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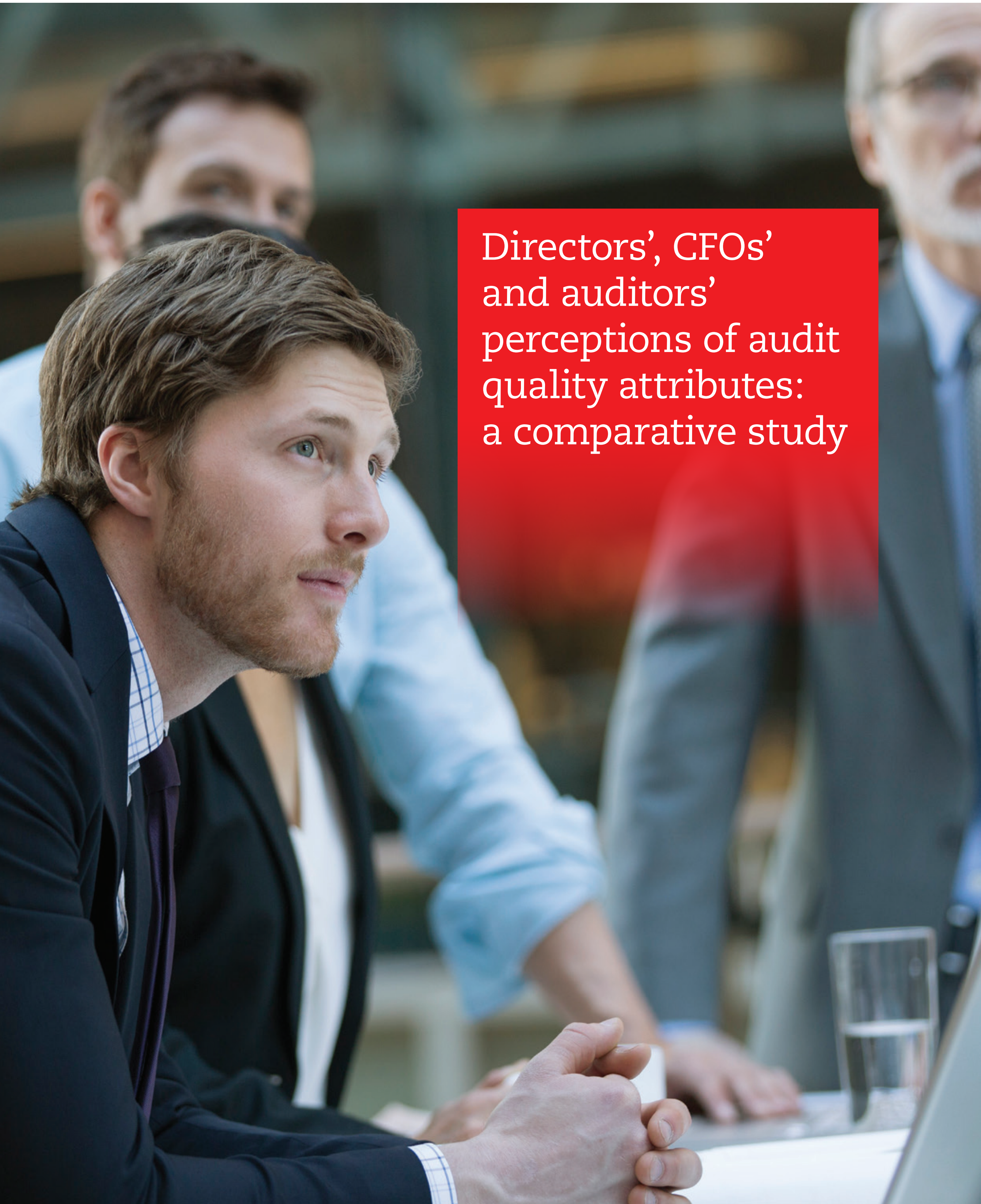

Directors', CFOs' and auditors' perceptions of audit quality attributes: a comparative study

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June 2016

This report compares the perceptions of auditors, CFOs and directors on the relative importance of 10 key audit quality attributes identified by prior research. Data was collected using online surveys and focus sessions. Considerable overlap occurs in the perceptions of the three groups, but also noteworthy differences. The focus sessions offer valuable insight into these similarities and differences. The implications of these findings for the IAASB's A Framework for Audit Quality are also discussed.

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ACKNOWLEDGEMENTS

Associate Professor Alan Kilgore, Macquarie University

Associate Professor Sue Wright, Macquarie University

Dr Karina Luzia, IGAP, Macquarie University

GLOSSARY OF ABBREVIATIONS

ACA	Adaptive Conjoint Analysis system (Sawtooth Software)
A	Audit partner
AQ	Audit quality
ASIC	Australian Securities & Investments Commission
CFO	Chief financial officer
D	Director
Framework	A Framework for Audit Quality (IAASB 2014)
IA	Information asymmetry
IESBA	International Ethics Standards Board for Accountants (operating under the auspices of the International Federation of Accountants (IFAC))
NAS	Non-audit services
RIS	Relative importance score

1. Introduction

Key elements or attributes of audit quality continue to be a particular focus of interest for audit regulators and standard setters.

Key elements or attributes of audit quality (AQ)[1] continue to be a particular focus of interest for audit regulators and standard setters after much-publicised corporate failures such as Enron, followed by the 2007–8 global financial crisis, highlighted the importance of AQ for maintaining corporate stability and public confidence in financial markets (Wallman 1996; Monroe and Tan 1997; Coffee 2001). To address this, regulatory measures such as the Sarbanes–Oxley Act (2002) in the US and the Economic Reform Program (Audit Reform and Corporate Disclosure) Act (2004) (CLERP 9) in Australia were introduced to bolster market stability, partly by addressing AQ and public confidence. More recently, the International Auditing and Assurance Standards Board (IAASB) released *A Framework for Audit Quality* (2014) which, in its own words, 'describes the input, process and output factors that contribute to audit quality at the engagement, audit firm and national levels, for financial statement audits'.

This report compares the perceptions of three key stakeholder groups – auditors, CFOs and directors[2] – of the perceived relative importance of 10 selected primary attributes of AQ identified by research to date. The main aim of this report is to compare the perceptions of audit industry stakeholders on the 'supply' side, represented by the auditors (ie sellers), with those on the 'demand' side (ie purchasers), represented by the CFOs and directors.

The three investigated stakeholder groups represent varying degrees of information asymmetry (IA), where IA refers to the difference between the level of access that the purchasers of a good or service (ie

1 The term 'audit quality' is used here as it is used in the academic literature. In this sense, high AQ is auditing conducted in accordance with a range of constraints restricting the 'decision space' within which responsible auditing decisions are made (Knechel 2000). These constraints include *professional standards* and *codes of professional conduct* as set out in the guidelines of national auditing bodies, as well as certain *legal restraints, ethical principles* and *safeguards against natural cognitive limitations* that affect human decision-making. There is, of course, no guarantee that an audit conducted within these constraints will be comprehensively 'successful', since it is possible that even the most conscientious and astutely conducted high-quality audit could fail to detect a material misstatement.

2 A 'director' here means an executive or non-executive director, but not a CFO. In Australia CFOs are not generally referred to as directors, and they do not sit on the board. The majority of the directors surveyed in this study are non-executive directors.

The survey results indicate considerable overlap in the perceptions of the three stakeholder groups regarding the relative importance for AQ of some of the investigated AQ attributes, but there are also noteworthy differences of perception for others.

CFOs, directors) have to information about its quality and the access to that information available to the seller (ie auditors) (Stigler 1961; Akerlof 1970). It is possible to place each of the investigated stakeholder groups along an IA continuum going from low to high IA. Auditors are the designers and suppliers of audit services, and also control the way they are supplied, giving them comprehensive knowledge of the quality of the audit provided. They therefore experience low IA. CFOs, as purchasers of audit services, have a reasonable degree of access to and communication with audit team members, hence experience a moderate degree of IA. Finally, directors' access to the audit process is generally limited – confined to interaction with audit partners and managers at board or audit committee meetings, audit tender/proposal documentation and enquiries from management, including CFOs – hence they experience relatively high IA.[3]

IA is a theoretical lens[4] used for formulating expectations, undertaking data analysis, and for examining similarities and differences in the perceptions of the stakeholder groups. This report looks in particular at the possibility that the perceptions of auditors, CFOs and directors will vary systematically according to the level of IA they experience for a given attribute, attaching more importance to attributes for which they experience low IA and less importance to attributes for which they experience high IA. It also considers the extent to which differences and similarities in perception can be explained by whether respondents stand on the 'demand' or the 'supply' side of audit services. Finally, the report considers how the stakeholders' perceptions align with the IAASB's *Framework for Audit Quality* (2014) ('the Framework') and in particular, to what extent the relative importance that the stakeholders ascribe to the investigated AQ attributes corresponds to the emphases to be found in the Framework's account of the factors central to AQ.

This report draws together and compares the results of three earlier survey studies by the present researchers, each of which investigated the relative importance that a particular stakeholder group attaches to a range of 10 attributes commonly associated in the scholarly literature with AQ. Kilgore et al. (2014) examined the perceptions of CFOs, while Kilgore and Martinov-Bennie (2014) focused on the perceptions of auditors, and Martinov-Bennie and Kilgore (2015) investigated the perceptions of directors. Online surveys were used to gather the perceptions of approximately 50 members of each group. The survey data is supplemented in this study by data from focus sessions conducted with representative members of the three stakeholder groups.

The survey results indicate considerable overlap in the perceptions of the three stakeholder groups regarding the relative importance for AQ of some of the investigated AQ attributes, but there are also noteworthy differences of perception for others. The focus sessions offer some persuasive explanations for these similarities and differences. The findings suggest that while the results endorse the Framework's emphasis on auditor competence and an auditor's capacity for interaction as drivers of AQ, stakeholders' perceptions offered relatively less support for the Framework's emphasis on auditor independence as a significant contributor to AQ.

