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# Quantifying Audit Quality: A Proposal Inspired by Recent Initiatives

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***Quantifying Audit Quality:  
A Proposal Inspired by Recent Initiatives***

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## **Quantifying Audit Quality: A Proposal Inspired by Recent Initiatives**

### **Abstract**

Audit quality has gained intensive attention since the cascade of audit failures in the concluding years of the last century and the first few years of our new century. The Sarbanes-Oxley Act of 2002 [hereafter identified as the Act] introduced a new oversight strategy to enhance the quality of audits. To assure the performance of quality audits, the PCAOB was charged with responsibility for inspecting registered public accounting firms that perform financial audits for publicly-owned companies in the United States. To date, however, this process has not resulted in measurement of audit quality.

Since 2002, there have been two additional significant initiatives related to audit quality. One was the Federal Government's Single Audit Sampling Project which was reported in 2007; the other, the establishment of the Center for Audit Quality, as an affiliate of the American Institute of CPA (AICPA) in early 2007.

From a reading of these three initiatives, it was evident that while each makes a contribution none is sufficient to determine audit quality of publicly owned entities. This paper includes a review of these initiatives, as well as a general structure for undertaking an objective statistical study to measure audit quality. The task is feasible, but will require several years of well designed efforts.

The development of criteria and of their measurement is not a one-step research effort. Several years of experience of data gathering and careful statistical testing are necessary. Over time, criteria identified must be tested for reliability and validity.

The initial years of efforts at objective measurement should be considered experimental; such efforts will not result in ranking or rating particular accounting firms. Only after validity and reliability of measurement are assured will there be a basis for measurement of individual firms.

*(Note: An earlier draft of this Working Paper was presented at a session of the American Accounting Association: Mid-Atlantic Region Meeting April 24-26, 2008, Hyatt Regency Hotel, Penn's Landing, Philadelphia, PA).*

### ***Quantifying Audit Quality: A Proposal Inspired by Recent Initiatives***

Audit quality has gained intensive attention since the cascade of audit failures in the concluding years of the last century and the first few years of the new century. The Sarbanes-Oxley Act of 2002 [hereafter identified as the Act] introduced a new oversight strategy to enhance the quality of audits. To assure the performance of quality audits, the PCAOB was charged with responsibility for inspecting registered public accounting firms who perform financial audits for publicly-owned companies in the United States. To date this process has not resulted in measurement of audit quality.

Since 2002, there have been two additional significant initiatives related to quality. One was the Federal Government's Single Audit Sampling Project; the other, the establishment of the Center for Audit Quality (CAQ), as an affiliate of the American Institute of CPA (AICPA).

Audit quality must be quantified to provide valid and reliable judgments. To date there are no fully developed objective criteria for *audit quality*. While the three initiatives above identified have promising goals, none is sufficient for measuring audit quality. The need for measurement is clearly reflected in the goal of the PCAOB; the feasibility is implied in the design of the Federal Government Single Audit Sampling project and: significance is reflected in the activities of the CAQ.

There needs to be a comprehensive statistically-based project that can not be concluded in a year. Several years of careful study are required. The population would be registered firms who audit publicly-owned companies in the United States. In the initial years of the proposed project, the findings should be considered tentative, as criteria must be tested for reliability and validity. Ranking or rating individual firms will not be quickly established.

Outcomes for several years – possibly three to five -- would be reported to disclose progress and continuing problems in the quest for reliable and valid criteria. It is not unreasonable to expect that as many as five years of such study of audit quality will be required before criteria for measurement are sufficiently valid and reliable for “scoring” the quality of audit performance in individual audit firms.

This paper discusses the three initiatives and then introduces a brief, general presentation of a structure for study of audit quality. The paper includes discussion of the following: 1.. The PCAOB inspection process; 2. The Single Audit sampling project of the President's Commission on Performance and

Integrity; 3. The Center for Audit Quality; 4. Clues – but not a model; 5. A proposal for quantifying audit quality. 6. Some final comments

## 1. The PCAOB Inspection Process

The responsibility for inspections is stated in the Act in these words:

The board shall conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with this Act, the rules of the Board, the rules of the Commission [SEC], or professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. (Sarbanes-Oxley Act of 2002, Sec. 104, Inspections of Registered Public Accounting Firms, 13)

