

Impacts of commercial pressures on audit performance



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Given the commercial pressures are Auditors doing a good job?

Introduction

For two decades the debate has raged regarding whether auditors are performing their tasks adequately, within the bounds of the commercial pressures they are under. In preparing this paper, we have studied current research and comment surrounding this issue. Our opinion is that, although there are areas of serious concern and issues that need to be addressed, generally the auditing profession is doing a good job.

“ The debacle of Enron has shaken core assumptions about auditors and auditing.” (Kay and Carsberg 2002). Following the collapse of Enron, and its auditor’s Andersen, the role, competency, quality and standards of auditors came under increasing scrutiny, resulting in a raft of headlines such as the one quoted.

The call from Kay and Carsberg, and others, for national and international standard committees to be set up, was quickly responded to. The US Sarbanes-Oxley Act (2002) and UK Combined Code of Corporate Governance (2003), both of which imposed stringent conditions onto the audit process, were swiftly introduced. As a result, the profession, through the IFA ^[1] (2006) responded with a complete overhaul of standards.

All these regulations and standards have been subject to constant revision since their inception. However, concerns still exist regarding auditor performance as recent attempts by the UK government to criminalize certain audit failures shows (Parliamentary Correspondent 2006). In the same article

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audit firms responded, stating such a move would be “ *both costly and ineffective*”^[2] and that the “ *proposed offence will inevitably lead to defensive auditing, which is not in the interests of the profession or clients.*”^[3] .

The auditing process, particularly in respect of Plc's^[4] is a complex procedure. There is a significant amount of preparatory work to be undertaken prior to the audit itself, including an understanding of the client's business, evaluation of the risk, and the costing and construction of the audit itself (Dassen et. al. 2004, ch. 6). This will determine the depth, breath, and percentage of testing required, fulfilling their tasks and complying with the requirements of all the applicable regulations and codes. This process also includes reaching an agreement on the fees to be charged. The audit task is even more complex when the organisation involved is a multi-national or transnational corporation. In addition, auditing firms have to ensure that they, and all of the persons involved in the audit, when preparing the audit, need to take into account all modifications and improvements to IFA standards, Company Law and the Combined Codes (Grey and Manson 2004).

To monitor audits standards the government set up the Audit Inspection Unit (2006). The task of this unit is to ensure audits have complied with all current regulations (see page 6 of the report). Their latest report covered the “ big four” firms and, for first time, the next five largest auditing firms.

Seventy-seven audits were reviewed, over a number of sizes and industry sectors (see Appendix 1). Although, in general terms, the report responded positively, concluding that auditing firms are maintaining a reasonably high

standard, there were some concerns. They found that progress on previous recommendations had been slower than expected, although there were mitigating circumstances (see section 4. 1. 1, p. 11). In addition there was some concern expressed regarding the audit documentation (section 4. 4. 7, p. 21). However, in other areas, such as leadership and human resources (section 4. 2), improvements had been seen. In their final analysis, only in three areas did the Unit make further recommendations.

Addressing the position from the government viewpoint, a report was commissioned by the FRC ^[5] (Oxera Consultancy Group 2006). This report concentrated on the availability of auditor choice to corporations, and the competitive aspect of the profession in general. Whilst agreeing with the Audit Reporting Unit's conclusion that generally the audit profession was performing their tasks well, this report expressed concerns in other areas. These focused on the dominance of the major audit firms within Plc and international fields. The fear is this leads to lack of choice and has produced increases in fees that exceed inflation by a significant amount, as much as 11%. There was also recognition that, from a logistical and cost point of view, it was virtually impossible for other auditing firms to compete for this market.

One of the resultant fears that most corporate management expressed, was the problem that would be caused if there was a consolidation from four to three firms, and the impact this would have on other accounting and financial services, as well as the audit choice.

Conclusion

Having studied all of the research, we would concur with the conclusion that in view of the commercial concerns, audit firms are generally performing a good job. However, in our opinion, there is a need to address the competitive issues surround audit firms in the cases of quoted company audits. We would recommend that the laws of competition should be applied to the audit industry to ensure the numbers of firms do not reduce still further, and that ways should be considered to enable other firms to compete successfully in this market.

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Footnotes

[1] International Federation of Accountants

[2] Baroness Noakes, a former KMPG partner

[3] An Ernst & Young spokesman

[4] Public Limited Companies

[5] Financial Reporting Council