Developing a framework for audit quality management in audit firms

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Introduction

Over the last few decades service quality has been investigated by many managers, researchers and scholars due to its influence on business success, measured with growing profitability, customer satisfaction, loyalty towards service provider, etc. (Cronin, Taylor, 1992; Chang, Chen, 1998; Silvestro, Cross, 2000; Zeithaml, Bitner, 2003, et al.). Quality is crucial in order to increase an organization’s comparative advantage, achieve long-term positive image and increase sales (Ruževičius, 2006). The stressed importance of service quality has triggered a plentiful amount of research revealing different approaches and new concepts (Finn, Lamb, 1991; Kettinger, Lee, 1995). The results of the research imply that an analysis of service quality should be conducted in each service provider’s organization, choosing an appropriate quality research approach and methodology (Edvardsson, 1996). General rules and concepts should be adapted to a particular service’s specifics in order to increase efficiency of service quality management (Suuroja, 2003). Emerging new theoretical models, such as internet banking (Broderick, Vachirapornpuk, 2002) and information technologies-based services (Zhu et al., 2002) evince the development of the service quality concept in various services.

The financial audit service can be seen as an inseparable part of the controlling system in each country with a modern economy (Lakis et al., 1992; Lakis, 2007; Mackevičius, 2009). Historical circumstances imply that when an audit’s functions become weaker, not meeting markets’ expectations, it is common to doubt whether the audit system is working effectively, as well as whether particular audit companies are carrying out their work in a quality way. These thoughts are justified when breaches of auditors’ work have been detected. The quality of the financial audit service (further – audit quality) has already been researched for three decades, however, as the Financial Reporting Council of Great Britain (Financial Reporting..., 2006) states, there is no single definition of audit quality. This point of view can be explained by audit service complexity: due to triangular relationships between auditors,

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auditees (clients) and third-party users, the audit service must meet the expectations of all stakeholders involved. A large number of corporate scandals triggered a lot of discussion about the duties, responsibility and general role of auditors in investment markets, and also raised some questions how to balance the audit service in a satisfactory way for both clients and investors. This has led to a series of research and discussions about what quality audit is, mainly for the purposes of identifying the drivers which can affect audit quality while restoring the credibility and importance of the audit.

Based on the problem stated, the **objective** of the paper is to investigate the existing definitions of audit quality, identify its main elements and provide a framework for audit quality management in audit firms.

The main **contribution of the paper** is a developed framework for audit quality management, covering both main stakeholders of auditing triangular relationships: third-party users, as well as audit clients. Due to a slump in audit prices, complex competition and a high level of homogeneity, the authors of the paper focus not only on external users’ perceptions, as the prior large body of literature does, but also stress audit clients’ need for satisfaction in the comprehensive framework. Based on the framework presented, recommendations for future audit quality research are provided.

**Research methods** used: literature analysis, synthesis and comparison.

1. **Modern concept of service quality**

The definition of quality can be interpreted differently depending on the situation. In short, the definition of quality can be described as a product’s (including a service’s) compliance with the requirements and specification set (Crosby, 1979). It may be seen as compliance with a list of detailed criteria perceived as a standard. If these criteria are met, the service becomes suitable for use (Juran, 1974). The criteria could be analyzed employing various quality approaches: transcendental, compositional (structural), the client’s needs, manufacturing, etc. (Garvin, 1984). The number of different views implies that quality is a dynamic phenomenon, differently perceived by particular customer groups and dependent on the quality object characteristics (Ruževičius, 2006).

The shifting model of an organization’s management stresses the organization’s interactions with its external business environment, suggesting that service quality should also be investigated from the perspective of the customer. Seth *et al.* (2005) mentions the following important factors forcing service organizations to focus on the customers: fast spread of information between the customers, increased customer attention to organizations and the flexibility of their processes, needs complexity and constant shifting, etc. The customer and his involvement in the service process are in the epicenter of these changes.
The customer sets his quality standards in accordance with his expectations (Grönroos, 1990, 2007; Parasuraman et al., 1985; Tam, 2007). Although expectations can be interpreted differently, in general they can be explained as a hope or belief that he will receive something. This abstract meaning shows expectations being derived from various external factors (Groth, Dye, 1999), such as the client’s needs (Ruževičius, 2006; Laroche et al., 2004; Mattila, Wirtz, 2006), the service provider’s external communication (Walker, Baker, 2000; Ho, Zhong, 2004), the service price (Bitner, Hubbert, 1994; Drew, Bolton, 1997; Vengrienė, 1998) and others.

