	**12.4**					√		
44	**12.5**					√		
45	**13.1**					√		
46	**13.2**			√		√		
47	**13.3**			√		√		
48	**14.1**							√
49	**15.1**		√	√	√			
50	**15.2**		√	√		√		
51	**16.1**			√	√			
52	**17.1**		√	√	√	√		
53	**17.2**		√	√	√	√		

Research Report: The Future of Auditing

"Keeping Capital Markets Efficient:

Towards a National Strategy on the Future of Auditing"

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CHAPTER 18

CONCLUSION AND RECOMMENDATIONS

1.0 INTRODUCTION

No product or service is valued by a market unless the underlying characteristics and contributions made by the product or service are known to that market. Markets act efficiently and will price goods and services according to the value that the buyers in the market see exhibited by the product or service. The price paid for the product or service will be the intersection of the price demanded by the suppliers and the price prepared to be paid by the purchasers.

Goods that are seen as 'compliance' goods are invariably subject to price minimisation by purchasers. Typically, a 'compliance' good is one which is required by regulatory authorities and is not valued inherently itself. There are those in the market for audit services who believe that auditing is a 'compliance' good. There are others who believe auditing provides substantial benefit to shareholders, to the board of directors of a company and generally to the community. This benefit extends to the capital market and to the quality of information used in that market. Whether or not it is seen as something that is of value, it is the case that the inherent characteristics of the audit are not well exposed or necessarily understood to all in the capital market. This, in some circumstances has given rise to a mismatch between the value delivered and the value expected. This mismatch has been called an 'expectations gap'.

Auditing is in a class of goods and services that is referred to in the economic literature as an 'experience good'. An 'experience good' is something that you cannot fully understand the characteristics of until you have actually experienced the delivery of the product. Many services such as dental, medical, legal or even airline travel can also fall into this classification. The essential characteristic of these products is that you have to experience them to understand the qualities. You might have some prior description or review of the service. You may even have family members or colleagues who have experienced them but, unlike physical goods, these products need to be experienced by the individual for the individual to have a full understanding of the nature of the product. Compare, for example, the purchasing of a new motor vehicle with the purchasing of audit services. One can test drive the motor vehicle and one can choose colours and options, but one has the opportunity to see the product before purchasing it. The purchase of an audit is based mainly on reputation and the promise of delivery of something of a quality and a nature that is desirable.

Hence, audit is difficult to understand without experience of it. Further, even if there is experience of it, key stakeholders see little of the experience. For instance, directors know little of what transpired during their company's audit. This means that compared with, say dentistry, full understanding is doubly hard. At least with dentistry you get to live and feel the experience.

It is in this context that the comments in the next section and the recommendations that follow it should be read. Many of the recommendations seek to assist in overcoming the level of information asymmetry existing between audit and those who cannot experience it directly.

2.0 WHERE THEN WILL THE FUTURE OF AUDIT TAKE US?

During the early years of the twenty-first century, policy makers and certain participants in the market for audit services have taken important steps to map out the future of audit. In Australia the changes to the regulatory regime (CLERP 9) after the spectacular corporate collapses of the early years of this decade have seen some important "big picture" changes. We have seen changes in auditing standard setting with greater representation in the process from those outside the supply side of the market; the legal backing of auditing standards; more detailed requirements over the independence of the auditor; a reduction in professional self-regulation and co-regulation, together with an increase in regulation and oversight by Australia's principal regulator in this area. There are similar changes in other jurisdictions around the world to a different extent and with a different nature, but regulatory change has been one of the hallmarks of auditing in the past several years in many parts of the world. The unresolved question remains as to whether these changes have had their intended effects.

2.1 What were the intended effects of the regulatory changes?

There were many well intended changes to the regulatory regime in the earlier part of this century that may have provided value to the market for audit services, enhanced the audit attestation function and enhanced financial information that is crucial to the efficient operation of the capital market. However, it is difficult to conclude that all these regulatory changes have had the intended effect. The intended effect can be gleaned from the six overarching principles for the Corporate Economic Reform Program in general, reproduced in the CLERP 9 Discussion Paper as:

- analysis of costs and benefits of proposed changes;
- development of a consistent, flexible, adaptable and cost effective regulatory and legislative framework;
- reduction of transaction costs for firms and other market participants;
- achievement of appropriate balance between government regulation and industry regulation;
- removal of barriers to entry for service providers; and
- improved harmonisation between Australia's regulatory framework with those applying in major world financial markets (Corporate Law Economic Reform Program No. 9 Discussion Paper (2002: 14)).