### 1.1 PCAOB Chose a Supervisory Approach

As implemented currently, the approach to responding to the requirement for inspections is reflected in what the Chairman noted in the Annual Report for 2005:

The inspection team takes a supervisory approach to oversight and seeks through constructive dialogue to encourage firms to improve their practices and procedures. Every Board inspection that includes a quality control criticism alerts the firm to the opportunity to prevent criticism from becoming public. (PCAOB, Annual Report 2005, 9)

During an inspection engagement there are discussions about problems identified. Such discussions are held with members of the audit team, the firm's staff member responsible for the inspection, national office experts and managing partner or chief executive of the firm. (for more discussion re inspection reports see PCAOB, *Statement Concerning*. . . )

### 1.2 Inspectors Do Not Determine Level of Audit Quality

The supervisory approach does not provide a basis for determining overall audit quality of the firm inspected based on the public report provided for each inspection. Decisions about choice of audits, topics to be the focus of the inspection, and the number of audits to be inspected appear to be made related to each public accounting firm under inspection. Information about such decisions are not disclosed in the inspection reports that are available to the public.

Each inspection report states the following:

. . . the board cautions against drawing conclusions about the comparative merits of the annually inspected firms based on the number of reported deficiencies in any given year. The total number of audits reviewed is a small portion of the total audits performed by these firms, and the frequency of deficiencies identified does not necessarily represent the frequency of deficiencies throughout the firm's practice. Moreover, if the Board discovers a potential weakness during an inspection, the Board may revise its inspection plan to target additional audits that may be affected by that weakness, and this may increase the number of deficiencies reported for that firm in that year. (See any inspection report posted at PCAOB website)

Notwithstanding the limitations of an inspection, the deficiencies noted do reflect failure to meet professional guidance in the particular audit inspected. Left unanswered is the extent to which a deficiency is pervasive throughout the population of a firm's yearly audits. The reader, therefore, of an inspection report has no basis for drawing conclusions based on deficiencies reported.

### 1.3 Disclaimers Noted in Inspection Reports

An introductory page for each inspection states clearly other limitations of the information provided in an inspection report. Among the statements are these:

Any references in this report to violations or potential violations of law, rules, or professional standards should be understood in the supervisory context in which this report is prepared.

The Board. . has no authority to prescribe the form or content of an issuer's financial statements. That authority, and the authority to make binding determinations concerning an issuer's compliance with GAAP or Commission disclosure requirements, rests with the Commission [Securities and Exchange Commission]. (See any Inspection Report posted at the PCAOB website)

### 1.4 Contribution to Audit Quality Not Determinable

At this point in the implementation of its oversight role, the PCAOB is not engaged in providing a conclusion about audit quality of an inspected registered public accounting firm or of inspected firms taken as a group. The most recent report that discussed inspections was related to inspections in 2004, 2005, and 2006 of domestic triennially inspected firms [*Triennially inspected firms are small firms with fewer than 100 audit clients who report to the SEC*]. The scope of the report was noted in the initial paragraph:

This report discusses areas of the audit where PCAOB inspectors have observed significant or frequent deficiencies in the first PCAOB inspections of triennial firms. The descriptions are included in this report in order to alert triennial firms to areas where they could improve performance and to inform the public about certain inspection findings for triennial firms over the past three years. (PCAOB, *Report on the PCAOB's 2004. . .*)

In the Conclusion of this report the Board stated that it “issued this report to highlight areas where firms can focus their attention to order to enhance the quality of their audits.” Readers were reminded, though, that the deficiencies noted are not the only areas requiring attention. Each firm should, “in the course of monitoring its own audit performance, identify and address any specific impediments to compliance with PCAOB standards.”

The earlier noted supervisory nature of the inspection process is reflected in the Report here cited. There is implied that firms can enhance audit quality by noting the deficiencies described in this summary report and by also monitoring audits. The Report noted that “many triennial firms have informed the Board’s inspection staff that they have instituted improvements in their audit processes after dialog with PCAOB inspectors. There is no comment that such assertions were objectively verified by the inspectors.

There is no information about audit quality as a result of the inspection process. Furthermore, it is not clear how the inspection process as currently implemented is meeting the requirement noted earlier in Section 104 of the Act which refers “to assess the degree of compliance. . . .”

