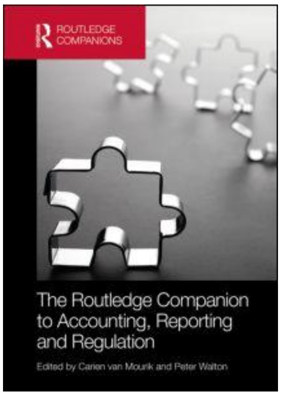

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Auditing, Regulation and the Persistence of the Expectations Gap

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Auditing, Regulation and the Persistence of the Expectations Gap

Christopher Humphrey, Anna Samsonova and Javed Siddiqui

1. Introduction

The statutory financial audit for a limited company is essentially a process through which the credibility of the financial statements produced by the company's management are independently assessed by an external auditor, who then reports his/her opinion to the company's members (i.e. its shareholders). However, as Humphrey (1997) points out, the auditing assessment or examination should not regarded as an exact science, ensuring 100 per cent accuracy of the information contained in the financial statements. Rather, the assumed purpose of an audit is to ensure that the financial statements are reasonably free from material misstatements and errors, with auditors having a formal responsibility to express their opinion regarding the 'truth and fairness' of the financial statements prepared by the entity.[1]

It is often said in relation to audit practice that a fundamental obligation on the part of any auditor or audit team is to maintain an audit trail – a level of documentary detail that would enable another auditor or member of the audit team to follow and appreciate the audit work undertaken. The importance of an audit trail is usually raised or highlighted in the context of auditors needing to protect themselves from any potential legal liability claim by being able to demonstrate at the time that the audit work was performed that it represented a reasonable set of tests and judgements – and avoids the audit process being judged inappropriately with the benefit of a level of hindsight that, by definition, was not available to the auditor.

1.1 Developing a perspective on the audit function

Intriguingly, when the role and efficacy of auditing is discussed in public policy circles and reforming initiatives or strategic imperatives are proposed as ways of delivering a better or more comprehensive form of auditing, the contextual emphasis that is so critical to the practice of individual audits is usually lacking. Debates are often extracted or isolated from their historical context, such that reform proposals can be represented as distinctive, new initiatives and options, even though they may have been considered (or even tried) a number of times in the past. They are given a contemporary feel and status that belies their past, their historical trail.

Such a state of affairs has three important implications for any study or analysis of the audit function. First, it is crucial to appreciate that while standard setters and regulators may be keen to use terms and phrases that claim that 'an audit is an audit', the subject of auditing is neither something that is, nor should be studied from a perspective that takes it as, fixed and absolute. Indeed, rather than being clear cut and with a definite pattern of development and advancement, the history of auditing is, and continues to be characterized by (or at least associated with), the notion of an auditing expectations gap – that auditors are not performing to the levels expected of them and/or that there is an educational mismatch between what auditors say they are supposed to do and what the investing public and others to whom the auditor is responsible thinks they should be doing.

Second, this standing and status of auditing means that, conceptually, it is important to recognize that there are a multiplicity of theories and perspectives that can be applied to the role of auditing and the study of its practice. As earlier analyses of the subject of auditing have illustrated (see Humphrey, 1997), it is evident that auditing can be studied from several broadly defined perspectives, including:

- a *normative* approach (stating what auditing and auditors 'should' do);
- an *economic* approach (which seeks to understand the individual and corporate incentives and motivations that influence the demand for and supply of audits); or
- a *critical* approach (which seeks to understand the social and political influences on the provision of audit services and which challenges, rather than takes as given, appeals to notions of professionalism and the claimed pursuit of the 'public interest').

In essence, such approaches can be represented on a contextual continuum, wherein auditing is capable of being studied in quite acontextual terms or in very tightly specified conditions and contextual constraints. Audit can be examined through approaches which drop the assumptions of political neutrality typical in traditional perspectives on professionalism and root themselves in the political forces that help to shape audit practice and govern the environments within which audit work is undertaken. Additionally, it is possible to classify studies of auditing in terms of those that seek to evaluate the performance of auditors and measure what audit practice has or has not achieved – as compared to those that seek to understand the reasons, factors and influences that have served to shape, refine and develop such practice. The analysis of auditing can also be at a micro- or macro-level, obtaining specific insights of the audit approaches applied on individual audits and within individual firms or seeking to draw general conclusions about the broad nature and impact of the audit function.

Third, there is a strong imperative not to seek to study auditing in absolute terms but to focus on understanding key thematic movements, disruptions and shifts in emphasis over time. For instance: to recognize emergent tendencies and patterns of change (and resistance to change); to be sensitive both to linear development and to evident circularity in attempts to reform practice; to understand and question the degree to which there is consistent and effective process of learning from experience and the events of the past; to review the status and influence of claims to expertise and associated shifts in ruling forms of expertise and the reliance place on any such expertise/assumed forms of authority, and to appreciate the significance of changes in the scope of audit practice and its relative societal reach and influence.

1.2 Auditing as an object of inquiry and a brief summary of this chapter's objectives

It is always important to keep a clear sense of perspective and focus with respect to the precise subject for study regarding the development of audit practice. It is also essential that the value and interest in what is being studied is both well understood and made clear to the reader. In the field of auditing practice, this very often leaves the role of the researcher as being one that seeks to put such practice more visibly under the public microscope; to make sure that claims made for audit practice are adequately supported by and assessed through a sound knowledge of what is being done in the name of practice.

This role is reinforced by the substantial invisibility of audit practice, or at least the quality attained by such practice. The formal, published audit report has been said in the past to be one of the most expensive professional reports when measured in terms of the word length of the audit report divided by the audit fee. However, relative to other professional services offered by accounting firms, it is not one of the most visible and easily appreciated. You may well hear a client saying how well their accountant had performed in reducing their tax liability or providing sound business planning advice, but you are unlikely to hear them praising the quality of the audit that they had just received. Further, what auditors can and cannot say in public with respect to their audit work seems to be very tightly governed, whether formally or through established custom and myth, by notions of client confidentiality and professional ethics. If the deterrent effect of the audit is sufficiently strong, in terms of providing some form of external check on corporate management and discouraging errant behaviour, the audit report is only likely to have a significant information value in the rare (or surprise) cases when something is wrong. The norm being that the audit opinion is an expected affirmation of an assumed state of affairs and of normally low surprise value. Finally, as with many functions which are rooted in verification and proof-testing, as second-order control functions rather than first-order production functions, they are commonly associated with notions of the routine and images of being boring and tedious to all but those with an attraction to checklists and a strict adherence to rules and procedures.

