

THE FORCE OF LAW AUSTRALIAN AUDITING STANDARDS AND THEIR IMPACT ON THE AUDITING PROFESSION

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ABSTRACT

This study examines the impact of the introduction of the legally enforceable Australian Auditing Standards (ASAs) on the auditing profession after the first year of implementation. The study compliments and extends the Australian Government's April 2006 pre-implementation Regulation Impact Statement (RIS) which identified potential costs, benefits and other impacts of the new regulatory regime. Relevant data was collected through interviews with RIS key stakeholders. Overall, the results suggest that the additional burden of compliance with the legally enforceable ASAs has not increased audit quality or public confidence, which were the main aims of the government's regulatory intervention.

CLASSIFICATION CODE: Auditing, Regulation

KEY WORDS: Audit Quality, Auditing profession, Auditing Standards, Impact of Regulatory Intervention, Public Interest

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1. INTRODUCTION

This exploratory study examines the initial post-implementation perceptions of the main impacts on the auditing profession and practice after the first audit period under the force of law Australian Auditing Standards (ASAs). It also builds upon and compliments the April 2006 Regulatory Impact Statement (RIS) conducted by the Australian Government, and the CPA Australia survey (2006)¹. This research is timely given the lack of any other systematic post-implementation data, and informs the regulators and the auditing profession of the perceived initial costs, benefits and other operational impacts on the key stakeholders.

The Australian Government's justification for the specific regulatory reforms adopted in the wake of the corporate collapses, including the statutory requirement for auditing standards to be legally enforced under section 336 of the Corporations Act 2001 for financial audits commencing 1 July 2006², was to provide a clear public interest focus, and to ensure that auditing processes and standards are of the highest quality. It is noted that such legally enforceable auditing standards are relatively rare with Australia and France at present the only 'western' countries to adopt such an approach.

The analysis of the data collected indicates a number of significant differences between expected costs and benefits of the new regime as indicated in the RIS and what respondents have portrayed as their experience after the first year of implementation. Overall the results of this study do not provide strong support for the Australian

¹ CPA Australia 2006 Survey focused on the perceptions of members on the impact of CLERP 9 reform on auditing and public confidence pre-implementation of the legal ASAs.

² Accounting Professional and Ethical Statement (APES) 410 provides that conformity with auditing and assurance standards is mandatory for all audit and assurance engagements, effective 1 July 2006.

Government's introduction of the legally enforceable ASAs as an appropriate response to achieve an increase in the quality of audits and public confidence.

2. THE REGULATION IMPACT STATEMENT (APRIL 2006)

Prior to any new regulation being implemented, the government releases a RIS detailing whether the impact of the new regulation on business is warranted and efficient.

The RIS addressing the introduction of the new legally enforceable ASAs was released in April 2006, providing pre-implementation views from the affected stakeholders including representations from the auditing profession, regulators, business and standard setters. The comments from the various groups are summarised in Appendix A.

The identified potential costs and benefits of the legally enforceable standards from the RIS (April 2006) analysis are as follows:

Costs:

- Auditors/firms may need to revise audit programs. However, the costs associated with these changes are no more than for a normal update.
- Auditors already comply with auditing standards, hence little, if any, compliance costs.
- Any costs will be short term and relate to the first year of compliance.

Benefits:

- Consistency with existing structure of standards.
- Changes to ASAs to avoid misinterpretation over the auditor's obligations.
- Conformity with ISAs and best international practice

3. RESEARCH QUESTIONS

The ‘Public Interest Theory’ of regulation holds that government regulation is supplied in response to public demand for the correction of inefficient market practices and perceived market failure (Posner 1974, Peltzman et al 1989). Therefore according to this theory the Australian Government’s intervention in the standard setting process, in particular making ASAs legally enforceable was justified, as it “considered the public interest first and foremost” (RIS April 2006: 4).

An alternative explanation could be a desire to demonstrate to the investment community and the profession that, as a result of an emerging lack of confidence in the accounting profession, the government needed to act. The action could be seen as a ‘political’ motivation and it is consequently of interest to investigate the perceived motivation for the government to intervene in a process which up to this point had been predominantly in the hands of the profession. Hence the following research question is addressed.