## 2. The National Single Audit Sampling Project

In 2002 during a U. S. House of Representatives hearing about the importance of single audits and their quality, the Controller at the time testified that “several Federal agencies had disclosed deficiencies as a result of single audits.” Also noted among findings were:

In single audits, auditors did not perform adequate tests and, in some cases, gathered no evidence through tests of compliance requirements; and Quality Control Reviews (QCRs) by another large agency found a high percentage of audits in which adequate testing had not been performed.

Yet, such information about some audits was not deemed sufficient to know exactly what was the situation as related to audit quality. The Comptroller noted:

The selection of audits for review was not statistically-based and that a statistically-based measure of audit quality was needed.

Each year the Federal Government provides billions of dollars of Federal funds to state and local government entities and to non-profit organizations. In 2007, the total funds provided to state and local governments were \$449 billions. The Single Audit Act of 1984 (and Single Audit Act Amendments of 1996) established a requirement for annual audits of non-Federal recipients and subrecipients. It was clear at the 2002 hearing that something more was needed to determine audit quality of single audits.

## 2.1 The Project's Leadership

The Audit Committee of the President's Council on Integrity and Efficiency (PCIE) was the overall body responsible for the Project, which was a collaborative effort. Involved were PCIE member organizations, as well as a member of the Executive Council of Integrity and Efficiency (ECIE), and three State Auditors.

The coordination needed to determine the quality of single audits using statistical methods and to make recommendations to address noted audit quality issues. In the covering letter of the Chair, PCIE Audit Committee, is reflected in the following note:

By agreement with Office of Management and Budget (OMB) and the other participants, the U. S. Department of Education, Office of Inspector General, coordinated the administration of the Project, and prepared the Project report.

## 2.2 Scope of the Statistical Study

The scope of the Quality Control Reviews (QCRs) included the fieldwork and reporting related to internal control over compliance with laws and regulations for selected major Federal programs. The Project QCRs did not review the audit work related to general-purpose financial statements, the correctness of the auditor's opinion on such statements, or the auditors' consideration of internal control over financial reporting.

QCRs were performed for 208 single audits randomly selected from a stratified universe of all single audits for the one-year period from April 1, 2003 through March 31, 2004. These 208 audits were selected from the 38,000 audits in the specified population. The sample was split into two strata, with Stratum I including audits of entities that expended \$50 million or more of Federal funds. Stratum II included audits of entities that were recipients of at least \$500,000, but less than \$50 million.

The assessment of audit quality was based on the extent to which the auditee conformed to applicable requirements, standards and procedures. OMB Circular A-133 sets forth requirements that are to be reflected in the documentation for audits. Criteria were developed related to the requirements. The categories established by the Project personnel were:

<b>Group:</b>	<b>Category:</b>
Acceptable	Acceptable; accepted with Deficiencies
Limited Reliability	Significant Deficiencies
Unacceptable	Material Reporting Errors
	Substandard

In determining single audit quality statistical sampling was used to estimate audit quality for the universe and for each of the two strata. Each audit within a stratum had equal chance of being selected for review and in projecting results; each audit was given equal weight.

(While the results are very interesting, this paper deals with the process; therefore, the results are not discussed. ( see President's Council on Integrity and Efficiency, *Report on National Single Audit*. . . )

### 2.3 The Value of a Statistical Sampling Approach

Franzel, Director, Financial Management and Assurance, United States Government Accountability Office discussed the Project before a Senate Subcommittee. She noted:

During the 1980s, GAO issued reports that identified concerns with single audit quality, including issues with insufficient evidence related to audit planning, internal control and compliance testing, and the auditor's adherence to Generally Accepted Government Auditing Standards (GAGAS). The federal Inspectors General as well have found similar problems with single audit quality. The deficiencies we cited during the 1980s were similar in nature to those identified in the recent PCIE report. (GAO, *Single Audit Quality*, 7)

In her comments, Franzel noted:

In our view, the current status of single audit quality is unacceptable. We are concerned that audits are not being conducted in accordance with professional standards and requirements. These audits may provide a false sense of assurance and could mislead users of audit reports regarding issues of compliance and internal control over federal programs. (GAO, *Single Audit Quality*, 13)

