Effects of the new regulations of the audit profession on the audit firms’ strategies

Mohamed Khaled Amr Abbas Eldaly

BA, M.Sc., IFRS

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University of Bedfordshire

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In the name of Allah, the Beneficent, the Merciful

“Act! Allah will behold your actions, and (so will) His messenger and the believers”

The whole Quran, Surah Al-Tawba, verse 105
Dedicated to my father, mother, and sister for their guidance, encouragement and their financial support; to my wife for her love, patience, and infinite support; to my toddler “Ahmed” for his lovely smile. And finally to the memory of Professor Ahmed Ali Gabr the previous dean of the Higher Institute of Computers and Information Technology, Sherouk-Academy, Egypt, Hopefully he is in a better place than we live……,

Mohamed Khaled Eldaly
United Kingdom, 2012
Acknowledgement

All the praise and thanks be to Allah, prayer and peace be upon the most honorable prophet Muhammad, peace be upon him.

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Papers and presentations

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- **Audit Firms’ Strategies Towards New Regulations of the Audit Profession**, Accounting Forum, submitted in 2011 and revisions to satisfy the reviewers’ requests were done and resubmission of the revised version was sent in July 2012.

- **An Analysis of FRC’s Efforts to Regain the Public Confidence in the Audit Profession**, Critical Perspectives on Accounting, submitted on July 2012 and currently under the reviewing process.

- **Serving Global Clients Within Changeable Regulatory Framework: How Do the Big 4 Audit Firms Work?**, Auditing: Journal of Practice and Theory, submitted on October 2012 and currently under the reviewing process.

- **Audit Firms’ Strategies that have emerged to react to the Changeable Audit Environment**, the 36th annual conference of the European Accounting Association (EAA), Paris, France, May 2013.

- **Serving Global Clients Within Changeable Regulatory Framework: How Do the Big 4 Audit Firms Work?**, the 23rd annual conference of the British Accounting and Finance Association (BAFA), Newcastle, UK, April 2013.


- **Governmental Audit Regulations in Developed Countries: the Case of the UK**, the 35th annual conference of the EAA, Ljubljana, Slovenia, May 2012.

- **Auditors’ Perceptions Toward the Independent Audit Oversight in the UK**, the 22nd Auditing and Assurance Conference of the Auditing Special Group of BAFA, London, UK, May 2012.
• Independent Audit Regulators and Promoting the Public Confidence, the 22nd annual conference of BAFA, Brighton, UK, April 2012.

• How the big four firms in Egypt have been affected by the new changes in the audit environment, Outcomes and Impacts conference, University of Bedfordshire, Luton, UK, July 2011.

• Perceptions of Egyptian Auditors toward the Governmental Regulators of the Audit Profession, the 21st annual Auditing and Assurance Conference, BAFA, Edinburgh, UK, May 2011.

• Framework of Governmental Audit Oversight in Developing Countries: Case Study from Egypt, the 21st BAFA annual conference, Aston, UK, April 2011.

• Governmental Audit Oversight in Egypt, research poster, Outcomes and Impacts conference, University of Bedfordshire, Luton, UK, July 2011.

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• Outcomes and Impacts conference, University of Bedfordshire, Luton, UK, July 2011.

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• Doctoral colloquium, British Accounting and Finance Association (BAFA), Aston, UK, April 2011.

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• Presenting in a number of internal seminars of the Business and Management Research Institute (BMRI), University of Bedfordshire.
Abstract

The audit firms play an important role in the capital markets by verifying that auditors provide reliable information to the decision makers. However, trust in auditing firms has been questioned following Enron’s failure and accounting scandals at WorldCom and other companies. As a result, Arthur Anderson failed and the number of big audit firms fell to four firms and no one knows who might be next. Defond and Francis (2005) believe that a critical trigger occurred when Deloitte & Touch issued a “clean” peer review report on Arthur Andersen in December 2001, just a few weeks before Andersen publicly announced that it had shredded documents related to Enron audit. The credibility and integrity of the profession’s self-regulation program was immediately in doubt. To protect public interests and to restore confidence in the capital markets, the USA government issued the Sarbanes-Oxley Act (SOX) in 2002. Similarly, the Financial Reporting Council in the UK provided the Professional Oversight Board with similar mission.

