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Global Boardroom Insights

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The Future of Audit

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A NOTE FROM KPMG'S AUDIT COMMITTEE INSTITUTE

It's telling that so many private companies around the world have their financial statements audited – even when they're not always required to do so. An audit provides lenders, investors, and the capital markets with critical added assurance on the integrity of the company's financial statements and related controls. As we've heard more than one observer say, "if the financial statement audit didn't exist today, someone would invent it." That said, audits – and auditing – are, in some ways, on the cusp of dramatic change, if not reinvention.

In this edition of *Global Boardroom Insights*, we explore the current state of the audit – where audit quality stands today, drivers and indicators of audit quality, and various stakeholders' expectations of auditors – and what the near-and-long term may hold for auditing. Is audit quality continually improving? What are the key drivers and indicators? Should the auditor's report be expanded beyond the "pass/fail" audit opinion? What innovations can companies expect to see in auditing in the next 3-5 years?

We posed these and other questions to seasoned audit committee chairs and audit professionals; and while their answers differ in nuance and emphasis, several themes are clear. Audit quality remains strong today, but the push for greater transparency and insight into the auditor's work, and the advent of data analytics capabilities to help auditors scrutinize a much wider pool of transactions, continue to raise the bar for the audit profession. Indeed, the ever-present "expectations gap" – understanding what the audit does, and does not do – will continue to be a challenge for auditors; but expectations are nevertheless rising as regulators around the world move toward expanded auditors' reports, and call for more insight and perspective from auditors (and audit committees).

Not surprisingly, the audit committee's engagement with auditors – as well as internal audit and the finance organization – continues to deepen; and as one audit committee chair notes, discussions are increasingly risk-oriented. "Today we have a better handle on what the company's critical areas of risk are, and where the auditor needs to be particularly focused." This bodes well for the company, its investors, and the marketplace – and it hints at the evolution of the audit.

We hope you find this edition of *Global Boardroom Insights* helpful in sparking robust discussions on audit quality, the role of the auditor, and the future of audit.

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U.S.

Wim Vandecruys
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Robert Araeb
Nigeria

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Brazil

INTERVIEW INSIGHTS AT A GLANCE

AUDIT QUALITY
Views were consistent: Sparked by corporate failures and the financial crisis, and driven by regulatory reforms, more deeply-engaged oversight by the audit committee, and continual improvements in the audit process and profession, audit quality has continued to improve over the past decade. On the future of audit, our interviewees offered a range of perspectives.

DRIVERS OF AUDIT QUALITY

Professional skepticism and training – Univocally put forward as the pinnacle drivers of audit quality: audit teams and partners bringing the skills, independent discussion and challenge to the company.

Robust focus on critical areas of risk – Risk-oriented audit plans and approaches that are articulated and addressed rigorously.

Open and transparent communication with the audit committee – Auditors and audit committees communicating through open and frank dialogue where sensitive or difficult matters can be aired, and where expectations can be established and reinforced.

Linkage between internal and external audit – Fundamental for the audit committee in seeking to ensure that key areas of risk – financial or otherwise – are subject to some assurance.

Value beyond the statutory audit scope – Bringing wider perspectives to the table: benchmarking industry and other relevant information, leveraging audit work to help companies understand the strategic risks they face and offering perspectives on financial information outside the statutory annual report.

Innovation – All consistently point to the use of big data and analytics – allowing testing of larger populations versus small samples, supporting better identification of high risk audit areas, and bringing value to companies through the benchmarking opportunities it offers. Auditors, however, should not compromise on genuine understanding of the business and the financials when computers are doing a progressively larger part of the work.

EXPANDED AUDITOR'S REPORT

While increased transparency on audit focus areas is generally seen as a plus in strengthening investor confidence, the risk of boilerplate language, liability considerations, and unclear scope and/or expectations pose challenges. One key question: should auditors be the "original source" of information about the company?

AUDIT FIRM ROTATION

Views differ widely: While those supportive of mandatory audit firm rotation point to the benefit of bringing a fresh set of eyes to the audit, those opposed express concern that mandatory rotation is not only costly and disruptive; it may not deliver tangible benefits – and could actually hamper audit quality, particularly if auditors "lose a step" in the first year.