The PCIE report presents compelling evidence that a serious shortfall in the quality of single audits continues to exist. (GAO, *Single Audit Quality*, 18)

In her testimony, Franzel noted that the audit quality problems noted in the statistical study were similar to such problems in prior reports. For example, she referred to reports from December 1985 and March 1986 that stated “auditors performing single audits frequently did not satisfactorily comply with professional auditing standards.” (GAO, *Single Audit Quality*, 12)

The evidence from the statistical study provides a baseline of “current status” and at the same time provides a means of monitoring quality in the future. Franzel’s testimony moves beyond the findings of the study itself to note the types of revisions that need to be considered for guidance provided. Furthermore, she commented on how the disciplinary process to date had failed to meet expectations for dealing with auditors who have failed to meet their professional responsibilities.

#### 2.4 Contribution to Audit Quality of the *National Single Audit Sampling Project*

The U. S. General Accountability Office (GAO)’s testimony presented on audit quality (October 25, 2007) by Franzel reveals the level of assurance provided from conclusions based on a statistically based investigation. That factor – level of assurance – is totally lacking in the actions to date of the PCAOB. The silence about any type of evaluation of the PCAOB’s supervisory efforts for the first three years of full inspections means there is no basis to date to make a judgment about the interpretative wisdom of the PCAOB’s inspections.

The key contribution of the efforts of the President’s Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency is a profound, fundamental observation: *Only a statistical study provides sufficiently valid information for policy decisions that will enhance audit quality.*

Additionally, the findings contribute guidance for policy decisions as we as to educational/learning needs, and the determination of appropriate sanctions for failure to meet requirements. While there are useful conclusions for those who perform all types of audits, the study was related only to certain components of Federal Government Single Audits.

### 3. The Center for Audit Quality

The Center for Audit Quality began functioning as of January 2007. The motivation for creation is noted at the website as:

The Center for Audit Quality was created to serve investors, public company auditors and the markets. The Center’s mission is to foster confidence in the audit process and to aid investors and the capital

markets by advancing constructive suggestions for change rooted in the profession's core values of integrity, objectivity, honesty and trust.

Note that the foregoing does not include the word *quality*. The Center is a nonpartisan, not-for-profit entity that acknowledges that it will conform to all legal requirements for disclosure of its activities.

To accomplish this mission, the Center will work:

to make public company audits even more reliable and relevant for investors in a time of growing financial complexity and market globalization. It will also undertake research, offer recommendations to enhance investor confidence and the vitality of the capital markets, issue technical support for public company auditing professionals, and help facilitate the public discussion about modernizing business reporting.

### 3.1 The Structure of Center for Audit Quality

As noted earlier, the Center for Audit Quality is affiliated with the American Institute of CPAs. The Center is autonomous with a governing board and is supported by its member firms.

U.S. accounting firms that are members of the American Institute of CPAs are eligible for membership in the Center for Audit Quality at some level. U.S. accounting firms that have registered with the Public Company Accounting Oversight Board (PCAOB) are also eligible for membership. U.S. accounting firms not registered with the PCAOB are eligible for associate membership. Non-U.S. firms, while ineligible for membership, are able to subscribe to certain materials issued by the Center.

A Governing Board with leaders from public company auditing firms, AICPA, and the representatives from investor and issuer communities oversee the activities of the Center. The Board establishes committees, advisory groups for identified matters, and task forces needed to fulfill the mission of the Center.

There is an executive director who is responsible for leading the Center's operations. The executive director reports to the Governing Board.

No information is provided at the website about the number of members or the membership of committees,

### 3.2 How Center for Audit Quality Perceives Its Role

The following is from one response (at the Center's Website) to the question, How is the CAQ different from other organizations related to accountancy and auditing?