RQ1: What is the perceived motivation of the government in making the ASA’s legally enforceable?

Consistent with ‘Public Interest Theory’, the lack of success of self-regulation by the professional bodies has been seen in the past to be due to lack of enforcement powers against non-complying members (Walker 1993, Walker and Robinson 1994). The new ‘black letter’ legally enforceable mandatory requirements included in all ASAs, along with penalties for non-compliance represent a significant departure from the prior AUSs which allowed for a much greater level of judgement to be exercised by the auditor in undertaking and documenting the audit process. Given the increased regulation and monitoring of the profession and the detailed enforceable requirement of ASAs a reaction by the stakeholders would be expected. This is addressed in the following research question.

RQ2: What is the reaction of professional bodies, and accounting firms to the legally enforceable ASAs?

A number of studies (Gaffikin 2005, Godfrey et al 2006) imply that governments intervene to correct market inefficiencies and the optimal approach to regulation will be evident in increased audit quality. Given the perception that public confidence in the information produced by corporations, and in particular the audit process has been undermined by recent corporate failures, the legally enforced ASAs were introduced via CLERP 9 to enhance the integrity of the audit function and thus restore public confidence. The FRC's strategic direction proposes that the AUASB should develop ASAs that are of the highest quality, conform to ISAs and follow international best practice (RIS April 2006). "CLERP 9 reforms have by and large raised the bar for the auditing profession and will help regain investors' confidence" (CPA Australia 2006: 10).

Prior studies (Mitnick 1980, Gaffikin 2005, Godfrey et al 2006) also pose that government regulation is costless when it is pursued for public interest as a result of market failure. In addition, the RIS (April 2006) asserts that there would be little, if any, compliance costs to the audit firms. Hence, the perceived benefits and costs are addressed in the following research questions:

RQ3: What are the perceived key benefits of the legally enforceable ASAs?

RQ4: What are the perceived costs of the legally enforceable ASAs?

4. RESEARCH METHOD

The research method utilised in this study involved semi-structured in-depth interviews with the key stakeholders affected by the new legislative framework. This exploratory-orientated method allowed the researchers to elicit the respondents' views, feelings and perspectives on the impact of the new legislative framework after the initial year of introduction. The respondents interviewed represent the key groups affected by the new regime namely, accounting/audit firms, professional bodies and regulatory bodies. These are the same stakeholder groups that were consulted in the government's pre-implementation and consultative phase. It was not possible to identify specific individuals who responded to the RIS however by using the same stakeholder groups and interviewing individuals at a senior technical level within groupings it is considered that those interviewed were appropriate and representative both from a practical and technical perspective. Furthermore, the accounting firms interviewees were selected as the most appropriate participants by each of the firm. With regard to the professional bodies in particular, these individuals would have had the responsibility to respond to the RIS.

The accounting firms stakeholder group consisted of the 'Big 4' (Sydney offices) and the NSW Audit Office. The NSW Audit Office is included as a large accounting firm given its significant client base consisting of audits for over 400 NSW government entities under the Public Finance and Audit Act 1983 and the Corporations Act 2001. Furthermore the NSW Audit Office senior professional staff are members of either CPA Australia or ICAA. Four of the accounting firm participants consisted of two partners (directors) at each interview, with one a specialist in compliance at the technical level, whilst the other a practicing partner (director) familiar with audit engagements. The remaining 'Big 4' partner interviewed plays a key role in the assurance/advisory work area and is involved primarily in technical compliance issues. Professional bodies'

participants were representatives from CPA Australia, ICAA, and IIA³. All were in technical advisory roles responsible for their respective bodies' policies, responses to audit regulation and engaging with members and government in liaising on these issues. The IIA was included as a professional body given their members' involvement with the external auditor and exposure to the ASAs in practice. Regulatory bodies' participants included an ASIC representative, a current senior AUASB representative as well as a recent member of the IAASB, who also had a significant role on the AUASB prior to and post his role on the IAASB and was therefore deemed appropriate.

Each participant was identified by a code number to ensure confidentiality. The number of interviews conducted within each stakeholder group and the applicable code for their responses are summarised in Table 1.

