



# ICAS/FRC RESEARCH FUNDING OPPORTUNITY



## THE SKILL AND COMPETENCY REQUIREMENTS OF AUDITORS IN TODAY'S COMPLEX GLOBAL BUSINESS ENVIRONMENT

The Institute of Chartered Accountants of Scotland (ICAS) and the UK Financial Reporting Council (FRC) seek research proposals to undertake a major project to investigate "What mix of attributes, competencies, professional skills and qualities need to be combined in an audit team in order for it to perform a high quality public interest audit in a modern and complex global business environment?" The project is being commissioned as a contribution towards restoring market confidence through improving audit quality and re-building trust in the audit profession.

An integral point of this project is to be clear on what is required of auditors today, how they currently deliver what is required of them and how this might change in the future<sup>1</sup>. In addition, it is anticipated that the project will explore what the purpose of an audit is – not from a legal, technical or regulatory perspective, but from a philosophical perspective. Against that background, the project can progress to examine the professional skills and competencies required of an audit team seeking to meet that purpose.

Research proposals are invited to consider this issue. Examples of questions that are of specific interest to ICAS and the FRC include the following:

- **What is required of auditors today and what are they responsible for?**
- **How do they currently deliver what is required of them and what should they be doing that they are not currently doing?**
- **What skills and competencies are needed in order for auditors to execute a high quality audit?**

As corporate reporting changes, so will the nature of assurance change, including the need for more assurance on the 'front half' of the annual report. Under this scenario, it is likely also that the attributes, competencies, professional skills and qualities required of auditors will change. This, in turn, implies the following issues:

- **Is there a need to reconsider the staffing model for the audit of complex businesses to incorporate, for example, individuals with relevant business experience within the audit team and, if so, what are the training implications thereof?**
- **Is there a gap between firms' existing competency frameworks for auditors and the skills needed to achieve audit quality?**
- **Are the recruitment models and development processes of the modern audit firm adequate to address future needs?**

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<sup>1</sup> In this regard, audit is defined in the context of the audit of financial statements based on current scope and is taken to include other assurance that it would evidently be appropriate for an independent auditor to provide based on current and developing reporting requirements and practices that focus on providing transparency in the capital markets.



The final report should draw conclusions and implications for policy makers and the profession. ICAS and the FRC will use the report to inform public debate and policy development and the project will therefore be high profile.

In addition to the financial support offered by the grant, ICAS and the FRC will offer in kind assistance to help the successful team gain access to relevant individuals. The project will be overseen by a Steering Committee that combines experienced individuals from the firms, industry, investors and academia. Richard Fleck, Chairman of the FRC Conduct Committee, will chair the Steering Committee.

### **Introduction and background to the study**

Auditors are entrusted by law to give an opinion on the truth and fairness of the financial statements of the companies they audit. Politicians, regulators, investors and other commentators claim that the 2008 financial crisis highlighted weaknesses in the statutory audit – especially with regard to banks and financial institutions – and have criticised the audit profession. For example, The House of Lords (2011) report calls for greater communication between regulators and auditors, greater competition and innovation in the audit market, and for auditors to exercise greater judgement in decision making.

In the view of the European Commission, the financial crisis highlighted considerable shortcomings in the European audit system. According to the Commission, these shortcomings manifested themselves in the fact that “Audits of some large financial institutions just before, during and since the crisis resulted in ‘clean’ audit reports despite the serious intrinsic weaknesses in the financial health of the institutions concerned”.

Under new legislative proposals adopted on 30 November 2011, the Commission is seeking to change this situation by clarifying the role of the auditors and introducing more stringent rules for the audit sector aimed in particular at strengthening the independence of auditors as well as greater diversity into the current highly-concentrated audit market.

Furthermore, the Commission is also proposing to create a Single Market for statutory audit services, allowing auditors to exercise their profession freely and easily across Europe, once licensed in one Member State. Allied to that, there are proposals for a strengthened and more coordinated approach to the supervision of auditors in the EU.

In the UK the FRC is implementing changes designed to improve the effectiveness of company stewardship and to improve the assessment of going concern.

Taken together, all the measures aim to enhance the quality of statutory audits in the EU and restore confidence in audited financial statements, in particular those of banks, insurers and large listed companies.

### **Assurance in the modern world**

The research should consider the scope and role of the auditor as they are being reviewed internationally. Existing ICAS and FRC publications should, of course, be used. Of particular relevance is the ICAS (2010) report on *The Future of Assurance*, which sets out its vision as follows: “the highest quality of reporting facilitating efficient capital markets and an assurance framework to inspire confidence in that reporting”.

An improved assurance framework is likely to be central to the realisation of this vision. However, what are the components of this new framework? Clearly, there needs to be greater understanding and clarity around what an audit seeks to achieve, and what is meant by 'audit quality', including the need for heightened professional scepticism and the challenge to the audit profession to exercise greater judgement.