The consequences of such a state of affairs for the development of auditing knowledge are multifaceted. At one level, it very often means that developments in auditing are not deemed to be 'newsworthy', while at another level the relative invisibility of audit can mean that we hear more about general claims as to what auditing can do as against definitive evidence as to what it does achieve in practice. Further, the difficulty in getting close to practice can also mean that researchers are required to rely extensively on proxy variables when seeking to measure audit quality or key dimensions of audit work; such that the significance of research findings is invariably disputed depending on how credible and plausible one finds the chosen proxies – and leaving some authors to conclude that we know a great deal about audit quality while others argue that we know a lot about proxies for audit quality but not very much about the intricacies and complexities of real life, day-to-day audit practice. It can also mean that the social significance of auditing is underestimated or misrepresented, and that key changes and developments in the world of auditing are missed or underappreciated because auditing is seen as a 'boring' and tedious practice. Alternatively, the profession (with its massively successful multinational accountancy firms) can be seen more as a commercialized business venture (as against a public-spirited mission or calling), leading to criticisms made by the profession as to perceived threats to audit quality being regarded as special-pleading, rather than fair and appropriate comment.

Taking the above factors into account, this chapter addresses one specific but very important dimension of the auditing arena – namely, contemporary developments in auditing regulation and their implications for auditing practice and the auditing profession more generally. Earlier studies of auditing expectations (e.g. Humphrey, 1997) have highlighted the frequent degree of contrasts over time between assessments of auditing at a particular point in time (as being a dull and tedious function) with much more positive future projections (in which auditing is set to be much more socially significant and even exciting) or between the claimed rise of an all powerful

Audit Society (see Power, 1994, 1997) and a growing scepticism and doubt over the capacity of the traditional financial audit to meet basic expectations of primary stakeholders. Such questioning brought with it over the past fifteen years a growing commitment to, and belief in, systems of independent regulation, public oversight and international audit standard setting. Yet the establishment of such systems were not sufficient to prevent the recent global financial crisis, which raises the question as to what has been achieved by such alternative regulatory systems and what has been their impact on the development of a professionalized audit function.

An intriguing but very simple way of capturing the issue is to consider how attitudes towards auditing standards have changed over the years. When the first formal set of auditing standards and guidelines were being developed (e.g. in the UK in the mid-1970s), it was commonplace to see such standards referred to as setting a basic minimum, with the assumption that the larger and more outward looking audit firms were performing to levels well above minimum standard. A sentiment well captured in the Foreword to Stoy Hayward & Co.'s *Audit Guide* (1983), which emphasized that 'although our audits must be up to standard, they must not be standard' (p. iv). Nowadays, when asked to describe their audit methodology or approach, most firms will characterize it as being fully compliant with International Standards on Auditing (ISAs) but say very little, if anything, as to whether (and how) it delivers a level of quality that exceeds that specified by ISAs. We no longer talk of standards of audit quality but the quality of audit standards. The issue we pose here is the extent to which such a change is practically significant and what the implications are for a profession that seems to have become more content with, or at least resigned to, fairly intrusive and exacting systems of regulation and oversight.

The chosen topic for analysis is interesting on a number of fronts. It has a very evident international dimension and appeal in that independent oversight and inspection processes in auditing now dominate globally and have largely replaced systems of professional self-regulation. Such internationalism is also appealing in that it introduces a new dimension to the analysis, inviting discussion that is not the standard one of pro- or anti-regulation but one interested in understanding the implications of changing regulatory structures and affiliations for the practical context within which auditing assignments and associated learning and professional processes are undertaken. Finally, with the observed persistence of the auditing expectations gap and the questions that this persistence directs at the auditing profession, both in terms of public communication and underlying rationales of audit practice, it is important to ask where processes of innovation and professional and technological development stand in relation to international auditing.

2. Regulating auditor independence

The demand for independent audits is frequently represented as deriving from a typical agency dilemma – a separation of control and ownership – resulting in information asymmetries (Watts and Zimmerman, 1983). Managers are perceived, particularly by shareholders, as being potentially able to maximize their benefits at the expense of the company's owners' 'self-serving behaviour'. Auditing, accordingly, is said to serve as a tool to help company investors in terms of forming an opinion on the trustworthiness of information presented by the management, which is especially useful if shareholder structure is diversified and ownership widespread. Such verification of the company's financial reports by an external auditor effectively provides an instrument with which company investors (agents) can monitor, control, and discipline their stewards (managers). Hence, auditing is often seen as a facilitator of corporate governance. In addition, Wallace (1985) argues that audited financial statements present an essential source of information that investors and third parties may use to minimize their risks (both systematic and business-related) when making decisions (*information hypothesis*). Furthermore, management, investors, and various third parties may view auditors as a sort of insurers to whom to shift their financial liabilities to lower the possible losses or to direct financial claims in the event of litigation.

It is also important to view accountancy, and auditing in particular, beyond organisational boundaries as an element of the society's social fabric (Hopwood and Miller, 1994). Indeed, auditing, as well as accounting, has an important social meaning in terms of promoting general economic stability and public welfare. Historically, however, there have been significant differences in the perceptions of auditors' responsibilities among the public and auditors themselves, or what has been otherwise referred to as an *audit expectations gap*. Humphrey (1997) defines such a gap as 'a representation of a feeling that auditors are performing in a manner at variance with the beliefs and desires of those for whose benefit the audit is being carried out'. Since the term 'audit expectation gap' first appeared in late 1970s in the terms of reference of the Cohen Commission set out by the American Institute of Certified Public Accountants in the US, the reasoning attached to it and the associated concerns have not changed much. Characteristically, the existence of the gap has been assigned to both lack of education on the part of the users and the failure of auditors themselves to dynamically interpret and respond to the changing public demands. The resilient nature of the gap has been documented and empirically illustrated in a variety of national context (see, for example, Porter *et al.,* 2009, for some recent reference), suggesting that the problem should not be viewed in isolation but rather as a continuation of the debate on some more fundamental issues relating to the nature of auditors' responsibilities.

In recent years, financial auditing has seen a significant growth in the scope of regulatory and standardization activities, driven, to a great extent, by the 'pressures for rationalization, formalization and transparency of the audit process' (Power, 2003, p. 392) stemming from the very nature of audit and specifically the fact that it is difficult for an outside party to observe what it is that auditors do or evaluate audit quality. Historically, bodies concerned with regulation of the audit professional have been concerned with the ability of the auditors to perform their responsibilities in an independent and objective manner. A few illustrations serve to make this point.