(INSERT TABLE 1 HERE)

A series of target issues to guide the interview process were identified based on the government's RIS (April 2006), the researchers' knowledge of the new audit regime, discussions with academic colleagues and practicing senior members of the auditing profession. The target issues are:

- the government's motivation for legally enforceable standards
- the main costs
- the main benefits
- the main impacts on audit methodology
- the main operational impacts (e.g. staff training, compliance.)
- audit quality
- justification

³ It should be noted that the NIA (National Institute of Accountants) was also considered however due to time constraint was not available.

The list of target issues was made available to the respondents prior to the interview and was explored in the interview to elicit their understanding and perceptions of the costs, benefits and direct impacts of legally enforceable auditing standards. Given the semi-structured nature of the interviews, the interviewees were able to express themselves without specific boundaries or restrictions (Farneti and Guthrie 2007) and without imposing a priori categorisation that may limit their responses (Fontana and Frey 2005). Use of issues and non-directional style of questioning mitigated any potential interviewer bias. The interview guides were designed to be as open-ended as possible to allow the interviewee to express their opinions and ideas and to further pursue relevant areas of interest. Once the list of target issues was covered, interviewers asked if the interviewees had anything further to add that might be relevant to the study. All interviews were approximately one hour in duration and were recorded on a digital device.

An interview protocol was established to guide and record the interviews. Each interview was attended by at least two researchers, simultaneously taking notes. Immediately after each interview, both researchers would collaborate and agree on the interviewee responses made under the relevant issues and themes. These agreed combined interpretations were recorded onto handwritten Issues Sheets, which were used to recheck consistency and accuracy of transcripts by each researcher in order to circumvent the main disadvantage of in-depth interviews, in that free responses are viewed as difficult to analyse (O'Dwyer 2004).

The next step was to utilise the digital audio recordings on any issues that remained unclear or inconsistent with each researcher's transcription. To add further validity to the data collection process, the finalised agreed interview interpretations were sent to the interviewee for review and approval. This allowed the interviewee not only to validate the interpretation of the interview, but also provided them with an opportunity

to refine, clarify, delete or add any further details relevant to the study to ensure no relevant omissions or misinterpretations by the researchers. The agreed individual interviews were summarised for each stakeholder group by one of the researchers. These summaries were validated by the second researcher with any differences referred onto the third independent researcher. The key themes identified framed the process by which the data is analysed.

5. RESULTS AND DISCUSSION

Research Question 1 (RQ1) attempts to shed light on the government's motivation in introducing legally enforceable ASAs. According to the RIS (April 2006: 4) "the main objective was to ensure that the new redrafted Auditing Standards consider the public interest first and foremost and to produce high quality standards based on ISAs".

The review of the stakeholder responses suggests general agreement that the government's motivation was primarily driven by corporate collapses and the need to increase public confidence in Australian financial markets. The government's reaction was perceived as a means of ensuring higher audit quality and an increase in the level of confidence in the capital market. The stakeholder responses indicate that 'Public Interest Theory' is a plausible explanation for the government intervention, and are in alignment with the RIS (April 2006). The summarised responses are presented in Table 2.

(INSERT TABLE 2 HERE)

Although respondents refer to 'public confidence' rather than 'public interest', the overall consensus that the government acted in articulating the collective goals of the Australian community post corporate collapses by responding with regulation is evident from Table 2. However, individual responses show varying emphasis placed by each of

the stakeholder groups on different aspects of public confidence as being more important in the Australian Government's motivation.

The accounting firms' emphasis can be summed by AF2: *“Given the corporate collapses there was a perceived need to address the credibility of the profession. Government needed to restore confidence in the quality of the audit and the introduction of legally enforceable auditing standards and monitoring by ASIC was a mechanism to achieve this, that is, take the standard setting/enforcement away from the profession”*.

On the other hand the professional bodies' emphasis on financial markets confidence is articulated by PB1: *“The government considered this was also a necessary step to enable further participation and access to capital markets”*. Similarly PB2 suggest that: *“Corporate collapses had an impact on market confidence in financial reporting and audits and the effectiveness of self-regulation by the profession was questioned. Government reaction of taking standard setting away from the profession and introducing force of law standards was a means of increasing the level of confidence in the financial market”*.

