

Preliminary research findings of three FAR-studies: what has been found so far?

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Received 20 July 2018 | Accepted 5 October 2018 | Published 18 October 2018

Based on the 2016 call for research proposals, six research projects were launched as a first beacon on the FAR research agenda, strengthening the collaboration between auditing academics and practitioners. During the second plenary session of the conference, representatives of two of the research teams presented initial insights of their studies. These presentations were provided by Therese Grohnert and Wim Gijselaers (concerning learning culture) and Anna Gold (regarding group audits). Furthermore, Olof Bik and Jan Bouwens, who are working on a FAR project in a so-called ‘joint working group’, presented their study on partner incentives and performance. A summary of the findings of the three studies follows next, supplemented with a short overview of the discussion with the audience.

How to create a learning culture in audit teams?

Therese Grohnert and Wim Gijselaers (and their co-researcher Roger Meuwissen) are affiliated with Maastricht University

Why are some audit teams better than others at collaborating, at resolving complex problems, and ultimately, at performing? Do ‘hard’ factors make the difference, such as team composition or budget pressure? Or are ‘soft’ factors key, such as tone at the top and team beliefs? These questions lie at the heart of the study by Grohnert, Meuwissen and Gijselaers. The purpose of their study is to investigate what conditions enable audit teams to perform well. In particular, the focus is on team learning, which they define as “continuously and collaboratively developing new knowledge as part of daily work activities”.

1. Semi-structured interviews

As a first step in the study, 29 auditors from large and mid-sized firms were interviewed, ranging from junior staff to experienced partners. Each auditor provided insights from their professional experiences on two different team settings: working with a team that collaborated effectively and working in a team that did not manage to do so. The purpose of these semi-structured interviews was to find out: (1) what kind of behaviors auditors found effective for performing well in their teams; (2) which mechanisms are effective for actively fostering these behaviors during the audit work; and (3) which conditions enable teams to display these behaviors.

2. Effective team behaviors

The first interesting insight is that auditors described three groups of effective team behaviors that led to good team performance: (1) openly sharing information, help and feedback; (2) constructively managing conflict; and (3) consciously restructuring teamwork to adapt to changing circumstances. These three behaviors are well established in the team learning literature, and research has connected them to high performance in a variety of other fields, from aviation and education to management. The stories told by practitioners help to parse the drivers and conditions of these team learning behaviors.

3. Same drivers, different needs

The second insight from the study, so far, is that auditors from all professional ranks identify the same drivers for team learning, but they differ on what they consider to be necessary for team learning. For example, staff auditors

indicated to rely on a psychologically safe team environment: being allowed to ask questions and admitting to mistakes without fearing negative judgment from others. Managers, on the other hand, were mostly concerned with how to create such a safe environment. From the senior level onwards, auditors most frequently mentioned the behavior of leaders as the key driver behind team learning behaviors. These leadership behaviors include asking team members to share concerns early, initiate informal contact between team members, and share one's own concerns and problems with the team members. Finally, more experienced team members reported that in order to collaborate effectively, team members needed to be aware of their interdependence. Having this 'team feeling' was perceived to lead to all three learning behaviors.

4. Conditions for learning

Finally, auditors mentioned the conditions that enable them to effectively collaborate and to learn. Face-to-face contact and being familiar with each other was perceived to facilitate leadership and the 'team feeling', as well as sharing. The role of hierarchy in audit teams was perceived to be quite ambiguous. On the one hand, a clear hierarchy was associated with efficient decision-making. On the other hand, it was perceived to prevent team learning behaviors from occurring, unless team members perceive supportive leadership and psychological safety. Finally, auditors frequently mentioned the importance of team composition. Interestingly, however, team composition was never related directly to any team learning behavior or one of the other drivers and conditions. Only in the absence of sufficient staffing levels seniors mentioned experiencing increased stress.

5. 'Soft' factors are important

These tentative results show the importance of 'soft' factors. Team dynamics, partner and management involvement, as well as the importance of developing new professional knowledge are central to understanding team performance. Actively facilitating the three team learning behaviors through role modelling at the top and through creating a psychologically safe climate provides more options for managing audit team performance than a strong focus only on composition or hierarchy.