In complex, global businesses, does the real value added by assurance arise from challenging the key sensitivities, judgements and estimates made in the course of preparing the financial statements and then being able to provide assurance that those matters are soundly based and appropriately reflected in the financial statements?

Can value be added without a fundamental reassessment of what is required to create an audit team, with the appropriate mix of competencies and professional skills that are necessary to execute a high quality public interest audit in a modern and complex multi-national environment?

### **Audit team competencies**

Audit quality is frequently described as being dependent on two variables. First, the competence of the auditor – for example, the ability to detect a breach in the client's accounting system. Second, the independence of the auditor – for example, the willingness to report any identified breach in the client's accounting system.

Relatively little research effort focuses on what is meant by auditor competence, with notable exceptions being the FRC's *Audit Quality Framework* and the IAESB's *IES 8, Competence Requirements for Audit Professionals* and its proposed revision, extending this work to engagement partners. Extant literature tends to rely either on narrow proxies of competence, such as firm size or scale of fees, or experimental research where audit staff may be exposed to questionnaire-based vignettes of practice designed to determine, for example, ethical behaviour or knowledge. Within the audit quality literature, the key role of audit teams is largely overlooked. A gap exists between the attributes, competencies and professional qualifications and skills of audit personnel and their ability to perform a modern, high quality public interest audit, particularly in highly complex and challenging multi-national environments. A large complex audit today may require, for example, the professional skills of engineers, actuaries, economists, investment bankers and MBAs; that is, staff other than purely professional accountants. In the sustainability assurance arena, a wide variety of non-accounting professionals are employed. A multi-skilled audit team provides the audit partner with the best chance of exercising the necessary professional judgement to enhance audit quality and restore the confidence in financial statements that the European Commission is striving to achieve. How might the partner select, develop and utilise the best team? What skills and competence will the partner consequently require?

The audits of the largest global businesses are undertaken largely by the four largest accounting firms (the Big Four) with smaller audits taken up by a number of 'middle tier' firms. The Big Four, as professional services firms, represent the largest employer of graduates in the UK. Graduates are recruited from all backgrounds in the hope of securing 'the brightest and the best' – in the face of fierce competition from investment banks and other financial services organisations. Recruits will undertake significant training while at the firm, with audit trainees studying for a well-regarded professional accountancy qualification.

However, despite the role the accounting profession plays in the economy, accountants are frequently portrayed as unglamorous. Longstanding research

efforts identify that negative stereotypes of accountants are enduring. Paradoxically, at a time when graduate unemployment is high, major firms still have vacancies and audit firms struggle to retain newly qualified chartered accountants. As a result of this, firms have to rely heavily on the recruitment of newly qualified accountants from overseas, which implies that UK accountants are just not attracted to the work, despite the economic situation.

### Terms of agreement

A final draft of the report is to be delivered by **30 September 2013** and authors will be required to make short presentations of interim and key findings to the Steering Committee, ICAS and the FRC. A presentation of final results at an ICAS/ FRC sponsored event will also be required. Reports should be a maximum of 10,000 words in length. Draft reports will be reviewed using the Steering Committee, practitioner, academic and investor reviewers, with a view to publication and use by ICAS, the FRC and to influence other policy makers. Grant funding in the region of £25,000 is available. If any additional funding is required in excess of this amount, justification should be provided in the submitted proposal.

Publication in academic journals, following submission of the final report, is also encouraged.

It is essential that the research report should identify the public interest in these issues and be of interest to policy makers, regulators, members of the profession, investors and academia.

### Expressions of interest

If you are interested in undertaking this project, please email [research@icas.org.uk](mailto:research@icas.org.uk) attaching a proposal, together with summary CVs, by midnight on **16 November 2012**. You should explain why you believe you or your research team are suitable individuals to undertake the project, demonstrating your knowledge and experience in the area. You should specifically state how any team will be structured and brought together and responsibilities for completion of the report. The proposal should include details of the proposed research questions and methodology, identification of preliminary literature, a summary of the key issues which you believe are likely to arise from the project, and an indication of any assistance required from ICAS and the FRC, for example to access potential contacts or interviewees. The expression should include the amount of grant, in sterling, which you require to complete the project and a breakdown of the estimated costs. The expressions of interest will be considered by a panel of academics and non-academics from ICAS and the FRC to arrive at a final decision. Applicants will be advised of the decision by **30 November 2012**.

For further information about this funding opportunity or any queries please contact the ICAS Research Centre:

Tel: +44(0)131 347 0237

Email: [research@icas.org.uk](mailto:research@icas.org.uk)

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CA House 21 Haymarket Yards  
Edinburgh EH12 5BH  
[research@icas.org.uk](mailto:research@icas.org.uk) +44 (0)131 347 0237  
[icas.org.uk](http://icas.org.uk)



5th Floor Aldwych House 71-91 Aldwych  
London WC2B 4HN  
[enquiries@frc.org.uk](mailto:enquiries@frc.org.uk) +44 (0)20 7492 2300  
[frc.org.uk](http://frc.org.uk)