An interesting point of view on expectations has been provided by Japanese management consultant Kano (Kano et al., 1984). The author divides expectations into three categories: basic, performance and exciting. Basic expectations are self-evident characteristics of the service; they are mandatory and the customer does not think about them because he expects them to be in place. Performance expectations are linked with the main problem the customer seeks to solve when using the service. Exciting expectations contain the belief that he will get something extra from the service, something above the core value. If the exciting expectations are not met, there is no significant disconfirmation, however, if they are satisfied the highest perceived quality can be achieved, thus affecting customer satisfaction and triggering loyalty towards the service provider. Kano et al. (1984) states that this concept of expectations shifts on a timely basis: due to imitation of other service providers, exciting expectations turn to performance, and prior performance turns to basic. That means that if a particular service used to excite, nowadays and in the foreseeable future it may only satisfy basic needs and solve the client’s main problem, however, it does not reach the highest quality perceptions. Those service aspects which were above the core value soon may be crucial in order to achieve the minimum level of confirmation.

2. Audit service: the need to meet the expectations of the stakeholders involved

According to the large body of literature (Dunn, 1996; Humphrey et al., 1991; Mackevičius, 1999), the audit service faces an audit expectation gap problem which shows audit performance often not meeting the higher expectations of the stakeholders involved. Lakis (2007) names expectations and their influence on the perceptions of users involved in auditing as a one of the current problems in modern auditing. Triangular relationships between auditor, client and third-party users refine the meaning of „customer” within the audit service content, highlighting the importance to assess and ensure confirmation with both stakeholders’ expectations, raised by their needs. The need for auditing can be illustrated when using the common agency (agent-principal) theory, shown in the following model (Figure 1).
As we can see from Figure 1, agency theory examines the problems arising from relations between the representative and the principal. When the representative has power over the principal’s resources (assets, funds) and he is set up to act for the principal’s benefits, the need for supervision and control arises. According to Power (1997), the supervision function is best implemented when an independent auditor performs this duty. The need for quality audit increases along with the increasing gap of the principal’s property and its control (Watts, Zimmerman, 1983), when the need for accountability arises from the side of hired managers to the company’s owners (Messier et al., 2011). These problems are usually undertaken by an external auditor who acts as an agent – an intermediary between the two sides – issuing mainly for the principals auditor’s report as evidence of the work accomplished. Contrary to common belief, and according to the model presented, auditors tend to favor more third-party users and their needs, however, as Fontaine and Pilote (2012) imply, the auditees also have some expectations of the audit and want to stay on good terms with their auditors. Based on that, it might be taken into consideration whether the definition of audit, presented in the Audit law of the Republic of Lithuania (Lietuvos Respublikos..., 1999), for instance, is complete and sufficient in terms of audit quality assessment and management. The law defines financial audit as a verification, during which the auditee’s financial reporting is under investigation in order to present an opinion about its fairness. In other words, it is a process (verification), which ends with the auditor expressing his opinion on the result of the service – the auditor’s report. Since an audit is performed according to auditing standards and is often perceived simply as a „verification”, Goldman and Barlev (1974) give an insight that an audit may be seen as a commodity, no matter from which service provider it is purchased. By contrast, Cosserat and Rodda (2009) highlight the „shifting audit paradigm” (p. 10) nowadays. The new audit paradigm sees audit not only as a formal verification, but more as a value-adding service, useful also for the client. Audit firms face fierce competition and often they have to exceed clients’ expectations in order to
succeed – in other words, they try to differentiate their services, making them more heterogeneous, avoiding the so-called “commoditization effect”. Following the previously mentioned Kano concept (Kano et al., 1984), it can also be stated that exceeding expectations in audit service markets has become “mandatory” – the value-added service approach has become “natural”, an expected performance, important in general quality assessment. The connection between “added-value”, the more abstract “value” in general, and “audit quality” can be validated when analysing service value and service quality concepts. Zeithaml and Bitner (2003) argue that service value is an element of service quality. Reeves and Bednar (1994) state that value is the same as quality. However, it is appropriate to see quality expressed as a ratio of value and price (Dahlgaard et al., 1998). We can link value with quality in the definition we already used: quality is a confirmation of the expectations, while the expectations reflect something desirable, which is to say that it is something that creates value – usefulness, benefit. When the service solves the problem the client used to have, it met his expectations, thus creating the value. The importance of the value added aspect in auditing might be justified when analysing the results of research covering stakeholders’ expectations. Research carried out in various countries, including Great Britain (Institute of…, 2006) and Lithuania (Audit and Accounting…, 2013), validate this statement: the results imply that clients expect from their auditors, free of charge, consulting on tax optimization, help in accounts preparations (especially consolidated) and advice on performance efficiency, etc. Such results and thoughts stated lead us to pay more attention to both stakeholders involved when trying to define audit quality and construct a framework for its management.

