

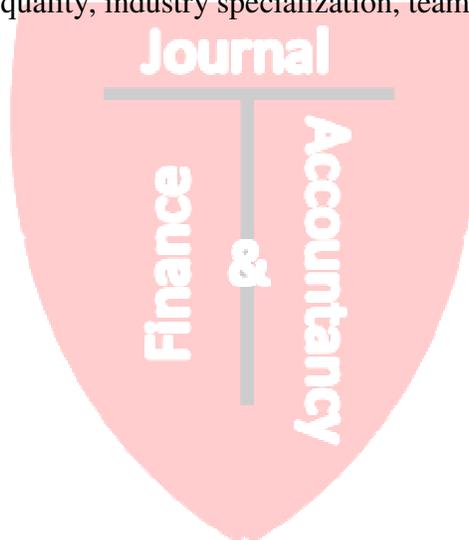
## Audit team formation

Ifeoma A. Udeh  
Virginia State University

### ABSTRACT

This paper discusses audit team formation. Audit teams affect audit quality, and how teams are formed is an audit engagement practice influenced by audit firm management practices and processes. Though audit teams play significant roles, their formation and implication for audit quality has received limited attention from researchers and practitioners. This paper discusses current practice of audit team formation based on availability or decision-maker's preferences, identifies issues associated with the practice, and discusses approaches to enhance audit team formation such as specialization, team training, team evaluation and team continuity.

Keywords: Audit team, audit quality, industry specialization, team evaluation, team training



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## INTRODUCTION

The Public Company Accounting Oversight Board (2012) noted audit quality problems may result from management structures, practices, and processes of audit firms. These factors affect audit engagement practices such as audit team formation. Forming a team is an initial step towards audit quality (Kilgore et al., 2011), since team members' perceived inclusion and value to the team motivates higher performance (Ellemers et al., 2013). Audit firms' managements need to leverage their resources, by at least, forming teams based on audit staff knowledge, experiences and expertise to achieve quality audit (Gardner et al., 2012), and not based on staff availability or decision-maker's preferences. An effective team is not automatic (Burke et al., 2013), since team members should be invested in the goals, the process to achieve the goals, and they should be accountable for the outcome.

The objectives of this paper are twofold. The first objective is to encourage audit practitioners to rethink audit team formation, since it has implications for audit quality, staff retention, and career enhancement. The second objective is to motivate audit researchers' interest in investigating audit team formation, as an audit quality element. To achieve these objectives, the paper discusses a current practice for audit team formation, identifies some of the issues with the practice, recommends ways to enhance the audit team formation process and discusses the implications of the recommendations.

## AUDIT TEAM STRUCTURE

According to Bamber (1983, p. 396) "an audit is usually conducted by an audit team, which is characterized by a hierarchical structure and division of labor." Audit teams usually comprise the audit partner, senior-manager/manager, audit senior, audit staff, and specialists such as tax professionals (Muczyk et al., 1986). The number of people at each hierarchical level depends on the size and complexity of the audit (Muczyk et al., 1986). Audit firms "use teams extensively as the primary means for coordinating people with diverse skills needed for a particular project" (Dereli et al., 2007, p. 371).

Using teams enhance audit effectiveness, since team members pool their knowledge and expertise (Owhoso et al., 2002), while sharing the work by assigning audit sections to team members (Vera-Muñoz et al., 2006). While no team member works independently, "a prerequisite for effective team performance is that individual members each contribute non-overlapping outputs" (Owhoso et al., 2002, p. 899). Hence, within an audit team, value-driven collaboration is essential.

## CURRENT PRACTICE AND ISSUES

In forming an audit team, aside from the audit partner position, some audit firms fill the remaining hierarchical levels of the team based on staff availability or decision-maker's preferences. Employees are assigned to a team if they are available or if the decision-maker (e.g. partner) prefers working with them. This practice of forming teams based on staff availability or decision-maker's preferences is observable in all sizes of audit firms. There are issues associated with such practices. First, the career interests and skill-set of staff may not be adequately considered. Assigning staff to teams without consideration of career interests may have adverse

effects on audit effectiveness and efficiency, due to lack of intrinsic motivation and satisfaction (Vera-Muñoz et al., 2006).

Second, fit between client needs and staff competence may be overlooked. Knowledge and consideration of client needs are crucial (Dereli et. al., 2007), since they enable the formation of audit teams with commensurate competence. For instance, client complexity is a key factor in team formation. Clients with complex and unstable environment may require audit teams with less rigid approaches, while structured audit teams may suffice for clients with less complex and stable environments (Rudolph and Welker, 1998). Third, forming an audit team based on staff availability or decision-maker's preferences heightens the difficulty of comparable replacement in the event of staff attrition. With a systematic approach to team formation, the requirements for an audit are identified. Knowledge of the requirements and the skill-set used to satisfy the requirements make it easier to replace the skill-set, as needed.

Fourth, clients have differing economic importance to audit firms. Though all clients should receive optimal service from their auditors, it may be of interest to audit firms to ensure clients with economic significance are served by suited audit teams. For instance, such clients' audits may have staffing priority (Hackenbrack and Hogan, 2005). Fifth, team formation based on decision-maker's preferences may create staff scheduling biases, staff evaluation biases, and factions in a firm. Also, undue staff pressure may occur and result in adverse performance.

## **RECOMMENDATIONS AND IMPLICATIONS**

According to Gardner et al. (2012, p.1001), "the resource-based view of the firm explores how firms develop reliable ways to integrate knowledge resources to generate superior performance, even when facing uncertain contexts." The knowledge resources of audit firms are the staff, and to provide quality services, audit firms form and use teams for audit services. The notions discussed below are important to forming and maintaining effective audit teams.