The stated objective of CLERP 9 itself is useful also: 'The underlying objective of the reforms is to improve the operation of the market by promoting transparency, accountability and shareholder activism.' (Explanatory Memorandum to the CLERP 9 Bill 2003: Clause 1.4). The relevant portion of the Introduction to the CLERP 9 Bill states that the Bill sets up a framework that includes measures designed to improve the reliability and credibility of financial statements through enhanced auditor independence (eg partner rotation, disclosures around non-audit services), improved enforcement arrangements (eg legally backed auditing standards) and measures to better allocate and manage risk (incorporation, proportionate liability) Corporate Law Economic Reform Program No. 9 Bill (2002: 2-3).

2.2 Have the regulatory changes affecting auditing brought a positive cost/benefit outcome?

Some would argue strongly that the enhanced regulation has meant that the documentation requirements have been strengthened and have resulted in better quality auditing. The extent to which decision making is now documented and thus defensible was stated by several interviewees as a positive. It has, however, not come without cost. In some instances this cost has been difficult to separate out from other costs because of the existence of other contemporaneously timed changes in financial reporting, including the introduction of AIFRS.

The costs of these changes are evident at many levels. Some have argued strongly that these changes and the documentation requirements in particular, represent a distraction from the primary objective of the audit and have meant more time and effort has been spent on documentation rather than dealing with the substantive issues of the audit. The changes have also meant that many see there has been an extension in the routine nature of much of the work, which may not suit the present generation of audit firm recruitees, that is, Generation Y.

The withdrawal of co-regulation as the primary policy position and the creation of separable regulatory frameworks have produced potential separation between those who regulate the audit market and those who supply into it. In effect, this may have exacerbated a second expectations gap that runs parallel to but is separable from the expectations gap between Users and audit Suppliers. Interviewees discussed an observable gap in expectations between Regulators and Suppliers.

The changes have also given rise to a potentially unintended consequence. The remuneration and rewards for members of the auditing profession have been seen to decline in relative terms while the risks and the level of scrutiny and potential penalties have increased. If true and sustained, this development has a consequence for the long term recruitment and retention of staff interested in and passionate about auditing. The nature of the change in the work and the increase in the mechanical and routine also means that there are potentially less opportunities for auditing staff to develop their business acumen and gain an understanding of their clients more broadly.

We have found evidence that auditing staff have not only acquired more limited reward opportunities and face higher risks, but they also have severe limitations on alternative income possibilities through investment because of the changed independence requirements. These independence requirements also have the effect of potentially causing inefficiencies in the supply of consulting services to audit clients. Similarly, the rotation requirements of the independence of clients means that potential inefficiencies are introduced especially where an audit client is in a particularly complex or highly regulated industry; the five-year cycle might actually give rise to inefficiencies in the conduct of the audit although it may provide enhancements in independence.

With the changes, we found no difference in the frequency or extent of reading of the audit report compared with reading prior to the regulatory changes. However, it is noted that the audit report remains standardised and has not been substantively altered, adjusted or elaborated upon with the regulatory changes.

In the interviews that were conducted, we did not find many who believed that the legal backing of standards adds to the value of an audit, indeed we found few individuals independent of the audit standard setting process itself who believed that legal backing would make much difference. We found no one who was prepared to say that the capital market has been enhanced by the legal backing of standards. Perhaps there are others who we did not interview who would be prepared to take such a position.

We have no evidence that the change in membership of the Auditing and Assurance Standards Board has not had a positive consequence in making it more accountable to a wider group of stakeholders within the market for audit services. There is no evidence that the legal backing of standards has in fact enhanced the credibility of financial statements, the quality of auditing and its role in the capital market or reduced the likelihood of unsignalled corporate collapse. The introduction of independence regulatory changes has been important and has caused structural change in the market. We do not know if we have avoided an independence catastrophe as a consequence of these regulatory changes, but they may have. We can conclude however that they have given rise to considerable cost - both financial and non-financial. The changes to oversight, including but not limited to regulatory inspections, have also given rise to costs and have, we would argue, profoundly changed the structure of the work, which will have considerable ongoing consequences for audit firms and their staff.

Despite the potential negatives listed above, we still see a market that does not seek to change a mandate to the auditing profession that makes it obligatory for all listed companies as well as many others to undertake a statutory audit of one form or another. The key to the value of the audit is to ensure that the market sees the characteristics it brings and chooses to value them. The future of audit is all about ensuring that value is delivered; the alternative being the ‘compliance good’ philosophy and driving down of costs and fees as a consequence. One interesting outcome of recent regulatory change has been the dissipation of auditor concerns over legal liability.

2.2 Responses by a market that is increasingly under pressure

The recent past has seen considerable pressure applied to audit firms and indeed the market for audit services generally. As suggested above, these pressures come in many forms but, when viewed from the supply side of the market, there is evidence of pressure in respect of price of the services delivered. There are also pressures in respect of the inspections and regulatory oversight, sometimes, we are advised from many different sources; pressure in terms of recruiting appropriate staff both at junior and more senior levels and a loss of opportunities to deliver auditor provided non-audit services and pressures from changes in the expectations of work patterns and scale of work by Generation Y employees. This list is not comprehensive.