Michele Hooper – PPG Industries (U.S.)

"Audit quality is rooted in the quality of the engagement team – the quality of the lead engagement partner, the sufficiency of the firm's resources, how auditors are trained, their level of expertise, their ability to be sceptical and objective and to push back on management when needed."

Michele Hooper is president and CEO of The Directors' Council, and serves on the boards of PPG Industries (chair, audit committee) and UnitedHealth Group (chair, nominating and governance). She previously served on the boards (and chaired the audit committees) of AstraZeneca PLC, Target Corporation, and Warner Music Group. Michele serves on the board of the Center for Audit Quality, and is a member of the Economic Club of Chicago, the Commercial Club, Executive Leadership Council, the Chicago Network, and the Committee of 200.

Kees Storm – Anheuser-Busch InBev (Belgium)

"Financial information provided to the market needs to be reliable – and this goes beyond the statutory accounts. It applies to all information reporting to the market, and any quality audit should factor in procedures on such financial information."

Kees Storm is chairman of the board of Anheuser-Busch InBev, where he chaired the audit committee until 2012. He also serves as vice chairman at Unilever and chairman of the supervisory board of PON Holdings, and is a member of the board and audit committee of Baxter International.

Jakob Stausholm – Statoil (Norway)

"Data analytical methods – making effective use of big data – will change audit methodology radically and sooner than one might think. Opportunities to innovate the audit profession have never been greater."

Jakob Stausholm is a member of the board of Statoil ASA (where he chairs the audit committee), and is Chief Strategy, Finance &Transformation Officer at Maersk. Previously, Jakob worked as group CFO for global facility provider ISS, and for Shell in various senior finance positions.

Prof. Herbert Onye Orji – Nigerian Stock Exchange (Nigeria)

"I see auditors making more and more use of industry, competitor and other relevant information to sense check the numbers they are auditing in a particular company."

Professor Herbert Onye Orji, OON, serves as board/council member of the Nigerian Stock Exchange – where he also chairs the Audit & Risk Management Committee – and is the chairman of the National Broadcasting Commission. He is also the chief adviser to the executive governor of Abia State. Previously, he was vice-chairman of the Industrial Training Fund, chairman of the Nigerian Economic Summit's committee on federal government budgeting strategy and process and chairman/ CEO of Summa Guaranty & Trust Company Plc (Member of the Nigerian Stock Exchange).

Jim Liddy – KPMG (U.S.)

"Audit quality is grounded in the experience and commitment of the engagement team. Professional skepticism, constructive challenge and transparent communication are also necessary ingredients of a quality audit effort."

Jim Liddy is Vice-Chair of Audit in KPMG's U.S. member firm. In addition, Jim serves as the Regional Head of Audit, Americas region and Chair of the Americas Audit Steering Committee. Jim has spent more than 30 years serving KPMG clients and has held various leadership roles throughout his career.

Carlos Sá – Banco do Brasil / Marisa (Brazil)

"With a trend towards using more IT and data-analytics, auditors have to guard that they don't lose grip on their knowledge and understanding of the business and the strategic risks."

Carlos Sá is a member of the audit committee of Marisa (a Brazilian retail company) and Mitsubishi do Brasil, and a member of the fiscal council of Banco do Brasil. He also served as a member of the fiscal council of Marfrig (a food processing business) and as director of internal audit, risk & compliance services at KPMG in Brazil.

Has audit quality improved since the financial crisis – and if so, what do you attribute that to?

MICHELE HOOPER:

I do believe that audit quality has improved, but that really started right after Sarbanes-Oxley. Financial reporting stakeholders – audit committees, external and internal auditors, company management – are all more aware of and focused on their responsibilities. The process is clearly much stronger and the underlying quality of what is in those reports is much better. I think about audit quality not only in terms of the overall process – getting our financial reporting done, and with a high degree of accuracy – but whether we're getting better at articulating and addressing areas of financial risk. Today, there's a much better discussion and articulation of critical areas of risk in the scope of both the internal and external auditors' work. The linkage between internal and external auditors is stronger than ever, and that helps link the company's major areas of risk with the financial statements. I think the financial crisis helped to strengthen those links as well, because in a lot of people's minds that crisis was risk-driven.