### **Audit Teams by Industry Specialization**

Forming audit teams based on staff specialization and interests (Lindow and Race, 2002; Muczyk et al., 1986), improves audit effectiveness since commitment increases (Vera-Muñoz et al., 2006). More so, the likelihood of enhancing audit realization through audit effectiveness increases when team members are specialized in the audit client's industry (Owhoso et al., 2002). Considering each audit engagement is different, and clients perceive audit team attributes (e.g. team knowledge) as more significant than audit firm attributes (e.g. audit firm size), with respect to audit quality (Kilgore et al., 2011), audit teams need to "access and use each member's unique portfolio of resources" (Gardner et al., 2012, p. 998).

In considering specializations and interests, the output of each level of the audit process should be an input for a subsequent process level (Bamber, 1983). Such a structure will minimize overlap of effort without incremental contribution, and thus enhance audit efficiency. Hence, in forming audit teams, the competencies and experiences of team members at each process level should be considered. And for effectiveness, significant differences should exist in the team member competencies at each process level (Bamber, 1983; Owhoso et al., 2002); otherwise, the value added at each process level becomes marginal at best.

## **Audit Team Training**

Fundamental auditing knowledge (Generally Accepted Auditing Standards) and industry specific knowledge, which together address conceptual and technical competence, are discussed in most staff trainings. However, audit teams also need communication, collaborative and management skills (Dereli et al., 2007). An audit firm's culture that encourages audit team training will influence the development of such skills which consequently will enhance team effectiveness (Vera-Muñoz et al., 2006). While it may be impracticable to form and train audit teams before each audit engagement, audit team training may be provided during regular staff trainings, with a purpose of enhancing understanding of team dynamics.

Audit team trainings can incorporate discussions on team and responsibility structures, effective communication between team members (Liu et al., 2011; Rudolph and Welker, 1998), roles and expectations of members (Vera-Muñoz et al., 2006), and trust and cohesion between members (Notgrass et al., 2013; Mach et al., 2010). Further, understanding crisis management and developing the necessary skills, such as seeking help and noting performance declines, are important subject-matters since issues often arise within teams (Burke et al., 2013).

Similar to regular staff trainings, audit team trainings may be formal or informal in nature, and varying training methods such as discussions, demonstrations, or hands-on practice may be adopted (Burke et al., 2013). Additionally, subsequent to forming an audit team, specific engagement team training may be organized, when possible, to address engagement-specific matters that will enhance the functionality of the particular audit team.

## **Audit Team Continuity**

In forming audit teams, the notion of balancing team continuity, objectivity and career development (Lindow and Race, 2002; Muczyk et al., 1986) is important. Audit firms are unable to control completely staff attrition. However, when forming audit teams, firms can plan to retain, to the extent possible, the same team members on an audit engagement. This is important since team continuity minimizes information asymmetry (Bedard and Johnstone, 2010), helps improve the functionality of the team, and enhances the audit effectiveness.

Team continuity is encouraged by person-task fit. This suggests timely consideration to staff intended career path. For instance, requiring a team member, who is a tax specialist, to audit benefit plan may not be motivating. Though exposure to diverse tasks helps career advancement (Lindow and Race, 2002), a lack of motivation limits it. With respect to objectivity, person-task rotation helps ensure new perspective on tasks, since after a while a different staff performs a given task. With this approach, same team members remain on an audit, thus minimizing information asymmetry issues (Bedard and Johnstone, 2010), while enhancing objectivity.

## **Audit Team Evaluation**

Audit firms usually evaluate and reward staff based on criterion such as performance in audit engagements (Vera-Muñoz et al., 2006). However, audit firms rarely evaluate the audit teams (Sokol, 2002). Evaluation is important to audit team formation and effectiveness. Though team evaluation occurs subsequent to team formation, the knowledge and expectation of it occurring may motivate informed decisions about team member choices, all else equal. Audit

firms may reward teams through recognition, uniform monetary rewards across all team levels, or additional paid time-off.

Team evaluation assesses the effect of the entire audit process on key participants (e.g. client, audit firm, and audit team members). Considerations from the client's perspective may include audit quality, client satisfaction, and timeliness. Compliance with audit firm quality control, audit realization, audit efficiency, and staff retention are considerable factors from an audit firm's perspective. And considerations from audit team members' perspectives may include learning opportunities, job satisfaction, and level of perceived inclusion and value (Ellemers et al., 2013).

The notion is for audit teams to evaluate an audit engagement performance, from a team perspective, by identifying the strengths and weaknesses of the team, and seeking ways to manage the weaknesses while enhancing the strengths. Findings from such evaluations will help the audit team determine the (1) appropriateness of the procedures and processes, (2) audit engagement's compliance with audit firm's quality control, and (3) processes shareable firm-wide as best practices (Chiesa et al., 1996).

An all-inclusive evaluation at the closing meeting after audit report issuance is recommended. Team member participation fosters trust and helps keep the focus on continuous improvement (Vera-Muñoz et al., 2006). As stated by Burke et al. (2013, p. i101), "the ability to speak up in a non-threatening and respectful manner...is a hallmark of learning organizations and the teams within them." In addition, obtaining client input may be beneficial since it provides an insight about the client's satisfaction with the service provided by the audit team (Hubbard, 2004). Client input may be sought by the audit partner during the exit meeting with the client, and thereafter, the partner shares the information with the team members during the closing meeting.

## CONCLUSION

Since an audit team is a key element of audit quality, it is important to view audit team formation as a critical process through which the emerging team is knowledgeable, effective and complementary. Such a team may be formed by considering staff industry specialization and interest, staff training, audit team evaluation and team continuity, from the onset. Team formation based on staff availability or decision-maker's preferences is restrictive, and since audit team formation reflects audit firms' culture, firms should consider their management practices.

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