One component of the strategic response by at least some in the market for audit services has been to 'commoditise' the audit work. Commoditisation is a common mechanism used in industries where there is a provision of a service to respond to price and other pressures. Its application in auditing may therefore have been entirely predictable. Parallels can be found in the transport industry, the pharmaceutical industry, in such practices as conveyancing and even in the delivery of medical services in some parts of the world, amongst others. Commoditisation has the effect of driving down costs but it has been shown to remove some of the 'glamour' or intrinsically satisfying aspects of service delivery. Consider for example the airline industry and the comparison of airline travel a quarter of a century ago with the 'low cost carriers' of today. The same basic functional service is delivered but the removal of the prestige or mystique of the service is apparent.

The commoditisation response also has the effect of making the work more standardised and formulaic and, as a consequence, better able to document the processes that have been undertaken in the work. While this commoditisation response may have occurred with or without the regulatory changes of recent years, it seems likely that those changes have at least exacerbated these responses. We saw no evidence that this trend was reversing or perhaps reversible. Given this, policy settings need to minimise any potential adverse consequences of commoditisation so as to maximise the net benefits of this trend.

The intersection of the commoditisation response (and the consequential effect on the nature of the work), together with, as noted above, the reality that much of the quantity of the more procedural work is undertaken by Generation Y employees. This results in what might be seen as a 'perfect storm'; where the expectations of the nature of work have gone in one direction and the actuality of much of the work available to be undertaken has gone in the other. We have evidence that there have been attempts by audit firms to deal with the symptoms that have arisen here. This includes the creation of variety by rotation of clients to provide diversity of work (including the creation of 'middle market' work), to give staff exchanges and facilitate graduate studies. These methods however all deal with the symptoms of commoditisation but the trend towards commoditisation itself remains unchanged and probably unchangeable.

What are the other responses to a market that is increasingly under pressure? These responses could come from firms, regulators or those who set policy.

One strategy could be implemented by a cooperative engagement by firms and regulators at least and would involve creation of a mechanism for the market to observe the value of the inherent good or service being provided. If the value of the product or service can be better displayed to the purchasers of that service, then the drive-down in costs and the understanding of value is made more possible. Put another way, this would ensure the transparency of the value of the product to the client. There have been previous attempts to provide transparency of value and the accounting firms PricewaterhouseCoopers and KPMG in recent years attempted to make more evident the processes that go on within major audit suppliers.

Perhaps in ensuring that the market sees value, we need 'windows' on both processes and outcomes so that auditing is more observable by the market. When was the last occasion you saw a newspaper report with the headline, 'Auditor Does Good Job'?, or when were we informed of the number of audits conducted in the last calendar year that were successful and aided the efficiency of the capital market? Where we do have a window on audit outcomes including positive ones? Where we have them, they are invariably 'bad' news stories. The very inspection service that the regulator has set almost inevitably means that only bad news is ever revealed. No evaluation exists of particular processes within accounting firms as being 'above satisfactory' or 'equal to world's best practice'. One can understand why a regulator may not want to do this, but it does not add to the efficiency and competition to drive up the value of the audit and, in that sense, it does not aid the efficiency of the capital market.

2.4 Where to from here?

What is the future of audit then? If the market increasingly becomes suspicious and even cynical about the value of the audit, then the ultimate prize of a mandated audit may be at risk. We observed no evidence that the removal of the mandate, which would make audit entirely voluntary, was on the minds of market participants.

Throughout the chapters in this Report are policy suggestions that may assist in addressing some of the challenges we infer from participants' observations. For example, one suggestion is recruitment of staff who are better 'fit for purpose' given the commoditisation trend. Is it the case that particularly intellectually able graduates, who will expect, indeed demand, variety and challenging work, should be the target of recruitment? Are the current selection criteria in graduate intake processes optimal?

There are other policy recommendations, for example, the area of materiality (or tolerance for error) has not been exposed to considerable debate in the wider market for audit services. Providing information, transparency and communication vehicles, at very least between auditors and audit committee members, increases the value of the audit and permits a more informed discussion on the matter. One can see value in the audit by simply changing the materiality level and understanding the consequences of that both to cost and to the quality of the audit. The need for more flexibility in audit reporting, for more dialogue between regulators and suppliers, for peak bodies with overarching responsibilities where currently non-comprehensive arrangements mean that overlaps or underlaps occur, for more research into the

efficacy of regulatory changes and for plain English, widely available, explanations of audit processes and the role of audit in enhancing capital market efficiency; these are some of the actionable recommendations made within each chapter that arise from studying the responses of the many participants to this project. The next section summarises in full these various suggestions, before final 'Concluding Remarks' are made.