The regulatory bodies overall view of the government's motivation was to ensure that Australia is *“well positioned internationally in terms of our regulatory framework for reporting and audit (i.e. use of standards, status of standards, level of inspection”* (RB3) by increasing audit quality and regulating the profession. This view expressed by the regulatory bodies is similar to their RIS (April 2006) pre-implementation position.

Research Question 2 (RQ2) explores the professional bodies' and accounting firms' reaction to the legally enforceable ASAs. A negative reaction was expected as the government intervention in mandating the standards and monitoring the compliance shifted the balance of power further away from the profession and implied that professional judgement and self-regulation was not effective (AUASB 31 August 2005

media release). This sentiment was echoed by RB3: *“In Australia, traditionally we had two bodies (ICAA/CPA Australia with NIA emerging) which promulgated standards and regulated themselves. After the corporate collapses, the government took steps to increase audit quality and to regulate the auditing profession.”*

The data from the stakeholder summary (refer Table 3) illustrates the overall negative nature of the firms’ responses to RQ2. The audit firms consider the legal enforceability of ASAs to be an overreaction and a lack of understanding of the nature of the audit process by the government. According to AF4: *“Auditing is an art rather than a science”* and *“is about making judgements not about prescriptive legal rules”*.

(INSERT TABLE 3 HERE)

The negative response of the firms is acknowledged by the regulatory and professional bodies. RB3’s statement affirms that there is a *“sense of significant impact on practitioners (auditors ‘carrying the can’)*. *The number of registered auditors is dropping and there have been suggestions that the new regulation is an incentive for people to leave the profession”*. PB3 also notes *“there was a lot of moaning”* and a *“grudging acceptance”* (PB1).

The response to RQ2 is in contrast to the RIS (April 2006), where the 14 respondents were noted as ‘broadly supportive’ of the legislative proposal and legally enforceable standards. Given that under the regulatory ‘Capture’ or ‘Interest Group Theory’ the Australian professional bodies will most likely seek as much control as possible over the setting of standards in order to influence legislation, it was inevitable that the accounting profession did not want to relinquish any aspect of the standard setting process including enforceability to the government (Posner 1974, Walker and Robinson 1994, Walker 1987, Gaffikin 2005, Godfrey et al 2006).

Research Question 3 (RQ3) explores the perceived key benefits of the new audit regime . In the RIS (April 2006) and CPA Australia survey (August 2006) four out of five respondents thought that the new legally enforceable ASAs would improve audit quality even though the underlying basis (of auditing) has not changed. However the CPA Australia study also highlights that the general public are “unlikely to benefit because the reforms do not address the public’s lack of understanding of audit” (CPA Australia 2006: 5).

The stakeholder responses in this study provide limited support for increased audit quality, namely by the regulators. Although audit firms admit some benefits (refer Table 4), they do not believe that there are any real changes to audit outcomes and highlight potential risk of increased focus on process rather than substance under legally enforceable ASAs. AF2 asserts that *“it is questionable if there has been any real increase in audit quality. There is no change in audit outcomes; mainly the change is in additional rules in relation to the process”*. AF4 agrees that the *“underlying audit process/audit quality remains fundamentally the same; however a greater portion of the time is spent on documentation which does not necessarily increase audit quality. The increase in focus on documentation to ensure legal compliance with form runs a risk of process taking over from substance and not identifying significant issues/risks requiring judgement.”*

However, there is an agreement that the legally enforceable ASAs have forced the profession to refocus and increase consistency and execution of the process. According to PB3 there has been some benefit of *“greater consistency and transferability of skills across auditors and consequently less costs/impacts for clients when changing auditors”*. PB1 also comments that a benefit of the new regime is that *“auditing is seen as an advanced technical specialist skill”* and *“if you are going to audit you need to be serious about it”*. Although the stakeholder responses provide limited support for

increased audit quality, there appears to be no mention of increased public confidence (refer additional discussion of impact on public perceptions).