Chapter 2 presents the relevant AQ literature, including the IAASB's Framework (2014). It also outlines in more detail the notion of IA and the related concept of a credence good, and presents some background literature on these concepts. In Chapter 3 the methodology is outlined and Chapter 4 presents survey results. Chapter 5 discusses those results in relation to prior literature, and uses data from the focus sessions to explore similarities and differences in the stakeholders' perceptions of the investigated AQ attributes. The findings' implications for the Framework are outlined in Chapter 6 and the conclusions are summarised in Chapter 7.

3 There are stakeholder groups who experience even higher IA than directors – – for example, investors are further removed from the audit process than directors. Future studies could extend the scope of the present study by investigating other stakeholders (such as investors) and other relevant attributes (such as audit fees).

4 The authors acknowledge that the choice of Information Asymmetry/Credence Goods framework is just one of a number of possible theoretical perspectives. Future studies may use alternative frameworks.

2. Literature review

There is 'little consensus about how to define audit quality' (Knechel et al. 2013: 407).

2.1 APPROACHES TO INVESTIGATING AUDIT QUALITY (AQ)

There is 'little consensus about how to define audit quality' (Knechel et al. 2013: 407). Many researchers rely on the two-part definition provided by DeAngelo (1981), which defines AQ as a combination of the probability that the auditor will discover a material misstatement in the client's financial statements and the probability that they will report it. This definition views AQ as a function of auditor competence (discovering misstatements) and auditor independence (reporting misstatements).

Because both of these aspects of AQ are unobservable, researchers have used two 'indirect' methods of investigating AQ. One of these approaches measures AQ using surrogates or proxies (eg Francis 1984; Hogan and Jeter 1999). This approach is more suited to the study of audit firm attributes, whereas the present study examines a wider range of attributes, including team attributes. Furthermore, proxy-based studies are best used for examining single attributes, whereas the present study investigates 10 attributes simultaneously, so as to compare their relative importance for AQ from the perspective of each of the three stakeholder groups. Given the nature of this study, a second indirect approach, usually called a behavioural approach, was used. Studies using this approach (eg Schroeder et al. 1986; Duff 2004) assume that AQ comprises a set of attributes valued by audit market participants and investigate the perceived relative importance of these attributes of AQ in the judgement of providers and users of audit services – in the case of the present study, auditors, CFOs and directors.

2.2. PRIOR LITERATURE INVESTIGATING ATTRIBUTES OF AQ

The 10 attributes investigated in this study were selected on the basis of the importance accorded them in prior academic literature. These attributes are *audit firm size* (Rusmin 2010; Karjalainen 2011); *the duration of the audit partner's tenure* (Carey and Simnett 2006); *the provision of non-audit services* (Elstein 2001; Bedard, et al. 2008); *the audit firm's experience of the client's industry* (Knechel et al. 2007); *the audit partner or manager's attention to the audit* (Carcello et al. 1992;

IA, to recall, refers to the difference in the degree of access that the purchaser of a good or service has to information about its quality relative to the seller's access to that information.

Kilgore et al. 2011); *communication between the audit team and the client's management* (Behn at al. 1997); *the audit partner's knowledge of the client's industry* (Zerni 2012); *the senior manager or manager's knowledge of the client's industry* (Carcello et al. 1992); and *a very knowledgeable audit team* (Li and Chen 2011).

In comparing the perceived importance of AQ attributes for those standing on the 'supply' side of an audit with the perceptions of those standing on the 'demand' side, this report extends the work of previous comparative studies by Carcello et al. (1992), Goodwin and Seow (2002), Beattie et al. (2013) and Kilgore et al. (2011). Carcello and his collaborators (1992) investigated which of 41 attributes are perceived as contributing most to AQ by preparers of financial statements (CFOs), auditors (represented by Big Four audit partners) and users (represented by bank chief lending officers). Goodwin and Seow's study (2002) compares the perceptions of auditors and directors in Singapore regarding corporate governance practices relating to the quality of financial reporting and auditing. Beattie and her co-investigators examine the perceptions of UK-listed CFOs, audit committee chairs (directors) and audit partners on the impact on AQ of 36 economic and regulatory factors introduced in the wake of the Sarbanes–Oxley Act (SOX) in the US (Beattie et al. 2013). Kilgore and colleagues investigated the relative importance of audit team and audit firm attributes as perceived by two groups of audit service users – namely, audit committee chairs/ members (as 'insiders') and financial analysts/fund managers (as 'outsiders') (Kilgore et al. 2011).

Each of these studies gives attention to the perceptions of one or more of the three stakeholder groups investigated for this report, thus offering useful points of comparison. This study differs from previous comparative studies, however, by investigating whether perceptions of AQ vary systematically according to the perceiver's level of IA and, unlike the previous studies, it examines and compares the perceptions of the three investigated stakeholder groups across the full range of attributes discussed.

2.3 INFORMATION ASYMMETRY (IA) AND CREDENCE GOODS

The study uses IA as a lens for investigating stakeholders' perceptions of AQ. The notion of IA is closely related to the concept of a 'credence good'. In the economics literature a credence good is a good or service which a purchaser buys 'on trust': it is bought without the purchaser's being able to determine, and hence verify, the quality of what they have purchased either before or after purchase, the relevant attributes being unobservable from the purchaser's viewpoint (Dulleck and Kerschbamer 2006; Spiegler 2006). An example is a tonic that supposedly enhances the overall health of those who take it: having imbibed the tonic over a prescribed period, the purchaser cannot verify whether their health has improved, remained the same, or perhaps even deteriorated.[5] IA, to recall, refers to the difference in the degree of access that the purchaser of a good or service has to information about its quality relative to the seller's access to that information. When someone purchases a credence good, their inability to observe the quality of what they are buying even after receiving what they have purchased places them in a position of high IA relative to the seller, who can be assumed to have comprehensive knowledge of the quality of what they are selling.

A number of researchers have argued that audit services are a credence good (Lizzeri 1999; Causholli and Knechel 2012; van Buuren et al. 2015). The limited ability of a purchaser of audit services to determine the quality of an audit either before or after its completion has three potentially serious implications. Firstly, the purchaser is uncertain about whether the supplied service fully caters for their needs, creating a potential for under-treatment and hence a risk of financial failure. Secondly, the purchaser is uncertain about whether they really need what they are purchasing, creating a potential for overtreatment and the possibility of unnecessary costs. Thirdly, the purchaser is uncertain about whether they have actually been supplied with the service they have paid for, resulting in a potential for overcharging, and, again, the possibility of unnecessary costs (Causholli and Knechel 2012; van Buuren et al. 2015).

5 'Search' attributes contrast with 'credence' attributes in being directly observable by the purchaser prior to purchase, while 'experience' attributes, though not observable by the purchaser before the purchase, are observable after purchase (Nelson 1970; Dulleck and Kerschbamer 2006 Spiegler 2006)).

This study investigates only Input, Process and Interaction factors, and only at the engagement or firm levels.

Adding to the inequality of the relationship in which the purchaser or client stands to the supplier of audit services is the fact that the auditor who supplies these services, and therefore stands to benefit from market inefficiencies of the abovementioned kinds, is also the assessor of the client's audit needs. Finally, the inequality of this relationship is aggravated by a widespread misconception that the client is able to assess the quality of received audit services following an audit (Balsam et al. 2003; Krishnan 2003).

These considerations raise the question of which attributes the various stakeholders in the audit industry regard as relatively more important for AQ, and how accessible those attributes are to them, given their differing levels of IA. It is of particular interest to know whether the purchasers of audit services in this study have access to the AQ attributes they themselves perceive as having the most impact on AQ, and whether these perceptions are influenced by their ability to obtain reliable information about those attributes. Thus this comparative study of auditors, CFOs and directors examines whether these stakeholders' different levels of IA have an impact upon their perceptions of the relative importance of a range of AQ attributes and the underlying reasons for these perceptions, and whether the perceptions of the auditors representing the 'supply' side of the industry differ in nature from those of the CFOs and directors representing the 'demand' side.

Information about some of the attributes examined in this study is readily available to users of audit services such as CFOs and directors. Thus information about 'Audit firm size' is public knowledge, while information regarding 'Provision of non-audit services (NAS)' is disclosed in the financial statements, and information about 'Audit firm industry experience' is generally known or available on the audit firm's website. The remaining attributes in this 'readily accessible' category are 'Partner knowledgeable about client industry' and 'Senior manager/manager knowledgeable about client industry'. Information about these is available to CFOs during the audit process through their contact with the audit team, while directors have access to this information through interaction with the audit partner and manager at board or audit committee meetings and from audit tender/proposal documentation.

Information about the remaining attributes is generally less readily available to CFOs and directors. Information about 'Audit partner tenure' on continual audits can be accessed by making enquiries or by checking audit reports over recent years, while information about 'Audit quality assurance reviews' is confidential. Finally, information on the attributes 'Partner/manager attention to audit', 'Communication between audit team and client management' and 'Very knowledgeable audit team' is generally regarded as not readily available to directors because it requires direct observation of the audit process, while CFOs have some access to information about these attributes because of their contact with the audit team during the audit process.

Given auditors' comprehensive access to information about all AQ attributes; that CFOs and directors have ready access only to some of these; and assuming that CFOs have more access to information about the remaining attributes than directors, it is reasonable to expect that the level of IA experienced by auditors is very low; CFOs is moderate; and directors is high. Thus a general expectation of this study is that industry stakeholders' perceptions of the relative importance of AQ attributes vary according to the level of IA. Hence stakeholders who experience high IA in relation to a given attribute will be disposed to ascribe to it less importance as a driver of AQ than attributes for which they experience low IA.

2.4 AQ ATTRIBUTES INVESTIGATED AND THE IAASB'S FRAMEWORK FOR AUDIT QUALITY (THE FRAMEWORK)

The Framework discusses the factors contributing to AQ under the headings Inputs, Process, Outputs, Key Interactions and Contextual Factors. This study investigates only Input, Process and Interaction factors, and only at the engagement or firm levels. Input factors are concerned with what the auditor brings to the audit process, and in the Framework they are discussed under the headings, 'Values, Ethics and Attitudes' and 'Knowledge, Skills, Experience and Time'. Process factors are concerned with the engagement procedure itself, especially its rigour and quality-control measures. Interactions include both formal and informal communications between the

> 'The audit engagement partner and other experienced members of the engagement team are accessible to management and those charged with governance'.

various participants in the financial reporting supply chain. For the purposes of this study, the Framework's various AQ factors are analysed in terms of independence, competence, and interaction, and each of these is considered in turn.