The Center for Audit Quality represents the first time that public company auditors, as a group, have joined with public leaders in the investor and corporate communities to discuss the issues facing the capital markets, conduct research on these topics and ultimately make recommendations that will foster confidence in the capital markets. . . . (Website: [www.thecaq.org](http://www.thecaq.org))

The Center for Audit Quality is an advocate for the auditing profession. Its efforts are not driven by objectivity. In a comment letter sent to the Advisory Committee on the Auditing Profession, Office of Financial Institutions Policy on November 30, 2007, was the following:

The PCAOB inspections are **designed to determine** [bold added for emphasis] the extent to which audit firms have, and adhere to, adequate quality control policies and procedures that address all significant aspects of public company auditing, as well as the effectiveness of performance on specific audit engagements. The PCAOB's regulatory oversight and ability to access comprehensive information about audit firms helps to ensure investor confidence in the quality and independence of the firms. . . . **In the final analysis, investors can trust that a regulator is deeply involved and committed to our audit quality.** [bold added for emphasis]

The bolded phrase and sentence are vague; they fail to communicate exactly what is being achieved by the PCAOB as perceived by the CAQ. Disclaimers in inspection reports imply that there may not be support for what the CAQ declares as *designed*. (see page 5 of this paper). One interpretation of the *in the final analysis comment* could well be that since the PCAOB is an oversight group, you can assume it is driven by interest in audit quality. Yet, the CAQ in assuring "that investors can trust," without providing empirical evidence to support the conclusion.

To date, there has been no public disclosures from the PCAOB of any criteria that *measure* audit quality or that they are involved in objectively determining valid and reliable measures of *audit quality*.

The Center, as noted earlier, is an advocate for those firms that audit publicly-owned companies. Such a Center can provide something of value. The Center sponsored a Public Dialogue Tour. Wise observations among panelists participating in the Tour, for example, may have provided insightful ideas that would merit objective study and investigation. The nature of the outcomes of the Tour sessions and how they will be implemented will provide clues as to the strategy this new Center for Audit Quality will pursue.

### 3.3 Activities Undertaken by the Center

During its first year, the Center initiated a public dialogue tour, celebrated the fifth anniversary of the Sarbanes-Oxley Act of 2002 and provided alerts to members,

comment letters related to regulatory matters, and met with regulatory groups. Just a few comments will be provided about the Public Dialogue Tour and alerts to members at this point:

Public Dialogue Tour. The description of this ten-city tour at the website noted that the purpose was:

To discuss potential improvements to the quality, relevance and integrity of financial reporting. We are visiting various regions of the country to hear directly from users of audited financial information and better learn how business reporting might evolve to meet the information needs of all types of investors.

:Those participating are selected from leading regional issuers, investors, current and former regulators, government officials, and academics. At the conclusion of the tour (meetings began in Denver, CO in April 2007 and concluded in Washington, DC in July 2008), the Center announced that it would summarize and publicize the discussions held in the ten cities. (In addition to the two named, there were meetings in Charlotte, NC, Minneapolis, MN, Seattle, WA, New York, Chicago, IL, San Francisco, CA, Dallas, TX, and Boston, MA.)

The goal in sponsoring these tours was to improve the audit process based on ideas presented and discussed by participants. Recommendations will emphasize making company audits “more transparent, easier to understand and even more reliable.” (See Website for a more complete discussion of the Public Dialogue Tour [www.thecaq.org](http://www.thecaq.org))

Member Alerts. Matters of interest to members are the subject of alerts that are provided from time to time. However, those alerts that are considered broad-based are posted for nonmembers to view. Illustrative of the alerts listed for all accessing the website were: Highlights of the Advisory Committee on the Auditing Profession’s Telephone Meeting (April 7, 2008) and CAQ issues White Paper on Illiquidity of the Markets (October 3, 2007).

#### 4. Clues, But Not a Model

The foregoing three sections of this paper discussed briefly three recent efforts to deal with audit quality. As noted earlier, none is exactly a model for determining audit quality of registered firms that audit publicly-owned entities that report to the Securities and Exchange Commission yearly.

Below are brief comments about each of the three initiatives: :

PCAOB Inspection Process: The supervisory approach that begins with determining what audits will be selected and what aspects of audits selected will be inspected may indeed be highlighting the most vulnerable aspects of audits for the given year. However, such a selection process, as a disclaimer clearly

identifies, does not provide a basis for making a judgment about the public accounting firm's quality or for the total population of audits done by that firm in the given year or all audits done by all firms.

If there was a strict interpretation of the requirement as stated in Section 104, possibly, a measure of quality would be an immediate goal of the PCAOB. As noted earlier, there is no information about the extent to which the inspection strategy, a supervisory approach, is perceived to be a short-term one or if what has been done during these early years will persist into the future.

