

Business Risk Auditing and the Auditing Profession: Status, Identity and Fragmentation

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Abstract

Pre-Enron, there was much anticipation that developments in risk-based audit methodologies were in the process of better systemising the knowledge base of auditing and enhancing its operational effectiveness. Post-Enron, those claims have been contested, with the accounting profession having to defend itself from allegations made by business and regulators that audit practice is flawed. This paper examines Business Risk Audit (henceforth BRA) as an institutional event (Burchell *et al.*, 1985) through which to analyse and comment upon the audit industry and the accountancy profession in the UK. We examine BRA technique as a social and institutional practice that auditors have to establish and negotiate with their environment (Hopwood & Miller, 1994). In order to embed BRA technique, audit firms have to establish legitimacy and enrol allies in the institutional environment (Latour, 1987). This in turn involves defining or redefining a claim or claims to knowledge upon which the profession stakes its professional status and jurisdiction (Abbott, 1988). The paper's title signals three interrelated dimensions of this technical-professional interface: status, identity and fragmentation. The paper seeks to explore some of these key issues through documentary analysis and material derived from a series of interviews held with audit partners from a number of large, mid-tier and small audit firms with offices in Manchester and/or London, England and a limited number of former-audit staff now working in business consulting and private equity.

Introduction

In 1999 KPMG's US 'Assurance and Advisory Services Center' published the booklet *The Financial Statement Audit* with the subtitle 'Why a New Age requires an Evolving Methodology'. The publication profiles and publicizes the 'evolving' audit methodology, with audit mutating to a "risk based, strategic systems, methodology" fit for "the economy of the 21st Century" (1999: p. 4). While the text is a minor archetype of rhetorical justification, illustrating the critical force of language (Arrington, 1999), it also brings to the fore the problems that professional firms and institutions confront and the linguistic strategies they enact in order to justify and promote a new and abstract system of knowledge for a practice that few non-professionals, or lay-persons, can assess). The new audit methodology has been heralded as the 'audit of tomorrow' (for example, see Stewart, 1998; 1999a; 1999b), and a complete transformation in 'assurance' practices is said to be accompanying changes in the management and organization of today's corporations (for a review, see Lemon *et al.*, 2000. The KPMG (and others, cf. Bell *et al.*, 1997) document deploys many of the key tropes and symbols of modern management discourse to analyse a 'situation' and outline the favoured answers. The language of transformation is very prominent. Much of the writing plays upon terms that both unsettle the reader and yet re-assure him or her that while serious challenges to business survival exist, solutions are at hand. The opening page cites the chair of the AICPA, O. Kirtley:

"People want to know more about what is going to happen tomorrow. The rules of business and the economy are changing." (KPMG, 1999:1)

Adjacent to the above is another quotation from Frank O. Marrs, the Partner-in-charge of Assurance Services at KPMG suggesting that:

"Now the audit can do much more than confirm the financial statements; it can be an important tool for helping management assess where their companies are, where they want to be, and why they are not yet there" (KPMG, 1999:1)

The keyword is *change*; masses of processes are 'developing', 'evolving', usually at a more rapid pace or with greater frequency. With change, as 'the 20th Century draws to a close' has come increased 'competition', heightened and more frequent 'demands', 'new and increasingly complex organizations' which in turn 'fuel the need' for new responses in the 'information age'. Metaphors of change, speed and frequency are transformed into a subliminal question for the reader: are *you* being left behind? The document identifies the most important element or consequence of this global change as being 'risk':

“Change translates into varied and ever-evolving risks - some that organizations may recognize or know how to identify and manage and others that are completely new to them” (KPMG, 1999: 2).

Of course, to define financial reporting risk is to identify a constant of the audit process, but to understand ‘new or developing risks’ requires a new audit methodology. Accordingly, KPMG has developed a new audit that is ‘evolving’ to meet the changes. Setting this scene of rapid change and heightened risks for the ‘evolving’ business environment, the pamphlet outlines the contrast between the ‘traditional’ audit, suited to a prior age, and the new methodology in which analysis of business risk informs the assessment of audit risk, and hence the audit process and conclusions. Traditional audit is oriented towards ‘compliance’¹, the evolving audit *creates value*, the traditional approach is ‘transactions based’, the evolving audit is *risk based* (KPMG, 1999:9). The text is mindful also to affirm the maintenance of core attributes such that, while audit methodologies appear to have new orientations, at the same time “the auditor’s goal remains constant: to provide an independent opinion on whether an organization’s financial statements are fairly stated in accordance with Generally Accepted Accounting Principles” (KPMG, 1999:4). Audit may be evolving, but old values persist. Similarly, while the new risk based approach is central to this evolving audit, risk analysis in audit has also existed as a ‘rudimentary approach’ since the first half of the 20th Century.²

In 2003, at the start of the twenty-first century, a reader’s reception of a text promoting Business Risk Based Audit Methodologies is, however, likely also to be ‘evolving’. Pre-Enron, there was much anticipation, fuelled by the Big 5 firms, that developments in risk-based audit methodologies were in the process of better systemising the knowledge base of auditing and enhancing its operational effectiveness. Post-Enron, those claims have been contested, with the accounting profession, rather than setting new agendas, having to defend itself from numerous allegations made by business, media, academics and regulators that audit practice or regulation (or both) is flawed.

The UK accountancy bodies have attempted to define the Enron and WorldCom failures as peculiar to the US environment and the so-called ‘cook-book’ approach of US GAAP. Yet the swift response of US Congress in passing the Democrat inspired Sarbanes-Oxley Act in July 2002 and the desire to appoint an SEC Chairman deemed ‘tough enough’ to address corporate governance and accountancy’s problems have not left the UK profession, and its principles-based approaches to regulation, immune from debates proposing the banning of consulting services, the need for compulsory auditor rotation, more detailed audit reporting and other

amendments to audit firm practices that address conceptions of the flawed independence of audit. Alongside more wide-ranging examinations of corporate governance and the role of non-executive directors (Higgs, 2003), the entire audit industry remains under the scrutiny of government, corporate directors, investors and the press (DTI, 2003). To date, the impact of Enron in the UK on audit activity has largely been reported in terms of increased insurance premiums and possible future opportunities to increase audit fees through the need for auditors to increase the level of audit work.