3.0 SUMMARY OF RECOMMENDATIONS

Below is a summary of each of the recommendations that are drawn from the individual chapters. This table is provided here as a summary of the individual recommendations and their specifics. The recommendations however, should not be read out of context of the wider discussion. In particular we emphasise that many of these matters are not new and for some of the recommendations, it is not the first time that they have been made, but this does not reduce their validity or their importance. In a number of instances, progress towards achievement of the ultimate recommendations has been made. We do not imply that in all cases, ineffective or inappropriate progress has been made. However, we would assert that progress towards achievement of the recommendations may have some way to go. Additionally, in a number of cases we have made suggestions that have not been pursued previously or arrangements that are not presently in place.

These conclusions, recommendations and potential action items may be of use to the reader as a summary but we again remind readers that they need to be considered within the context of the wider discussion in this Report. The authors have expressly not ordered these recommendations with a view to priority or specific order of importance. They appear in the same sequence as they appear in the text, with reference to the chapters in which the words of the various participants either explicitly or implicitly gave rise to the suggestions.

Some of the recommendations are more easily implemented than others. Some require legislative change, which may be considered by some too difficult to achieve. However, the recent furore over executive remuneration demonstrates that where there is a will, legislative change can be made quite quickly.

3.1 Summary of Recommendations

Ch.	Issue	No.	Conclusion/Policy/Action	Suggested Responsibility
3	The audit expectations gap continues to exist, is complex and multifaceted (existing at least between Users and Suppliers, Purchasers and Suppliers and Regulators and Suppliers) and at the least is costly to the efficiency of the market for information within the capital market and may have many other costs associated with it.		Minimise the audit expectations gap to the extent possible.	All parties in the market for audit services
3	Differential incentives on part of Suppliers and other stakeholders to create, or maintain an audit expectations gap, even to the extent of 'manufacturing' it, depending on the circumstances. Diversity amongst Users and Purchasers (and even some Regulators) in terms of the sophistication, capability and motivation to fulsomely understand the audit process and outcomes.		Recognition that the audit expectations gap will never be closed and that eliminating differential incentives for a gap to exist and 'educating' all stakeholders is not possible. Focus on stakeholders who are motivated and have the capability to have their knowledge and understanding of audit and its outcomes raised and focus on specific topics known to be the subject of misunderstandings (eg materiality, use of term 'test basis'). Because of shared objectives and sophistication level, the gap between Suppliers and Regulators should be given the highest priority in terms of gap minimisation.	All stakeholders in the market for audit services
3	Perceived complexity of financial reports limits potential for communication solutions for auditors.	3.1	Policy maker recognition that enhancing the readability and understandability of financial reports is a multifaceted, multi-agency responsibility with no single body taking overall responsibility for monitoring more than technical compliance with accounting standards etc. A body, likely the FRC, should take on explicit responsibility for monitoring aspects of the	FRC (possibly using round-tables jointly chaired with ASIC)

Ch.	Issue	No.	Conclusion/Policy/Action	Suggested Responsibility
			quality and understandability of financial reports.	
3, 4, 5	Audit report wording is standardised/ commoditised which hides the degree of auditor judgement involved in relation to a specific auditee, ignores the diversity of the audience in terms of motivation for and capability of understanding of audit outcome information and uses terms that can be misconstrued (eg material misstatement, test basis).	3.2 3.3	Amend audit reporting standards to encourage more nuanced and auditee-specific audit reports in order to encourage reading by target audience. Perhaps this should be in the form of appendices to a standardised report (Refer also Recommendation 3.5). While audit reports need to fulfil minimum legal requirements, there should be positive encouragement by regulators to allow auditors to include nuanced and subtle explanations and observations in a way that adds value to the report for interested readers.	AUASB ASIC
3	Generalised non-reading of the auditor's report – potential to miss emphasis of matter paragraphs.	3.4	Consider the current guidance on location and highlighting of emphasis of matter paragraphs to ensure they are conspicuous.	AUASB
3	The standardised audit report wording uses terms that can be misconstrued and hence which may contribute to the audit expectations gap. In particular, there is evidence of misunderstanding of the use of the terms 'reasonable assurance', 'material misstatement' and 'test basis'.	3.5	Change wording within the auditor's report to minimise the audit expectations gap (eg 'This audit is a certification of the X percentage probability of the absence of misstatement in the financial report above an absolute aggregate dollar value of Y'..or "We are X per cent confident that there are no misstatements in the financial report above an absolute dollar value of …...").	AUASB
3	Several Suppliers' comments indicate that they do not understand that authorities in Australia view the external audit as a form	3.6	Creation and wide dissemination of an overarching, high level, educational piece on the role of audit in Australia's society, including content in plain English on for which types	FRC? AUASB? Joint