(INSERT TABLE 4 HERE)

In conclusion, the stakeholder responses fail to support the government's expected benefits. This result is in line with the 'Political Economy of Regulation Theory' (Joskow and Noll 1981) according to which 'public interest' and regulation acceptance depends on public confidence, hence there needs to be an educated effort on behalf of the regulator in acquiring acceptance (Gerboth 1973, Solomons 1978). 'Self-regulation Theory' (Kinney 2005) and 'Institutionalist Theory' (Baker et al 2006) suggest that for the shift in regulation from 'self-regulation' to 'mandated' regulation to be accepted, there needs to be a full understanding of the objectives of the change in regulation approach. This view is also supported by the CPA Australia (2006: 6) survey namely that "the impact on confidence will depend on how the new standards are communicated to the public, the capital markets and investors". This is echoed by AF3's comment that: "*external review of profession and legally enforceable ASAs should create more confidence in financial reporting framework. However, for this to be achieved a balance media reporting regarding impact of the process is necessary*". PB1 similarly suggests that: "*Professional bodies need to do more to increase the awareness of the value of an audit 'a really valuable service that is largely unseen'*". PB2's statement that "*regulators and standard setters need to improve communication of the benefits of the new regime to the public*", further supports this sentiment.

Research Question 4 (RQ4) attempts to determine the costs associated with the new audit regulation. The RIS (April 2006) did provide initial pre-implementation predictions that audit firms may have to revise programs but this would not be more significant than a normal update and consequently costs of compliance will be minimal.

Similarly according to ‘Public Interest Theory’ the government is assumed to intervene with minimal costs and burden to business (Brown and Tarca 2001, Uche 2001, Hantke-Domas 2003).

The responses in this study suggest difference of opinion between the stakeholder groups. According to the regulators after the initial year of audit the costs of compliance are still minimal. In contrast the professional bodies and accounting firms note that there are substantial up front costs of training, mapping of methodology to black letter requirements in ASAs as well as continuing increased costs of documentation, technical support staff, and compliance in respect to the external ASIC inspection process (refer Table 5). A number of accounting firm respondents noted that the focus on compliance has made audit less desirable as a profession, adding to the retention of staff impact.

(INSERT TABLE 5 HERE)

5.1. *ADDITIONAL DISCUSSION AND ANALYSIS*

Despite an overall consensus by the stakeholders as to the motivation for the government’s regulatory intervention as generally being in the “public interest” respondents were also questioned as to whether the government’s approach of introducing legally enforceable ASAs is justifiable. The results of this were mixed.

(INSERT TABLE 6 HERE)

The overall view of accounting firms is represented by AF5’s comment that, “*the government overreacted and not sure whether the path of legal ASAs is warranted*”. This is also reflective of the ‘Big 4’ in their responses to the RIS (April 2006) and their ‘concern with unintended consequences’ of the introduction of legally enforceable ASAs.

In contrast to the accounting firms, the regulatory bodies' responses affirm the government's justification of legally enforceable ASAs and are aligned with their initial stance outlined in the RIS (April 2006): "the approach will increase audit quality, increase capital market confidence and will position Australia globally".

The professional bodies, on the other hand, remain to be convinced either way as illustrated by PB1's statement; "*Perhaps justified given it is market driven and a response to market demand for change to standard setting*". PB1 also states that "*the idea was that Australia would have a world class reporting framework, hope that all initiatives have an affect, however they won't happen overnight*". Similarly, PB2 suggests that they "*will wait and see whether the government is justified in its approach*".

In conclusion, the stakeholder groups differ in their views whether the government's response in making ASAs legally enforceable is justifiable as the appropriate regulation choice.

The accounting firms (refer Table 7) also suggest that one of the impacts of the increased audit cost has been some tension in auditor/client relationship; "*clients have been grappling with IFRS compliance/costs and any increase in audit fees based on the change of scope under new ASAs is difficult to explain*" (AF3). The increases of 10-30% in audit costs suggested by a number of firms have in fact not been recouped on many engagements.

However, regulators and professional bodies suggest that the firms are blaming increases in fees on legally enforceable standards while in fact these are costs of the new ASAs and should have been built into audits some time ago. This view is illustrated by RB1 who does "*not think there is a lot of cost in new regime; the increase in costs is not attributable to legal standards, these costs in risk and internal control*

documentation should have been already factored in under the revised pre-legalised ASAs". Similarly, PB1 states *"practitioners are looking to blame audit fee increases on force of law audit standards, when in reality should have been raising fees when audit risk standard came out, now under the new regime you have to comply, people overreacted to make sure they document everything"*.