Auditing Practice as an Agent of Institutional Change in the Accounting Profession

It is now widely accepted that there is much to be gained from attempting to understand accounting in its social context (see, for example, Burchell *et al.*, 1980, 1985; Cooper & Sherer, 1984). Yet auditing research has remained relatively immune from the influence of this type of theorizing, particularly in terms of empirical analysis of contemporary audit practice. Much of the post-Enron analysis has focused on scandalous and emotive elements of the case, the technical complexities of accounting rules and practices, the excesses and abuses of corporate America, assessing whether such scandal(s) could happen in the UK or elsewhere, and proposing (and implementing) a range of reforms to improve corporate governance. The day-to-day professional and working environment of corporate external auditors and the impact that the Enron case has had upon them and their methods/practices has not attracted that much attention.

At this juncture intriguing possibilities arise for the study of professional change in auditing practices and accountancy as an institution (Ackroyd, 1996). While certain writers have suggested that late modernity holds stimulating challenges to the role of professions (Reed, 1996) and some others have developed a tradition in alternative critical studies of developments in audit methods (e.g. see Fischer, 1996; Humphrey and Moizer, 1990; Pentland, 1993; Power, 1992; 1995) articles to date on the development of business-risk methodologies have tended to be assertive documents promoting change (e.g. Stewart, 1998, 1999a; 1999b) or have concentrated on the content of official, audit manuals of the large, multinational accounting firms (e.g. see Perrin, 1998; Lemon *et al.*, 2000; Winograd *et al.*, 2000). There have been no studies yet seeking to explore the way in which the implementation and application of new audit technologies is shaped by the formal and informal processes and norms that make up the organizational culture of an audit firm (see Anderson-Gough, Grey & Robson, 1998; 2000 for an assessment of such factors in the making of the professional accountant).

This paper examines Business Risk Audit (henceforth BRA) as an institutional event (Burchell *et al.*, 1985) through which to analyse and comment upon the audit industry and the accountancy profession in the UK. Our concern is not to offer a technical critique but to look at the technique of BRA as a social and institutional practice that auditors have to negotiate with their environment (Hopwood & Miller, 1994). In order to embed BRA, audit firms have to establish legitimacy and enrol allies in the institutional environment (Latour, 1987). This in turn involves defining or redefining a claim or claims to knowledge upon which the profession stakes its professional status and jurisdiction (Abbott, 1988).

To this end our paper is concerned with the following connected issues: What is at stake in the development of a new audit methodology? How are new claims to knowledge articulated? To what constituencies are knowledge claims addressed? What were the conditions of possibility for BRA's emergence - to what conditions was BRA a response? In what network of relationships was BRA established and then embedded (insofar as this has already been achieved), and what effects have this (mere) audit methodology had upon the institutional configuration of the profession and the organizations in which it is practiced? Are there challenges that still or have since arisen to face the ascendance of Business Risk Auditing? We suggest that the BRA event is not simply indicative but productively revealing of the changing character of the accountancy profession in the UK, the status of auditing and the professional identity of auditors - in the Big Firms, of course, but also in contrast to the professional self-image of accountants and the norms and beliefs of auditors in small and medium sized firms.

The research is based in part upon historical research and analysis of the professional and academic literature concerned with describing and tracing BRA. Professional and firm documents concerned with auditing regulation, audit practice and proposed changes to professional practices, such as education and training, have been reviewed. Interviews were also held with audit partners and senior managers from a range of 'Big' 4', 'mid-tier' and small accountancy firms with offices in Manchester and London, England and with a limited number of former auditors, now working in business consulting and private equity. The interviews explored, among other things, perceived key attributes, abilities and professional identities of auditors, the basic rationales underpinning current audit practice, the extent to which such practice has changed or been under pressure to change over the last few years, the contribution that auditing activity makes within particular firms, both in terms of income generation and its impact on the firm's operational culture, and the main areas where change, as it is now perceived, will happen.

In the next section we address the first problematic, the conditions in which BRA emerged as a response by audit firms to problems they themselves have defined. We detail the discursive rationales and institutional emergence of BRA, and link these to the development of audit firms and the status of audit within such firms during the 1990s. .

Business Risk Auditing, Audit Practices and Organizational Legitimation

As Alvesson has argued (1994; 1999), in certain areas of professional expertise, where professional abilities and the quality of work are difficult to observe, and knowledge is a 'slippery' concept, the claim to knowledge by professions will be routinely supported by the management of rhetoric, image and social processes in order to anchor competence within the profession's environment. As such, even a core professional expertise that has been embedded in the accounting profession for decades, such as audit, is supported by processes that reaffirm professional expertise to a 'public' that seeks further assurance, or, perhaps, shows an uncomfortable propensity towards different 'expectations'.

As our opening discussion suggested, the emergence and announcement of BRA is, perhaps, a more than usually public event. Companies are, of course, legally required to have audits of their accounts conducted, and competition between the professional firms for audit business has been intense. Since the late 1980s audit clients have become much more prepared to shop around for their audit (Greenwood & Lachman, 1996). The contest for audit clients has also contained audit fee levels. Indeed, audit firms appear to have been keen to 'lowball' (Sikka & Willmott, 1995) the bid for audit in the hope or expectation that the provision of non-audit services will be a sufficiently lucrative and offsetting source of profitability. As such, analysis of the market for audit labour and audit services has become an important approach to understanding professional change (Robson *et al.*, 1994). The growth of the international client base has been one condition for an intense spate of mega-mergers between the large audit firms from the Big Eight to the Big Five, and, more recently, with the collapse of Arthur Andersen, to the Big Four, a process that seems to have been conducted in conjunction with an ever increasing diversification in the services offered by such firms (Dezalay, 1991, p.793). While some methodological problems with the measures remain, there is some justification for affirming the supply of audit services market as highly concentrated (Moizer & Turley, 1989; Pong, 1999; Tonge & Wootton, 1991).

Rarely, perhaps, has the *technology* or *methodology* of the audit itself been promoted so visibly

as a vital component of the audit’s merchandising instrument (Power, 2000). Other developments in audit methodology such as risk *sampling* in auditing appear not to have attracted the same kinds of public proclamation. The presence of texts such as *The Financial Audit Statement* has signalled a highly visible marketing of the statutory audit function, and is indicative of the radical shift in audit that some commentators (e.g. Power, 2000) have implied. As Lemon *et al.* (2000) have observed, while KPMG has been a central figure in the establishment of the BRA methodology “during the 1990’s several of the major international accounting firms developed their methodologies on the basis of business risk analysis” (p. 1). Accordingly, as Lemon *et al.*’s study of business risk methodologies encompassed three countries³, all the Big Five (as was) and two or three of the largest ‘second tier’ firms in each country, the authors were assured in stating that while some differences of approach existed the BRA approach in all firms

“There is good reason to view the business risk approaches as a significant innovation to the existing model” (Lemon *et al.*, 2000, p. 10).