The Framework addresses *independence factors* in a number of contexts. For example, under the general heading of Input factors in section 1.1 (Values, Ethics and Attitudes, Engagement Level), paragraph 1.1.2 reads: 'The engagement team exhibits objectivity and integrity' and paragraph 1.1.3 reads: 'The engagement team is independent', while in section 1.2 (Values, Ethics and Attitudes, Firm Level), paragraph 1.2.1 reads: 'Governance arrangements are in place that establish the appropriate "tone at the top", and which aim to safeguard the firm's independence' and paragraph 1.2.3 reads: 'Financial considerations do not drive actions and decisions that impair audit quality'. Under the general heading of Process factors, section 2.1 (Audit Process and Quality Control Procedures, Engagement Level), paragraph 2.1.1 reads: 'The engagement team complies with auditing standards, relevant laws and regulations, and the audit firm's quality control procedures'.

Competence factors are also addressed in a number of contexts. For example, under Input factors in section 1.1 (Values, Ethics and Attitudes, Engagement Level), paragraph 1.1.4 reads: 'The engagement team exhibits professional skepticism', and in section 1.2 (Values, Ethics and Attitudes, Firm Level), paragraph 1.2.4 reads: 'The firm emphasizes the importance of providing partners and staff with continuing professional development opportunities and access to high-quality technical support'. Under the same general heading, in section 1.4 (Knowledge, Skills, Experience and Time, Engagement Level), paragraph 1.4.1 reads: 'Partners and staff have the necessary competences', paragraph 1.4.2 reads: 'Partners and staff understand the entity's business', and paragraph 1.4.5 reads: 'Staff performing detailed "on-site" audit work has sufficient experience, its work is appropriately directed, supervised and reviewed, and there is a reasonable degree of staff continuity'. In section 1.5 (Knowledge, Skills, Experience and Time, Firm Level), paragraph 1.5.4 reads: 'Sufficient training is given to audit partners and staff on audit, accounting and, where appropriate, specialized industry issues'. Under the general heading of Process factors, in section 2.2 (Audit Process and Quality Control Procedures, Firm Level), paragraph 2.2.1 reads: 'The audit methodology is adapted to developments in professional standards and to findings from internal quality control reviews and external inspections'.

The Framework outlines key interactions between various financial reporting supply chain participants, including auditors and management in section 4.1, and auditors and those charged with governance in section 4.2, as well as regulators, financial statement users and others. *Interaction factors* are also emphasised under Input factors, in section 1.4 (Knowledge, Skills, Experience and Time, Engagement Level), where paragraph 1.4.7 reads: 'The audit engagement partner and other experienced members of the engagement team are accessible to management and those charged with governance'. Under the general heading of Process factors, in section 2.1 (Audit Process and Quality Control Procedures, Engagement Level), paragraph 2.1.3 reads: 'There is effective interaction with others involved in the audit'.

The sections of the Framework addressed in this study are summarised in Table 2.1.

In this study's investigation of the alignment of auditors', CFOs' and directors' perceptions of AQ with the factors that the IAASB's Framework presents as the most important contributors to AQ, particular attention is given to whether the emphasis the Framework places on competence, independence and interaction corresponds to the emphasis placed on those factors by the stakeholder groups surveyed. For this purpose the 10 investigated attributes are classified according to whether they represent independence, competence or interaction between auditor and client. The assignment of attributes to these three categories is presented in Table 2.2. By mapping the rankings that the stakeholder groups accorded to attributes associated with independence, competence and interaction onto the factors associated with those three qualities in the Framework, the extent to which the stakeholders endorsed the relative emphases that the Framework places on these attributes can be assessed.

Table 2.1: The IAASB *Framework for Audit Quality* factors addressed by the attributes investigated (indicated in parentheses)

		ENGAGEMENT	FIRM
Input	Values, ethics and attitudes	Emphasis on values such as objectivity, independence, due care and scepticism (section 1.1) (Provision of NAS; Audit partner tenure)	Emphasis on a firm's independence, not being driven by financial considerations, professional development and a culture of consultation (section 1.2) (Audit firm size; Audit Partner tenure)
	Knowledge, Skills, Experience and Time	Emphasis on the audit partner's responsibilities, competence of the engagement team and the gathering of sufficient evidence (section 1.4) (Partner knowledge of client industry; Very knowledgeable audit team; Senior manager/ manager knowledgeable – client industry)	Emphasis on firm policies that promote appropriate experience and knowledge on the part of the audit partner and audit team (section 1.5) (Audit firm size; Audit firm industry experience)
Process	Audit Process and Quality Control Procedures	Emphasis on audit standards, compliance, risk assessment and methodology (section 2.1) (Partner/manager attention to audit)	Emphasis on firm policies and procedures for the audit process (section 2.2) (AQ assurance review)
Interactions		Interactions between auditors and management (section 4.1) (Communication between audit team and client)	

Table 2.2: Independence, competence and interaction AQ attributes investigated

INDEPENDENCE	COMPETENCE	INTERACTION
Audit firm size	Audit firm size	Communication between audit team and client management
Provision of NAS	AQ assurance review	
Audit partner tenure	Partner knowledge of client industry	
	Very knowledgeable audit team	
	Partner/manager attention to audit	
	Audit firm industry experience	
	Senior manager/manager knowledgeable – client industry	

3. Method

The surveyed auditors were enlisted with the co operation of a senior partner in each of a number of audit firms.

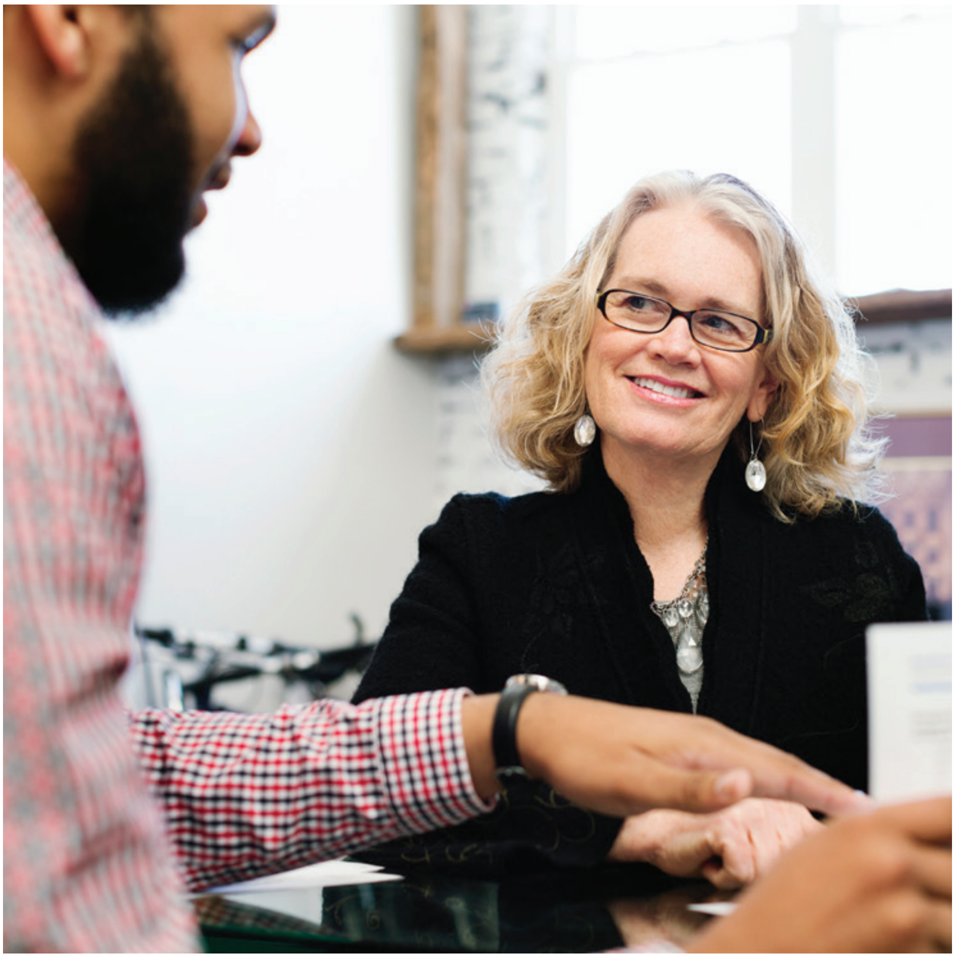
3.1 PARTICIPANTS

The surveyed auditors were enlisted with the co operation of a senior partner in each of a number of audit firms. The participating CFOs were recruited using the database of a professional body. The directors in the study were recruited from companies in the Australian Securities Exchange (ASX) 300 using the *Boardroom* and *DataAnalysis Premium* databases. Those from the three groups who agreed to participate were sent a link to the online survey. Completed surveys were received from 49 members of the auditor group, 68 members of the CFO group and 38 members of the director group. A summary of participants' demographic data is presented in Appendix 1a.

One focus session was held in Sydney and one in Melbourne, with eight stakeholders attending the former and five attending the latter. The participating directors, CFOs and auditors were enlisted after they had responded to an invitation for expressions of interest that appeared in the survey. The demographics of the participants are presented in Appendix 1b.

3.2 THE SURVEYS

The survey data was gathered and analysed using Sawtooth Software's Adaptive Conjoint Analysis (ACA) system – an online survey system developed by Johnson (1987). ACA is 'adaptive' in that it tailors later questions in the survey according to a respondent's replies to earlier questions, thus customising questions to each respondent. ACA is able to investigate a concept – in this case AQ – by breaking it down into a range of component attributes, and then establishing the importance that each respondent attaches to each attribute relative to the others. It then calculates respondents' scores across the surveyed group in order to generate a Relative Importance Score (RIS) for each attribute for each group. RISs indicate how important, relative to the other attributes, a given attribute is perceived to be by respondents across the group. The ACA method scales the RISs so that the total score for all attributes is equal to 100. Thus if all 10 surveyed attributes had been considered equally important they would all have had an RIS of 10. RISs are ratios:



The aim of the focus groups was to seek clarification about whether, in the case of the same or similar perceptions, the groups held those perceptions for the same reasons and, in the cases where their perceptions differed, the reasons for those differences.

the higher the score, the greater the relative importance of the attribute; hence an attribute with a score of 10 can be considered twice as important as an attribute with a score of five.