KEES STORM:

Yes, I believe so, mainly because of intensified public scrutiny towards auditors and audit committees and because of lessons learned from the financial crisis. Both of these factors made external auditors and audit committees shift gears to be more proactive in their focus on strengthening audit quality. I also believe the added value delivered by external audit – beyond the statutory audit report – has increased over the years as more and more companies are demanding this from their external auditors.

HERBERT ONYE ORJI:

Nigeria has definitely seen some major improvements in audit quality over the last decade. This happened in two phases in my view. The first was between 2006 and 2010, when the financial crisis gave all of us a rude wakeup call as to the importance of audit quality. Generally speaking, the amount of professional scepticism of the auditors had leapfrogged since – with auditors challenging management more robustly on areas of significant judgement and estimates, certainly in the financial services industry. Corporate failures placed a lot of focus on the role of the auditors and audit quality, and auditors have stepped up their game accordingly.

The second wave of improvement in audit quality came about when the Federal Executive Council in Nigeria introduced IFRS as the national reporting framework, in view of the country's ambitions of becoming one of the fastest growing economies by 2020. The Nigerian Accounting Standards Board (NASB) was put in charge of this process and directed Significant Public Interest Entities to adopt IFRS by 2012, with some exceptions for smaller companies. The IFRS migration track provided an opportunity for many organisations to "clean" out their books. Having the leading knowledge in the application of IFRS, auditors assisted in ensuring that high quality conversions where done, thus adding to audit quality.

JAKOB STAUSHOLM:

Yes, I believe external audit quality has increased – certainly since the big corporate failures around the turn of the century, although finance departments and external auditors did not immediately know on what legs to stand. So it took time to develop good practice, but it paid off – and some of those good practices were even transposed in regulation later on.

One example where you can specifically see that audit quality has gone up is in the deliverables that we in the audit committee get from the external auditors. The other thing I see as a contributor to audit quality over the last decade is the practice of audit partner rotation – and I applaud mandatory audit firm rotation as well, although only with sufficiently long intervals.

New regulation certainly has increased audit quality to some extent, but I also think that a lot is about behaviour – both of the audit committee and the auditors. The audit committee has to make sure that there is a clear expectation for a high quality audit. If the audit committee is only concerned about getting some signatures on paper, the full value of the audit will never be unlocked. Regulation is a good foundation, but it is up to the auditor and the audit committee to really make it work through mutual respect, carefully listening and dialogue

JIM LIDDY:

Over the last decade, I think KPMG member firms' focus on audit quality – our emphasis on objectivity, independence and professional skepticism – has improved significantly. However, the financial crisis did teach auditors that a quality financial statement audit cannot be expected to address a flawed business model or less-than-robust risk management processes. For example, many companies had a "velocity business model," with their business model and compensation schemes grounded in originating or acquiring assets, packaging them for distribution, often in complex structures and derivatives, and getting them off the balance sheet as quickly as possible while retaining nominal amounts of residual risks. While financial markets were receptive to these structuring and distribution activities, everything was fine. But the moment the market lost confidence, access to capital disappeared and it all came crashing down. Before the crisis, people generally assumed resilience of funding sources. Now people understand that this is not always the case and not all assets or structures are created equal. That said, I think auditors focus on audit quality has never been greater. One area that I am particularly pleased with is the increasing dialogue with audit committees regarding engagement planning and with assessment efforts, as well as discussions regarding significant judgments and estimates that underlie the fair presentation of a company's financial statements.