3. Audit quality definitions and a general framework for researching and understanding audit quality

The content of audit quality – characteristics, affecting factors – is often the subject of research in scientific literature. The definition of “audit quality” is common in research papers in journals such as “Auditing: A Journal of Practice and Theory”, “Accounting Horizons”, “Accounting Review”, “Journal of Accounting Research”, “Managerial Auditing Journal”, etc. Rarely is the subject examined in European literature.

Authors such as Francis (2004) and Chadegani (2011) stress the notion that despite being investigated for more than three decades, audit quality still hasn’t been properly conceptualized or given one common definition. This may be explained by the constant shift of audit theory and practice, and the complexity of the audit service. The problem could be appropriately illustrated citing Sulamain (2011) who presents the opinion that the auditors themselves are not always aware of the quality of service they have provided. However, it is important to investigate and define audit quality in order to create audit value – audit quality is noted as a main condition of securing
audit value creation (Kustienė and Petraitienė, 2012); audit is valuable if it is „conducted accurately” (Mackevičius, 2009, p. 120) and if it is quality (Moizer, 2005).

One of the first audit quality researchers in academic literature, DeAngelo (1981) describes audit quality as a market-perceived probability that the auditor will detect the breach (misstatement) and report it (will take all actions needed to communicate the breach). Lee et al. (1999) gives a more audit terminology-oriented definition – it is the probability that the auditor will provide a qualified auditor’s opinion when financial statements are materially misstated. According to Palmrose (1988), it can be argued that these kinds of definitions are all about the assurance level provided in the auditor’s report. An accurate auditor’s report provides a particular guarantee of the reliability of financial reporting for those interested, implying whether it shows a company’s financial position and results as they are in reality (Lakis, 2007); it expands financial accounting functions and ensures the reliability of the results in financial statements (Davison et al., 1993), and proves whether the company’s accounting policies are met (Deumes et al., 2010). Titman and Trueman (1986) interpreted it in simpler terms – audit quality is about the accuracy of the information the auditor provides third parties with. The accuracy of information is closely related to earnings management, and due to that Davidson and Neu (1993) emphasize the detection of earnings management as a cornerstone of audit quality. This implies that a quality audit should detect misstatements not only due to error but also because of such fraudulent activities as earnings management.

Misstatements are caused by fraud or errors in the financial statements prepared by management of the auditee, supervised by those charged with governance. Antle and Nalebuff (1991) state that an audit should be perceived as a joint-product. Its quality should also be seen as a result of both partners involved – auditors and preparers. If the auditee’s internal control is implemented and operates effectively, the possibility of achieving desirable assurance that the information presented in the financial statements is free of misstatements is higher.

In order to achieve accuracy of desirable information and provide reasonable assurance with an appropriately stated and issued auditor’s report, it is necessary to follow some professional rules and regulations. Compliance with auditing standards, as well as professional ethics, leads to an efficient audit evidence obtaining system (Beckmerhagen et al., 2004). The standards are emphasized in the General Accounting Office’s (2003) definition of audit quality: the quality of audit is achieved when the audit is performed on the basis of auditing standards which give all conditions to provide reasonable assurance that financial statements are prepared in accordance with generally accepted accounting principles and are not misstated due to fraud or error (p. 13). Besides the professional standards, Kustienė and Petraitienė (2012) note professional ethics as an integral part of audit quality: a quality audit is such an audit which was carried out in accordance with the provisions of professional ethics, as well as with auditing standards and laws. The authors stress the result of a quality audit – a competent auditor’s opinion.
Rittenberg et al. (2010) links audit quality with the expectations of market participants. According to Power (1997) and Sutton (1993) different expectations of various information users provide difficulties in defining and measuring audit quality. For instance, audit clients’ expectations can be higher than those of external users, so the audit quality concept should include such aspects as useful recommendations (Sawyer, 2006; Vaicekauskas, Mackevičius, 2013). It is noted that some audit clients first of all see auditors as consultants of accounting, finance and business issues in general. Such clients can be called „source seekers” (Beattie, Fernley, 1998). This issue is also often covered in annual transparency reports issued by audit companies. The companies notice the added value of the audit service, which increases service content more towards clients’ expectations. This expectations-based approach suggests audit quality investigation is not only a verification activity but a client-oriented service, which is commercial, paid for and often chosen voluntarily (Sulaiman, 2011). According to Duff (2004), audit quality should also include a client service dimension.

Based on the above interpreted audit quality definitions and related aspects, it might be stated that audit quality is a multidimensional construct. In a simplified statement it can be defined as a level of confirmation between the value audit creates and the expectations to audit of third-party users and audit clients. Expectations, driven by the stakeholders’ needs, are met or exceeded if:

− auditors issue an accurate and reliable auditor’s report;
− auditors present useful insights and recommendations for the audit client, thus creating added value of the service provided;
− auditors reduce the likelihood of material misstatements due to fraud or error;
− the audit is conducted in compliance with professional standards, ethics and applicable laws at all audit stages;
− the audit is performed by competent auditors who are able to detect misstatements (skill, experience) and report them (independence), practising in properly organised and managed audit firms who care about their good reputation;
− auditees realize their responsibilities and assure a quality internal control system within the firm.