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Improving the quality of global group audits

Anna Gold is professor of auditing at the Vrije Universiteit Amsterdam. Her co-researchers on this project are Denise Downey (Villanova University) and Andrew Trotman (Northeastern University).

Inspection agencies across various jurisdictions repeatedly find deficiencies in group audits and regulators have expressed concerns regarding the quality of group audits. This project, presented by Anna Gold, is designed to help identify underlying root causes contributing to the low audit quality exhibited within many group audits, through the perspective of component auditors themselves.

1. First results

To date, 111 experienced component audit leaders have been surveyed in Australia, India, and the Netherlands, representing multiple global firms. Anna Gold presented the key findings concerning four audit phases (staffing, planning, fieldwork, and review), and then provided further collective insights from component auditors on potential overall barriers to component audit quality. These findings and insights are derived from preliminary descriptive statistics, univariate tests and qualitative analyses which have been conducted to date.

2. Staffing: availability is the dominant determinant

Component auditors' responses suggest that group auditors provide limited and untimely direction and input to guide component audit staffing decisions. Staff availability appears to be the dominant determinant in component audit staff selection. More timely receipt of scheduling requests is viewed as a positive feature to the staffing phase of audits perceived to be of higher-quality. However, when component auditors take greater ownership over staffing, they perceive improved audit outcomes.

3. Planning: low level of component auditor autonomy

Component auditors generally comply with group auditor specifications of the audit plan, including risk and materiality, as there are relatively few modifications of these specifications, suggesting a relatively low level of component auditor autonomy in planning the audit. Component auditors also consider group auditor involvement, direction, and coordination in the planning phase

as particularly important in differentiating the quality of the component audit process as well as audit outcomes. However, there are some instances where the component auditors alter group auditor specifications, because they perceive the group auditor doesn't sufficiently understand the component, which is in line with concerns voiced by the regulators and standard setters.

4. Fieldwork: communication is needed

Engagements on which component auditors openly share information with the group auditor, where spontaneous communication between the group and component auditors is possible, and where meetings take place with the group auditor during fieldwork, are associated with better perceived audit processes and outcomes.

5. Review: less than 50 percent

Consistent with regulator concerns, less than half of our component auditor respondents receive review comments from the group auditor. The lack of such review by the group auditor is associated with poorer audit quality outcomes from the perspective of component auditors. In the cases where a review does occur, several review characteristics may enhance the potential of improving audit outcomes. Factors like the level of detail, skepticism, quality, and timeliness of the reviews are all associated with greater perceived audit outcomes, providing valuable recommendations for group auditors.

6. Barriers are limited

The component auditor respondents experience relatively limited cultural and language barriers during their engagements and interactions with the group auditor. This result is interesting, given the cross-cultural nature of the collaboration and the related regulatory concerns. Of the few responses on cultural barriers, the prominent barrier described relates to differences in accounting and audit quality requirements between the component and group countries. Another barrier impacting component auditors' capacity to perform the audit adequately is insufficient engagement fees. Commonly, the group auditor sets the budget for the component audit, which is often lower than the component audit team would require to conduct an effective audit. One takeaway from this finding is that there should be increased communication on fees with a detailed upfront agreement on fee structure. However, the extent to which this is feasible in an environment of increasing fee pressure and regulatory risk is an open question.

7. Conclusion

This study offers valuable insights into group and component auditor practices through the perspective of component audit leaders. The results provide preliminary support for regulators' call for greater group auditor in-

volvement in component audit activities. However, the findings also point to the importance of the adequate involvement of component auditors.

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Audit partner performance and incentives systems in relation to audit quality

Olof Bik is professor of behavioral & cultural governance and director of the accountancy programs at Nyenrode Business Universiteit. He is also a member of the management board of FAR. Jan Bouwens is professor of accounting at the University of Amsterdam Business School and member of the management board of FAR.

Next to the regular research projects and case studies, FAR initiates several so-called 'joint working groups'. In these groups, academics, audit practitioners and key stakeholders closely cooperate in studying significant audit issues, which are directly relevant to the public. One of the two existing working groups covers 'The future audit firm business model' (the second working group, which is not discussed here, works on 'Root cause analysis methods in auditing'). One of the research projects in the joint working group 'The future audit firm business model' involves audit partner performance measurement and compensation systems.