Operational definitions of the 10 attributes used in this study are summarised in Table 3.1.

3.3 THE FOCUS GROUPS

Focus groups were used in this study, in addition to the surveys, for two reasons. First, one of the established functions of focus groups is to facilitate the interpretation of survey results – in particular, 'to clarify poorly understood results' (Morgan 1996: 135) and to achieve this, 'through [the] giving of examples and explanations by focus group participants' (Hillyer 1998: 92). Second, the introduction of an additional method of data collection and analysis provides a means of corroborating the results of the study through methodological triangulation – that is, by 'cross-checking' data and results through the use of more than one data source (O'Donoghue and Punch 2003; Denzin 2006).

With these objectives in mind, two focus sessions were held, each bringing together representatives from all three stakeholder groups. The focus group discussion, facilitated by one of the researchers, was guided by survey data results indicating similarities and differences between the three groups. The aim of the focus groups was to seek clarification about whether, in the case of the same or similar perceptions, the groups held those perceptions for the same reasons and, in the cases where their perceptions differed, the reasons for those differences. The similarities and differences used to guide the focus group discussion are summarised in Appendix 2. The discussions were recorded, transcribed and analysed within the context of the differences and similarities identified by the results of the survey data.

Table 3.1: AQ attributes including operational definitions used in the survey

ATTRIBUTE	OPERATIONAL DEFINITION
Audit firm size	Big Four / Mid-tier / Local firm
Partner/manager attention to audit	Activity level of partner / manager
Communication between audit team and client management	Nature and frequency of communication
Audit partner tenure	Duration of auditor-client relationship
Audit quality assurance review	Audit quality control review
Provision of non-audit services (NAS)	Percentage of NAS fees to audit fees
Audit firm industry experience	Industry specialisation
Partner knowledgeable about client industry	Years of experience in client industry
Senior manager/manager knowledgeable – client industry	Years of experience in client industry
Very knowledgeable audit team	Years of experience in accounting and auditing

Source: Kilgore et al. (2011)

4. Survey results

The survey data comparison revealed the following five similarities in the perceptions of the three groups.

The survey data comparison revealed the following five similarities in the perceptions of the three groups.

1. All three groups ranked 'audit firm size' as the most important attribute as an indicator of AQ, relative to other attributes. 'Audit firm size' received an RIS of 18.4 from auditors, an RIS of 15.13 from CFOs and an RIS of 14.66 from directors.

2. All the groups ranked 'partner/manager attention to audit' as the second most important attribute as an indicator of AQ, relative to other attributes, with an RIS of 16.87 from auditors, an RIS of 12.5 from CFOs and an RIS of 14.18 from directors. Hence, auditors and directors gave this attribute a higher RIS than did the CFOs.

3. All three stakeholder groups placed 'Communication between audit team and client management' above the mean relative to the other surveyed attributes, with directors, CFOs and auditors giving it RISs of 11.31 (ranked third), 10.03 (ranked fifth) and 10.76 (ranked third) respectively.

4. All groups perceived 'Audit partner tenure' as having a relatively low importance for AQ compared with other attributes. The attribute received an RIS of 5.16 (with a ranking of 10) from auditors, an RIS of 5.96 (ranking of 9) from CFOs and an RIS of 4.97 (ranking of 10) from directors.

5. The groups also agreed on the relatively low importance attributable to 'audit quality assurance reviews' (both internal and external) as an influence on AQ. This attribute received an RIS of 5.37 (with a ranking of 9) from auditors, an RIS of 5.23 (with a ranking of 10) from CFOs and an RIS of 5.09 (with a ranking of 9) from directors.

Nonetheless, as Table 4.1 shows, interesting differences of perception were revealed in the rankings that the three stakeholder groups gave these four attributes.

The survey revealed the following two differences in perceptions between the three groups.

1. Auditors' perceptions of 'provision of NAS' differed from those of CFOs and directors – a difference manifested in the rankings given to this attribute. Auditors ranked the attribute eighth (RIS 7.82) while CFOs ranked it third (RIS 12.19) and directors ranked it fifth (RIS 10.07).

2. The three groups had similar perceptions as reflected in the RISs of the four 'knowledge' attributes – 'audit firm industry experience', 'partner knowledgeable about client industry', 'senior manager/manager knowledgeable about client industry' and 'very knowledgeable audit team'. They all viewed these attributes as having a relatively moderate influence upon AQ compared with the other investigated attributes. Nonetheless, as Table 4.1 shows, interesting differences of perception were revealed in the rankings that the three stakeholder groups gave these four attributes. Thus of these four attributes, the one ranked highest by directors ('Senior manager/manager knowledgeable about client industry', ranked fourth of all attributes) was ranked only seventh by the auditors and the CFOs, and the one ranked highest by the CFOs ('Partner knowledgeable about client industry', ranked fourth of all attributes) was ranked only sixth by the auditors and the directors, while the attribute ranked highest by the auditors ('Very knowledgeable audit team', ranked fourth of all attributes) was ranked only eighth by the CFOs and seventh by the directors. The full survey results are presented in Table 4.1.

Table 4.1: Survey results – Relative importance score (RIS) (rank) for auditors, CFOs and directors

	AUDITORS	CFOs	DIRECTORS
ATTRIBUTES	**RISs** (rank)	**RISs** (rank)	**RISs** (rank)
Audit firm size	18.40 (1)	15.13 (1)	14.66 (1)
Partner/manager attention to audit	16.87 (2)	12.50 (2)	14.18 (2)
Communication between audit team and client management	10.76 (3)	10.03 (5)	11.31 (3)
Audit partner tenure	5.16 (10)	5.96 (9)	4.97 (10)
Audit quality assurance review	5.37 (9)	5.23 (10)	5.09 (9)
Provision of non-audit services (NAS)	7.82 (8)	12.19 (3)	10.07 (5)
Audit firm industry experience*	9.19 (5)	9.98 (6)	9.68 (8)
Partner knowledgeable about client industry *	8.87 (6)	10.21 (4)	10.04 (6)
Senior manager or manager knowledge of client industry*	7.86 (7)	9.64 (7)	10.27 (4)
Very knowledgeable audit team*	9.70 (4)	9.13 (8)	9.74 (7)

* 'Knowledge' attributes

5. Discussion

The perception of all three stakeholder groups that 'Audit firm size' is the most important driver of AQ relative to the other surveyed attributes was anticipated.

5.1. AUDIT FIRM SIZE

The perception of all three stakeholder groups that 'Audit firm size' is the most important driver of AQ relative to the other surveyed attributes was anticipated – a result that finds wide agreement in prior studies of AQ (eg Dopuch and Simunic 1980; De Angelo 1981; Simunic and Stein 1987; Teoh and Wong 1993; Francis et al. 1999; Francis and Wang 2008; Francis and Yu 2009; and Karjalainen 2011). A number of explanations for this result have been offered: that larger firms have a greater reputation at stake, giving them an incentive to be more independent (DeAngelo 1981); that they are able to give their clients' financial statements a higher degree of credibility (Dopuch and Simunic 1980; Francis et al. 1999); and that they have the resources for hiring the best-trained and most talented staff, hence are able to provide a better service (Simunic and Stein 1987).

These explanations are generally supported by the focus group data in this study. The claim that greater resources give large firms the capacity to offer better services across a wider range of industries was endorsed particularly by the directors, all of whom agreed that they would only hire Big Four firms. As one remarked: 'It takes a lot of persuasion for me to use any other than the Big Four firms now…They attract the best partners at senior level. So I want that top quality and I'm not going to find it outside the Big Four' (D3).

There was also a perception that large firms carry a higher degree of credibility. A number of CFOs stated that the prestige and reputation of Big Four firms creates investor confidence:

> 'We needed to make sure that the investors were comfortable; we needed a Big Four stamp on the audit report'.
> (CFO1)

> 'It's having that name on the audit reports; it gives confidence to the investors'.
> (CFO3)

> Auditors disagreed among themselves about whether Big Four Firms provide a better quality service than mid-tier firms, depending on the size of the firm to which they belonged themselves.

An additional point that was repeatedly referred to as an important strength of Big Four firms was their 'global reach' – they provide a worldwide service:

> 'I want a partner that can work with me across the region, you know, across the globe'.
> (CFO1)

While the three stakeholder groups agreed that 'Audit firm size' is the most important driver of AQ of relative to the other investigated attributes, it is worth noting that auditors gave this attribute a substantially higher RIS than it received from CFOs and directors. Although the auditors agreed that firm size is the most important of the attributes as a contributor to AQ relative to other attributes, they disagreed among themselves about whether Big Four firms provide a better quality service than mid-tier firms, depending on the size of the firm to which they belonged themselves. One mid-tier auditor argued that:

> 'The only difference I see between a Big Four and a mid-tier is just volume. We've got all the skill set, all the range of services, all the international affiliations that a Big Four has… we have quality training, we have quality people, we provide a quality service'.
> (A2)

Those auditors who preferred 'Big Four' were themselves members of Big Four firms. One Big Four auditor commented: 'Certainly in the big firms I think we've got very strong discrete lines of business in industry specialisation. As a partner… I've worked across multiple sectors over the years… I know the specialists in the firm I can draw [upon] if I really need to delve deeply into an issue I'm not across.' (A3).

Among the previously-mentioned studies comparing the perceptions of stakeholders on the 'supply' side of the audit with those on the 'demand' side, Beattie et al. (2013) reached conclusions similar to those here. They ranked 'Audit firm size' fourth among 36 attributes studied, with auditors perceiving this attribute to have a greater influence upon AQ than the influence with which it was credited by CFOs and directors.