CARLOS SA:

In Brazil, after the introduction of the 2009 Corporate Governance Good Practices (a voluntary corporate governance code equivalent) it was demonstrated to the capital market that well prepared board members and audit committees should interact more with the external auditors. Note that audit committees are generally not mandatory in Brazil, but most companies have established an audit committee on a voluntary basis – to help the board in overseeing risk management systems, internal and external audit, etc. These self-regulatory initiatives have strengthened audit quality as part of an ongoing process. However, there is no doubt that stronger regulatory oversight – from the PCAOB and CVM, which is the Brazilian securities and exchange commission – were also drivers of audit quality.

That said, dealing with and preventing fraud as audit committees and auditors in Brazil remains a huge challenge because of the complexity of the fraud constructions and agreements in which they are cemented. Really understanding the strategy and business processes of the company and effectively teaming up with the board and audit committee is the best way for auditors to help mitigate fraud risk, to a certain extent. However, bringing it to zero is impossible in my view.

What are the most important drivers of external audit quality?

MICHELE HOOPER:

First, I think most audit committees recognize that they have an increased responsibility for oversight of the financial reporting process and the external auditors, and they're taking that responsibility seriously. They're more engaged in their work and in their interactions with auditors. Audit committee agendas have expanded, and we are having deeper conversations with the external auditors and internal auditors and the CFO – and our conversations are very risk-oriented. It wasn't always that way. Today we have a better handle on what the company's critical areas of risk are and where the auditor needs to be particularly focused. Audit quality is rooted in the quality of the engagement team – the quality of the lead engagement partner, the sufficiency of the firm's resources, how auditors are trained, their level of expertise, their ability to be skeptical and objective and to push back on management when needed.

KEES STORM:

I believe a quality audit is one that ensures the integrity of the financial statements. Financial information provided to the market needs to be reliable – and this goes beyond the statutory accounts. It applies to all financial information reported to the market, and any quality audit should factor in procedures on such financial information in my view. From an internal perspective, management and the board have to be confident in financial information being used to measure performance and make decisions – not just in Belgium and the UK, but also in China and Uzbekistan. It is important that internal and external auditors team up effectively to make this work. In my early days, having internal and external audit to leverage each other's work was far from easy. I see improvements over the last few years but I still feel that auditors are wary of relying on internal audit to the fullest extent.

HERBERT ONYE ORJI:

Auditors no longer focus purely on the historical information of the entity they audit, but also widen their perspective to the environment in which the entity operates. I see auditors making more and more use of industry, competitor and other relevant information to sense-check the numbers they are auditing in a particular company.

I came across an interesting example in the manufacturing industry where auditors drew a correlation between the depreciation rates used by the company against similar entities in the same industry, manufacturers in different industries, as well as the rate of degradation of machinery and various other external factors. Such factors included the effects of manufacturing assets located in tropical or coastal areas as compared to those in dry locations and the effects of unstable electricity supply on machinery versus consistent high quality electricity supply. In the specific case at hand, a higher charge to depreciation was justified because there was inconsistent supply of electricity to the manufacturing plant. For me, this is what audit quality is about – the auditor being able to think laterally and ensuring that the financial statements that they are auditing are indeed in tune with the reality of the entity and its external environment.

JAKOB STAUSHOLM:

Having a healthy set of financials is what it is all about. You simply cannot run a business without having a first class financial reporting process in place. That is why auditors are there.

It's crucial for the auditor to excel in its interaction with the company and specifically the finance function. Auditors have a unique opportunity to help the finance function to see things from a different perspective. Executing your "standard" job as an auditor is one thing, but it is equally important to add value beyond this. The advantage of Big Four audit firms is that they see many more companies and have a much wider view on what good practice is. There is so much that the finance function can learn from auditors. To a certain extent, this also applies when interacting with the audit committee.

I firmly believe that the audit partner should demonstrate full commitment and professional skepticism to critically digest all the information obtained from the audit and to get into the right stimulating and challenging dialogue with the audit committee and the board. An effective and competent audit partner is able to unleash the full value of an audit through in-depth discussions, challenge and really ensuring the right issues are on the table and understood to make sure sensible conclusions are eventually reached.