Ch.	Issue	No.	Conclusion/Policy/Action	Suggested Responsibility
	of 'delegated regulation' (Knott 2002). In Australia, audit is privileged by a mandate in many cases (that is, is required by legislation), has the shareholder as its centre as the client, and always is the beneficiary of restraint of trade policies (that is, only appropriately qualified persons can sign an audit report). These aspects of the current framework are not well understood by some Suppliers.		of entities audit is mandated, the audit process and for suppliers, a section reinforcing the privileged role that audits hold and the rights and responsibilities that level of privilege brings with it.	Professional Bodies?
3	Regulators allegedly sometimes do not practice 'delegated regulation' but instead dictate 'detail' to a point which interferes with audit efficiency, but even more seriously, with audit effectiveness.	3.7	Despite acknowledged existing mechanisms for communication, greater communication between Regulators and Supplier representatives from both larger and smaller audit suppliers and wider dissemination of feedback to the population of audit suppliers is needed to enhance communication of what each party (regulators and suppliers) is seeking to achieve.	ASIC Joint Professional Bodies AUASB
4	Many of the aspects of audit are not well understood by some Users and Purchasers.	4.1	Provision of collaboratively written, widely available educative material about auditors' work and process, focused on Users as the audience, written in layman's language and spelling out important things like the fact that the work involves sampling (arguably a less ambiguous word than 'testing'), may be particularly risk focused, deals with substantive issues pertaining to that particular industry or entity, and describing what levels of materiality are used and how these are determined. For consideration is whether these descriptions should be specific to the company or might be more generalised for a particular audit firm.	AUASB Joint Professional Bodies AICD ASA Individual audit firms

Ch.	Issue	No.	Conclusion/Policy/Action	Suggested Responsibility
		4.2	Provide educational materials in plain English in relation to use of the word 'material' and 'materiality' in an audit context.	
		4.3	Consideration be given to a government funded public education campaign of the type administered to encourage understanding of the importance of superannuation contributions.	Legislature
4	Information search costs for auditor's reports are high since these documents are currently available only by acquiring, and searching within, individual company annual reports	4.4	For listed companies, auditors' reports should be mandated as a separately filed ASX document (as well as located within the annual report) so that they can be searched in aggregate as publicly available information individually or for a particular class of company or type of report. Caveats would need to be drawn with the filing to the effect that the auditors' reports should be read in conjunction with the related financial reports.	ASX (Listing Rule) or ASIC
5	The concept of 'materiality' as it is used in an auditing concept is not well understood outside the profession and is a previously underemphasised part of the audit expectations gap. As such, costs are imposed on the market for information within the capital market.	5.1	Apart from the inclusion of generalised information about materiality and its role within audits (refer Recommendation 7.1), create specific guidance for audit committees in terms of their need to inform themselves about audit materiality and their right to request disclosure by the auditor to them of the level of 'tolerable error' used in the audit.	AICD IIA
		5.2	ASX to include in its Corporate Governance Guidelines and Recommendations a recommendation that audit committee members undertake structured education programs that include content related to the statutory role of audit, audit	ASX

Ch.	Issue	No.	Conclusion/Policy/Action	Suggested Responsibility
			processes and audit outcomes and audit committee member rights and responsibilities in relation to these features. This could be a recommendation that such requirements be included in corporate audit committee charters.	
		5.3	Consider the integration of audit-related concepts wherever relevant into subjects/units within tertiary and professional business qualifications (as many institutions do with ethics education).	AFAANZ Universities/ TAFEs Professional Accounting Bodies
6	The personal attributes of maturity, tenacity, self-assertiveness, resilience and integrity, many of which feed into the notion of 'emotional intelligence', may be as important to successful audit outcomes as technical auditing skills, yet are seldom targeted explicitly as graduate attributes by tertiary institutions and beyond in their teaching and learning programs.	6.1	Collaboration between relevant parties to assess the best way to build the development of key personal attributes into subjects/units and courses.	Suppliers, Professional Accounting Bodies, AFAANZ, Universities
6	Based on participants' comments the present audit business model in some practices is under stress. It is seen in some instances as heavily pyramidal, tending to overly rely on junior staff, least likely to possess the ideal 'personal emotional intelligence' attributes, at the interface between the client and the auditor and	6.2	Consider whether the current widely used business model is sustainable and optimal in the longer-term.	Audit firms
		6.3	Consider whether audit practices' current recruitment techniques test appropriately for the personal skills required to be a successful auditor.	Audit firms
		6.4	Consider developing more effective systems and processes for	Audit firms