(INSERT TABLE 7 HERE)

The accounting firms appear to differentiate between the costs of new ASAs and legal enforceability of ASAs, but they clearly attribute some additional costs to the new regime; *"Costs regarding framework for ensuring continual compliance"* (AF3), *"Increased costs (10-30 %) due to documentation"* (AF2) and *"Increased documentation and compliance has placed pressure to work additional hours"* (AF5).

Other cost increases specific to the new regime (refer RQ4 results discussion) relate to the loss of flexibility and judgement and mandatory performance of procedures that would have been considered unnecessary or of limited value. AF5 implies that there is *"tension between using audit judgement and complying with black letter requirements (process vs. objective). Less flexibility to changes in circumstances as need to comply with mandatory requirements even when risk is negligible."* The results support Buffini's (2006) prediction that audit fees will rise as a consequence of CLERP 9 reform and Andrews (2006) hypothesis that small firms will opt out of the audit market support firm's comments on the additional costs of the new regime.

Another significant issue of the new regime relates to ASIC's monitoring of compliance with legally enforceable standards and the penalties for non-compliance. Overall, the responses suggest uncertainty as to the likely consequences of non-compliance in terms of penalties but an agreement that this aspect of the new regulatory framework is very significant. PB3 concludes, *"yet to see whether this legislation has*

‘any teeth’ before it has a reputation”. However, all firms appear to be taking this seriously by implementing controls to ensure compliance in order to manage firm and individual (partner) risk exposures.

If an important reason for the introduction of enforceable standards was to increase public confidence then it was felt interesting to explore the stakeholders views as to the public perceptions of the legally enforceable standards. The summary of all individual responses in Table 8 illustrate a consensus that there has been ‘no impact’ on public perception and that the government’s prime goal of increasing public and investor confidence has not been achieved. In fact, some respondents suggest that it has been detrimental as it potentially increased the expectations gap even further.

(INSERT TABLE 8 HERE)

6. CONCLUSION

The aim of this study was to contribute towards an understanding of the impact of the introduction of the CLERP 9 audit regulation, and in particular the new force of law auditing standards, on the auditing profession by examining and complimenting the investigative pre-implementation RIS (April 2006) with post-implementation data. The data collected and reported in this study aims to contribute to the regulators’ and auditing professions’ understanding of the effects on the key stakeholders and provides useful guidance in relation to costs, benefits and other operational impacts.

In summary, the findings indicate a number of significant differences as to what the respondents have portrayed as their experience after the first year of audit under the new regime with regard to costs and benefits. The data also illustrates that the impact and perspectives of different stakeholder groups are not uniform. For example, the stakeholder groups supported the public interest notion as to the motivation behind the government’s introduction of the legally enforceable standards, however the emphasis

as to what this means varies between the groups. Accounting firms and professional bodies place more emphasis on separation of the standard setting from the profession as a response to corporate collapses whilst regulatory bodies place more emphasis on increasing confidence in capital markets. Furthermore, in contrast to the regulatory bodies, the profession does not consider that the extra burden of the legally enforceable ASAs has increased audit quality or public confidence. According to the firms, the additional significant costs of increased documentation, training, monitoring and reviews have not met the government's desired objectives of 'upholding public interest' in conformity with ISAs and high quality ASAs (RIS April 2006).

Issues associated with the Sarbanes-Oxley Act (SOX) of 2002 and the Public Company Accounting Oversight Board (PCAOB)⁴ in the U.S. also need to be considered in terms of potential to increase costs to the Big 4 in complying with the PCAOB standards and reviews. It is acknowledged that the development of audit methodologies is an 'international' exercise. Based on discussions with those interviewed, separate programs for SOX affected clients are required to be completed. However, given the US environment, additional audit steps may have been incorporated into the standard 'international' audit methodologies in addition to those actually required by the Australian ASAs. Considering the fact that the ASAs have been in force since 2004 (then known as AUSs), with the only subsequent real change being legal enforceability in 2006 then one must question what the firms were doing prior to 2006?