JIM LIDDY:

As a global network of member firms, we're continually focusing on factors that we know drive audit quality – strong leadership and tone at the top; engagement teams' knowledge, experience, and workload; and our system of audit quality control. As the business and auditing environments change, all of these elements need to continually evolve to keep pace. Beyond the "baseline" of delivering a quality audit – which any company that's being audited by a Big 4 firm expects – it's important to remember that member firms also provide value by delivering insight and perspective across a wide array of financial, regulatory, operational, and technological topics.

CARLOS SA:

External auditors have to avoid being "flexible" towards management; professional skepticism is key. Other important drivers of audit quality are good communications with audit committee, a clear understanding of what must be done, transparency in the relationship and commitment to do a first class job.

To make sure auditors live up to these expectations, audit committees must have an in-depth planning meeting with the external audit partner to discuss the company's key audit risks, the main points of sensitivity, and past problems, and to ensure that all the information needed is qualitative and received timely.

Auditor independence is fundamental as well. Personally, I'm particularly worried with the strong focus of auditors to sell additional non-audit services. The amount of consulting proposals we get from our external auditors is huge – and we regularly feel that they could affect auditor independence, although they insist that they will not. We have come to the point that we're considering installing a company-specific policy that prohibits any non-audit services provided by out external auditors.

What kinds of innovations do you expect to see from external auditors over the next 3-5 years?

MICHELE HOOPER:

The use of big data and analytics is impacting every aspect of our lives, and I would expect auditing to follow suit. I think using technology to tell us more about our companies is clearly within the auditor's wheelhouse. Instead of doing audit testing by sampling, you should be able to use big data to test 100 percent of the company's transactions – and I think a lot of firms are quickly going in that direction. They may not be there yet, but I expect within the next audit cycle or so that you'll begin to see the rollout of more broad-based data testing. Even testing 100 percent of a company's transactions is not going to catch every problem, but it will certainly help identify more of the potential problem areas.

KEES STORM:

It is technically not an audit innovation, but I would like to share the following as a best practice for audit committees: In one of the companies when I chaired the audit committee, we asked for satisfaction reporting on the external auditor in each country from the local finance responsibles – not primarily to assess external audit teams locally but more the other way around. By looking at any negative ratings, we knew where action was needed by the audit committee. Experience taught us that these negative ratings pointed to the countries where there were disagreements. In some cases, our conclusion was that the finance responsible did not a good job and we took actions accordingly. Anyway, you can only go that far if you are fully confident about your auditor's professional judgment and skepticism.

HERBERT ONYE ORJI:

I get the impression that auditors are progressively covering a lot more work with a lot less effort, using appropriate information technology to churn and mine relevant data.

You now find that they cover entire populations or much larger samples and are able to execute analytical work using large volumes of data to uncover risks, inconsistencies and errors in the information they are auditing. The use of technology will further help in driving external auditor quality up in the years to come.

JAKOB STAUSHOLM:

I am highly interested in what is happening in the business world around IT and big data right now. Data analytics can do things that we could have never imagined in the past. The audit profession is a profession I have enormous respect for – audit strategies and approaches have innovated and matured for centuries. For example, sample testing methods once were an innovation to gain comfort with big populations. I think data analytical methods – making effective use of big data – will change audit methodology radically and sooner than one might think. In my view, the opportunities to innovate the audit profession have never been greater.

JIM LIDDY:

Advances in technology and the massive proliferation of available information have created a new landscape for financial reporting. With investors now having access to a seemingly unlimited breadth and depth of information, the need has never been greater for the audit process to evolve by providing deeper and more relevant insights about an organization's financial condition and performance – while maintaining and continually improving audit quality. Consider the potential for more effective audits done by auditors with more dynamic tools and skill sets.

Today, in many cases auditors perform procedures over a relatively small sample of transactions – as few as 30 or 40 – and extrapolate conclusions across a much broader set of data. Using high powered analytics, auditors have the capacity to examine 100 percent of a client's transactions. We are be able to sort, filter and analyze tens of thousands or millions of transactions to identify anomalies, making it easier to focus in on areas of potential concern and drill down on those items of higher risk.