According to Chadegani (2011), audit quality is often perceived as a system of input-process-output elements and its relationships. Bearing in mind all the aspects identified, and employing a systematic approach, audit quality then can be presented in a systematic framework (Figure 2):

As can be seen from Figure 2, audit quality depends on two groups of input factors affecting audit quality. Factors relating to standards and laws issued by professional organizations and governments, as well as audit clients, could be seen as external – that means they are not controlled by the audit firm, but with mutual relations they have an impact on the audit firm’s performance. The regulations state the requirements and guidelines, often amended by changing investors and other third-party users’ needs and expectations, on how an audit should be conducted. On the other hand, the auditing practice also presents some implications how the standartization
could be improved. Audit clients also have an impact on audit quality with the accuracy of their accounts and internal control effectiveness which affect audit performance. In turn, regularly audited entities improve their financial statements and accounting discipline which in turn reduces the risk of misstatement in future audit engagements.

**Figure 2.** A framework for understanding and researching audit quality

![Diagram](image)

Source: compiled by the authors.

Auditors working in audit firms deal with their clients in accordance with the standards and laws set. Audit engagements are typically conducted by auditors on behalf of audit firms: both are responsible for an accurate and reliable auditor’s opinion. Auditors working in audit engagement teams determine the quality of a particular engagement, whereas a proper, well-organised and managed audit business entity has an impact on each engagement by well-judged client acceptance, effective personnel management, work review, etc. Due to that, various characteristics of audit firms and audit teams can be seen as internal audit quality factors, controlled by top-level audit firm executives. Further, in this paper audit quality factors relating to audit firms and audit engagement teams are analysed in order to construct a framework for audit quality management within an audit entity.
4. Third-party users oriented approach: factors affecting audit quality

Audit quality factors became an issue after corporate scandals, such as Enron, Worldcom, Tyco and many others. In the Baltic States audit quality has recently become a much debated topic after the bankruptcies of two related banks in Lithuania and Latvia. Contrary to popular belief, in corporate scandals the auditors did not perform their work dutifully to detect fraudulent activities, causing misstated financial statements (Francis, 2011, 2004; Woodland, Reynolds, 2003; Duff, 2004; Yuniarti, Zumarra, 2010; Financial Reporting..., 2006, etc.). Audit failures not only had a negative impact on audit companies’ reputations but they have also led to a decrease in confidence regarding audited information and the auditor’s profession in general (Duff, 2004; Financial Reporting..., 2006). A drop in confidence in auditing has triggered a series of audit quality research, mainly in the United States of America (DeAngelo, 1981; Carcello et al., 1992; Woodland, Reynolds, 2003, etc). Some significant contributions have also been provided by European authors and organizations, such as Dassen (1995) (Denmark), Duff (2004), the Financial Reporting Council (2006) (Great Britain), Cameran and Livatino (2003) (Italy), Zerni (2009) (Finland), Kustienė and Petraitienė (2012). Kazlauskië (2005) (Lithuania).

Audit quality is usually measured in terms of an auditor’s restated opinions. Audit failures are usually related to audit firms, not the actual auditor. Employing the methodology of restated opinions, the authors often question whether the biggest international audit companies make fewer errors than smaller audit service providers (DeAngelo, 1981; Krishnan, 2002; Becker et al., 1998; Turner, Sennetti, 2001; Dassen, 1995; Duff, 2004). The hypothesis is based on the so-called collateral theory which states that an audit firm’s reputation is a factor of the audit quality – the bigger the reputation is, the more the audit firm will perform a quality audit and try to avoid audit failure. Moizer et al. (2009) argues that in audit service markets, because of the low service materiality and high service importance for the third-parties, image plays a crucial role in forming expectations, thus – expected quality. Due to one failure it will lose its reputation and will not be capable of succeeding in the future. In such cases reputation works as collateral for a quality audit (DeAngelo, 1981).

Reputation is closely tied with the culture within the audit firm. The Financial Reporting Council (2006) argues that the organizational culture of an audit company is a crucial factor, stating that the organization culture is a unique environment in which the auditors work and which affects their point of view and way of thinking. Kustienė and Petraitienė (2012) see it from a more „big picture” perspective, stating that professional ethics are an element of audit quality, working as a kind of safety, ensuring the collection of appropriate evidence, its interpretation and the reliability of reports formed on the basis of the evidence gathered. Both the Council and the Lithuanian authors stress that audit performance, based on effective audit methodology, is a key factor.
Many scholars focus on the connection between audit pricing and audit quality, assessing whether higher audit prices have an adverse correlation with the auditor’s restated opinions (Palmrose, 1986; Ettredge, Emereigh, 2010). Since audit price is usually set when balancing staff of different experience, expertise and forecasted optimal working hours (Staliūnienė, Stungurienė, 2009), the price can have a significant effect on audit quality.