National Single Audit Sampling Project: This project was unique in determining to measure audit quality for a total year's population of a specific type of audit – the single audit. Inasmuch as the effort was to determine the extent to which recipients and subrecipients of government funds were adhering to the internal control requirements and other compliance and regulatory requirements, there was not included any review of the general financial reporting that was a component of the audits reviewed.

Any effort to measure audit quality for registered audit firms will find value in understanding in details of the strategy used for determining sample and for specifying the factors that were considered significant in “measuring” compliance.

The Center for Audit Quality: This Center has a membership of practitioners who are participating in committees, task forces, and in other ways that provide a valuable source for keen, insightful observations. Additionally, events, including the Public Dialogue Tour, bring together a broad group of key individuals with different points of view that also generate ideas worthy of exploration in an objective manner. While the term *audit quality* is in the name, the term is missing in explanations of what the Center does.

These three initiatives have inspired the briefly discussed proposal in the next section.

## 5. A Proposal to Quantify Audit Quality

The state of technology related to processing information makes it feasible to consider determining the quality of audits of publicly owned entities in the United States. The task is not an easy one; however, it is a task that is feasible and that could result in promising results in the quest to determine audit quality, not only for publicly-owned entities but for a wide range of private and not-for-profit entities who undergo audits by public accountants. The task must begin with an experimental thrust.

The ultimate goal to have criteria that provide a means of quantifying audit quality must meet rigorous standards of validity and reliability. A well organized, successful designed project might be completed in five years.

## 5.1 Prerequisites

There are a number of significant prerequisites. These are briefly described:

The Project's Leadership: The project will need to be under the direction of a totally objective body, possibly the PCAOB or the SEC.

The Project's Management: A group of scientifically educated personnel who are uninfluenced by political or professional pressures is needed to design and carry through the research required. This management team must be of impeccable character to assure complete confidentiality and objectivity throughout the life of the project. The group must be able to gain the cooperation of many to participate in a variety of ways to accomplish the goals of such a project.

The Goal of the Effort: The ultimate goal of the project is to provide criteria that assure valid and reliable objective measurement of audit quality. An intermediate goal is to measure audit quality for the total population, for example, of audits performed in compliance with PCAOB requirements. Finally, the project should conclude with criteria that support valid and reliable measuring of an individual firm's *audit quality*. Such objective assessments of individual firms will be helpful to the firms in reviewing – and redesigning – their auditing policies and practices.

The Impact on Firm Assessment: The initial goal provides a macro quality measurement that will be helpful to all firms whose audits are included in the population. At this point, though, there will be no basis for making judgments about audit quality at the firm level.

It is in the further investigations that relate to reliability and validity in relation to a single firm that will result in conclusions that will have meaning to individual firms. The driver of interest in such an effort is not the ranking and disclosure of firms' performance; the driver of interest is objective encouragement of the reward of quality performance of every audit.

## 5.2 The Initial Investigation

The initial task that will require cooperative effort of many is determining operationally what are possible criteria for to measure audit quality. The most insightful persons in the field of auditing – in practice offices throughout the country, in U. S. colleges and universities and in regulatory agencies – should be called on to participate in an anonymous fashion to provide their judgments. Their input must be reviewed, tested and retested astutely and carefully to ultimately determine the final criteria for audit quality. There are likely to be several experimental trials of criteria tentatively selected. This task will require patience. unrelenting objective review and wise interpretation for practical application to measuring the quality of performance of audits.

All information obtained from registered public accounting firms is secured so identification of specific firms is not possible. All original data must be handled in an absolutely confidential manner.

The design of the statistical sample must be determined. The population will be all the audits performed in the specified period. Given the industry specializations identified by public accounting firms, the sample should be a random stratified sample by major industry groups. There are other possible strata that can be identified for insightful views of what is transpiring in the performance of audits.

Possibly, audit samples for three years to five years will be considered useful for a macro view of audit quality as the refinement of criteria continues. All reports issued during the developmental stages will in no way identify individual firms. During this period, the PCAOB may continue to perform inspections, possibly, incorporating new strategies reflected in the project's efforts that appropriate for experimental implementation.