Ch.	Issue	No.	Conclusion/Policy/Action	Suggested Responsibility
	depends on retention of staff with the appropriate personal and technical skills for future leadership.		the management of client–specific knowledge and ensuring its continuity despite changes in audit team membership.	
		6.5	Consider developing more effective workplace flexibility practices to retain staff at points of major change in their personal lives.	Audit firms
		6.6	Alter recruitment policies to encourage hiring of many more Honours graduates (and others with higher level analytic skills).	Audit firms
6	Some stakeholders noted that opportunities for development of business acumen and industry knowledge in junior auditors has become more limited with increased independence requirements.	6.7	Consider development of a national database divided by industry groups and also geographic distribution including data that relates to audit, governance and risk issues relevant to auditees within the Australian market for audit services.	Professional Accounting Bodies Universities
		6.8	Enhance the adequacy of the teaching of auditing at tertiary level and in continuing professional education by developing high quality, realistic multimedia and case-based teaching and learning materials.	Universities/TAFEs Professional Accounting Bodies
6	Remuneration schemes which reward client accounting staff based on the number or extent of audit adjustments exist and can usurp the role of the audit committee and encourage conservative accounting rather than accounting that reflects the economic reality.	6.9	Include in the ASX Corporate Governance Guidelines and Recommendations a recommendation that audit committee members be advised if such a scheme is in place and, if so, how it operates.	ASX

Ch.	Issue	No.	Conclusion/Policy/Action	Suggested Responsibility
7	Many participants' comments indicate that in their view, higher levels of prescription have lead to more 'menial' work for junior auditors.	7.1	Consider greater use of mechanisms other than year 12 score for entry to university accounting degrees (eg as has been done for entry to Medicine) since the competitive forces to maintain university entrance scores as high as possible may not create circumstances for suitably disposed students to enter into Accounting degrees.	AFAANZ Universities
		7.2	Conduct research into whether the presence of alternative pathways to the professional body programs (to CPA Segments and CA Program) have a negative effect on entrance standards or on the quantity of accounting graduates entering or exiting universities in Australia. If there are other alterative pathways then what would be the likely consequences?	AFAANZ Universities
		7.3	Consider whether the 'best and brightest' really represent optimal audit firm recruits for the majority of appointments.	Audit firms
7	Auditing has an 'image' problem and has become less attractive as a career than it once was. The Global Financial Crisis (GFC) may mask this fact in the short-term, but it will resurface as an issue.	7.4	Consider how the profile of auditing as a career can be made more widely known as an attractive career option.	Professional Accounting Bodies
8	Widespread observations by participants at the time of questioning result in the conclusion that retention of staff is becoming more of a challenge than in the past.	8.1	Given feedback from more junior auditors, consider reorienting human resource performance systems to work optimally (eg taking into account the audit readiness of assigned clients) to reward merit and potential.	Audit Firms

Ch.	Issue	No.	Conclusion/Policy/Action	Suggested Responsibility
		8.2	Consider secondments to regulators (and others such as 'policy' officers) since secondments to clients are no longer as possible, presuming any potential conflicts of interest can be minimised or eliminated.	Audit Firms
		8.3	Inform staff not just about employment opportunities and career development that exists within their firm but also give benchmarked objective comparators to other alternative employment.	Audit Firms
		8.4	Engage with audit firm alumni not just as potential clients but also as potential returning employees.	Audit Firms
9	Discouraging auditor provided non-audit services (APNAS) for all sizes of clients creates inefficiencies and costs for shareholders.	9.1	Apply the ethical rules covering APNAS differentially according to some criteria such as listed company size (eg S&P ASX 500).	ASIC
9	Companies' disclosures regarding non audit service fee categories is inconsistent hence reducing comparability.	9.2	Provide guidance as to appropriate detailed services that fit within specific classifications.	AUASB
9	Audit division staff have reduced freedom with respect to investment opportunities compared with other public practice staff, but generally may not be as susceptible to losing employment in economic downturns because of the mandated nature of audit.	9.3	Investigate whether stability of employment characteristics compensate for foregone investment opportunities, and if not, compensate accordingly.	Audit Firms

Ch.	Issue	No.	Conclusion/Policy/Action	Suggested Responsibility
9	Although members of the three professional bodies in Australia (CPAA, ICAA and NIA) are bound by the IFAC-compliant APESB's APES 110, there remain Registered Company Auditors who as a question of fact are not members of those bodies and hence who are not necessarily bound by an ethical code based on IFAC's code through membership of a professional accounting body.	9.4	Include ethical standards within the AUASB's legal mandate or else the FRC provide the AUASB with a strategic direction to issue ethical standards for auditors.	Legislature FRC
9	Five year audit partner rotations are reported as creating problems for large, complex, highly regulated companies.	9.5	Consider differential application of audit partner rotation requirements rather than a 'one size fits all' approach.	Legislature ASIC
9	Several participant Suppliers commented on the point of audit partner rotation as being a trigger point for decisions regarding whether to leave or remain in the auditing profession. No data is available as to whether the point of partner rotation has increased the rate of exit from the profession.	9.6	Conduct research into movements in Registered Company Auditors per capita both before and after the introduction of the five year rotation requirement, controlling for other factors likely to affect these movements (eg retirements).	ASIC Professional Accounting Bodies Accounting Firms University Academics (would need to be provided with de-identified data)