2.1 Promoting auditor independence

In the United Kingdom, the Cadbury Committee (1992) produced a highly influential study of various aspects of corporate governance. With regards to the state of audit practice, the Committee identified an audit expectations gap as an area of concern, arguing it was a result of unrealistic expectations toward the auditors. The Committee's report also discussed the consequences of the provision of non-audit services (NAS) by the incumbent auditor and, after a lengthy discussion, concluded that imposing a ban on the provision for NAS would unduly limit the freedom of companies to select their sources of advice and consultancy. At the same time, the Cadbury Committee strongly advocated for full disclosure of audit and non-audit services provided by auditors and recommended that the 1991 regulations under the Companies Act on the disclosure of remuneration for NAS should be reviewed and amended as necessary in order to apply this principle.

In 1995, the UK's Financial Reporting Council (a body responsible for regulating the accountancy profession) set up the Hampel Committee, *inter alia*, to implement the recommendations in the Cadbury Committee's report. The Hampel Committee (1998) subsequently argued in favour of a stronger role for internal audit committees in monitoring the independence of the external auditor, especially in the case of the joint provision of audit and non-audit services.

Some of these suggestions were later incorporated into the UK's Combined Code of Corporate Governance(FRC, 2003).

At the turn of the century, a series of accounting scandals involving large US corporates, such as Enron, WorldCom, Waste Management, and Sunbeam, attracted significant public attention to the role of an auditor in safeguarding corporate accountability and transparency. The scandals created a major credibility crisis for the auditing profession, and exposed the problematic nature of the relationship between auditors and their clients (Copeland, 2003). This was acknowledged by a number of regulators around the world:

> 'Confidence in global financial markets was seriously shaken a little over a year ago by the high profile failure of Enron. As the scale of the accounting irregularities and the role of the auditors, Andersen, became clear, the credibility and reputation both of company directors and of the accountancy profession – and of auditors in particular – were called into question in a fundamental way' (CGAA, 2003, p. 4).

In an attempt to restore the credibility of the auditing profession, policy makers and professional accountancy bodies in various countries concentrated their efforts on developing regulatory strategies that would be able to address public concerns over the issues of auditors' independence and professional scepticism. This led most notably to the Sarbanes-Oxley Act 2002 in the US (SOX, 2002). In particular, this Act introduced a complete ban on the provision of some NAS and required the audit committee's approval for the provision of others. Following these provisions, the US Securities and Exchange Commission (SEC) (2003) required extended disclosures in listed companies' annual reports of the remuneration paid for a range of audit and non-audit services. The SOX Act (2002) also required mandatory partner rotation on the audit engagement team. Such measures were also mirrored in related regulation introduced by the European Commission (the executive body of the European Union) which prohibited the provision of a number of NAS while suggesting effective safeguards for others, and also, proposed for key audit partners to be rotated every seven years. Further important changes with regards to the regulation of auditing in Europe occurred as a result of the issuance in May 2006 of the revized Eighth Company Law Directive (2006/43/EC) on auditing, which among other things, provided for a stronger role for independent regulatory oversight of the audit profession (a subject that will be addressed in more detail later in the chapter).

2.2 A new crisis and European action

The 2008/9 financial crisis raised further questions about the state of corporate governance, particularly in the financial services sector. Although auditors were not initially blamed for the crisis, the efficacy of auditing as a control function gradually came under increased scrutiny. In the UK, the Treasury Select Committee of the House of Commons, published a series of reports into the governance practices of financial sector institutions (Treasury Select Committee, 2009). Although the reports found little evidence to suggest that the auditors had failed to perform their duties, important questions were raised about the general usefulness of the audit function and suggested the need for a major overhaul of the role of the auditor. Furthermore, the Treasury Select Committee raised continuing concerns with auditor independence, and specifically, the risks associated with the joint provision of audit and NAS, and asked the Financial Reporting Council (FRC), the UK's regulator for the accountancy profession, to consider introducing a complete ban on the joint provision of audit and NAS. In response to such a call, the FRC's

Auditing Practices Board launched, in October 2009, a consultation on the proposed revision of the Ethical Standards for auditors. Although the new version of the standards issued in 2010 (APB, 2010) did not impose any blanket prohibitions on the provision of NAS, it proposed a range of safeguards to protect auditor independence.

At the European level, against the backdrop of the financial crisis, the European Commission issued a Green Paper outlining its plans for future audit reform (EC, 2010). The Green Paper acknowledged that the financial crisis had exposed some inherent weaknesses in the audit function, as a large number of companies, despite being in poor financial condition, had managed to receive unqualified audit reports. According to the Green Paper, this raised serious concerns regarding the role of audit and highlighted again the significant presence of an audit expectations gap. The Green Paper sought consultation on a wide range of audit-related issues, clearly privileging reform of independence rules and regulations and the development of enhanced levels of competition in the audit market. Major reforms proposed by the Green Paper included extending the role of the audit, improving communications between the auditors and the shareholders, addressing problems associated with conflicts of interest, reducing audit market concentration, and improving independent oversight. Humphrey *et al.* (2011) analysed the underlying assumptions of the EC (2010) reform proposals. They pointed out that although the Green Paper proposed a number of reforms designed to influence the nature and scope of the market for audit services, there was a paucity of evidence that such measures would have the desired effect on audit quality. Similarly, a number of proposals were based on the premise that audit quality suffers due to lack of auditor independence. However, prior research investigating the effect of measures such as mandatory auditor rotation, provision of NAS, and audit firm governance on audit quality has been largely inconclusive. However, despite this, after some intense negotiations, the final reform proposals were published in November 2011 (EC, 2011), with provisions for mandatory rotation of audit partners, a complete prohibition on the provision for NAS, and extended supervision of the audit sector in the EU.

2.3 The developing role of audit committees

A final illustration regarding the regulatory focus with respect to auditing relates to the developing role of the audit committee. In addition to limiting the provision of NAS and introducing audit partner rotation, tendering etc., the role of the audit committee (AC) in mitigating threats to audit independence has been a significant continuing item on the regulatory agenda for more than a decade. ACs are expected to lead to higher transparency and reliability of financial statements as well as reduce the risk of the auditor providing an incorrect audit opinion (McElveen, 2002; Turley and Zaman, 2004). Moreover, they are expected to protect auditor independence by assuming responsibility for the appointment and remuneration of auditors, and providing an independent platform for auditors to express their opinions on management policies. In the UK, although the Cadbury Committee (1992) first proposed enhanced role of ACs in ensuring auditor independence, a more detailed guideline regarding the actual role of the AC was provided in the post-Enron era by the Smith committee. ACs were required to play a more pro-active role in decisions relating to auditor selection and remuneration. Also, the ACs were asked to produce a NAS policy for the company that would detail and justify the types of NAS the company would purchase from the auditors without posing a threat to auditor independence. Similar roles for the AC were also proposed by the EC (2002), which went on to suggest AC involvement in auditor selection, remuneration, and NAS selection process. The recently published EC Green Paper on audit policy (EC, 2011) also suggested strengthening the role of the AC in order to ensure audit quality, including playing an active role in the mandatory tendering process.