### 5.3 Beyond the Initial Investigation

During the first three years -- and for possibly the two following years -- attention will continue to be focused on determining what minimum combination of criteria is sufficiently valid and reliable to use for making judgments of audit quality in the total population of firms who perform audits as well as for individual firms..

During the years of the audit quality measurement project, there may develop a more objective attitude toward what is actually happening as audits are performed. (The leadership of the project may have talent in encouraging such an attitude) Professional staff of registered firms may volunteer to be observant and reflective on the tasks they perform and share their observations with the project team.

At the present time, reading and attempting to interpret the inspection reports raise questions. For example, there are letters written to the PCAOB by inspected firms that state disagreements with deficiencies noted with the firm nothing that judgments vary, etc. Such letters are not required in response to the receipt of an inspection report. . However, when Firms submit letters of comment, they are included in the inspection report (with any proprietary or other confidential information deleted). Yet, there is no disclosure about what is done about such letters. Is there a response? If a Firm, for example, is noting disagreement with a conclusion of the inspectors, does the PCAOB engage in a discussion with the Firm? Is there a resolution of the disagreement?

How does the PCAOB, for example, report a second review which concludes with the dropping, let us say, of the deficiency because of the Firm's defense?

There must be a possibility of making a judgment about which judgment – the PCAOB’s inspection team or the Firm – is better? How often should the two judgments be a “toss up” – and one judgment is essentially as good as the other. In such a case, does the PCAOB accept the Firm’s judgment? There is no disclosure of answers to such questions when effort was made to find such disclosures at the PCAOB Website.

Judgments of professionally qualified auditors are anticipated to be in agreement, since there is professional guidance that provides a framework for making judgments. If there are disagreements, in the majority of instances, differences can be resolved after a more careful reading and interpretation of the relevant guidance by those who initially disagreed.. Reasonable follow up with an effort at a “meeting of the minds” as to which alternative represents *best judgment* generally leads to a satisfactory resolution. Only in rare instances, is there no resolution of “what is the best answer.” This assumption that judgments will ultimately be the same that is critical in believing that audit quality can indeed be determined objectively.

## 6. Some Final Comments

Audit quality is indeed important in assuring credibility for auditor opinions. Quantifying audit quality is recommended as a worthwhile undertaking. As noted, there are promising initiatives giving attention to audit quality. However, the position presented in this paper is that none alone is sufficient. A combination of the three, also, is not sufficient.

### 6.1 The PCAOB Process

The PCAOB’s inspection process may indeed be leading to improvement in the quality of audits. That improvement is not measurable as a result of inspections which are supervisory in nature and do not follow a consistent strategy. To date, only deficiencies that rise to a certain level are disclosed in reports posted at the PCAOB’s website or discussed in reports of the PCAOB. Presently, there is no basis for making *any* judgment about audit quality for performance of audits of publicly-owned entities who are registered with the PCAOB. Statements about the rigorous review by the PCAOB and that audit quality is improving are not supportable with valid evidence.

### 6.2 Report about National Single Audit Study

The June 2007 *Report on National Single Audit Sampling Project* and its review in Testimony before the Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U. S. Senate (October 25, 2007) are impressive documents. They reflect a promising strategy. They reveal the confidence attached to interpretations and recommendations based on statistically obtained and analyzed data.

### 6.3 The Center for Audit Quality Initiatives

The initiatives of the Center for Audit Quality may be heightening attention to quality audits, but the position of advocacy does not assure the objectivity required to provide credibility to statements and announcements about financial statements of companies for which audits are performed.. Relying on opinion and astute public relations efforts to declare the quality of audits are not sufficient in an environment where information is available and technology provides capabilities that make analysis of audit results feasible.

### 6.4 Time to Measure Audit Quality

It is time to undertake the measurement of audit quality. The task will not be completed in a year. Several years of wisely designed, carefully performed statistical research studies will be needed. Through such efforts, there will be developed criteria that result from reliability and validity tests sufficient to support the judgments about audit quality not only for the audited population as a whole, but for audits performed by a single firm. The strategy for such an effort is merely sketched in brief comments here. Further development is needed. First, however, there must be genuine acceptance of the value of quantifying audit quality.

The anticipated goal is one that is critically needed. Firms performing audits with unrelenting commitment to quality that can be *measured* will be a major breakthrough in the world of public accounting.

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