Ch.	Issue	No.	Conclusion/Policy/Action	Suggested Responsibility
10, 11	Increasingly prescription of audits is seen to 'distract auditors' from their tasks.	10.1	Evidence should be gathered as to whether the regulatory reforms of earlier this decade have been cost beneficial.	FRC AUASB
11	There appears to be no agreed minimum documentation requirements between the regulator and auditors. It appears that, by default, PCAOB documentation requirements have been adopted by the Big 4 in internationalising their audit processes and applied to PCAOB and non-PCAOB regulated audits alike. In turn, Suppliers interviewed advise that they believe that this has been seen by Australian regulators as the minima and onerous when applied to both Big 4 and non Big 4 auditors in relation to the bulk of audits inspected.	11.1	Greater dialogue between auditor representatives and regulator representatives should take place.	ASIC Professional Accounting Bodies
12	There is evidence of tension and misunderstandings between Suppliers and Regulators at the time of the interviews. The authors note that current forums such as the ASIC Chairs Committee and various taskforces, the Regulatory Discussion Group, APRA's Superannuation National Auditors Consultative Committee (SNACC), ASIC Accounting Liaison meetings, the Research Group and other informal as well as formal meetings and discussions	12.1	Establish a new forum or make more effective existing forum for communication between Suppliers and Regulators and create wider dissemination of outcomes of those communications to ensure transparency and a comprehensive understanding of these communications by the supply side of the market.	ASIC APRA

Ch.	Issue	No.	Conclusion/Policy/Action	Suggested Responsibility
	did not all exist at the time.			
12	It is difficult to encourage communication between Suppliers and Regulators when there is no peak body for Registered Company Auditors.	12.2	Encourage formation of a peak body for registered company auditors or alternatively adapt existing structures to achieve greater communication and then dissemination of outcomes.	CPA Australia ICAA NIA
12	It is noted that there has since been increased funding to ASIC, but at the time of the interviews several participant stakeholders perceive ongoing under-resourcing of ASIC both in monetary and expertise terms.	12.3	Adequate resourcing of and training in audit related matters of regulatory inspection staff so they hold both relevant expertise and experience.	Federal Government ASIC
12	An alleged 'one size fits all' approach by ASIC to inspections.	12.4	A more nuanced and informed approach to inspections which might include engagement with peak body for registered company auditors.	ASIC
12	Reports on ASIC inspections tend to focus on negative aspects.	12.5	A more balanced approach to ASIC reporting on inspections.	ASIC
13	In the unlikely event that there was a failure of one of the Big 4 accounting firms, it is probable that there would be adverse effects on the market for audit services and particularly for competition in that market. Yet the ongoing viability of these partnerships cannot be observed and there appears to be no contingency plans by those who regulate this market.	13.1 13.2	If not already in existence, a contingency plan to deal with the threatened failure of one of the Big 4 should be established. Regulatory oversight, perhaps on a confidential basis, of the financial statements of the Big 4 accounting firms.	ASIC APRA ASIC

Ch.	Issue	No.	Conclusion/Policy/Action	Suggested Responsibility
13	There is no single regulatory body responsible for oversight of the 'well being' (eg number per capita, level of activity of, level of maintained competence of) of the pool of Registered Company Auditors.	13.3	Establishment of body responsible for oversight of the well being of the pool of Registered Company Auditors. Alternatively existing mechanisms could be adapted to deal with this matter. As a minimum ongoing Registered Company Auditor accreditation should be dependent on carrying an appropriate amount of professional indemnity cover, complying with minimum annual continuing professional education requirements and be subject to appropriate quality review processes.	FRC
14	Entities that require what might be called 'micro audits' often are required by their Constitution or by legislation (eg Incorporated Associations) to be subject to be audit, when a review would suffice.	14.1	Consider reviewing with a view to amending (often State and Territory) legislation so that the term 'review' rather than 'audit' is used, or indeed a choice between both, where appropriate.	Legislature
15	Reliance by the external auditor on the internal auditor requires procedures to investigate the competence and level of independence of the internal auditor that tend to negate any efficiencies involved in reliance.	15.1	Consider ways in which external auditor reliance on internal audit may be facilitated. This can emanate from both the internal or external audit side of the market.	AUASB
15	It is difficult for the market to perceive the value of internal audit when present in a company.	15.2	Companies should be encouraged or required to disclose detail about the internal audit function, what level it reports to, the type of work it engages in, the number of personnel involved, etc.	ASX G100
16	There is demand for assurance on various	16.1	Provide thought leadership by developing subject specific	AUASB