In conclusion, the data collected in this study does not provide strong support for the Australian Government's introduction of the legally enforceable standards as an appropriate response to achieve an increase in the quality of audits. However, the findings in this study need to be appropriately placed and understood within the context

⁴ PCAOB was created by SOX as an independent body overseen by the Securities and Exchange Commission (SEC) to regulate registered accounting firms that are allowed to audit public companies traded in the U.S. securities market. Although the PCAOB is a private-sector body, its standards have the force of law.

of the new regime's relatively short implementation time frame. The long term impacts may change and this cannot be ascertained until some time into the future after more audits have been completed under the current regime. Also the realities of the legally enforceable ASAs may differ for medium and small audit firms. Additional research using the actual working papers of firms would assist in confirming the perceptions reported in the current research.

APPENDIX A

Summary Stakeholder Pre-implementation Comments on the Impact of Legally Enforceable ASAs

STAKEHOLDERS	SUMMARISED RESPONSES
REGULATORS	<ul style="list-style-type: none"> • Clear public interest focus • ASAs are of high quality • Conform with ISAs • Mandatory requirements in bold to denote authority • ‘Should’ change to ‘Shall’ • Little compliance costs to audit firms • Most comments on wording of Exposure Drafts • Clarity on the auditor’s obligations
PROFESSIONAL BODIES	<ul style="list-style-type: none"> • Generally supportive of ASA as legal instruments • Increase in technical bulletins to members • Clarity important to legal enforceability • Dramatic changes to standards not in public interest • Concerned with SME impact and audits of small entities • Concern with non-compliance and significant consequences • Agrees with government’s wait and see approach to Clarity Project • AUASB should exert influence with IAASB, rather than move in different direction with standard setting process • More research should be undertaken on the merits of the increased regulation in corporate governance • Standards are written as for the profession, not as codified legal instruments
AUDIT FIRMS-‘BIG 4’	<ul style="list-style-type: none"> • Oppose additional reporting and administrative reporting requirements in relation to independence • Concerned about unintended consequences from the legal ASAs • Increased audit documentation • Concerned about ultimate interpretation by regulators and courts of the legal ASAs • Overall support to approach • Legal professional privilege change to law
AUDIT FIRMS-SME	<ul style="list-style-type: none"> • Do not understand the detail of the new ASAs • Increased compliance costs • Increased audit documentation • Will necessitate staff training • Increased time on audits

(Based on *Submissions Received by the AUASB on Group Exposure Drafts 1 to 5*)

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Table 1: Coding of Each Individual Response under the Stakeholder Category

Key Stakeholder Group	Coding of Individual Respondents				
Accounting Firms	AF1	AF2	AF3	AF4	AF5
Professional Bodies	PB1	PB2	PB3		
Regulatory Bodies	RB1	RB2	RB3		

Table 2: Summary of Australian Government’s Motivation for Making ASAs Legally Enforceable

Accounting Firms	Professional Bodies	Regulatory Bodies
<ul style="list-style-type: none"> • Government under pressure to respond to corporate collapses • Separate standard setting from the profession • Increase confidence in audit quality • Access to US markets 	<ul style="list-style-type: none"> • Government reaction after corporate collapses was to take standard setting away from profession • The new regime was introduced to regulate rather than disable the profession • Increase confidence in the financial market 	<ul style="list-style-type: none"> • Government response to corporate collapses was to regulate the profession to increase audit quality • Ensure global positioning in terms of regulatory framework and reporting

Table 3: Summary of Reaction to the New Regulation

Accounting Firms	Professional Bodies	Regulatory Bodies
<ul style="list-style-type: none"> • Overreaction by government • Another change • Partners opting out of profession/ questioning continuing as auditors • Auditing is about making judgements not about prescriptive legal rules 	<ul style="list-style-type: none"> • Additional costs of increasing awareness of legal ASAs; additional training and resources • Firm’s grudging acceptance and a ‘lot of moaning’ • Overreaction blaming legal ASAs for increased costs that were really part of revised risk standards 	<ul style="list-style-type: none"> • Audit firms reaction has been negative • Concern with increase in documentation costs • ‘Big 4’ comfortable with compliance but small firms lobbying against changes