During the conference, Olof Bik and Jan Bouwens shared and discussed preliminary insights on these issues by presenting three main components of current policies and by asking the question to the participants: “how can audit quality be increased by partner performance measurement and compensation?”

1. Audit quality as the driver of performance: three main components

Dutch legislation requires that audit firms’ remuneration systems, including the partner profit sharing system, appropriately comprise audit quality incentives. Hence, signing auditors should receive incentives to enhance audit quality (AQ) via their remuneration system. Therefore, the focus of the study is on how audit partner performance incentives systems, compensation, and profit sharing have recently developed as a result of more emphasis on audit quality.

More specifically:

- a. Regarding measurement: how is audit quality measured in current partner performance management systems? What specific AQ measures should be used?
- b. With respect to performance evaluation: how is audit quality performance rated, based on the audit quality measures? And how does audit quality performance influence overall performance, as compared to other performance areas concerning clients, markets, or firm strategy?
- c. Concerning compensation: how can be observed that AQ is actually included in the incentive systems and how does AQ performance translate into partners’ remuneration (including profit sharing)?

1. Preliminary insights

Policy documents of ten audit firms show that firms differ in the way in which audit partner performance and compensation *policies* include audit quality incentives. For example, in general, a policy shows that partner performance measures distinguish between four main areas: client, people, firm and quality. However, the scope and depth of AQ measures differs between firms.

Furthermore, regarding performance ratings, firms range from not having an explicit rating, to having an AQ rating that is part of other performance measures (e.g., part of the client metric), or even to explicit AQ ratings based on an extensive quality dashboard.

Concerning compensation, audit firms distinguish between equal profit sharing (all partners equally share in the profit, irrespective of their specific roles and responsibilities) and partner-based sharing (which uses a competence grid on which performance drives variable pay). Moreover, policy documents show three ways in which audit quality performance influence partner compensation: (1) by using penalties in case of poor quality performance (measured by a percentage of the profit or by an absolute amount); (2) by integrating quality per-

formance into performance-based compensation (e.g., if quality is under the norm, the whole performance rating is lower, regardless of performance on other metrics); or (3) by providing an (explicit) bonus for good quality performance.

It should be noted that even if audit quality incentives are a part of audit partners’ performance measurement and compensation systems, the question remains whether this positively affects audit quality.

2. Do quality incentives lead to higher audit quality?

The practitioners were put to work, by posing them a general question: how would you use audit quality through partner performance measurement and compensation, in order to increase audit quality?

Three specific questions were discussed:

1. Should individual partner performance play a role in partner compensation?
2. Should audit firms use performance measures to assess the performance of equity partners and should their profit share be adjusted accordingly?
3. Should audit firms distinguish between long term performance (for example: promotion to a higher-level results in a semi-permanently higher profit share) and short term performance (for example: one year variable bonus or malus)?

Summary of the discussions

Many of the questions posed during the discussions of the above presentations were related to the research methods used. But also topics that are more germane to practice were discussed. For example, what makes learning in audit teams different from learning in teams in other professional settings? Two characteristics account for that. First, audit teams show a quite clear hierarchy attached to tasks and responsibilities, which influences social interactions and the organization of the work. This in turn affects auditors’ experiences. The second characteristic is that there is not one stable team that auditors work in all the time. So, audit team members get less time to know each other well than in other professional settings. Auditors often work in more than one team at the same time. These two characteristics may alter the existing knowledge from other professional settings. Getting to know each other, and understanding each other, of course also is an important factor in group audits.

And how should audit quality incentives be integrated into performance measurement? On the one hand: does a bonus for audit quality suggest that delivering quality is optional rather than self-evident? On the other hand: if quality criteria are not incorporated into performance and remuneration systems, wouldn’t that convey the message that getting a bonus is not dependent on audit quality? Furthermore, decisions have to be made regarding compensation based on individual versus collective perfor-

mance and short versus long term performance. Individual incentives could stimulate the high performers, but individual performance might be hard to measure since the audit is a collective effort and performance measures may be distorted. And while short-term rewards can de-

tract from long term performance, small short-term steps are often necessary in realizing change. The discussion was ended with these words: ‘The trickiest audits are often the worst paid ones. The performance and remuneration system needs to take this into account’.

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