Prior research provides mixed evidence regarding the role of AC in ensuring audit quality. Although there is an abundance of studies on corporate governance and auditor remuneration in the highly regulated environment of the US (see for example, Ashbaugh *et al.,* 2003; Carcello and Neal, 2000; Krishnan and Visvanathan, 2009; Larcker and Richardson, 2004; and Zhang *et al.,* 2007), in less regulated environments, including the UK and Australia, there is less evidence on the relationship between corporate governance quality and auditor remuneration, and the evidence that does exist is largely inconclusive. Whereas Peel and Clatworthy (2001), examining audit fees in the pre-Cadbury (1992) period, find no significant evidence that board structure variables significantly affect audit fees, more recent studies (such as Zaman *et al.,* 2011), find that effective ACs play an active role in ensuring audit independence.

3. Promoting (international) auditing standards

The transformation in processes of audit regulation, especially in terms of the growing importance of international influences and market-based solutions, is well evidenced by the growing influence of International Standards on Auditing (ISAs). The capacity to set auditing standards, traditionally associated with national professional bodies and nation states, has been gradually shifting towards the realms of global governance, with a key role played by the International Auditing and Assurance Standards Board[2], the body that develops International Standards on Auditing (ISAs) (Tamm Hallström, 2004; Loft *et al.,* 2006; Humphrey and Loft, 2010b). The IAASB states that its mission is to become a global audit standard setter and make ISAs the world's preferred standardization framework for the delivery of high-quality audit services designed to appeal to adopters from a variety of national contexts. Therefore, ISAs have been envisaged as a type of global standard of audit best practice and a vehicle for international audit harmonization (IAASB, 2007).

As with many other voluntary standards, ISAs are principles-based in the sense that they prescribe how to do things by defining 'the types of administrative processes that are supposed to lead to high quality' (Brunsson and Jacobsson, 2000, p. 4–5). First called International Auditing Guidelines, they started to appear in 1979, and now the total number of ISAs has reached thirty-six (at the time of writing). ISAs have been adopted in over 120 countries worldwide. The standards are presented in groups governing various aspects of an audit. ISAs 200–299, for example, outline the auditors' responsibilities as well as the nature and general organization of an audit, including audit documentation and internal quality control. Other groupings of ISAs provide technical guidance on specific stages of the audit process from audit planning (ISAs 300–499) to evidence gathering (ISAs 500–599), using the work of others during the audit (ISAs 600–699), and the preparation of an auditor's report (ISAs 700–799). In 2004–2009, the IAASB undertook the so called 'Clarity Project' with a key objective to make ISAs more understandable in terms of the clarity of definitions and prescriptions used in order to stimulate further uniformity in audit practice (IAASB, 2004). The IAASB's recent pronouncements (IAASB, 2008) characterized 'clarified ISAs' as a comprehensive and adequate response to recent changes in accounting practice, such as a growing acceptance of fair value accounting.

The global travel of ISAs has been underpinned by their appeal as credible methodological guidelines as well as by their perceived ability to serve as a means of improving the public image of audit practice and its quality. In the wake of the 1997/98 Asian financial crisis, for example, the Financial Stability Board (then Forum) recommended 12 international standards of best practice, including ISAs and International Financial Reporting Standards (IFRS), to be adopted by national governments as a way to boost their levels of corporate governance, increase financial transparency, and restore investor confidence (Kristof and Wudunn, 2000). This event was significant in terms of helping to build a global image of ISAs as it effectively meant that 'public authority was accordingly being placed behind private standards, giving them a more important status not just in terms of processes of corporate reporting but also to the larger project of insuring financial stability' (Humphrey *et al.,* 2009, p. 811).

3.1 From standards' adoption to compliance with standards

While the emphasis on the importance of adopting ISAs remains, one can observe some major concerns growing in professional and regulatory circles over the workability of the standards, the actual degree of 'compliance with standards', and perceived deficiencies in the strategies of enforcement (see, for instance, IAASB, 2011). Some individual country experiences illustrate what Power argued over a decade ago (Power, 1997, p. 8) that audit routines can be 'loosely coupled to the purposes which they are intended to serve and rarely function according to the official blueprint'. In this regard, the IAASB Chairman Arnold Schilder noted in a recent public speech:

> the standards themselves are only one part of the equation: there is also the essential matter of implementation. Plans need to be made for adoption, yes, but planning must also consider training and support. We should not, and do not, underestimate the practical challenges of implementation (Schilder, 2011, p. 3).

The existing academic and professional literature has provided ample evidence of the challenges of international audit harmonization and the complexities of achieving global compliance with one set of international auditing standards (Wong, 2004; Hegarty *et al.,* 2004; Walter, 2008). Wong (2004), for example, notes significant inconsistencies in localized understandings of the notion of standards adoption across countries and, specifically, what full convergence with ISA should entail – which, he argues, makes it difficult to assess progress toward international harmonization. Furthermore, Wong points to the complex and changing structure of the standards themselves as well as significant institutional constraints (such as those relating to the market infrastructure, legal systems, education level, and others) as key factors contributing to the inconsistent application of ISAs. Furthermore, a fundamental challenge with regard to assessing the actual level of compliance with ISAs has been to break through the layers of auditors' declarative statements in order to understand what working with the standards actually involves in every-day practice. Despite a few attempts to unveil the audit firms' internal dynamics and work processes (see, for example, Mennicken, 2008, and Samsonova, 2011, focusing on the Russian context), the true limits of what ISAs can (and cannot) achieve remain insufficiently understood.

Additionally, the value of auditing standards in terms of setting the boundaries for the kind of assurance that auditors can reasonably be expected to provide cannot be viewed independently of the actual quality of financial reporting rules and practices. In particular, it has been argued that the growing acceptance of fair value accounting, promulgated in the standards issued by major accounting standard setting bodies such as the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) in the US could have had an adverse effect on the auditability of accounts based on such standards (Power, 2010). As the recent global financial crisis demonstrated, times of extreme volatility in financial markets do not only lead to uncertainty in the application of fair value measurements and arguably reduce the information value of such valuations but also significantly challenge audit systems and techniques in terms of their capacity to determine and assess the relative reliability of such valuations, the risks facing companies and the stability of their reported financial positions.