Much of the BRA innovation consists of the focus upon the modelling of risk in business processes as the basis for establishing financial statement risk and, accordingly, the focus of audit testing. The following from Bell *et al.*, (1997, p. 50) summarizes the key differences between traditional audit and BRA:

Figure 1

Comparison of Traditional and New Business Risk Control Paradigms

Old Paradigm	New Paradigm
Risk assessment occurs periodically	Risk assessment is a continuous process
Accounting, treasury, and internal audit responsible for identifying risks and managing controls	Business risk identification and control management are the responsibility of all members of the organisation
Fragmentation – every function behaves independently	Connection – Business risk assessment and control are focused and coordinated with senior - level oversight
Control is focused on financial risk avoidance	Control is focused in the avoidance of unacceptable business risk, followed closely by management of other unavoidable business risks to reduce them to an acceptable level
Business risk controls policies, if established, generally do not have the full support of upper management or are inadequately communicated throughout the company	A formal business risk controls policy is approved by management and board and communicated throughout the company
Inspect and detect business risk, then react at the source	Anticipate and prevent business risk, and monitor business risk controls continuously
Ineffective people are the primary source of business risk	Ineffective processes are the primary source of business risk

The process of financial statement attestation incorporate greater “added value client service” by allowing the auditor to comment both upon business risks and the accounting implications of those risks. Business risk audit is also widely understood to offer audit firms economies of professional audit labour. Lemon *et al.*, (2000) suggest that this ‘top down’ approach to auditing, starting with the business processes and down to the financial statements, offers greater audit effectiveness, efficiency, client service, better corporate governance and consistency at an international level⁴.

In the promotion of BRA methodologies, the claims of KPMG appear to have been particularly influential. Notwithstanding the populist presentations of ‘evolving auditing’, the 1997 publication of *Auditing through a Strategic-Systems Lens: the KPMG Business Measurement Process* (Bell *et al.*, 1997) is widely regarded as an important formal, technical expression of the BRA philosophy of auditing (Power, 2000)⁵.

The oratory of this text also bears careful scrutiny. Many of the same claims to the ‘value creating’ or value-adding role of BRA are found here as in *The Financial Statement Audit*. While some sections of *Auditing through a Strategic-Systems Lens* appear to have been significantly driven by a consumer marketing orientation, most of the text aims towards more learned models of justification that accord with the normative types of legitimacy that professionals recognise and affirm.

The monograph opens with the following quotation:

“In our time, the confidence, maturity and promise of a science should be measured not by its power to reduce the complex to the simple . . . but instead by its willingness to study complexity with advanced methods under descriptions that respect the reality of what is being studied. (David J. Depew and Bruce H. Weber, *Evolution, Ethics, and the Complexity Revolution*)(Bell *et al.*, 1997, p.1)

Initially offering a daring indication of the scientific foundation for the new auditing approach, the monograph proceeds to establish certain academic justifications for BRA and organizational complexity in an involved global economy. To this end, two of the authors, Ira Solomon and Howard Thomas were respectively KPMG LLP Distinguished Professor of Accountancy at the University of Illinois at Urbana-Champaign and James F. Towey Professor of Strategic

Management also at the University of Illinois at Urbana-Champaign. Moreover, while the first named author, Timothy O. Bell, is Director of Assurance Services at KPMG LLP, he was also previously a member of the accounting faculty at the University of Texas at Austin. The monograph also has a preface by William Kinney, one of the most senior figures in American auditing research over the past three decades.

The text runs through the methodological underpinnings of BRA, the relationships between strategy, business risk and audit, but gestures towards other, quite diverse, knowledge claims to justify the new audit. In no small way *Auditing through a Strategic-Systems Lens* aims towards the status of a scientific knowledge. The first page continues:

“Accounting plays a central role in the efficient allocation of resources in market-based economies. By adding credibility to accounting measurements and disclosures, auditing has for centuries made it possible for accounting to play such a key role. Today’s global economy and the business organizations operating within it, however, have become so complex and interdependent that new approaches to auditing must be developed. With these new approaches, the auditor would embrace and master, rather than simplify, the complexity inherent in the economic web of interrelationships of which the client organization is a part. (Bell *et al.*, 1997, p.1)

As well as economic reasoning, cybernetics systems methodologies are drawn upon to portray the organization as a “complex, living” system (Bell *et al.*, 1997: 15). Decision sciences modelled upon cybernetics are explained in order to outline the organization as a quasi-organic body. And New Age physicist/philosophers, such as Fritjof Capra, are cited in support of the ‘holistic’, ‘systems’ approach exemplified by BRA (1997: 14). *Auditing through a Strategic-Systems Lens* is a very eclectic mix. The most important point, however, is that Bell *et al* further extend the process of reconstituting the knowledge base of audit from compliance and substantive testing towards the auditor as business risk assessor. Although the monograph is short on detail as to the specific audit procedures and practices introduced or modified by business risk audit methodology, its role is to delineate how ‘external’ audit is remodelled and re-crafted to address matters of internal control, internal audit and assurance.

As others have noted (Power, 2000) one of the anticipated consequences for BRA practice is that the requirement for substantive testing of transactions is diminished. Yet while in other respects *Auditing through a Strategic-Systems Lens* lacks detail as to the nature of the new audit practices that constitute this methodology, its significance lies in an elaboration of the bodies of knowledge that are claimed to underpin BRA. In an industry in which client confidentiality is used to justify the limited access granted to researchers and secrecy of methodology is justified as a

competitive weapon, the Bell *et al.*, (1997) document stands out as another example of an open public expression of the new auditing, albeit to a different, if overlapping, constituency - knowledgeable professionals, regulators and academics (1997). Both KPMG documents, Bell *et al* and *The Financial Statement Audit*, denote the value adding ideals of BRA as the main source of legitimation and, in so doing, announce a revolution in audit methodologies. In legitimating business risk audit in these terms, at the same time the profession legitimates itself by attaching its expertise to dominant cultural values such as efficiency, rationality and science (Abbott, 1988; Dirsmith *et al.*, 2002).