This will enable auditors more than ever before to help assess risks and identify trends through the audit process. With smart data, each year's audit will also "learn" from prior years, exposing areas of possible risk and building a self-enriching knowledge base to better inform companies.

CARLOS SA:

Everybody talks about IT and use of big data, but a more traditional and basic audit methodology might be equally important, although not innovative. Detailed company performance analysis – analytical reviews and otherwise – is and has to remain a crucial audit step. Indications that numbers are higher or lower than expected are crucial to be able to assess in what areas more audit work must be done. This is not a task for junior audit staff members, but for seasoned auditors who know the business and understand the strategic risks faced by the company. With a trend towards using more IT and data-analytics, auditors have to guard that they don't lose grip on their knowledge and understanding of the business and the strategic risks.

Specifically for Brazil, recent frauds offer pretty clear examples of what's needed. If the board authorized an investment of US$ 1 billion, for example, support documents, studies and opinions always exist. Auditors should look at this and any payment not in line with these documents must be questioned and checked. It's that simple. In my view, many of the fraud cases in Brazil are missed because the audit teams are too young team and the supervisory review is suboptimal.

Should the external auditor's report be expanded to include critical audit matters and evaluation of information outside of the financial statements?

MICHELE HOOPER:

I'm still forming my opinion on the scope of the auditor's report, but I don't believe that the external auditor should be a "source" of information about the company – I don't think that's appropriate. Financial statements and disclosures are the responsibility of management, with oversight by the audit committee and an audit opinion from the auditor. I'm not comfortable with auditors opining on information outside the scope of their responsibilities. Take cyber risk as an example. You're seeing more discussion and disclosure around cyber security issues in financial communications, but today I don't think it's the auditor's role to be weighing-in on an issue like cyber beyond what they currently look at as it relates to internal controls over financial reporting. Frankly, I'm not even sure that some of the discussions the external auditor has with the audit committee on certain critical audit matters should be included in an expanded auditor's report. If more disclosure is required, I would prefer to see a more fulsome MD&A and/or audit committee report providing that needed disclosure.

KEES STORM:

I'm still an auditor at heart. I still think it is an amazing profession, but the current standard audit opinions miss the point and fail to get read by anybody in my view.

I always find the section on risks in annual reports very useful to get a sense of the company's challenges and opportunities. Therefore, I would be in favor of auditors pointing out what they believe are the company's significant audit risks how they dealt with them in the audit.

If you would extend auditor reporting to also include audit findings, the question of wording kicks-in – and I know how involved those discussions can be. Much more work will go into discussing the report in the audit committee. I am sure most audit committees do not want to see differing views on the financials in their auditor's opinion, so they will have to work towards solutions. Also, my sense is that findings and related wording would tend to be on the prudent side, which – again – is perhaps not what the market would expect to see.

JAKOB STAUSHOLM:

Technically, our audit firms are only signing off on the IFRS accounting. I worry that the financial reports as published by companies today more and more tend to focus on non-IFRS numbers and / or other key performance indicators, that usually are not subject to any level of independent assurance. I do not have a problem with getting auditors into the game here, but I do believe one has to define very clear what an auditor has to do and not do. I think this is something the audit profession has to structure. Reasonable assurance reporting on non-GAAP measures on its own will achieve little, in my view. What stakeholders and markets really want is a full set of accounts that satisfies their needs and that is signed off by external audit in its entirety.

JIM LIDDY:

I think there are opportunities to increase the relevance of the auditor's report -- for example, attestation of the critical accounting estimates section of the MD&A, or discussion of critical audit matters. But a couple of caveats are important here. Auditors should not be the original source of information about the company; the report should focus on objective information; and any changes to the auditor's reporting model should add value and clarity -- versus creating investor misunderstanding or expanding the "expectations gap" in terms of what an audit does and does not do.

CARLOS SA:

Yes. More transparency is always welcome in my view, including auditor reports bringing more insights and information.

In your view, does mandatory rotation help or hinder audit quality?

MICHELE HOOPER:

The first question I always ask is, what is the problem that regulators are trying to solve? Regulators in Europe initially were focusing on mandatory firm rotation to increase competition among the firms.