But even more challenging than determining the precise level or degree of standards compliance has been the task of understanding the underlying reasons for any such compliance/non-compliance. From an individual country perspective, a greater level of compliance with international standards such as ISAs has been traditionally associated with a high degree of internationalization of the general business and audit professional environment, evident from the presence and influence of foreign capital, international audit firm networks, and a greater orientation of local companies towards the demands of the global capital market (Hegarty *et al.,* 2004). However, there have been those arguing that, even in countries with sufficient institutional capabilities, international pressures alone are often not enough to trigger substantive changes in the actual practice of financial reporting and auditing (and a degree of movement that goes substantially beyond declarative statements of intent). Walter (2008), for example, in his analysis of standardization projects in the countries of East Asia points to the economics of standards compliance (i.e. a correlation between costs and benefits of compliance) and the effectiveness of monitoring and external oversight arrangements as having a stronger influence (compared to international pressure) on how global standards, such as ISAs, are followed and the likelihood of what he terms 'mock', i.e. disguised, non-compliance.

On the international stage, a significant project directly concerned with issues of substantive compliance is the ROSC (Reports on Standards and Codes) initiative, introduced by the World Bank and the IMF (International Monetary Fund) in 1999. The ROSC initiative has examined the degree to which developing and emerging nations observe the aforementioned 12 international standards of best practice, including ISAs, which were endorsed by the Financial Stability Board. ROSC country reports are designed to 'assist the country in developing and implementing a country action plan for improving institutional capacity' and 'raise awareness of good corporate governance practices among the country's public and private sector stakeholders'.[3] A like-minded initiative, launched in 2004 by the International Federation of Accountants (IFAC), namely its Compliance Program, seeks to ensure that 'international audit standard-setting processes are seen to be globally credible and sufficiently responsive to public interest demands' (Humphrey and Loft, 2010b). As part of the Program, IFAC member bodies (i.e. national professional accounting institutes) are required to make their best efforts to comply with the provisions of the Statements of Membership Obligations (SMOs), and specifically, provide regular updates as to the state of progress with regards to accounting and audit reforms.

4. The rise of regulatory oversight

With this growing emphasis on compliance with, and enforcement of, (international) standards has come a greater concern with the development of systems of external oversight over the auditing profession – and especially in relation to the auditing of 'public interest entities'. The rise of independent and quasi-governmental audit oversight at a national level is evident from the growing number of regulatory oversight agencies established in various countries – and through which a body of inspectors carries out control checks of the quality of public company audits. Among prominent examples of this trend is the formation of the PCAOB (Public Company Accounting Oversight Board) in the United States, following the publication of the Sarbanes–Oxley Act 2002 (SOX) in the wake of the Enron scandal and the subsequent demise of the company's auditor Arthur Andersen (see Shapiro and Matson, 2008; Canning and O'Dwyer, 2011;

Malsch and Gendron, 2011). SOX entrusted the PCAOB with the responsibility of undertaking quality control inspections of audit firms with public company clients. The expectation was that PCAOB inspections would be more impartial than the former 'peer reviews' that were being undertaken by the larger auditing firms; the PCAOB was considered as a body independent of the audit profession and the inspectors would be selected on the premise that they could not be current employees of audit firms. However, recent studies have expressed doubts as to the effectiveness of such inspections. Lennox and Pittman (2010), for example, demonstrate that PCAOB inspection reports are perceived as less informative (compared to peer reviews) by auditors' clients and have not affected the clients' audit firm choices, raising questions, in turn, regarding the PCAOB's failure to disclose certain information, such as the detected weaknesses in the audit firms' quality control systems and firms' overall quality ratings.

This rise of independent public oversight has developed in parallel with the establishment of umbrella transnational institutions to provide support to the activities of national audit regulators – two notable examples being the European Group of Auditors' Oversight Bodies (EGAOB) and International Forum of Independent Audit Regulators (IFIAR). IFIAR was set up in 2006 with the aim of fostering knowledge sharing and collaboration between national audit regulators and achieving consistency in their approaches to monitoring and promoting audit quality. IFIAR now has a membership of 41 independent national regulators, including the PCAOB (US), FRC (UK), H3C (France), and *Abschlussprueferaufsichtskommission* (Germany). IFIAR's meetings are formally observed by such influential transnational bodies in the field of financial market regulation and stability as the Financial Stability Board (FSB), IFAC's Public Interest Oversight Board (PIOB), the International Organization of Securities Commissions (IOSCO) – a development which further highlights the growing significance of global regulatory arrangements for public audit oversight.

4.1 The influence of oversight on the audit profession

The regulatory arrangements and developments described above have been said to represent one of the most potentially substantive and fundamental changes in the history of contemporary public accounting (for further discussion, see Malsch and Gendron, 2011, p. 456). They have been heralded, for instance, as marking the end of the audit profession's self-determination to define and defend the boundaries of auditing as a professional practice and auditors' specified social roles. That said, it has also been claimed that, despite such changes, there remains a major regulatory gap. According to Malsch and Gendron (ibid., p. 473), even with the rising importance and international coordination of the national approaches to audit regulatory oversight, there are insufficiently strong oversight arrangements at the global level to respond adequately to the truly international nature of the largest audit firms. IFIAR, for example, provides a platform for communication among the national oversight bodies but does not possess the authority to determine the direction of their monitoring activities, nor does it have the capacity to act independently as a global audit oversight body itself. An additional interpretation of the regulatory environment at the global level is that it is taking on the form of a 'shared (public–private) system'. In analysing the development of governance arrangements associated with international auditing standard setting, most notably the establishment of the IFAC's Public Interest Oversight Board (PIOB), and exploring the relationship between IFAC and international bodies such as IOSCO, the Basel Committee and the EU, Loft *et al.* (2006) classified the PIOB as a form of 'embedded oversight'. In reviewing subsequent global regulatory developments in the aftermath of the recent global financial crisis, Humphrey *et al.* (2009, p. 814) extended this form of argument to suggest that 'there is a form of allegiance' (ibid. p. 817) developing between private professional interests, namely large international audit firm networks, and national and international audit public oversight bodies, where the firms are deemed successful in achieving (informal means of) influence – and essentially regaining a degree of authority to determine the boundaries of audit practice and the public accountability of auditors.

Such patterns of development are also a reminder that in an era where talk of globalization is so prominent, it is important to keep such notions in context – and to recognize that there are potential limits to the spread and influence of globalization, given the scale of differences in the legal, political and social cultures that still exist across countries. For instance, it is intriguing that, despite the evident emphasis on public interest standard setting and oversight, there does not seem to be a universally accepted understanding across different national audit communities as to whose 'interests' exactly the category of 'public interest' represents. In the specific context of auditing, what the most appropriate forms and ways by which such interests serve to define (and change) existing conceptions of the nature and scope of auditors' responsibilities are left open to debate. Country regimes of auditor civil liability serve as a pertinent illustration here.