If the language of justification has the 'creation of added value' for the client as its central theme, then plainly this is all of a piece with the competitive and concentrated market environment for audit clients previously outlined. Moreover, while the overall structure of the profession has been marked by mergers and audit concentration, the internal organization and culture of the large audit firms are equally relevant to the development of the new audit methodology. By shifting the rationale of audit to encompass business advice, BRA offered auditing the potential of enhanced standing as a practice within the large firms. The spectacle of the split between Andersen Consulting and Arthur Andersen in 1999 was indicative of the tensions and rivalries between the self-styled value adding activities of Professional Service Firms' non-audit services and the 'statutory' practice of audit attestation. Although plainly the provision of statutory audit to a corporation is, at the same time, a conduit to the provision of many 'value creating' non-audit services (tax, management consulting) the studies that exist of audit firm culture (Anderson-Gough *et al.*, 1998a, 1998b, 2000; Dirsmith *et al.*, 1997) have affirmed that audit is now accorded low status in the hierarchy of the Big 5 professional service firm activities. Whereas ten years ago there were less than a handful of qualitative and ethnographic studies of accountants (Dirsmith & Covaleski, 1985; Harper, 1988, 1989), the present decade has seen something of a proliferation of such work (for a review, see Anderson-Gough *et al.*, 1998a, 1998b, 2000; Coffey, 1993, 1994; Dirsmith & Covaleski, 1985; Grey, 1994, 1998; Hanlon, 1994). We now know a great deal more about how accountants live their daily lives and enact professionalism, at least in the large public accounting firms.⁶ Such studies of audit trainee and professional socialization in the UK and the US large audit firms share many of the same judgments as to the constitution of the accounting professional and the main features of professional identity amongst auditors and trainees. Notions of being professional emerging from such work show the significance of 'appearance' and behaviour⁷. The personnel management systems of the large firms have reinforced through appraisal forms that the notion of 'professional', refers trainees' personal aspects and conduct, especially in front of the client⁸. This does not mean that auditors lack

concern with formal accreditation as professionals - indeed, the contrary. The way in which accreditation is conceptualised, however, appears some way removed from the traditional picture of the profession as a repository of technical knowledge or as exemplifying a public service ethic. Trainee accountants in the process of learning these conventions seem to demonstrate that professional behaviour is conducted and rationalised in the name of client demands. The client discourse is a significant factor in the organizational control of these firms (Anderson-Gough *et al.*, 2000).

For audit trainees for example, the act of *qualifying* as a Chartered Accountant, or, more exactly, *having* the qualification, now seems to provide the overriding discursive rationale for taking employment with a 'Big' audit firm. Whilst other trainee professionals may choose their profession and begin their training with a strong sense of why the work they will be doing is important to them and the public (and perhaps see this service ethic corroded later), trainee accountants seem to place little value on the profession *per se*. As the client service ethic is closely connected to commercial awareness (and seizing the opportunities to expand the firm's non-audit services), it is unsurprising that while many audit trainees consider the possibility of a career within the large audit firms, the audit task is commonly perceived as one of the lower prestige points of the audit firm hierarchy. As Anderson-Gough *et al.* (2000) concluded:

“Notwithstanding the claims of practicality and general business training that trainees attach to their work in audit firms, one curious element of this is the low esteem in which audit is held once qualified. Audit is no longer held to be a lucrative, challenging or enticing career within the firms by the majority of those who either leave or remain with the firms in the hope of future partnership.” (p.)

Part of this erosion of status appears to be allied with audit's declining profitability; despite the unmistakable strategies of the large firms to treat audit as the gateway to the pursuit of the more diverse and financially rewarding non-audit services; audit fee pressure aside audit partners *could* justify the value of the audit function to the firm as a subsidised or loss leading activity. The increasing emphasis in the firms for 'managing' partners through measures of fee income, realisation rates and profitability, however, suggests that in practice that audit partners are just as subject to the same financial targets as their senior managers and partners in other 'commercial' divisions of the firms (Covaleski *et al.*, 1998).

The propensity for corporations and other third parties to litigate against the global audit firms has also impacted upon the risk and return associated with audit (Tonge & Wootton, 1991). In turn this has incentivized the large audit firms, as Covaleski *et al.*, (2002) have

suggested, citing the AICPA, “to migrate up the economic value chain” and lay claim to wider areas of management expertise and consultation. In short, the professional identity of accountants trained within audit firms has become closely connected with the discourse of client service and adding value to the client – to the extent that traditional audit functions, and the audit divisions providing such services, have lost status in their own organizations. A number of our interviewees noted that audit partners were not generally seen as major players within the firm partnership structure (although there were some exceptions) and that audit partners were continually under pressure to demonstrate improved recovery rates.

Seen in these terms, BRA offered an attractive re-conceptualization of the audit craft. Re-inventing audit as a commercial practice has offered an opportunity to recapture the prestige that the declining profitability of audit had eroded. The notion of ‘adding value’ to the client embedded in the new audit methodology resonated closely with the identification of corporate management as the essential audit client (for more discussion, see Anderson-Gough *et al.*, 1998; Humphrey and Moizer, 1990). Accordingly, BRA presented both an external legitimation to the ‘client’ and an internal justification of audit to the seemingly higher status functions and divisions of the modern large professional service firm. As such, perhaps the business risk audit event marks another stage on the transition of the accountant and auditor from ‘professional expert’ to ‘businessperson’.

However, if these rationales offer a justification to the clients and the firms themselves, the embedding of BRA has required the enactment of other processes of legitimation and transformation. The next section explores how the professional associations of accountancy have been enrolled to facilitate the BRA methodology.

Institutionalizing Business Risk Audit

Whilst the emergence of BRA has tried to push the market appeal of audit from a statutory requirement towards a form of quasi-management consulting, and as such has signalled a change in the rhetoric of audit, the embedding of BRA in the organizational field of the profession has been an ongoing political project for the audit firms and their professional association (Covaleski *et al.*, 2002). The large firms’ advertising brochures and academic monographs have been supplemented by the overlapping involvement of the professional institutions.