The findings on 'Audit firm size' support the expectation that because directors, and to a lesser extent CFOs, generally experience high IA in relation to most AQ attributes, they will place a relatively high value on attributes about which they have ready access to information. 'Audit firm size' is such an attribute, and both directors and CFOs accorded it a very high RIS, ranking it as the most important AQ attribute among those studied here. Auditors, who generally experience a negligible degree of IA in relation to all AQ attributes, also gave this attribute a higher RIS (18.40) than either directors (RIS 14.66) or CFOs (RIS 15.13). Nonetheless, auditors' reasons for placing a high value on 'Audit firm size' are likely to be quite different from those motivating directors and CFOs' assessments of this attribute, with auditors exhibiting bias in favour of the firm size attributable to their own firm.

5.2 PARTNER/MANAGER ATTENTION TO AUDIT

All the stakeholder groups gave this attribute a relatively high RIS, ranking it as the second most important AQ attribute. Prior studies that have investigated the control exercised by the audit partner over the audit process generally show that high value is placed on this attribute. The audit industry stakeholders surveyed by Schroeder et al. (1986) placed this attribute first out of 15 investigated for its contribution to AQ, while those surveyed by Carcello et al. (1992) perceived 'Active engagement partner/manager' as the second most important contributor to AQ of all attributes investigated in that study. Knechel (2000) argues that because auditing calls for decision-making, AQ depends significantly on judgements made by the audit team and audit partner. Further evidence of the importance stakeholders attach to the impact of 'Partner/manager attention to audit' upon AQ can be found in Kilgore et al. (2011).

Auditors gave the attribute a higher RIS (16.87) than did CFOs (12.50) and directors (14.18). The focus session data offers an

Directors emphasised that they must have full confidence in the person in charge of the audit.

explanation for these differences. On the question of why directors gave the attribute a higher RIS than did CFOs, the directors emphasised that they must have full confidence in the person in charge of the audit. As one director remarked:

> 'Both [partner and manager] are extremely important to me…I mean, as directors we're signing off on these annual accounts. We've got legal responsibilities. So I want the best partner in the country, really, to be by my side as I sign off on those accounts… The manager is also extremely important, because the partner relies upon that manager. We've got to have absolute confidence that we…trust each other… Because I've also been burnt in the past'.
> (D3)

That directors should be concerned about having an audit partner and senior manager they can trust is understandable, given the responsibility directors carry for their organisation's well-being – and particularly in view of the high IA they experience in relation to this attribute.

A number of CFOs mentioned that during an audit directors tend to keep close contact with their CFO, who in turn has direct contact with the audit team, and is therefore able to keep directors informed about the progress of an audit. One CFO commented that directors seek constant feedback from their CFOs during an audit because:

> 'They want to make sure…I'm getting the right level of engagement with the auditor. So the directors are going to know pretty quick when we don't'.
> (CFO 1)

Regarding the higher RIS that auditors gave to 'Partner/manager attention to audit', they explained that audit partners and managers like to be involved in the audit process because this is their most important source of job satisfaction. As one director remarked: 'The one thing that drives [an auditor] from a job satisfaction point of view…is the activity, the time at the client, involved with the client and getting to know their business and delivering that type of engagement' (A1).

The survey results offer mixed support for the hypothesis that directors will attach a relatively low value to 'Partner/manager attention to audit', because they experience high IA in relation to this attribute, and that CFOs will attach a relatively high value to it because they experience lower IA in relation to it. The relatively high value both directors (RIS 14.18) and CFOs (RIS 12.50) attach to the attribute is therefore contrary to expectations for directors but accords with expectations for CFOs. The fact that both directors and CFOs rank this attribute as second most important suggests, however, that for particular attributes that directors consider to be very important, they may actively seek to reduce IA through indirect channels. Arguably, because it is imperative for them to have complete confidence in the audit partner, in the case of 'Partner/manager attention to audit' they seek this information through the CFO.

5.3 COMMUNICATION BETWEEN AUDIT TEAM AND CLIENT MANAGEMENT

All three stakeholder groups perceive this AQ attribute to be relatively important, with both auditors and directors ranking it higher (ranked third) than CFOs (ranked fifth). The relative importance that the three groups attribute to effective communication between an audit team and the client's management is supported by other studies – for example, Schroeder et al. (1986), Behn et al. (1997), and Murray (2013).

The focus sessions enabled investigation of the reasons why directors rate this attribute so highly as an influence upon AQ. As discussed in section 5.2 above, one reason why they do so is the directors' high level of responsibility for their firm's financial well-being coupled with the high IA they experience in relation to the progress of the audit. The directors benefit if the auditor communicates with the CFO, who can in turn keep the directors informed about the audit process.

> Auditors provide an important source of information about alternative or new business practice.

Another reason why directors value an auditor's capacity to communicate also emerged from the focus sessions. This is that auditors provide an important source of information about alternative or new business practices. Discussing the most important factors making up competence in an auditor, one director emphasised the capacity to communicate: 'It's got to be somebody who's…able to communicate, show sympathy with the client, or whatever, so that there's that behavioural aspect that's just as important [as independence and other virtues]…It's communication, relationships, relationship building with the client…to me that's a key part of what's in the mix these days' (D3). A CFO agreed:

> 'If you have built that [relationship with the audit partner] upfront or over a period of time, that goes to the heart of…getting a quality job done'.
> (CFO4)

Later the same director elaborated further: 'So for me the value add is often about additional insights, particularly bringing what other industry players are doing that's different and perhaps might be better…So it's a process of improvement…the opportunities to perhaps do things differently…Because of that mutual respect there's that sharing of information' (D3).

Again there was agreement from CFOs: 'from a CFO's perspective the age-old question about auditor competence isn't so much about knowledge of accounting standards…It's the balance of being technical and being commercial' (CFO4). Auditors also emphasised the importance of communication:

> 'industry experience is…a factor, but it's not the biggest factor. The biggest factor with any client is your relationship: you need to service that client…That's where I think the value is sometimes tied up: on an individual engagement and individual interaction level'.
> (A1)

These comments provide insights as to why directors, auditors and CFOs all regard auditor communication with management and those charged with governance (ie directors) as a relatively important driver of AQ. Directors attach a particularly high relative value to this attribute, both as a means of compensating for their high IA in relation to the audit process and as a source of valuable business information for their firm. A reasonable explanation for the high relative value auditors place on this attribute is that auditors value clients as their source of income, and recognise the importance of good communication for maintaining a strong relationship with their clients.

The survey results are consistent with those of previous comparative studies of stakeholders' perceptions of the importance of communication between auditor and client. Beattie et al. (2013) report that the attribute 'Auditor required to communicate with client audit committee' was rated highly important on the pooled responses of their surveyed directors, CFOs and auditors.

The present report's findings for 'Communication between audit team and client management' do offer mixed support for prior expectations. CFOs experience relatively low IA in relation to this attribute, since they are easily able to ascertain the extent to which the auditor communicates with their management. Therefore, it was predicted that they would rate this attribute as being relatively important as an influence upon AQ. CFOs do in fact ascribe relatively high importance to this attribute as an influence upon AQ, hence this supports the original expectation. Directors experience higher IA in relation to this attribute so it would be expected that they would rate it as relatively less important. However, in fact directors give this attribute the same importance for AQ as do CFOs (ie ranked second) – a result that fails to support the original expectation.

On balance the evidence supports the view that longer tenure promotes higher AQ.

5.4 AUDIT PARTNER TENURE

It has been noted at the beginning of Chapter 4 that the low RISs and rankings (ranked 10 by directors and auditors; 9 by CFOs) received by this attribute from all three stakeholder groups show that they perceive it as having relatively less importance for AQ than the other investigated attributes.

The low RISs for 'Audit partner tenure' are of interest given changes to partner tenure introduced by regulators and standard setters in numerous jurisdictions. For example, the *International Ethics Standards Board for Accountants Code* (IESBA code, 2015) requires that audit partners be rotated after a prescribed number of years, usually restricting a partner's association with a particular client to seven years, the reason being a perception that a longer association could impair the partner's independence.

A number of studies have investigated this issue in the context of national and international regulations, such as those contained in the IESBA Code. Some of these studies – eg Carey and Simnett (2006) – support regulations restricting the number of years an audit partner can continue a relationship with a client, on the grounds that longer tenure promotes a 'cosy' and self-serving bias in the auditor. Other studies – eg, Johnson et al. 2002; Myers et al. 2003 ; Chen et al. 2008; Chi et al. 2009 – find that the longer an audit partner's relationship with a client, the more they learn about the client's business and financial circumstances, enabling them to provide better AQ. Although there are arguments on both sides, on balance the evidence supports the view that longer tenure promotes higher AQ.

In the focus sessions the directors were in agreement that longer tenure is more likely to facilitate than to undermine AQ. One director commented that: 'the more complex the company, the longer it takes the partner to be across the job. So I don't think they really get across the stride of it until about year three, and by year five it's going really well' (D1).

A CFO made the point that they can be heavily reliant on the knowledge audit partners have of their business, especially in technical areas:

> 'If you're in that sector of technology, the partners know your business. Whether it's A, B or C, they're all working in that business all the time. So they know all the revenue issues and things like that'.
> (CFO1)

She went on to say that CFOs can be even more reliant on the day-to-day business knowledge of the audit senior manager; losing either the audit partner or senior manager could create a heavy burden for the CFO.

On tenure restriction as a device for enhancing independence, one auditor commented:

> 'I think it's been a bit of a blunt instrument, this sort of shorter rotation period. I actually honestly think it's not in the interests of audit quality…You talk about banks…They're just such big beasts. Five years goes very quickly'.
> (A3)

Clients can confidently assume that an auditor will be independent, hence competence is the most important issue.

Apart from longer tenure being perceived as conducive to auditors' acquiring a better understanding of their clients' business, the supposition that longer tenure might have a negative effect on auditor independence was generally dismissed in the focus sessions by all three stakeholder groups – a further explanation for the low RISs received by this attribute. A facilitator's question as to why the attribute received a low ranking received these two successive responses from two auditors: 'Because it's a given' (A5); 'Yeah, we can't influence it' (A3).