Ch.	Issue	No.	Conclusion/Policy/Action	Suggested Responsibility
	non-financial information types, much of which falls within a 'risk management' framework.		guidance for assurance on certain types of non-financial information within an overarching framework of 'risk management'.	
17	The Auditing Standards constrain the level of assurance to 'reasonable' even where there is client need for something above this level and where the circumstances exist where it can be delivered.	17.1	Provide a framework whereby higher than 'reasonable' assurance can be given within Auditing Standards, in circumstances where there is client demand and an ability to deliver at that higher level. It is acknowledged that this suggestion would mean a departure from the assurance framework of the IAASB unless changes were also made at the international level.	AUASB
17	Agreed-upon procedures engagements cannot provide any assurance.	17.2	Consider whether 'agreed-upon' procedures engagements should be able to provide a level of assurance. It is acknowledged that this suggestion would mean a departure from the assurance framework of the IAASB unless changes were also made at the international level.	AUASB

4.0 CONCLUDING REMARKS

A key outcome of this research has been to make inferences from the invited opinions of many different stakeholders in the market for audit services. These invited opinions suggest a number of challenges in that market and ways in which such challenges might be addressed from the viewpoint of contributing to capital market efficiency. Although challenges are identified in this Report, the innate 'stress testing' of auditing brought about by the GFC bears witness to its present robustness.

By faithfully incorporating the words of participants who contributed to this project, we have left the power of their words untouched. At the same time, using this 'window' to the views of participants in the market for audit services at a point in time, we have sought to synthesise and distill themes and common perceptions. These perceptions, we would judge, are interpreted as 'fact' by those who hold them, but we have come to learn that 'fact' is in the eyes of the beholders and may not be shared by others.

We have concluded that various stakeholders see that the external financial statement audit is valued and that there is no call to reduce or eliminate its mandate. However, we conclude that the audit expectations gap survives. We are of the view also that it is not possible to close this gap completely and that to aim to do so is an unrealistic expectation. Our view is that efforts to minimise the gap should focus on where they have most likelihood of success and, for a number of reasons, this likelihood does not lie with a focus on retail investors. Suppliers and Regulators share a similar advanced level of sophistication in understanding financial information and share also a common motivation to minimise any expectations gap between them. We conclude that this may be where efforts should focus, whilst simultaneously generating relevant educational materials for more general use. Efforts, we believe, should focus on specific topics our research has led us to believe as contributing to misunderstandings, such as materiality.

In terms of reforms to the regulatory regime over the past several years, we find some evidence of unintended consequences. There is a recognition that audit documentation quality has improved, but at a cost.

The apparent 'commoditisation' of the audit has multifaceted consequences. We point to some of these consequences and provide suggestions as to how they can be managed. We also observe that the audit opinion provided across a whole range of auditees is almost identically worded. This in and of itself may have contributed to an undervaluing of the financial statement audit in the market for information. We suggest amended audit report wording and reporting formats to address this issue.

We infer from participants' comments that some audit committee members and even directors exhibit less than complete understanding of matters relating to the external audit and we make recommendations for ways that these cohorts might be better alerted to address this.

We observe many challenges relating to the staffing of Suppliers to the audit market. These relate to more junior staff and 'Gen Y' issues, as well as the challenges for providing

appropriate incentives for more senior staff and the limitations some of the regulatory changes have caused there. Some of these issues may be suppressed by the GFC but the core underlying characteristics seem unlikely to change.

The working title of this research project has been 'The Future of Audit'. While it is always the case that the future is what you make of it, this is true in particular for the market for audit services in Australia and beyond. The absence of a call for the reversal or reduction of the audit mandate is a powerful starting point for the future. The absence of reference to auditors' legal liability in statutory audits, as could have been expected to arise as a concern from prior research into the expectations gap, is noted also.

There are no doubt challenges, many of which are noted in the preceding 500 or so pages. Importantly we find evidence of unintended consequences of recent regulatory changes. Lessons need to be learned before further changes and implementation of such changes. The forthright views of participants in the market have been documented here. These may be useful in informing policy positions and changes to those positions by a range of stakeholders, including those who set public policy, those involved in the supply of audit services and those who set auditing standards and give guidance to the audit market.

The authors have attempted to avoid platitudes or 'motherhood' statements in writing this Report. Those who were expecting them will be disappointed. Similarly those who choose to 'cherry pick' more critical observations in this Report will not be representing its contribution faithfully or in the spirit in which it is intended.

The 'future of audit' is not without its challenges and there are actions that can be taken by key participants in the market for audit services. Auditing is now and can be expected to remain a key part of the delegated regulation within the Australian economy.