Covaleski *et al.* (2002) indicated how the re-alignment of the services provided by professional service firms can be characterized as a ‘dramaturgy’ of exchange relations between the large

firms and the professional associations that speak for the profession. The aspirations of the large firms in the USA to re-define themselves as 'global knowledge experts' encompassed not only themselves, but also the AICPA, the SEC and the Institute of Internal Auditors (IIA) in debates and conflicts over the role of auditing professionals and the economic relationships between audit firms and their clients.

In the UK, the acceptance of BRA has seen an adjustment of practices associated with the professional institutes. Although BRA is almost exclusively associated with the largest of the audit firms, the professional associations in the UK have facilitated a wider acceptance of the 'assurance' methodology. One key element of this exchange has been a struggle between the large and small firms to re-structure the education of prospective accountants and auditors. As Lemon *et al.* (2000) suggested, the introduction of BRA embodies assumptions about the expertise and competences of auditors:

"A business risk approach emphasises judgement, and broad skills to be able to assess the position of a business in its environment, matters of strategy, operations and finance. This has implications for the nature of the formal qualifications recognised as appropriate for auditors, for the structure of educational courses accredited in the process of qualification and the recruitment and training of audit staff by the public accounting firms. ¼ there is a heavy emphasis on strategic management embodied in the business risk approach and, as a consequence, auditors conducting audits under that approach will have to be strongly conversant with the strategic management literature" (p. 22).

Revising the intellectual content of professional training has helped to assert the case that the accountant or auditor has the established competence or expertise to conduct a re-invented audit function. Demonstrating command over, and the appropriate credentials for (Reed, 1996), an abstract body of knowledge is a fundamental element of professional jurisdictional control (Abbott, 1988). Without a credible background of expertise and training the claims of BRA could be held in question by occupations whose competing or overlapping concerns with business risk viewed BRA methodologies with suspicion - such as, for example, the professional associations of internal auditors. In fact, some years prior to the publication of the Lemon *et al.* study, the English Institute (ICAEW) had initiated a review of the professional training process. For example, in 1996 the ICAEW set up an internal inquiry into the future of the profession and the skill set of the accountant of the future. The resulting consultation document, *Added Value Professionals: Chartered Accountants in 2005*, constructed a future in which the possible oversupply of chartered accountants and loss of audit work would be compensated by a transformation of the audit sector towards assurance reporting to third parties on matters such as pensions, internal control, public sector services as well as the traditional audit client (ICAEW,

1996: 20-1). By setting out the agenda for the UK profession in these terms the 1996 report set in train a series of reform to professional accreditation that would put together the future in these terms.

In part the added value business professional ideal reflected the potency of the large firms, though in practice this leverage operated through the engagement with issues by their appointees to the relevant ICAEW internal committee. The chair of the key ICAEW committee responsible for educational matters, the Education and Training Committee (E&T), Peter Wyman, a senior tax partner in what later became PricewaterhouseCoopers⁹, had begun a review of the structure and curriculum of the examinations constituting the professional qualification process. The ICAEW's E&T Committee issued in a 'Green Paper' in 1998 entitled *Creating the Added Value Business Advisor*, which in many ways served to reinforce the validity of business risk auditing. The Green Paper recommended the adoption of specialist pathways within the training process. Whilst certain technical skills remained core to the training process, the Green Paper proposed elective routes within the examinations process to broaden the potential education of prospective 'entrepreneurial' accountants. Wyman travelled across England and Wales to make presentations to Local District Societies explaining the proposals and 'bring on board' the medium and small accounting firms. Representatives from the smaller accounting firms regularly voiced concerns in public meetings and in the financial press at the diluting of 'core' accounting competencies, in favour of a more general business or, perhaps, even MBA style education. Though such programmes to educational curricula are rarely without controversy, the changes suggested by *Creating the Added Value Business Advisor* were consistent with the skills changes that subsequent BRA methodologies have claimed as being necessary if 'traditional' accountants are going to be capable of becoming business risk assessors.

Professional auditing standards make up another arena in which the new audit methodology has to be assimilated. To this end, on both national and international auditing regulatory stages, business risk audit has stimulated the development of new auditing standards orientated towards the new methodologies and which in turn add validity to BRA as a professional audit practice. For example, the Audit Risk Project of the International Auditing and Assurance Standards Board (of the International Federation of Accountants) was set up explicitly to integrate the regulation of audit risk assessments with the design of audit procedures. In October 2002 the IAASB issued four replacements for previous ISAs that dealt with Internal Control and Computer Information Systems (IAASB, 2002a, 2002b, 2002c, 2002d). Whereas previously risk

assessment standards were considered a separate niche issue for regulations and auditing standards, new standards regulating the quality of risk and risk assessments are central components of the assessment of financial statement risk- -in other words, they now assume the BRA methodology and in so doing reinforce its centrality to the audit process. BRA is established as the legitimate object of regulatory activity and becomes further embedded in audit practices.

Of course, the programmatic ideals of BRA are by no means concluded and thus far the potential for conflict between professional members or the accounting profession and other occupational groupings appears not to have been that visible. Yet as Covaleski *et al.* (2002) have shown in the USA, as part of a wider programme of outsourcing of internal control issues in corporations, actions by the AICPA supported by the large firms have brought them into dispute with the Institute of Internal Auditors. In the UK, where the professional groupings associated with internal auditing and control are much less visible and more fragmented, possibly the opportunities for the Big 4 firms to extend their jurisdiction appear less obstructed. Nevertheless, it would appear that competition for the corporate internal control market has intensified with the advent of BRA (Power, 2000; Dezalay, 1991).

In summary, business risk audit (BRA) has offered to the audit industry and the profession a new form of rationality and legitimacy for the audit task. Audit or rather assurance appears to occlude the distinction between audit and business (or value adding) services in a seeming harmony of interest between auditor and corporate management. As such BRA has not so much marginalised audit independence (Jeppesen, 1998; Power, 2000) as recast the audit as a process of mutual *interest* between the business director and the auditor (Power, 2000). Already the fixing of BRA in the educational training of auditors is in process and regulators appear to have been persuaded to adopt BRA as the defining methodology of audit for standard setting. The next section of the paper examines the tensions that have emerged from the re-invention of audit, starting with the relationships of accounting professionals to their institute and to each other.