Yet the point was also made that independence is something all parties take for granted and that clients can confidently assume that an auditor will be independent, hence competence is the more important issue:

> 'Independence within the firms is so robust and so thorough that it's just a given…The independence is a given and the competence is absolutely critical to doing a decent job'.
> (A5)

Of the previously-mentioned studies comparing the perceived importance of AQ attributes of those standing on the 'supply' side of the audit with the perceptions of those standing on the 'demand' side, the findings of Beattie et al. (2013) on the perceptions of auditors, CFOs and directors about the impact of auditor rotation rules on AQ are of some relevance to this study. Averaging the perceptions across all groups, their findings were similar to those reported here: rules limiting audit partner tenure were perceived as having 'no significant effect' (Beattie et al. 2013: 66). Even so, in that study auditors ascribed less importance to limitations on audit partner tenure as an influence on AQ than did CFOs and directors. Beattie et al. also noted that in general CFOs' and directors' perceptions tended to correspond more closely with each other than with those of auditors – a phenomenon Beattie et al. attribute to their relatively closely associated roles in the audit industry, compared with those of auditors. Goodwin and Seow (2002) similarly report that their surveyed auditors and directors perceived limits on audit partner tenure as having little effect on auditor independence.

Since restrictions on audit partner tenure are public knowledge, it would be predicted that directors would be inclined to ascribe more importance to this attribute than to other AQ attributes, given their general circumstances of IA. As the RISs show, however, they ascribe even less importance to it relative to the other attributes in this study than do the other surveyed stakeholders – a result which does not support the original expectation.

5.5 AUDIT QUALITY ASSURANCE REVIEWS

All three stakeholder groups attribute uniformly low RISs and rankings (ranked ninth by auditors and directors; tenth by CFOs) to 'Audit quality assurance reviews'. Most of the research to date finds a positive relationship between quality controls and reviews and AQ – for example, Epps and Messier (2007) and Schneider and Messier (2007). The present results do not necessarily conflict with the prior studies' findings but suggest that this attribute is relatively less important than the other attributes investigated.

In the focus sessions, representatives from all three stakeholder groups expressed the view that the reviews make little positive contribution to AQ, at best merely reflecting the quality of an audit retrospectively. A director elicited strong agreement from the other directors when he remarked that:

> 'Many directors…perceive [what ASIC says about audit quality as] just a bit of noise in the system. They feel that the work that is being done by the auditors is adequate for their needs. Whether or not they've had a perfectly documented impairment review process that's been checked by three people after the event is probably not all that relevant to the average director'.
> [D1]

There was general agreement in the focus sessions across the stakeholder groups that reviews are excessively concerned with compliance

One CFO remarked that quality assurance reviews bring about no substantial improvements in audit practice, but merely divert attention towards things that should be regarded as 'a given':

> [It's not about] adding value. You're not at the coal face with the business. So in my mind… it's back in the office ticking the boxes and doing all the 'Have we done everything?', 'Are our files correct?'…those kind [of things]'.
> (CFO1)

An auditor remarked: 'to my mind these are lag indicators. This is after the event… I think there are so many other places to drive audit quality' (A5).

There was general agreement in the focus sessions across the stakeholder groups that reviews are excessively concerned with compliance. Auditors said that they were primarily concerned that their clients' interests should be served rather than with the fact that an audit is subject to review. As one auditor put it:

> What's more important to me is that I've got a quality, knowledgeable team [and this counts] above the fact that I know that I'm going to be reviewed at the end of [the audit]'.
> (A5)

In comparing the present findings with those of previous studies of the perceptions of different audit industry stakeholders, the findings of Beattie et al. (2013) are of interest. Their study was not directly concerned with audit quality reviews but more generally with the regulation of the audit profession, but their survey included an open-ended question asking respondents what changes in the regulatory framework would, in their opinion, most improve AQ. The authors report that '[t]he most popular form of improvement across all three respondent groups was that prescriptive regulation was excessive and that judgement should again have a central role in the regulatory framework' (Beattie et al. 2013: 72). They also comment that '[t]he emerging evidence of an unintended consequence of the changed regime causing audit to become overly process-driven is of considerable concern' (Beattie et al. 2013: 77).

Since the outcomes of quality control reviews are confidential, it can be assumed that CFOs and directors experience high IA with regard to this attribute, and therefore it would be expected that they would give these reviews a relatively low rating as an influence on AQ. This is supported by the present results: directors ranked this attribute ninth and CFOs ranked it tenth. Interestingly, auditors, from a vantage point of very low IA, also ranked this attribute ninth as an influence upon AQ. When comparing these results, however, it is worth noting that auditors would have made their assessments on a quite different basis than directors and CFOs, given their position as suppliers as distinct from purchasers of audit services.

5.6 PROVISION OF NON-AUDIT SERVICES (NAS)

The three stakeholder groups differ widely in their perceptions of the importance of 'provision of NAS' for AQ, with auditors ranking this attribute eighth (RIS 7.82) relative to other attributes, directors ranking it fifth (RIS 10.07) and CFOs ranking it third (RIS 12.19).

Empirical evidence for the claim that a higher percentage of NAS has a negative impact on AQ is mixed, with some studies finding a lack of convincing evidence for it (eg Bedard et al. 2008), other studies supporting it (Kanagaretnam et al. 2011; Schmidt 2012), and a third group of studies finding against it (Knechel and Sharma 2011; Svanström and Sundgren 2012).

Comparative studies are particularly interesting when they bring out strongly differing perceptions between respondent groups. The present study of the perceptions of auditors, CFOs and directors about the impact upon AQ of placing limits on NAS raises the question of why auditors ascribe less importance to such limits as an influence upon AQ than do CFOs and directors, and why CFOs in turn ascribe less importance to such limits as an influence upon AQ than do directors.

> 'I think…for the CFO it's more important because the CFO wants value and value isn't just the opinion.'

The focus sessions suggested answers to these two questions. The directors argued that auditors rank this attribute as less important because NAS is an important source of revenue for them, making them resistant to the placing of limits on NAS:
'The auditors want business' (D1)
'That's right' (D2).

The implication is that although auditors see that this attribute could negatively influence auditor independence, they wish to emphasise that that this possibility is small, while CFOs and directors have less reason to downplay this. The focus sessions brought out a different reason why CFOs rank this attribute as more important than do directors. This is the value CFOs place on the auditor as a general business adviser – something that would not be matter of particular concern to a director.

> 'My thought around audit quality is, is the company doing the right things effectively?…So where do we go for that help? Well, probably the auditor. So I want them to come in and help me with my business process improvements and all this…I want to go to the auditor because he's supposed to be my trusted business partner and he knows our business as well as I do'.
> (CFO1)

> 'I'm expecting [the auditor] to have their governance and their compliance and their auditing standards and all that as a platform. But when I'm talking about what's going to add a CFO value…it's about the additional understanding and being able to have a discussion with me about…what drives my business'.
> (CFO1)

> 'I think commerciality is the big thing you get. It's all the typical accounting auditing things are there, the standards and the technical side of things, but just being able to blend that with that commerciality'.
> (CFO 3)

An auditor argued that this viewpoint follows naturally from a CFO's perspective: 'I was expecting [CFOs] to desire [non-audit services]…If you can get an audit firm that deeply understands your business, its helping you when you're doing your due diligence on acquisitions. It's helping you to do your tax services. This is in your interests as a CFO' (A3).

In the focus sessions the directors were more concerned with compliance, and were cautious about consultation with the auditor on matters of business:

> 'The thing that…the CFO would always prize is the ability to talk through issues with [the auditors]…and to reach…shall we call it an adult resolution to an issue…But ASIC is just as likely to come in and tell the audit partner that the audit partner is being unduly influenced by the views of the company'.
> (D1)

One auditor offered this explanation of why the question of placing limits on NAS is more important for CFOs than auditors: 'I think…for the CFO it's more important because the CFO wants value and value isn't just the opinion. It's the ancillary stuff. The number of times we get calls from management level clients: "Please can you help me with this. What's the answer to this? I have this thing that talks about impairment: I don't know what it means…"' (A1).

Auditors ranked the "knowledge" attributes quite differently from both the directors and CFOs.

The present findings differ from those of previous comparative studies of stakeholders' perceptions of AQ, where the general finding has been that the provision of NAS has little impact upon AQ. The combined view of the auditors, CFOs and directors investigated by Beattie et al. (2013) was that this attribute has 'no significant effect' upon AQ. In the study of

CFOs' and auditors' perceptions by Carcello et al. (1992) the attribute 'Firm provides no consulting services to client' was perceived as one of the 10 of least importance for AQ among the 41 attributes investigated. The auditors and directors investigated by Goodwin and Seow (2002) found, similarly, that neither group perceived that the provision of NAS had a significant impact upon AQ.

The present results support the hypothesis that because information about 'provision of NAS' is readily available to CFOs and directors as part of financial information reported, they will place a relatively high value on this attribute, and will tend to rate it more highly than do auditors, who experience very low IA across all AQ attributes, exhibiting no bias in favour of this attribute. This expectation is supported by the high ranking CFOs gave to 'provision of NAS' relative to the other investigated attributes, and it is not inconsistent with the ranking of fifth that the attribute received from directors. The expectation is also not inconsistent with the fact that auditors gave this attribute a lower ranking than CFOs and directors.

5.7 THE 'KNOWLEDGE' ATTRIBUTES

Table 4.1 in Chapter 4 shows that, overall, the 'knowledge' attributes all received rankings of around the median or higher from the three stakeholder groups, suggesting that these attributes are all regarded as of some importance for AQ. This is consistent with prior research on these attributes – for example Carcello et al. (1992), Knechel et al. (2007), Lowensohn, et al. (2007), Li and Chen (2011) and Zerni (2012).

As noted in Chapter 4, a closer look at Table 4.1 shows interesting differences of perception between the three stakeholder groups about the relative importance for AQ of these four attributes. The directors ranked 'Senior manager/manager knowledgeable about client industry' highest (fourth out of all 10 investigated attributes), followed by 'Partner knowledgeable about client industry' (sixth). CFOs gave 'Partner knowledgeable about client industry' a substantially higher ranking than the directors (fourth out of all 10 investigated attributes) but gave 'Senior manager/manager knowledgeable about client industry' and the other two 'knowledge' attributes relatively low rankings ranging from sixth to eighth. Auditors ranked the 'knowledge' attributes quite differently from both the directors and CFOs, giving 'Very knowledgeable audit team' the highest ranking among them (fourth out of all investigated attributes), followed by 'Audit team industry experience' (fifth) – attributes to which both directors and CFOs gave relatively low rankings, ranging from sixth to eighth.