Geiger and Raghunandan (2002), and Cameran and Livatino (2002) question whether long-term auditors are more likely than first-year auditors to issue a client with a favorable auditor’s report. The authors tend to focus on audit firm rotation as an audit quality factor. The European Union’s audit reform, which is in its preparation stage, also pays a lot of attention to the rotation question, arguing that rotation is mainly useful for eliminating the risk of familiarity which is faced by long-term auditors.

The rotation question is often under investigation, as is the link between the restated opinions and non-audit services an audit client is provided with (Raghunandan et al., 2002; Kinney et al., 2003). Income from non-audit services creates an economic dependence which in turn reduces the audit firm’s independence and objectivity: if the auditor’s report is unfavorable for the client, he may discontinue to buy both audit and non-audit services from the audit firm. To avoid this, the audit firm may try to satisfy client with a favorable “clear” auditor’s report.

Another body of literature investigates not only factors relating to audit firms, but also the factors relating to the audit engagement team, auditors involved in particular engagements (Kustienė, Petraitienė, 2012; Kazlauskiene, 2005; Schroeder et al., 1986; Carcello et al., 1992; Behn et al., 1997; Kilgore et al., 2011 and many others). The research most often finds audit engagement team factors more favorable, important by the clients, third-party users than audit firm’s factors.

Kustienė and Petraitienė (2012) and Kazlauskiene (2005) accentuate the auditor’s independence as a key factor. If there is a doubt about the auditor’s independence, there is a doubt about the auditor’s report as well. This can be shown using DeAngelo’s (1981) audit quality dimensions: the ability to detect, and willingness to report material misstatements. The misstatement may be detected, but if there are dependence on the client, the misstatement may not be reported in the auditor’s report, making it unreliable.

On the other hand, great emphasis on the ability to detect the misstatements are put through the analysis of the auditor’s industry expertise (knowledge). Some industry auditors reach a higher level of audit quality, while making more effective planning decisions, assesing more effectively the client’s business risk, as well as the risk of material misstatement, complying at the highest rate with auditing standards (O’Keefe et al., 1994; Maroney, Simnett, 2009; Hammersley, 2006; Low, 2004).

Schroeder et al. (1986) and Carcello et al. (1992) imply that audit team members’ experience with the client can outweigh the client’s industry knowledge, if the team lacks it. The Financial Reporting Council (2006) also stresses the importance of stable,
experienced and well balanced audit teams. The more the team is experienced and stable, the more it becomes familiar with the client’s business and its risks, accounting system, etc. Additionally, they gain deeper experience and broader knowledge of auditing and accounting standards, which also positively affects the audit quality (Beattie, Fearnley, 1995).

Experienced auditors also usually have higher professional scepticism. Sceptical auditors more often make additional inquiries and carry out additional procedures (Shaub, Lawrence, 1996), pay more attention to fraud risk, more carefully evaluate audit evidence gathered (Hurt et al., 2010), and rely less on evidence gathered directly from the client (Bowlin et al., 2011). Since these characteristics of sceptical auditors have a positive impact on almost every audit stage, from planning to collected evidence evaluation, it can be summed up that professional scepticism affects audit quality in a positive way.

To sum up it can be said that many authors identify many different audit quality factors due to the complexity of the audit service and the diversity of its definitions. The authors of the paper believe that International Standard on Quality Control 1 (2009) provides a reasonable systematic approach on audit quality factors (elements, according to the standard), under whose scope many previously analysed factors fall. The standard states that quality a control system is the policies and procedures applied in order to achieve the necessary state of audit personnel appropriate for performing an audit in the right way and assuring that the auditor’s report is accurate. According to the standard, the audit firm should establish and maintain a system of quality control that includes policies and procedures that address each of the following elements:

- Leadership responsibilities for quality within the firm;
- Relevant ethical requirements;
- Acceptance and continuance of client relationships and specific engagements;
- Human resources;
- Engagement performance;
- Monitoring.