We also hear rotation as a way to bring in a fresh audit perspective and perhaps to improve audit quality. It's important to be very clear about what you're trying to fix. In my view, simply changing your auditor does not necessarily improve audit quality. In the U.S., Sarbanes-Oxley clearly puts the responsibility for the hiring, evaluation and compensation of external auditors with the Audit Committee. I think this is appropriate because if we are doing our jobs correctly, the audit committee should be providing ongoing, robust oversight, and evaluating and benchmarking performance to be confident that we're recommending the right external audit firm. Changing auditors is not something a company should undertake lightly or arbitrarily. And even when you change auditors for the right reasons, no matter how great the audit firm is, the audit tends to lose a step in that first transition year as the new team is getting up to speed on the company and its critical accounting issues.

KEES STORM:

In the specific case of auditor rotation, I believe external auditors – for years now – had effective systems in place. Partner rotation, in my view, is effective in eliminating the majority of the negative effects of long standing external audit firm relationships with clients. I see mandatory audit firm rotation as additional compliance related matter on the plates of audit committees and a very challenging one indeed – certainly for multinational companies. We have to consider varying regulations in multiple jurisdictions and we work with most Big Four auditors anyway. Just recently, because of rotation requirements in Brazil, we had to put the group audit of Anheuser-Busch InBev out to tender in order for us to be able to work with only one auditor globally. The resources that go into the "compliance exercise" are immense.

HERBERT ONYE ORJI:

Nigeria is on the verge of introducing a Unified Code of Corporate Governance. This initiative is led by the Financial Reporting Council of Nigeria and is likely to contain some mandatory rotation provisions for auditors.

A lot of progress has been made in the human conquest by doing repetitive work. The auditors' deep knowledge and insights into the organisation – gained from a long lasting relationship – thus surely helps in providing meaningful analysis and audit recommendations. Having said that, five years is half a decade. This is sufficient time in my view for an auditor to make an impact on an organisation. Mandatory audit rotation will be costly for companies, and I can therefore expect to see some resistance from some companies in the Nigerian market. However, I feel it should not be completely discarded because of the benefits it brings. One of the benefits for me is that this process compels management to re-invent themselves and to seek new ways of improving their source documentation processes in collaboration with the new auditors.

JAKOB STAUSHOLM:

I fundamentally believe that it is healthy to get a fresh pair of eyes from time to time, but we need to look for a balance between a long term relationship – and related in-depth knowledge of the company and processes – and new vantage points to keep enabling sufficient challenges from the auditors. It is, however, important that mandatory changes are not too frequent. It's similar to independence criteria for non-executive directors.
I think that non-executive directors become most effective in a big complex company after three to five years, but that it is sensible to replace them after seven to ten years. I think it's not too different with audit partners and audit firms. Also, I would not distinguish between rules around audit partner rotation and audit firm rotation. A big downside of mandatory audit firm rotation is the huge amount of effort that goes into it – both in the selection process itself and in the change process to get new auditors up to

speed. New regulation certainly has increased audit quality to some extent, but I also think that a lot is about behaviour – both of the audit committee and the auditors. The audit committee has to make sure that there is a clear expectation for a high quality audit. If the audit committee is only concerned about getting some signatures on paper, the full value of the audit will never be unlocked. Regulation is a good foundation, but it is up to the auditor and the audit committee to really make it work through mutual respect, carefully listening and dialogue.

JIM LIDDY:

We've had a healthy dialogue on this issue here in the U.S., and I think most stakeholders simply don't see mandatory rotation as a way of driving audit quality. The reforms put in place under Sarbanes-Oxley have clearly enhanced auditor independence and strengthened the reliability of financial reporting. Auditor independence, objectivity, and skepticism are constantly reinforced by existing measures under Sarbanes-Oxley – independent audit committee oversight, independent regulatory oversight, and our own system of quality control. And the more robust auditor communications with the audit committee and audit committee reports to shareholders are, the more confidence everyone will have in the independence and objectivity of the auditor and the audit process.