Tensions in the Professional Audit Coalition

“Two former PricewaterhouseCoopers partners have formed a 'new concept' audit firm, which will focus on helping companies meet the requirements of the Higgs' report and *promises to be completely independent of the company it audits.*

According to its founders, Jonathan Hayward and Richard Sheath, *Independent*

Audit Limited has been set up 'in response to the Enron and WorldCom scandals and will provide financial and corporate governance analysis - reporting solely to [company] boards and audit committees'.

As its name suggests, the firm says it will ensure that 'total independence from management is maintained'." (Larry Schlesinger, *Accountancy Age*, 17th February 2003 - emphases added).

To date the effect of recent US large audit failures on the professional coalition is uncertain. Thus far there seems to be a mismatch between the definite, almost clear-cut, nature of proposals for reform (such as the banning of consulting services, compulsory auditor rotation, more detailed audit reporting etc.) and a recognition that, with BRA, audit as conducted by the large audit firms is not what it was. However, from our interviews it is apparent that a source of tension has developed further between the concept of audit as understood by the small and medium firm practitioners and that of large firm auditors.

As Power (2000) has indicated, in part the rationales of BRA can be equated to the old adage that an auditor needs to understand the client's business. Yet in the same way that BRA has contributed to a radical redefinition or reinvention of audit, so we observe more clearly contrasting understandings of audit amongst accounting and auditing professionals. For some of the firms the scope and role of audit work goes beyond established and largely agreed notions and understandings of audit - "We are no longer just auditors, but we are respected business advisers". Some smaller audit firms still have financial statements at the forefront: "the theory of it hasn't changed, the practice of it hasn't actually significantly changed, an audit file that you pick up from a department today is very much the same as far as evidence and everything else is concerned as one that you picked up twenty years ago".

Audit now emerges as a much more varied, ill-defined and intangible service than implied or assumed in standard proposals for audit reform. In interviews it was apparent that many supposedly key auditing concepts (such as independence) were often not readily or explicitly referenced. Indeed the current lack of taken-for-grantedness of audit independence was the motivation (as illustrated at the beginning of this section) for some auditors to proclaim as a 'new audit concept' the firm that is concerned primarily with independence. While the discourse for change seems to articulate more client-driven rationales, developing audit methods (such as risk-based auditing) can be interpreted in different ways. What drives auditors is a complex mix of influences, including their own perceptions of their position within the firm, prior training and experience, the way in which their performance is assessed and official auditing standards and

practices within the firm and the profession more generally.

For example, many small firm practitioners remain sceptical as to the methodology of BRA. The push in recent years for the audit to become an added-value business service was commented upon with a sense of irony by many of the small-firm practitioners and, indeed, by some of the large firms:

“People go through fads and fancies and most things in auditing do go around in circles....you wait long enough and it [*the old methodology*] will be back again”

Many small practitioners were concerned that the processes of reinventing the audit had effectively cut audit work back to its bare bones and that, post-Enron, people had started to realise this and were gradually seeking to increase levels of audit testing. Moreover, most small practitioners asserted that the BRA philosophy (creating firm value) reflects a working model that they had effectively been operating with on their owner-managed business clients audit - the old adage of knowing the business – and where their audit was usually coupled also to accounts preparation and tax advice. In short, small firm practitioners believe that they know their clients’ business but are sceptical as to the capacity and ability of the audit divisions of the Big 4 firms to offer the same degree of understanding through BRA. One sole practitioner reported that while the proposal to increase the audit exemption for small firms had initially been a cause for concern, the fact that he had always been operating within a value-enhancing model meant that revenue streams were not at stake. In commenting on such a state of affairs, he reflected much of the business model currently underpinning the BRA philosophy in larger firms:

“It did concern me at some stage when it (audit exemption reform) was first mooted. I suppose I was wondering where my next pound was going to come from, but then the market has changed. I’m doing more and more accounting, business management, finance director type stuff than I ever did, and that’s what clients want”

Many interviewees, particularly from non-Big 4 firms, saw a need for audit reforms to distinguish between audits of multinational public limited company audits and smaller, largely, owner-managed entities:

“What I would like to see is that they [*the standard setters and the ICAEW*] should make a distinction between - clients that have public exposure, listed entities particularly and the rest. I think there's a tendency to one rule for all and I don't think that suits because I think it makes it impractical at the smaller end of the scale with owner managed businesses to do certain other things ...”.

The public limited company audit environment was viewed by small practitioners as

being driven more significantly by matters of public interest, information credibility assessment and the explicit independence of the external auditor, while audit in the owner-managed sector represents a more broad-based audit environment, with audit being just one of a range of services provided to the client. Accordingly, reforms such as banning auditors from providing other services to audit clients were generally viewed by small practitioners as having little relevance to the practice of audit in smaller, owner-managed businesses. Indeed, in this context, the ruling concept was not one of independence, but rather interdependence - with auditors and owner-managers working together in a mutually-dependent business relationship.

“I'm always at the client - always seeing what the client's up to, what's its doing. I'm very much a hands-on person, and some people would criticise me for that, 'as an accountant and running a business at an office, you should be here running the office'. I can see the independence argument, but at my level of industry, family-owned companies, it (separation of audit from consulting) would be a disaster. There was an expression when I first trained, and I still use it to this day, and it's the auditors' nose. It's allied to common sense. It's not just ticking a box, it's actually going and doing the job, getting to the grass roots and finding out what makes the place run and tick. I think it would be very wrong if the powers that be decide that audits got to be done by people who are not connected in any way, shape of form, with the firms they are auditing”

Unsurprisingly, small firm practitioners saw their approach to work and the type of services provided to clients as more integrated and cohesive. Yet they considered that serious questions confronted the audit approach and underlying business model being applied on the audits of larger, multinational corporations. Where there exists a clear distinction between owners and managers and clear issues of public responsibility and accountability, in their opinion should the role of auditors really be based so centrally on satisfying the business demands of managers? Indeed, many questioned whether top-managers, expert in their domain, really wanted business advisory services from their external financial auditors. Smaller, owner-managed businesses required their auditor to have a broad-skill base and to provide a broad range of services. However, they doubted that such skills were not already available in multinational corporations and, if they were not, doubted also that such organisations would automatically seek them from their external auditor. Assessing the credibility of externally published financial information might not be as inherently attractive as being an added-value business adviser, but if that is the social (and, potentially, even the client-management) expectation, it is something that was seen as having to be done and done properly.