These differences raise the following questions. Firstly, why do directors rate 'Senior manager/manager knowledgeable about client industry' and 'Partner knowledgeable about client industry' highest of the four attributes, and why do they rank the first of these substantially higher than the others? Secondly, why do CFOs place a particularly high relative value on 'Partner knowledgeable about client industry'? Thirdly, why do auditors place the highest value on the two 'knowledge' attributes – 'Very knowledgeable audit team' and 'Audit firm industry experience' – which both directors and CFOs ranked as relatively less important in relation to the other 'knowledge' attributes? The focus sessions offered some answers to these questions.

It is particularly important for directors to believe that they can put their trust in the senior staff member in charge of an audit.

On the first question, given their high IA in relation the audit process, it is particularly important for directors to believe that they can put their trust in the senior staff members in charge of an audit; it is through them that they are able to have confidence in the audit team and process. This was highlighted a number of times in the focus sessions.

> 'Directors…want to be sure that there's nothing happening, there's no systemic risk, etc.'
> (D2)

> 'I've got a very open relationship with my audit partners that I deal with. I don't like surprises. They know that…I met with the partner and manager prior to each audit committee meeting…a fairly frank and open relationship. To me that's absolutely key for me to have confidence in the team'.
> (D3)

This, arguably, is why directors place such a high value on the knowledgeability of the senior manager and audit partner.

Turning to the second question, CFOs have a quite different perspective from that of directors. Apart from having direct access to what is happening during an audit, CFOs are less concerned with audit outcomes than with the overall management of their company's business, and therefore value the audit partner as a source of information and advice over the longer-term running of their company's affairs.

> 'That [relationship with the audit partner] goes to the heart of…getting a quality job done…the value is not necessarily in the audit. It's in having a programme over a number of years that focuses on key areas for review for that business'.
> (CFO4)

> 'Auditor competence isn't so much around knowledge of accounting standards. It's that…balance of being technical and being commercial'.
> (CFO4)

The particular role and perspective of the CFO offers an explanation for the very high relative value CFOs place on having a knowledgeable audit partner.

Finally, the focus sessions offered an answer to the third question – why auditors value a very knowledgeable audit team and a firm with good industry experience above having a knowledgeable audit partner or audit manager. One auditor remarked that auditors serve many masters, but that their client is their first concern:

> 'What we're struggling with in the audit industry is the masters we serve. All the theory will tell you that we do this for the public interest, but now we've got to do it for the regulator, we've got to do it for…the managing partner, we've got to do it for the client and the value to the CFO…we've got to do it for the director…It's a really tough one to balance…[but] the master…is the economic one…The public doesn't pay the bill. [Our masters are] the ones that hire [us]'.
> (A1)

For an auditor intent on delivering a good service to their client, it is not their own performance that concerns them, for they know that, within their limits, they will do what is required of them. For them the challenge of producing a quality audit depends instead on whether they can rely on adequate support from their firm and team – especially since a firm and team can offer a level of collective expertise that goes beyond the abilities of any individual.

These observations provide a plausible answer to why auditors are more concerned with team and firm capacities...than with the competence of individual senior managers and audit partners.

'As a partner…I know the specialists in the firm I can draw on…So I kind of look at the collective rather than just my individual experience that I might have built up over the years. I've got a machine and a firm behind me that can help deliver that quality to the client'.
(A3)

'If I don't have a competent audit team underneath me and a competent manager and a competent structure I can rely on when I deliver the audit, that's a disaster'.
(A5)

These observations provide a plausible answer to why auditors are more concerned with team and firm capacities as an aid to doing their job than with the competence of individual senior managers and audit partners.

Turning to previous comparative studies of stakeholders' perceptions of the drivers of AQ, Carcello et al. (1992) report that the combined responses of their surveyed CFOs and auditors indicated that they placed a relatively high value on having a very knowledgeable audit team; the attribute was ranked in the top 10 of their 41 investigated attributes. Kilgore et al. (2011) similarly report that the combined responses of their surveyed directors and investors placed 'Very knowledgeable audit team' third in importance for AQ out of their 10 investigated attributes. It will readily be seen that the present study goes well beyond these limited claims. Unlike the abovementioned studies, the data given here and its analysis provide a systematic and direct comparison of the different stakeholders' perceptions of the relative importance for AQ of all the investigated AQ attributes.

Of the four 'knowledge' attributes, information about 'Audit firm industry experience' is most readily available to directors, followed by 'Partner knowledgeable about client industry' and 'Senior manager knowledgeable about client industry', while information about 'Very knowledgeable audit team' is least accessible to directors. Therefore, it would be expected that directors will favour 'Audit firm industry experience' over 'Partner knowledgeable about client industry' and 'Senior manager knowledgeable about client industry' as a positive influence upon AQ, and that they would strongly favour 'Audit firm industry experience' over 'Very knowledgeable audit team' as an influence upon AQ. Neither expectation is supported by the results. It is likely, however, that the influence of IA upon the directors' judgement will have been overridden in this context by role factors. As noted above, it is particularly important for directors to believe they can put their trust in the senior staff members in charge of an audit, and this would account for why, regardless of IA considerations, they singled out the industry knowledge of partners and senior managers, in particular, as more important for AQ than the industry experience of the audit firm as a whole.

6. Implications for the IAASB's Framework for Audit Quality (the Framework)

The Framework was introduced to promote AQ by focusing on the factors that underpin it, and to enhance confidence in the audit industry.

The Framework was introduced to promote AQ by focusing on the factors that underpin it, and to enhance confidence in the audit industry. Its success will depend significantly on whether its content and emphases have the support of the key stakeholders. One of the aims of this study is to assess empirically the extent to which the Framework captures the concerns of key stakeholders in the audit industry, by considering the perceptions of the three surveyed stakeholder groups about the relative impact upon AQ of the 10 investigated attributes. The Framework emphasises a range of factors, including independence, competence and interactions. Do the perceptions of the surveyed stakeholders support this uniform emphasis upon independence, competence and interaction, or do they support a more differentiated stance, emphasising one of these categories, or two, as against the Framework's across-the-board emphasis upon all three?

Table 6.1 shows the rankings that the three stakeholder groups gave to the competence, independence and interaction attributes in the online surveys. For the purposes of comparison the table includes an 'overall' ranking for each attribute, obtained by averaging the RISs the attribute received from the three stakeholder groups.

Table 6.1 differs slightly from Table 2.2 in respect of the attributes classified as independence attributes. Table 2.1 reflects the conventional view that 'Audit firm size' is a competence as well as an independence attribute, the rationale for which is that the greater resources of large firms enable them to maintain the highest professional standards while also minimising the likelihood that they will compromise their independence under pressure of financial considerations. Nonetheless, it became clear from the focus session discussions that the relative importance that the stakeholders attributed to this attribute derives from its character as a competence attribute – a fact that is reflected, for example, in the emphatic comment by one of the directors (D3) we quoted earlier in section 5.1 saying that her preference for Big Four firms derived from the fact that they 'attract the best partners at senior level' and that 'I want that top quality and I'm not going to find it outside the Big Four'.

The overview shows a marked preference for competence and interaction attributes over independence attributes.

In Table 6.1 'Audit firm size' has been classified as solely a competence attribute.

The overview shows a marked preference for competence and interaction attributes over independence attributes. The stakeholders awarded the competence attributes the top four rankings with 'Audit firm size' ranked first and 'Partner / manager attention to audit' ranked second. Of the four 'knowledge' attributes, which are competence attributes, two of them – 'Partner knowledgeable about client industry' and 'Senior manager knowledgeable about client industry' – are ranked third and fourth overall, while the other two – 'Audit firm industry experience' and 'Very knowledgeable audit team' – received overall rankings of seventh and eighth, respectively. While the remaining competence attribute – AQ assurance reviews – is the lowest-ranked attribute, the second-lowest – 'Audit partner tenure' – is an independence attribute, while the other independence attribute – 'Provision of NAS' – is ranked sixth overall. 'Communication between audit team and client management' – an interaction attribute – was ranked fifth overall after the top four competence attributes.

In summary, of the 10 attributes investigated, the competence and interaction attributes occupy all positions in the top half of the rankings, while the two independence attributes are both placed in the bottom half, including one in the second-lowest position. These results suggest that those factors in the Framework emphasising competence and interaction are relatively more important to all three stakeholder groups than those emphasising independence.

Table 6.1: Rankings given to competence, independence and interaction attributes

INDEPENDENCE	Ranking	COMPETENCE	Ranking	INTERACTION	Ranking
Provision of NAS	Auditors: 8 CFOs: 3 Directors: 5 **Overall: 6**	Audit firm size	Auditors: 1 CFOs: 1 Directors: 1 **Overall: 1**	Communication between audit team and client management	Auditors: 3 CFOs: 5 Directors: 3 **Overall: 5**
Audit partner tenure	Auditors: 10 CFOs: 9 Directors: 10 **Overall: 9**	Partner/manager attention to audit	Auditors: 2 CFOs: 2 Directors: 2 **Overall: 2**		
		Partner knowledge of client industry	Auditors: 6 CFOs: 4 Directors: 6 **Overall: 3**		
		Senior manager/manager knowledgeable – client industry	Auditors: 7 CFOs: 7 Directors: 4 **Overall: 4**		
		Audit firm industry experience	Auditors: 5 CFOs: 6 Directors: 8 **Overall: 7**		
		Very knowledgeable audit team	Auditors: 4 CFOs: 8 Directors: 7 **Overall: 8**		
		Audit quality assurance review	Auditors: 9 CFOs: 10 Directors: 9 **Overall: 10**		