4.2 Auditor liability as a disciplining tool

Auditor liability can be regarded as implicit form of enforcement of certain standards of auditing practice, with legal claims and resulting court cases yielding an opportunity for 'public' interests (be they corporate shareholders owners and/or various third parties) to test ruling conceptions of the scope of the auditors' duty of care and the requisite quality of audit work. The existence, therefore, of any significant differences in national auditor liability regimes can be taken as indicative or reflective of cross-country variation in the treatment of issues pertaining to auditors' public accountability. With regard to the scope of auditor liability, for example, some countries (e.g. the UK), rely on the principle of *joint-and-several* liability which implies that any auditor can be required to pay for the whole amount of damages, regardless of the degree of his/her involvement in the audit engagement in question or the responsibility of other parties. In other countries (e.g. Austria and Germany), auditor liability is limited to a certain level (capped liability) or (e.g. Spain) is determined in proportion to the auditor's actual degree of responsibility (proportionate liability). Significantly, cross-country variation also relates to the parties to whom an auditor is believed to owe a duty of care. In the UK, for instance, the notable legal decision in *Caparo Industries v Dickman* (1990) established that the auditor's duty of care should be owed to the client only (i.e. a company as a collective body) as opposed to individual shareholders or other third parties. In contrast, in France, where there is an especially strong emphasis on the auditor's social role and public duty, liability to third parties is defined in tort law and states that an auditor may be held liable not just towards an audited company but also to its shareholders and third parties reasonably expected to have been affected by the auditor's unprofessional conduct (Chung *et al.,* 2010). The European Commission has sought to act in this area in the face, it should be noted, of considerable pressure from the accounting profession in a number of member states. It duly issued a recommendation in 2008 aimed at harmonizing the national legislative approaches to auditor liability across EU member states (EC, 2008). However, the impact of the document looks to be modest, which further highlights the weight of context-related complexities attached to the issue of auditors' public accountability and, ultimately, to the very meaning of the standards and quality of auditing practice and its overall value to society (Humphrey and Samsonova, 2011). In particular, it does suggest that the essential 'meaning' of audit is never likely to be fixed or absolutely defined, despite the globalizing tendencies and the rise of international regulatory oversight regimes. This has important consequences and implications for the way in which auditing as a subject should be regarded and studied. The closing two sections of the chapter will address such issues.

5. The persistence of the expectations gap

When the Cadbury Committee published its report in 1992, it identified the *audit expectations gap* as one of the major problems facing the auditing profession. It pointed out that public expectations of auditors were unrealistic and therefore damaging, and also supported the establishment of a 'new system' that would set out tighter specifications of what is to be expected from auditing and associated audit work. The sections above have outlined a range of regulatory interventions undertaken by governments and regulatory agencies around the world aimed at improving public perceptions of audit quality and auditor independence, such as placing restrictions on the provision of NAS, reducing mandatory rotation of audit firms and partners, introducing measures to reduce audit market concentration. Such efforts have certainly increased substantially in scope and intensity in the aftermath of Enron and a number of other major corporate scandals of a decade or so ago, with Porter and Gowthorpe (2004) vividly capturing the fragility of the auditing profession's public image and the challenges facing it:

> The most damaging criticisms are those that suggest that an auditing firm has failed the society in which it works. So it is vital to understand what society expects of auditors. Of course it may be that society's expectations of auditors are unreasonable, or fall outside the framework to which auditors must work, but if so auditors need to explain why it is impossible to meet them (Porter and Gowthorpe, 2004, p. 1).

However, even with the passing of the SOX Act in the US, copy-cat legislation in a number of other countries, a revized Eighth Company Law Directive on auditing and, more recently, the Green Paper on audit in Europe, the global financial crisis of the past few years has served to expose, yet again, the resilience of the audit expectations gap. As the Select Committee of the House of Lords in the UK recently demonstrated, there remain significant official concerns that the auditing profession has failed to respond adequately to public demands:

> Investors and others demand that audit should provide broader, more up-to-date, assurance on such matters as risk management, the firm's business model and the business review. This additional assurance would help the audit to meet the current expectations of investors and the wider public (House of Lords, 2011, p. 24).

The auditing profession in the UK has disputed a number of the conclusions of the House of Lords report and there have also been some robust challenges to the premises on which the recommendations of policy documents such as the EU Green Paper are based (for a discussion, see Humphrey *et al.,* 2011). It is also worth acknowledging though that there is some evident national variation in terms of the scale and significance of the auditing expectations gap – with Porter *et al.* (2009) reporting the establishment, over the past decade, of more favourable societal perceptions of auditors' performance in New Zealand.

In remaining consistent with the themes and perspectives outlined at the beginning of this chapter, it is not our intention to close our analysis by trying to provide an absolute measure of the current scale of the auditing expectations gap – not least, because the nature, scale and causes of the gap are likely to vary significantly depending on the perspective and position from which it is being viewed. That said, it is probably fair and sufficient to say that the auditing profession continues to be under significant pressure to respond to the claimed significance and persistence of the auditing expectations gap. What is potentially more interesting than the pursuit of any definitive measure of the expectations gap is to recognize and seek to understand key patterns and transformations in the way in which the expectations gap is operationalized, referenced and acted upon. For example, it is fascinating to see the differing or alternative rationales that are put forward as potential reasons for the persistence of the gap. In prior regulatory discourse, the ambiguity of auditing standards was identified as an important reason for 'unreasonable' social expectations of auditors. However, some recent studies and policy reports (e.g. Sikka, 2009; House of Lords, 2011) have argued that the gap represents a much more fundamental failing on the part of the auditing profession in terms of providing an audit function that adequately cater for the needs of society. In this respect, Malsch and Gendron (2009), for example, report that the trustworthiness of audited financial statements and the claimed public belief in the quality of auditing are both mythical representations whose function essentially serves to maintain the current status quo within the financial system. They argue that company investors are, in practice, far more reliant on the perceived quality of management rather than the content of audit reports in their decision-making. Such 'reality' highlights the need for further research into the nature and sources of the changing social expectations towards auditors as well as the existing capability within the audit profession to respond appropriately and adequately.