Auditing appeared to be a more central determinant of the culture of the mid-tier firms, with

interviewees employing the more traditional notions in order to describe their professional identity – typified by the way respondents felt that they were, first and foremost, auditors. That said, while stressing the benefits of the traditional compliance role of the auditor, they also saw that such a function was always likely to deliver broader benefits to the ‘client’:

“I don’t think our approach has changed very much at all. It’s always involved some element of understanding of the clients’ business, understanding the risks, the internal and the environmental risks. The added value is really in the people that they’re dealing with. I suppose it’s worth saying that if I’d have thought my role was just about auditing, just going in and checking terms, then I would still not be here after 18 years. The enjoyment I get is actually dealing with the guys that run their businesses, and helping them grow. You build up a relationship with them, but it obviously has to remain independent and objective”

“We would find it harder to advise them successfully if we didn’t do the audit, because you learn a lot about the business from doing the audit. Equally, you learn a lot about the business through providing other services - which helps you in your audit. Tax compliance is an area where if you don’t do the audit, it becomes quite inefficient. There’s so much information on the audit file which you, and only you know, and you’re not going to give that to others”

Both small and mid-tier auditors were of the belief that the provision of *integrated* or complementary services did not give rise to potential conflicts of interest – largely because they were mainly dealing with owner-managed clients. However, they saw the issue of separating auditing and consulting work as being very relevant to the Big 4 firms:

“Advising on value is the biggest problem with relationships (corporate finance work) and independence (audit work). Because you’ve already said that a business is worth £Xm on the audit, then with the corporate finance work, can you come along and say it’s worth peanuts?”

“There is a paradox related to the size of the firm. The big four offer advisory services in a compliance environment, and in this setting, it needs to be split”

“Yes, definitely on PLC audits... auditors should not be a ‘jack of all trades and masters of none”

“I think we have a lot of sympathy with the view that smaller businesses don’t need an audit. It’s obviously part of the debate as to what extent they’re exposed to greater risk. I think there’s a difference between the listed companies and others. Companies where people can invest and you’ve got a big divergence between ownership and management. There is, I think, an argument, a good argument that listed companies should be dealt with separately. Where I am not convinced is that compulsory rotation will achieve anything. You’ve only got four firms really and they’re just going to be moving them around from one firm to another”

These separate identities were evidenced, and thereby maintained, through the firm’s employment policies. A small size audit firm partner reflects on his experience with people he had employed from the larger firms:

“I've employed people from the big five, or the big four as they now are, and they're just totally not 'with-it' as far as this level of work is concerned, they can't tune into the requirements and the needs of the man in the street [1/4] the guy who I employed from one of the big four was - yes, he was a chartered accountant, he just ticked boxes, he'd done the audit, the accounts came off the computer, he was quite computer fluent, laptops and all that, he didn't sit back to think 'well, what do they mean' - I said 'well, why, Philip, have you not done this, what about that - have you not looked at this - what about that, your papers don't say this, your papers don't say that - why, why, why - what if - ', you know, he just hadn't been trained properly in my view”

The smaller-firms saw the skill base of the auditor in narrower, more traditional terms. Given their client base, their audit staff had to be well skilled in basic accounting techniques and familiar with taxation regulations etc. The 'one-stop' approach adopted by audit clients meant that staff had to be good all-rounders, well versed in the 'fundamentals' of accounting. Newly-qualified staff from the Big 4 firms were no longer people that the smaller (or even the mid-tier) firms would actively seek to recruit as their accounting and audit background was perceived to be too narrow. However, middle managers from Big 4 firms were deemed to be very attractive employment candidates, reflecting a greater degree of regard from the small practitioners for the post-qualification training and experience provided by the medium firms.

In the large firms, a central attraction of BRA methodologies was that they would help to make the audit process more 'relevant' and creative and, therefore, more likely to attract high-flying, top-rate graduates into the firms. There were also comments that a broader, 'business aware' form of training and practice offered the audit sections within the large firms ways of generating respect from client management, as well the potential for generating additional fee income, which previously would have been assigned to the business consulting division. The skills base being sought, however, was different from the more traditional, accountancy-based skills favoured in the smaller firms – here it was understanding business and management models and key conceptual approaches in organizational strategy and psychology. Again, though, such developments appeared capable of generating fragmentation and division. A limited number of interviews with partners who had moved out of audit into business consulting and private equity firms revealed a real scepticism towards the promotion of BRA methodologies and their conceptual underpinnings and assumptions. Audit partners might talk of being 'relationship people' but for these former auditors, audit partners were most definitely not 'relationship people'. Such former auditors saw business consulting in a more favourable light and clearly positioned the audit section as being staffed by people who could not 'cut it' in business consulting. Auditors in the smaller firms were also sceptical of the effectiveness of such BRA

methodologies. Aside from arguing, as noted earlier that they had been operating a business-oriented approach to auditing for a while (and in a manner that they felt was more cohesive and appropriate), they felt that many of the profession's current problems had been brought on by the larger firms overly reducing audit testing levels. Some interviewees in mid-tier firms saw the scandals on the scale witnessed in the US as quite desirable in terms of a widening of the client base to service larger clients and benefiting from fee increases.

Divergent Constructions of Auditing and Professional Fragmentation

From the above analysis, auditing emerges as much more varied, ill-defined and intangible service than that which tends to be implied or assumed in standard proposals for audit reform. Supposed key auditing concepts (such as independence) are not readily referenced by respondents, while business-oriented audit methods and philosophies are capable of being interpreted in very different ways. What drives auditors appears to be a complex conjunction of influences, including perceptions of their firm, its traditions and systems, their status and rank within the firm, prior training and experience, the way in which their performance is assessed, and the profession more generally. That auditors struggle to identify any clear routes for reform is a consequence of the environment in which they operate – as interviewees regularly pointed out, simplistic reforms are likely to prove problematic when confronted with the operational complexity of audit practice. The danger for auditors is that they are currently rather marooned in this environment and quite limited as to what they can contribute to current debates. On one level, there is a danger of publicly acknowledging that things are a whole lot less certain than official professional proclamations would admit. On another level, there are powerful myths and traditions that are hard (if not dangerous) to discount. Thus, should auditors come clean in terms of what they do and don't do on audits instead of hiding behind the mystique of auditing? Should they be more communicative in audit reports or will all this detract from the so-called 'deterrent effect' of auditing? Can the audit process continue to develop in ways that may appear to be more supply-driven than demand-led; more about what audit firms wish to provide rather than what audit stakeholders desire? Should auditors start to challenge more explicitly other elements of the profession or maintain a rather more distanced (and distinguished stance) of not criticising fellow professionals? Can the audit of multinational corporations continue to be treated as the legitimate domain of the Big 4 firms, given the questions that have been raised over the strength and merits of their current audit approaches and underlying 'audit' philosophies? Should smaller audit firms be more vocal in expressing their preferences and desired strategies instead of accepting that they are unlikely to appear highly on the agendas of the Big 4 partners who so often represent the professional accountancy bodies of which they are

all members?