The elements can be seen in a consistent order: the audit firm’s leaders should take responsibility for quality within the firm. The responsibility is demonstrated when the firm accepts only those clients who have a good reputation and ensures that there is an appropriate and sufficient amount of human resources within the audit firm to cope with the engagements assigned. The audit staff should be sceptical, independent, and know the client’s industry and professional standards. These two levels mainly embrace factors such as the reputation of a good audit firm, reasonable and sufficient audit pricing, giving an „antidote” against threats arising from long-term relationships with the client, as well as non-audit service relationships. The audit firm and its staff should exercise an ethical attitude in all audit stages. This elements covers the previously mentioned ethical organizational culture within the firm, independence and other ethical factors. In order to detect misstatements while using the best traits of employed human resources in the most effective way, the appropriate audit method-
ology is needed. When audit evidence is collected and evaluated, it is important to reassess once again the most debatable decisions and risky areas prior to issuing the auditor’s report. The audit review by independent person is needed (engagement performance). This system should be periodically monitored when taking remedial action if any is needed.

5. The audit client-oriented approach: making audit more valuable

Identified factors affect audit quality in terms of detected misstatements, and due to that an accurate and reliable auditor’s report is issued. As previously mentioned when analysing various audit quality definitions, audits can provide additional benefits directly providing recommendations for the client in addition to adding value to the client’s business. „The new approach to auditing”, or the „new audit” (Eilifsen et al., 2001; Beattie et al., 2000) says that audit functions, that is to say the quality, should be reconsidered. Auditors in practice stress audit quality, not only compliance with the standards; the quality should also include added-value, which could help show auditors as client business oriented service providers (Sulaiman, 2011). In audit practice „audit value-added” is a common term, however, little is research into what factors could add more value to the client. The Chen et al. (2001), Behn et al. (1997), Dassen (1995) and Duff (2004) studies point out different factors such as the auditor’s responsiveness to the client’s needs, demonstrated empathy (willingness to help, to „walk in the client’s shoes”, according to Dassen, 1995), and familiarization with the client’s business problems. These attributes are not specified in audit regulations as mandatory, though research show them as being important, desirable.

As a value added service, audit’s origins lie in the transformation of the audit methodology, when auditors started to apply client’s risk-based procedures and techniques. This shift has led audit companies to position themselves not merely as auditors, but also as business advisors (Humphrey, Moizer, 1990). In order to perform a risk-based audit, it has become mandatory for an auditor to get acquainted with an audit client’s business specifics and to identify the client’s riskiest areas. The gathered knowledge of the client’s business, identified risks and useful insights can be „transferred” to the client in the form of consultations or recommendations at no extra charge. Eilifsen et al. (2001) states that in order to achieve this value it is necessary to: assess and analyse inherent risks very carefully, provide a comprehensive management letter, ensure effective feedback and have constant feedback. According to Mackevičius (1999), the „new” audit adds value through assessment of the client’s business risk in a comprehensive business environment, giving them guidance as to the potential risks when entering new markets. Identified risks help to strengthen auditee’s internal control system, improve financial and management accounting, disclose internal reserves, and contribute to the strategic planning and making predictions (Mackevičius, 2009; Deumes et al., 2010). Beattie (2000) agrees with this approach
and states that the clients expect from their auditors extra value, such as explanations of accounting standards, recommendations on improving internal control, general business consultations, etc.

Orientation to the clients’ needs and adding value to the audit service can be implemented when issuing an additional audit document – the management letter. The management letter is not regulated and nor is it in audit law or in auditing standards. This report is related to audit communication. In „communicational” international standards on auditing (such as ISA 260, ISA 265) some cases are mentioned when it becomes mandatory for an auditor to communicate to management and those charged with governance about various findings and observations, mainly about internal control. Besides internal control, the auditor should communicate matters related to observations about accounting policies, detected material misstatements, offered adjustments, audit scope limitations and others. In such cases it is appropriate to put these observations in writing and to get responses from the management and, if it is relevant, from those charged with governance. Received written feedback can be seen as a specific audit working paper useful for further audit decisions and procedures applied, including their nature, time and scope.

Besides the content of cited audit standards, the auditor can put every observation into the management letter if he sees it is valuable (important) for the client. It is very often justified in practice by the clients saying that „what is not significant for the auditor is not necessarily unimportant for the client”. Manson et al. (2001) argues that auditors can present matters possibly important for the client, dividing them into three groups: (1) internal control; (2) accounting system; (3) taxes. By issuing such observations and following recommendations in the management letter, auditors seek not only to step above the traditional audit approach, but also stress how things have been tailored to the individual client’s needs. In order to add value, it is necessary for the client’s management to approve the recommendations given and implement them in practice, and that they realise they are important in their business decision making process (Figure 3).