Furthermore, the aforementioned changes in the audit regulatory arena and, particularly, the rise of independent regulation and external audit oversight, are argued to have had a profound influence on the nature of auditing as a professional practice and the internal dynamics underlying audit firms' governance (Cooper and Robson, 2006; Robson *et al.,* 2007; Knechel, 2007; Gendron, 2009). Such literature provides evidence suggesting that among the major consequences of these contextual pressures has been an effective rise in a controlling, disciplining, self-protective and compliance-driven mentality towards auditing and a more restricted frame of reference for, if not fear towards, the making and exercising of professional judgement. Gendron (2009, p. 1021), for example, reports in this regard that 'bureaucratic control is increasingly privileged to the detriment of clan control [or peer pressure] – in managing large accounting firms'. Furthermore, he argues, audit partners rarely 'show enthusiasm about his or her career' and 'are increasingly considered as controllable cogs and disposable bodies'.

In the light of such observations, it is well worth asking, with respect to audit development, where the creative, free thinkers are now, the outspoken voices in the auditing profession. Are they being constrained and controlled by a compliance mindset which increasingly drives professional and regulatory circles? Leading members of the profession, especially those charged with senior management responsibilities in the large international audit firms, may criticise the profession's representative bodies for allowing regulators to get as far as they have in imposing their restrictive agendas. But to what extent do the profession and its leading professional firms find themselves on the back foot, struggling to regain the initiative in terms of the pursuit of reform? Who now is able to express radical, 'off the wall' views about auditing, the sort of views that may be something of an abstraction from the daily routines and restrictions of practice but whose effect and influence could be both stimulating and liberalizing? If auditors themselves are increasingly apprehensive about exercising professional judgement and/or perceive themselves as having little incentive to stand apart (even if the circumstances provide justification) from what accepted (international) auditing standards stipulate, this, arguably, represents a significant source of conceptual weakness in relation to the determination of the underlying rationales and nature of the contemporary audit function and its value to society.

Such tendencies can also invoke and legitimate a sense of defensiveness on the part of the profession in responding to corporate collapses and financial crises, and the questions for auditors that often result. On this issue, comparisons between the auditing profession's response to the 1997/8 Asian financial crisis, the 2001/2 Enron scandal and the 2007/8 global financial crisis reveal some interesting differences and consequences. For instance, the public questioning of the role of the auditors post-Enron contrasts quite significantly with the relative lack of discussion of the role of auditors in the immediate aftermath of the global financial crisis, suggesting that the profession drew some lessons from past experience and managed to mitigate to some degree the potential adverse effects of the crisis on the profession's public image and the attribution of blame. Humphrey *et al.* (2009, p. 816) demonstrate, in this respect, how the large audit firms actively shaped international regulators' sentiment behind the scenes in order to create 'a sense of preparedness for events and consequences that might follow from the crisis' – they did this, among other things, by 'relying on official assurances by independent oversight bodies as to the general quality of audit work' (ibid., pp. 810–11) and partaking in the IAASB's work on the development of fair value audit guidelines (arguably the most challenging and controversial area of auditing at present), which subsequently resulted in a revized ISA 540 'Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures'. Humphrey *et al.* concluded that the resulting outcomes of these activities were such that the profession had, so far, 'largely escaped critical comment and the apportionment of blame' (ibid., p. 810) to which other market agents (such as banks, rating agencies, and others) had been subjected. Indeed, the audit profession was quick to use the infamous statement of Paul Boyle, the chief executive of the UK's Financial Reporting Council, back in 2008 that the audit profession had had a 'good crisis'. Nevertheless, such conclusions proved to be something of an intermediate period of satisfaction and tranquillity – and have come back to bite the profession hard, with several subsequent inquiries (as mentioned above) raising critical questions as to what external auditors were doing in giving clean opinions to major banks that collapsed or went into serious financial trouble shortly after. Further, there remains a significant constant between the current and past periods of turmoil and questioning. While there has been a considerable amount of recent activity in developing new governance codes for audit firms and enhancing communications between auditors, audit committees and prudential regulators, four to five years after the start of the global financial crisis, it is still pertinent to ask just how much more have we gleaned and now know of the practical quality and value of the work of auditors? The auditing expectations gap continues to be characterized and fuelled by both knowledge and performance gaps.

6. Implications for the future of audit practice, research and regulation

A persistent expectations gap, in some ways, can be a comforting thing, in that it is clearly capable of being regarded, if not dismissed, as something that the profession just has to live with. If past efforts, whether genuine, half-hearted or self-serving, have failed to substantially close or eliminate the gap, why worry so much about it now? Indeed, a gap can be a positive feature as it implies that there is always something to improve, to develop and innovate. Better to have aspirationally high standards of expectation than standards so low that they are not only easily reached but also reflect a lack of social esteem on the part of the profession providing the requisite service or function.

There is also an inherent danger when formulating or recommending strategic action and different forms of public policy engagement that the familiarity and immediacies of the present are allowed to dominate over a sound knowledge of historical trends, patterns and intransigencies – with the result that contemplated and recommended action can subsequently prove to be either ineffectual, misplaced and/or counterproductive. That said, it is possible to see some potentially distinctive features in the present regulatory environment within which the profession is operating which collectively help to build a constructive and persuasive case for action on the part of the profession.

At one level, there has to be some doubt, especially in the EU context with the current insistence of reform under Commissioner Barnier, as to who is listening to the profession in its comments on audit reform proposals. Criticisms of reforms can run the risk of being rooted in a desire to retain the status quo when the status quo has been deemed by the profession's regulators as no longer acceptable. Alternatively, convincing arguments built up by one or a group of audit firms or professional institutes are likely to be undermined by the fact that the audit profession has not, on significant occasions, responded in a uniform way. For example, when reforms offer market opportunities to smaller firms, it has to be acknowledged that some such firms will choose to break away from the rest and promote themselves as offering a more viable and constructive option to the current status quo. A divided profession is most likely in a weaker position in terms of its negotiations with regulators and lawmakers.

Audit research explicitly focused on practice and the daily realities experienced by auditors and audit firms is starting to highlight the problematic nature of the topic of 'audit innovation'. In the pre-Enron days of business risk-based auditing approaches, there was a real buzz associated with the subject of innovation in auditing – new approaches were being trialled and even implemented (in some cases on a big scale). The motives for such innovation were varied, ranging from a desire to do better audits or more interesting audits to a more commercial orientation for more profitable audits. But whatever the motives, arguably the subject of innovation was alive. Firms talked of their own audit methodologies, of the special developments they were undertaking, of their distinctiveness and special advantages over other firms. There was a fresh and positive atmosphere associated with audit and the scope for innovation.