Concluding Comments

The emergence and dissemination of new audit techniques and methodologies have not received the attention in academic research that is merited by their significance. In the processes of establishing new claims to knowledge, there is the opportunity to examine the professional and social processes through which such claims emerge and the extent to which attempts are connected to the extension of professional jurisdiction. In so doing, the dynamics that underlie the institutions of the profession may be revealed and subject to tension. The paper's title signals three interrelated dimensions of this technical-professional interface: status, identity and fragmentation.

The new audit techniques and their associated discourses and rationales are intertwined with the status accountants and auditors perceive of themselves and their craft, and their identity as auditors (or 'business advisers'). In the moments of realizing new audit methodologies, they allow us to explore the tensions that exist or fractions that may emerge between institutional agents and interests in the profession. The aim of this paper has been to explore the extent to which the new audit methodology of BRA has been promoted by firms, and institutionalized in practice, what rationales are used by firms adopting BRA to legitimize the change, what are the different views expressed by the different concerned groups towards BRA, especially those of smaller firms, and the impact of such change at the organizational and professional level, especially post Enron.

Although BRA methodologies have dominated audit discourses over recent years, evidence presented in this paper suggests that within certain sectors of the profession, there is still scepticism expressed about their added value. Concerned groups not only doubt the inherent technical validity of such methods but also the conceptual change at the level of the idea, scope and role that audit plays in general. In all of this the lack of empirical analysis of contemporary audit practice and its implications for the status and identity of the profession remains striking. While the professional discourse in favour of BRA methodologies appears to articulate client-driven rationales, developing an understanding of how these methods gain legitimacy necessitates critical investigation of more complex mix of influences that are related to both the 'supply of' and 'demand for' audit. Although the large firms have attempted to establish the argument that the shift towards more risk based approaches is a response to 'demand', this paper argues that the call for change is, in market metaphor terms, supply driven by the large

firms, who brought into play these new methodologies through their auditing practice, to renegotiate terms of their professional status and widen their jurisdictional claims over other areas of expertise. Many of the imperatives for BRA are in our view reflective and constitutive of the organizational tensions in play within large firms. The BRA event is not simply another episode in the transformation of the identity of the Big Six/Five/Four from auditor firm to professional service firm (Greenwood *et al.*, 2002). This shifting notion of the accountant as business advisor has undermined the status of audit divisions to the extent that the business assurance re-invention of audit in part offered a welcome source of internal legitimacy to the audit services in the Big Four firms.

The paper revealed other sources of professional fragmentation between the small and large firm sectors. Differences between small and big firms' perceptions and commitments towards the new methods have highlighted diverse and competing notions of professional identity amongst professionals. For example, for some mid-tier firms, audit was and still is the main service provided. Hence, their professional identity hinges around and identifies with certain standard notions and attributes of auditing and accounting-based techniques. Larger firms on the other hand saw themselves as business advisors and tended to reject the label auditor as a descriptor for their work. Invoked by the adoption of BRA as a new methodology, these increasingly more irreconcilable differences in professional identities amongst practitioners have implications for the profession in general and also the nature of reforms proposed by firms to salvage the reputation of auditors after scandals such as Enron.

In the post-Enron environment, the history of BRA is by no means stabilized. As new 'retro' audit firms are established claiming to be truly 'independent', former external auditors demand that auditors "re-connect with shareholders" (see Acher, 2002) and evident differences appear in the views of members of the accountancy profession as to how auditing should develop (see Humphrey *et al.*, 2002), a lively period of further change in the market services probably lies ahead. The increasing emphasis upon mechanisms of corporate governance and the role of non-executive directors might paradoxically offer a challenge to audit, signaling a lack of confidence in the ability of auditors to deliver whatever it is the audit is intended to deliver - a question that, as we have seen with the audit expectations gap debate, has never been settled. As Big Firms have attempted to move ahead from audit to business advice, on the success or failure of the BRA methodology might rest the entire market for audit in the future. Indeed, it could be argued that the auditing profession is very much at a crossroads - but it is not the typical one portrayed in the media, centred on the need for auditors to become more active in

detecting fraud and preventing corporate collapses. While the latter issues are significant, they represent claims and expectations that are too divorced from the day-to-day practice and routines of auditors and audit firms. Rather than accepting 'wish-list' items or trying to fight them off as inappropriate, we believe it is likely to be far more socially productive to develop understanding of the practical achievements of today's audit methods (Eilifsen *et al.*, 2001), of the ways in which auditors behave and are treated within the firms and the extent to which performance measurement systems and cultural perceptions as to the relative status of auditing impact on auditor performance.

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Endnotes

1. While traditional audit is arguably heavily dependent on a compliance mode of regulation, it also depends upon deterrence - a mode of regulation not addressed by the BRA literature.
2. The argument here is that judgments of materiality in transactions testing is in its own way an acknowledgement of risk.
3. US, UK and Canada.
4. Mark Davies, a Canadian Assurance partner in KPMG Toronto, describes the top down risk based audit as analogous to determining "the health of the tree by identifying and focusing attention on branches most likely to be diseased".
5. The text has recently been supplemented by a book of cases on strategic-systems auditing (see Bell & Solomon, 2002).
6. There has been very little empirical study of smaller firms or of accountants in industrial settings.
7. This notion of professional conduct was in part communicated to the trainees through their formal appraisal procedures (see Covalieski *et al.*, 1998) and the competencies they defined: leadership, commercial awareness, client service, etc.
8. Covalieski *et al.* (1998) have argued that the focus on the personal aspects of dress, and make up and other aspect of personal appearance extends also to partners. In their study of US auditing firms they noted the sanctions against such items as "rubber watches", "short socks", "white pantyhose" and being seen, in the garden of your own home, shirtless.

9. Wyman is the current President of the ICAEW.