As can be seen from Figure 3, when issuing recommendations the auditor gets involved in the client’s business decision making process. It is necessary to maintain due care and pay attention to the auditor’s independence and other ethics principles. The independence principle prohibits the auditor from participating in the client’s business decision making, and in business management in general. However, when presenting some consultancies at no extra charge the auditor can emphasize particular areas of activity for improvement or alternatives, without infringing the independence principle. In order to maintain this independence, it is crucial to leave it up to the client’s management to decide upon the implementation of the recommendations provided. In other words, the auditor should maintain some distance between the audit relationships and the client’s business decision making.
Figure 3. Adding value with the management letter

It can be said that to provide such valuable information and recommendations, it is necessary to effectively evaluate and investigate a client’s inherent and internal control risks. In such cases the industry expertise of the audit team members could be crucial, because it covers these things with inherent risk-related aspects such as competition within the industry, current trends and threats, technological shifts and many others. Additionally, a proper audit strategy should be considered: an internal control relying strategy as opposed to a detailed testing strategy (Cosserat, 1999), could generate more useful information, because in order to rely on controls, auditors should assess its design completeness, as well as its operational effectiveness. Due to the importance of internal control in achieving long term business and operational goals, auditors could add more value. However, the authors of the paper believe factors affecting more the client oriented audit quality approach should be researched further in future studies.

6. A framework for audit quality management in audit firms and recommendations for future research

Summing up the research, after looking at two different audit quality approaches, which favour different stakeholders, having identified the audit quality affecting factors, and based on the analysis of service quality aspects and existing audit quality definitions, the authors of the paper propose the following framework for managing audit quality within an audit firm (Figure 4).
The framework covers factors affecting the audit firm and the audit engagement team, enhancing the ability to detect material misstatements, react properly with an ethical attitude, and communicate these problems, thus assuring an accurate and reliable auditor’s report, value adding management letter and favoring both third-party users and audit clients. The framework shows audit firm leaders, acting on behalf of the firm, responsible for the right attitude at the top, acceptance of new low-risk clients.
and continuation with old ones, an organizational culture with high ethical requirements, effective auditing methodology and review, competent and sufficient audit engagement teams who design and constantly monitor the system in order to make remedial action and comply with both stakeholders’ expectations.

The framework presented captures various different aspects and problems of audit quality management within the audit firm. The authors of the paper suggest the following issues be considered as a basis for future audit quality research:

− Although various authors suggest investigating factors which affect the audit team, there is little known about the role of the audit team structure and different members’ impact on audit quality. When it comes to the audit team, authors have investigated team members just as „auditors”, however, audit teams are usually built under the structure of a pyramid (Financial Reporting..., 2006), the auditor is in charge (partner) with the audit manager being at the top, then come senior auditors, juniors auditors, and finally trainees. Zerni (2009) reports on the „partner’s effect”, in other words, the strong impact of the partner’s characteristics on audit quality – same audit firms’ quality provided may significantly differ due to different partners. Little is known about the role of the youngest, less experienced auditors in audit quality, those who play a large part in audit fieldwork.

− Although audit value added is often a topic of discussion among practitioners and scientists, this topic is not sufficiently covered in academic literature. A variety of definitions used by authors and different interpretations of the subject contribute to the absence of a commonly accepted definition. Little is known about the practical aspects of value adding during audits, however, many audit firms through their internet homepages declare that they are more valuable than „usual”, „traditional” audit offers. In this paper we briefly covered the value of an additional audit document, the management letter, but there is a lack of in-depth studies on how to improve this document and make it more valuable.

− Intense competition between audit companies has caused a slump of audit prices. Due to relatively low fees it has become very difficult to provide more valuable services, bearing in mind strict audit planning schedules and the time costs necessary to give more at the same price level. However, this may be not a valid argument for clients operating with scarce resources. ACCA (2010a, 2010b) discussions show that small and medium entities expect auditors to provide such a kind of value because they simply cannot afford to purchase such services for additional charges. Participants of the discussions expressed belief that global business and a complex business environment increase auditors’ liabilities. According to Lakis (2007), auditors are qualified enough and have sufficient competence to handle various business related problems and issues, not only to perform audit procedures. The question is how to balance the efforts and perform audits within the time frame while at the same time providing more insights and recommendations. This implies that audit efficiency and effectiveness should researched.
Conclusions

The concept of audit quality has been analysed in the scientific literature for more than three decades. Doubts on the work auditors carried out in well-known corporate accounting scandals has triggered a series of audit quality research. However, there is no single widely accepted definition of audit quality.

Based on the analysis of existing definitions, audit quality can be defined as a level of confirmation between the value audit creates and the expectations of the audit of third-party users and audit clients. Expectations, driven by the stakeholders’ needs are met or exceeded if: (1) auditors issue an accurate and reliable auditor’s report; (2) auditors present useful insights and recommendations for the audit client thus creating added value of the service provided; (3) auditors reduce the likelihood of material misstatements due to fraud or error; (4) the audit is conducted in compliance with professional standards, ethics and applicable laws at all audit stages; (5) the audit is performed by competent auditors who are able to detect the misstetements (skill, experience) and report them (independence), practising in properly organised and managed audit firms who care about their good reputation; (6) auditees realize their responsibilities and ensure quality internal control systems within the firm. The disclosed elements of audit quality definition present audit quality depending on external factors related to professional standards, laws and audit clients, as well as internal factors related to audit firms and audit engagement teams practising within the firms.