7. Conclusions

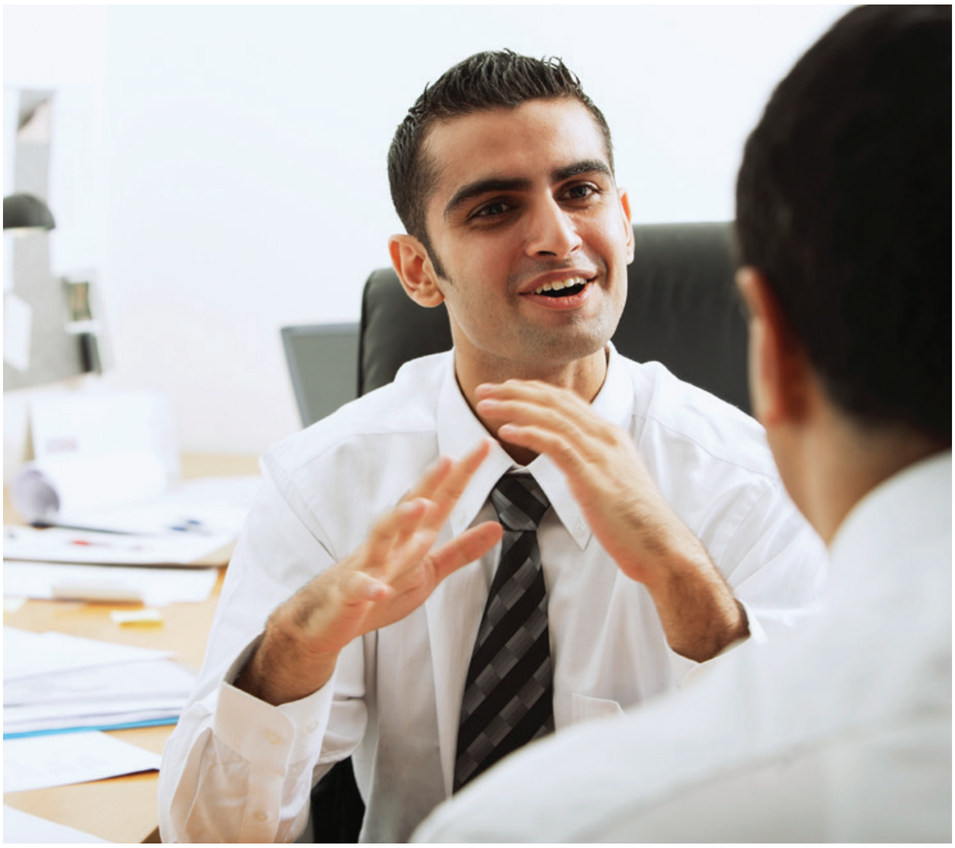
The results of this study ranking 'audit firm size' as the relatively most important AQ attribute by all the stakeholder groups support the findings by prior research that large firms deliver a better-quality audit service.

The results of this study ranking 'audit firm size' as the relatively most important AQ attribute by all the stakeholder groups support the findings by prior research that large firms deliver a better-quality audit service. This perception may be partly because information about firm size is publicly available, hence accessible to those who experience high IA. Those experiencing high IA may also favour large firms because their 'brand' offers security in the absence of ready information about the quality provided by suppliers of audit services. Interestingly, auditors, who experience low IA for all attributes investigated, agreed with CFOs and directors in ranking 'Firm size' as the most important AQ attribute.

The high ranking (second overall) received by 'Partner/manager attention to audit' is worthy of note. In the focus sessions it emerged that directors are particularly concerned that they have the utmost confidence in the senior members of the audit team conducting their audits. This may also explain why directors ranked 'Communication between audit team and client management' third among all surveyed attributes: by communicating with the client management auditors can reassure the directors of their close attention to the audit.

The focus sessions offered an additional reason why directors place a high value on 'Communication between audit team and client management' – namely, that auditors are an important source of information for their clients on alternative or new business practices. The high ranking given by directors to both 'Partner/manager attention to audit' and 'Communication between audit team and client management' is of special interest to auditors, since directors usually have ultimate responsibility for hiring their firm's auditor.

All three stakeholder groups gave relatively low rankings to 'Audit partner tenure' and 'Audit quality assurance reviews', the former receiving the second-lowest overall ranking across all attributes and the latter receiving the lowest. This suggests that the high level of importance commonly attached to these two attributes by regulators and standard setters is not shared by auditors, CFOs and directors. Restrictions on tenure have been introduced to promote auditor independence, but the focus sessions brought to light ways in which restrictions can reduce AQ – for instance by leaving insufficient time for partners to acquire comprehensive knowledge of certain industries, and by undermining the constructive role that audit partners, with their special grasp of their client's business affairs, can play as advisers to client CFOs.



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Appendix **1a**

Demographics for surveyed auditors, CFOs and directors

		AUDITORS		CFOs		Directors	
		Number	%	Number	%	Number	%
Total number of respondents		**49**		**68**		**38**	
Gender	Male	32	65.3	57	83.8	29	77
	Female	17	34.7	11	16.2	9	23
Age	18–24	0	0	0	0	0	0
	25–34	19	39.0	7	10.3	0	0
	35–44	20	41.0	17	25.0	2	5.3
	45–54	10	20.0	33	48.5	8	21.1
	55–64	0	0	10	14.7	16	42.1
	65–74	0	0	1	1.5	11	28.9
	75 and over	0	0	0	0.0	1	2.6
Highest educational Level	High School	0	0	1	1.5	0	0
	Technical College/Diploma	0	0	0	0	2	5.3
	Bachelor's Degree	39	80.0	31	46.0	18	47.4
	Master's Degree/MBA	4	8.0	23	34.0	8	21.1
	PhD	0	0	0	0	5	13.2
	Other	6	12.2	13	19.1	5	13.2
Professional Body Membership[6]	Association of Chartered Certified Accountants (ACCA)	5	10.0	8	11.8		
	Institute of Chartered Accountants in Australia (ICAA)	36	73.0	24	35.3	6	15.8
	CPA Australia (CPA)	2	4.1	24	35.3	7	18.4
	Australian Institute of Company Directors (AICD)					31	81.6
	Institute of Professional Accountants (IPA)	1	2.0	3	4.4		
	Other	21		28	41.0	15	39.0
Position in firm[7]	Chairperson					16	42.1
	Director(exec/non-exec)	8	16.0			38	100
	Director (other)					4	10.5
	CFO						
	Partner/audit partner	22	45.0				
	Senior manager/senior audit manager	11	22.0				
	Manager/audit manager	4	8.0				
	Other	4	8.0			4	10.5

Cont >

6 Some respondents indicated membership of more than one professional body, so percentage figures here do not have an aggregate of 100.
7 Some respondents indicated more than one position in their firm, so percentage figures here do not have an aggregate of 100.

Demographics for surveyed auditors, CFOs and directors

		AUDITORS		CFOs		Directors	
		Number	%	Number	%	Number	%
Total number of respondents		**49**		**68**		**38**	
Firm Size: Number of partners	1 to 9	4	8.0				
	10 to 19	1	2.0				
	20 to 49	1	2.0				
	50 or more	43	88.0				
Firm Size: Revenue	< $10m			2	2.9	3	7.9
	≥ $10m and <$25m			2	2.9	2	5.3
	≥ $25m and <$100m			13	19.1	3	7.9
	≥ $100m and <$500m			26	38.2	6	15.8
	> $500m			25	36.8	24	63.2
Firm Size: Number of employees	5 to 25			1	1.5		
	26 to 49			3	4.4		
	50 to 99			2	2.9		
	100 to 249			11	16.2		
	250 or more			51	75		

Appendix **1b**

Demographics for participants at the focus sessions

STAKEHOLDERS	GENDER	AGE (years)	POSITION	TIME IN CURRENT POSITION	TIME IN COMPANY	QUALIFICATIONS	EXPERIENCE IN STAKEHOLDER GROUP (years)
Director 1 (S[8])	M	64	Non-executive director, chair of Audit Committee	3 years	3 years	M. Com; FCA; FCPA; FAICD	7
Director 2 (S)	M		Director	25 years	25 years	B. Com; FCPA	
Director 3 (M)	F	59	Non-executive director	13 years	13 years	B. Com; MBA; FCA; FAICD	40+
CFO 1 (S)	F	40+	CFO	15 months	18 years	CPA (fellow)	20 +
CFO 2 (S)	M	47	CFO	5 months	5 months	ACCA (FCCA)	7
CFO 3 (S)	M	39	CFO	12 months	12 months	FCA; CPA; BA	15
CFO 4 (S)	F	45	CFO	9 months	9 months	ACCA	5
CFO 5 (M)	M	44	CFO services	5 years	5 years	B. Com; EMBA; CPA	5
Auditor 1 (S) (Mid-tier)	M	38	Audit Technical Leader	18 months	18 months	CA	16
Auditor 2 (S) (Mid-tier)	M	50	Partner	7 years	11 years	FCCA; CA	20+
Auditor 3 (M) (Big Four)	M	37	Partner	4 years	4 years	B. Com.; CA	16
Auditor 4 (M) (Big Four)	M	46	Partner	13 years	25 years	B. Com; ACA	25
Auditor 5 (M) (Big Four)	F	47	Partner	10 years	26 years	ACA (ICAEW)	26

8 'S' denotes Sydney, 'M' denotes Melbourne.

Appendix 2

Questions discussed in the Sydney and Melbourne focus sessions

Regarding similar responses across the three stakeholder groups

(1) What aspect of 'audit firm size' makes it the relatively most important AQ attribute?

(2) What aspect of 'partner/manager attention to audit' makes it the second most important AQ attribute relative to others?

(3) Why are quality reviews (both internal and external) ranked as relatively less important AQ attributes?

(4) Why is 'audit partner tenure' ranked as the second least important AQ attribute relative to others?

Regarding different responses from the three stakeholder groups

(5) Why is 'audit firm industry experience' perceived to be relatively more important by CFOs (ranked 4) and directors (ranked 5) than by auditors (ranked 8)?

(6) Why is 'provision of non-audit services' perceived to be more important by CFOs (ranked 3) and auditors (ranked 5) than by directors (ranked 8)?

(7) Why is 'very knowledgeable audit team' perceived to be more important by auditors (ranked 4) than by CFOs (ranked 8) and directors (ranked 7)?

Other questions

(8) What role does industry experience/knowledge play at different levels of auditor seniority?

(9) What is the perceived role of independence versus competence in relation to AQ?

(10) What attributes in addition to those investigated are potentially equally or more important to AQ and should be considered in future studies?

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