CARLOS SA:

In Brazil, according to CVM rules, listed companies have to rotate the external audit firm every five years, with a possibility to extend this term to ten years if the company installs a statutory audit committee. Most companies have established such a statutory audit committee because, in my view, it is important to keep your external auditor on board for more than five years – although in general, I do believe mandatory rotation is useful and valuable to refresh knowledge and receive new professionals.

Can you share some insights or "best practices" in evaluating and selecting auditors?

MICHELE HOOPER:

Hiring and evaluating the external auditor is the audit committee's responsibility with input from management. Investors and regulators should expect us to be on top of audit quality and the audit firm's performance – and whether a change would be right for the company. As part of our routine processes, the audit committee should be regularly assessing the external auditor: the quality and sufficiency of the lead partner and the team, frequency and openness of communication and interactions, benchmarking against other firms, demonstrating objectivity, skepticism and independence. It's important to remember that all audit firms are not equal. It's amazing how different they actually are when you go through a detailed tendering process. Has the firm audited companies in your industry, or as complex as your company? Will the engagement partner have the right level of expertise, knowledge, gravitas, and leadership qualities? Does the firm have the right resources in the locations needed? Can the firm resolve any technical independence issues that they may have? How will the communication process work with the various global resources during the audit and with the company? Done correctly, it's an intense process and evaluation to make sure that you select the right firm. I would not want to go through the full audit tendering process unless it was going to give us tangible value – so I would not want regulators to arbitrarily require tendering the audit.

KEES STORM:

Most tender processes usually try to measure audit quality based on objective performance indicators. Sometimes, these can be very straightforward. For example the number of audit hours budgeted. And believe me, hours per firm can deviate a lot.

Of course audit hours – or other performance indicators – are nothing more than a good starting point for querying auditors in depth on their proposed team and approach. Interviews with the lead audit partner and his left and right hands are fundamental.

You expect to get auditors with broad general and sector-specific experience that are able to assess where the company is heading in the years to come and with sound professional judgment and skepticism. Also, the types of questions you receive from prospective auditors can tell you a lot about their knowledge and experience.

The other way around, I love to question the audit plan and approach in depth: Why do you end up with these significant risks and scoping? How do you plan to tackle these risks effectively? But also very specific questions can be useful – for example, how would you deal with a fraud case in India? What kinds of resources would you deploy and how? Questions like these also help you to get a view on the professional judgment and skepticism of an audit team. So I think it's a combination of objective performance indicators and the audit committee's intuition.

JIM LIDDY:

A formal evaluation of the auditor should be conducted at least annually to assess the quality of the firm's services and resources. Did the engagement team demonstrate the skills, reach, and understanding of the business to focus on the key areas of financial reporting risk? But assessing an auditor's performance should also be ongoing. Beyond required communications, does the auditor communicate proactively and express frank views, whether management is present or in executive sessions? Does the auditor bring salient insights and perspectives on industry trends and regulatory developments that are pertinent to the company? The generally held view is that if a company is audited by a Big 4 firm, it's going to get a quality audit; that's the baseline. Beyond that, the bar is going to keep rising in terms of the value that companies expect from the audit—whether it comes from global resources or the use of data and analytics. Audit committees will find auditor selection to be a more nuanced consideration as the value of audit evolves and the future of audit unfolds.

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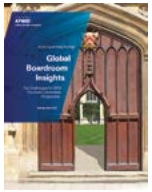
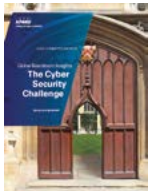
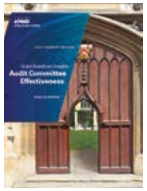


Issue 1
Top Challenges: The Audit Committee Perspective

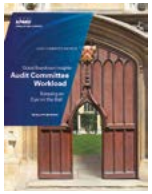
Issue 2
Audit Quality and Communication with Shareholders and Others



Issue 3
The Cyber Security Challenge



Issue 4
Audit Committee Effectiveness



Issue 5
Audit Committee Workload

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