The audit quality can be analysed with a view to different stakeholders’ needs and expectations: third-party users (investors, bankers, etc) or audit clients. The most common approach is based on the detection of audit deficiencies: whether the work carried out by the auditors has deficiencies or not. This approach explains audit quality as a probability that the auditor will detect a misstatement and report it if this misstatement is not accurateed by the client. The probability is reflected in the auditor report. This approach favors external users’ needs.

The less covered approach looks at auditing as a value-added service. Due to the high degree of audit service homogeneity, competition and price rigidities, it has become crucial to add more value to the audit service, not to exceed clients expectations but to meet them. Research in various countries shows this kind of expectation becoming more „performance” (natural, rooted with the perceptions of the service) than „exciting” (something unexpected the service can provide). As a result of this client-oriented quality approach, the management letter – the audit reporting document in which auditors submit their insights and recommendations in order to provide the client with more value – can be analysed.

After analysing both audit quality approaches, the authors of the paper have presented a comprehensive framework of audit quality management within the audit firm, which has external users, as well as audit clients, as the quality assessor. The framework is built upon the audit firm and audit engagement team factors, which can
be seen as input variables through the process of auditing stages affecting the accurate and reliable auditor’s report and value adding management letters, which in turn meet or exceed the expectations of both stakeholders.

Based upon the framework presented, the following issues can be considered as important topics in future audit quality research: the impact of the audit engagement team’s structure and less experienced auditors on audit quality; what kind of insights and recommendations the management letter should contain to be perceived as more valuable; how to add more value to the audit while not exceeding planned working hours.

References


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**Internet sources**


Summary

Over the last few decades audit quality has been investigated by many scholars, although it still hasn’t been properly conceptualized and lacks one common definition. This may be explained by the constant shifting of audit theory and practice, and the complexity of the audit service. The objective of the paper is to investigate the existing definitions of audit quality, identify its main elements and provide a framework for audit quality management in audit firms. The main contribution of the paper is a developed framework for audit quality management, covering both main stakeholders of auditing triangular relationships: third-party users, as well as audit clients. Due to a slump in audit prices, complex competition and a high degree of homogeneity, the authors of the paper focus not only on external users’ perceptions, as the existing large body of literature does, but also stress audit clients’ need for satisfaction in the comprehensive framework. The framework covers various audit firms and audit engagement team factors affecting audit quality and leading to quality audit outputs: an accurate and reliable auditor report and a value adding management letter. Based on the framework presented, recommendations for future audit quality research are provided.

Keywords: audit quality, audit firms, agency theory, framework for audit quality management.
Streszczenie

Ramy zarządzania jakością audytu w firmach audytorskich

W ostatnich kilku dekadach jakość audytu stanowiła temat zainteresowań wielu badaczy, choć jeszcze nie jest ona jednoznacznie rozumiana; nie ma też jednej wspólnej definicji tego pojęcia. Stan ten może być wyjaśniony stałą ewolucją teorii i praktyki audytu oraz złożonością usług audytorskich. Celem artykułu jest analiza istniejących definicji jakości kontroli, określenie głównych elementów jakości i opracowanie ram dla zarządzania jakością audytu w firmach audytorskich. Najważniejszym wkładem autora artykułu do dotychczasowej wiedzy w zakresie podjętej problematyki jest opracowanie ramowej koncepcji zarządzania jakością audytu, obejmującej zarówno głównych interesariuszy trójstronnych relacji audytorskich: użytkowników, stron trzecich, jak i klientów audytu. Ze względu na spadek cen audytu, złożoną konkurencję i wysoki stopień jednorodności, autorzy skupili się nie tylko na użytkownikach zewnętrznych, jak to jest czynione w obszarze literatury przedmiotu, ale również na podkreślaniu potrzeb klientów firm audytorskich. Ramowa koncepcja obejmuje różne firmy audytorskie oraz czynniki wpływające na jakość badania sprawozdań finansowych i prowadzące do uzyskania odpowiedniej jakości rezultatów audytu: dokładnego i wiarygodnego raportu biegłego rewidenta i dodającej wartość opinii biegłego rewidenta. Na podstawie przedstawionych ram w artykule sformułowano rekomendacje dla przyszłych badań jakości audytu.

Słowa klucze: jakość audytu, firmy audytorskie, teoria agencji, ramy zarządzania jakością badania sprawozdań finansowych.