A decade or so on and the audit world appears to be very different. A critical question is the extent to which the technology and practice of auditing has developed in recent years and to what degree, and in what ways, it is comparable to technological advancements in areas such as mobile telecommunications, medicine, computing and motor manufacturing. What is the equivalent advancement in the field of auditing to the smart phone, laser surgery or the hybrid/electric car? A common form of response to this question is for audit practitioners to point to information technology developments that have taken place in the audit arena: how audit files are now electronically set up, developed and maintained; how it is now so much easier for files to be updated by individual audit team members; and how any member of the team can immediately access the up-to-date version of the file. But what do all of these changes say about the level of innovation in audit as a professional knowledge base?

One example of the impact that technological development can have on the nature of financial reporting and audit practice, and the objectives served by business accountants and audit practitioners, is the implementation of the eXtensible Business Reporting Language (XBRL) since the late 1990s. A growing use of XBRL by companies worldwide has been encouraged by professional bodies, e.g. the American Institute of Certified Public Accountants (AICPA) and the Canadian Institute of Chartered Accountants, and by institutions such as the Securities and Exchange Commission (SEC) in the US and Her Majesty's Revenue and

Customs (HMRC) in the UK – who, respectively, mandated this new technology for the filing of company accounts in 2008 and 2010. XBRL has been designed to make it easier for companies to gather information about their financial performance in an electronic format, so that such information can then be posted on the Internet and shared instantaneously with various users, such as investors, members of the financial community and regulators. Such a system is said to have minimized the need for human intervention in the financial reporting process by providing a web-based platform where company financial information is stored and, when needed, retrieved by an interested user directly from XBRL 'instance documents' consisting of a collection of data points classified ('tagged') based on their common descriptive qualities (e.g. areas of financial reporting). Hence, the system allows for a tailored approach to how company financial statements are generated in a way which meets the demands of specific users. From the audit perspective, the spread of XBRL effectively promotes a continuous interactive process of internal audit and control where auditors gain an ability to notify company management of financial reporting issues as they arise. Whilst one can clearly imagine a variety of practical difficulties with providing an external audit assurance on the financial reports prepared using XBRL (such as the problem of applying substantive testing techniques in the electronic data environment or ensuring that all financial information is included in the tagging process and properly classified – see, for example, a report on the implementation challenges by the Canadian Institute of Chartered Accountants, 2005), the potential influence of XBRL arguably goes beyond the issue of technical implementation and relates to the very nature of audit work. Specifically, with such a technology, the content of company reports as well as the notion of a user of such reports becomes a flexible category as traditional general purpose financial reporting shifts more toward financial reporting for specific interests and objectives, which is bound to have some influence on public expectations as to the nature of the auditor's role. For example, with regard not just to what auditors are assuring with respect to the quality of the view provided by any one particular set of financial statements but the quality of the underlying systems producing the many varied sets of financial information demanded and extracted by users.

In terms of audit innovation, the initiative and power to drive through changes in practice arguably seems to have been passed to independent regulators and oversight bodies. Regulators increasingly determine what needs to happen in terms of audit development, they look more and more like the truth-sayers in terms of operational levels of audit quality and the font of knowledge in terms of what needs to happen or change. In a European context, there is certainly a very expansionary set of noises emerging from bodies such as the European Securities and Markets Authority (ESMA) as it looks to bolster its regulatory oversight role and capacity (for a discussion, see EU, 2012, p. 4). However, even the most cursory of glances at regulatory reports quickly suggest that this position is not one beyond question and challenge. Regulatory reports, for example, seldom give much indication as to where audit has worked well (and how, why and to what effect), tending to prefer to list series of failings. It is also routinely difficult to judge whether the fundamental failing was one of the quality of audit output and outcomes or a problem of process recording and documentation. What can be said with some certainty though is that the current so-called failings of audit in relation to the global financial crisis have happened under the very explicit and detailed watch of independent audit regulators. So if, for example, auditor scepticism or communication with banking supervisors has declined, it is something that regulators have either served to stimulate or proved incapable of stopping.

Whenever we contemplate new regulatory reform proposals, it is important to remember that regulatory reform does not start, and has never started, from a clean sheet. It is tainted by past experience, and both successes and failures – we should not assume that we are somehow living in a 'regulatory heaven', where regulatory failure is essentially beyond challenge and inevitably followed by yet more 'much needed' (but untested and untried) new regulations. That said, given the reported, or at least claimed, closeness (as noted earlier in this chapter) between the profession and its 'independent' regulators, it is also risky to assume that the profession has been a passive and uninfluential bystander in terms of the regulatory systems within which it is has to work. Indeed, it could be asked whether the profession and its response to criticism and crisis has ended up with the regulatory regime it deserves or what it needs given the business interests it pursues and the organisational structures it operates. This is an interesting issue as, ultimately, it goes to the heart of what professionalism means or comes to represent in the context of auditing.

When we talk of professionalism in auditing, we routinely evoke images of independence and freedom of thought, of individuals committed to truth and justice, of reasonableness and a rationality of evidence-based judgement and an overriding commitment to and belief in transparency. However, it may be that the auditing profession, at least in recent years but arguably for many years, has adopted a very much more pragmatic and business-oriented perspective on 'professionalism', one that prioritises commercial survival over a strong and undying adherence to a 'professional' code of practice. This is not an easy point to establish given that notions of professionalism and audit quality have a considerable degree of subjectivity and social construction. However, the profession has not been without opportunities to make the quality of its audit work more visible and better appreciated – and there is an important trade-off to consider with respect to whether a function is more valued when it is transparently performing to a certain level or when it retains a mystical quality wherein actual performance levels could well be lower than those perceived and/or anticipated. The idea of a ruling sense of commercial pragmatism is also suggested by an evident trend which sees proposed audit regulations very often being resisted strongly by the profession but once put into practice quickly becoming accepted ways of behaving.

Whether this is a commercially opportune decision or an inevitable and natural response (e.g. why continue to fight losing battles?) is an open question. But, significantly, it should also serve as a substantial reminder that there is much that the audit profession (and future entrants to the profession) can and should learn about the importance of remembering and not losing a sense of history. We need to ensure that professional qualified auditors, both in their initial and continuing professional education, have a far better appreciation of the history of auditing and the economic, political, social and cultural contexts in which the practice has developed and been shaped. We also need to think much more seriously about the intellectual (and not just ethical or commercial) values that govern the auditing profession. Ultimately, this is the audit trail that the profession really does need to maintain and promote.

Notes

1 For detailed textbooks analysing the audit process and the legal framework within which auditing is practised, see Gray and Manson (2011); Porter *et al.* (2008).

2 IAASB sits within the International Federation of Accountants (IFAC), a private organization for the global accountancy profession that brings together 159 national professional accountancy bodies from around the world.

3 See a statement on the World Bank's web-site: http://www.worldbank.org/ifa/rosc_cg.html.

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