Table 4: Summary of Perceived Main Benefits

Accounting Firms	Professional Bodies	Regulatory Bodies
<ul style="list-style-type: none"> • Discipline, refocus on profession • Increase in documentation provides consistency in process, audit execution • Global compatibility 	<ul style="list-style-type: none"> • “In time we will benefit, but not yet” • Internationally there has been recognition that audit is an advanced technical specialist skill • Restored confidence in capital markets • More conscientious audit process leading to an increase in audit quality in general • Clearer linkage between non-compliance and consequences • Independence of standard setting from professional bodies is positive in terms of perceptions • Transferability of skills across auditors 	<ul style="list-style-type: none"> • Increase in audit quality • Promote confidence in capital markets

Table 5: Summary of the Perceived Main Costs

Accounting Firms	Professional Bodies	Regulatory Bodies
<ul style="list-style-type: none"> • Once off implementation costs of reviewing methodology/ training and ongoing costs of documentation • Significant increase in technical resources • Costs of ASIC inspection reviews 	<ul style="list-style-type: none"> • Extra caution in terms of increased documentation under new ASIC regime • Concern that force of law is a deterrent to young auditors progressing to partner level • More likelihood of class actions 	<ul style="list-style-type: none"> • No significant increase in costs if complied with ASAs prior to legalisation • Firms using legal ASAs as an opportunity to make audits recoverable for costs that should have been already factored in under pre-legalised ASAs • Some initial costs of mapping methodology to ASAs • Increase in documentation costs is not attributable to legal standards

Table 6: Summary of Justifiability of the Legally Enforceable Standards

Accounting Firms	Professional Bodies	Regulatory Bodies
<ul style="list-style-type: none"> • Government needed to do something to expand audit scope and quality, however legal ASAs are unlikely to achieve this • Duplication of costs in terms of inspection/ monitoring 	<ul style="list-style-type: none"> • Perhaps justified given it is market driven and a response to market demand for change to standard setting • Makes people more aware of the auditing profession, auditing standards , world class framework and non-compliance consequences • Part of a process of ensuring Australia’s access to capital markets 	<ul style="list-style-type: none"> • Increase in audit quality • Justifiable in terms of positioning Australia globally in terms of its regulatory framework and access to capital markets

Table 7: Summary of the Impact on Audit/Client Relations by Individual Accounting Firms

AF1	AF2	AF3	AF4	AF5
<ul style="list-style-type: none"> • More formalised relationships/ documentation of relationship and client meetings • Audit fee increased due to IFRS/short supply of auditors/ insurance cost increases etc. rather than legally enforceable ASAs 	<ul style="list-style-type: none"> • Increase of 10-30% in cost due to documentation difficult to pass onto client 	<ul style="list-style-type: none"> • Some tension as increase in audit fees due to change of scope of ASAs, hard to justify to client • Clients still grappling with IFRS compliance costs 	<ul style="list-style-type: none"> • Increase in audit fees difficult to justify as client sees no change in audit outcome • Firm has not been able to recover costs of compliance • Some mandatory requirements are trivial and of client nuisance value 	<ul style="list-style-type: none"> • Direct costs increased by 15% on average • More frequent communication with client on increased number of issues • Increased profile with some clients

Table 8: Summary of Impact on Public Perceptions

Accounting Firm Respondents				
AF1	AF2	AF3	AF4	AF5
<ul style="list-style-type: none"> No difference in public perception Expectations gap potentially wider as public expectation of higher quality audit 	<ul style="list-style-type: none"> Small investors no impact Sophisticated investor maybe more aware 	<ul style="list-style-type: none"> Even sophisticated investor has trouble with 'true & fair', and assurance Potential for expectation gap to widen further 	<ul style="list-style-type: none"> No real impact on broad public Expectations gap unlikely to be reduced 	<ul style="list-style-type: none"> No real impact on broad public as they generally do not understand audit objective or process
Professional and Regulatory Bodies				
PB		RB		
<ul style="list-style-type: none"> Public is not interested General public and small investors would not know any different The public's level of understanding is questionable There is evidence that the expectation gap is still alive and well 		<ul style="list-style-type: none"> The general public does not distinguish between large and small audit firms. Issues and criticisms , regardless of the size of the firm, will have significant negative impact "I do not think that the public care nor understand what we do" Improvement in the quality of an audit, accountability of those charged with corporate governance 		