This thesis aims to explore the role of independent audit regulators in promoting confidence in the audit profession, and analyse the big four firms’ strategies that react toward these regulatory changes in the audit markets. The lack of studies in this area supports the use of grounded theory as a research methodology. 24 semi-structured interviews were conducted with the top management level of the audit regulators and big four firms’ partners. This study contributes to the literature as it provides a better understanding of the satisfaction of the big four audit firms toward the new independent regulators, and how these firms react toward the additional requirements of the independent inspectors.
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Chapter 1: Introduction

1.1 Background

Audit firms play an important role in the capital markets by verifying that auditors provide reliable, relevant, and timely information to the decision makers. In addition, the globalisation of the financial markets and institutions has tempted investors and shareholders to seek more compiled, classified, and audited global information. The role of the audit firms is widely regarded as vital among governments in developed and developing countries (Albahloul, 2003). However, trust in auditing firms has been questioned following Enron’s failure, as well as accounting scandals at WorldCom and other companies. Public confidence in the nations’ securities markets and the audit profession has been under attack. As a result, Arthur Anderson failed and the number of big audit firms fell to four firms (KPMG, PWC, E&Y, and Deloitte) with no one sure of who might be next. However, it is unlikely that one single audit firm will completely dominate the audit market (Mayhew, 2002).

Public confidence in the nations’ securities markets and the audit profession has been under attack. Defond & Francis (2005) believe that a critical trigger occurred when Deloitte & Touch issued a clean peer review report on Arthur Andersen in December 2001, just a few weeks before Andersen publicly announced that it had shredded documents related to the Enron audit. The credibility of the entire accounting profession was immediately in doubt along with the credibility and integrity of the self-regulation system.

To protect public interests and to restore confidence in the capital markets, the USA government issued the Sarbanes-Oxley Act (SOX) in 2002. SOX required the Public Company Accounting Oversight Board (PCAOB) to conduct periodical inspections of public accounting firms. PCAOB was also responsible for reporting, standard-setting, and enforcement authority over public company auditing firms (U.S. House of Representatives: Committee on Financial Services, 2002). SOX has undone over 50 years of professional self-regulation by removing from the accounting profession the authority to set standards and the authority to monitor the application of standards (Defond & Francis, 2005). A set of audit regulations which require auditors to perform additional tasks and efforts has been issued. For example, restricting auditors
to provide non-audit services for their audit clients, and asking auditors to issue their opinion on the effectiveness of their clients’ internal control systems.

SOX has been followed by similar laws in different countries such as Bill 198-Canada, J-SOX Japanese, German Corporate Governance Code, CLERP9-Australian corporate reporting and disclosure law, Financial Security Law of France, L262/2005—Italy and King Report South African corporate governance code. Similarly, the Financial Reporting Council (FRC) in the UK provided the Professional Oversight Board (POB) with a similar mission. The new changes in the audit regulatory framework in many countries challenge the audit firms. The audit firms have to be committed to the new governmental requirements and provide evidence to external governmental inspectors in order to prove that they are doing what they should do according to applicable standards and regulations. The global regulatory challenges of the audit profession represent the main phenomenon of the entire study.

In 2006, the International Forum of Independent Audit Regulators (IFIAR) was established by 16 countries. Further, in 2008, the European Directive recommended that all members establish an independent audit oversight. It seems as though the audit firms, particularly the big four audit firms and their global networks, faced a global challenge and entered a new stage with new regulators setting new regulations. This global trend of independent oversight of the audit firms’ performance has led me to study the research problem at the global level by considering the perceptions of participants regardless of their nationalities or resident countries. Having said this, there are certain differences in terms of names and times of issued regulations in different countries. Therefore, and according to the practicality of studying certain oversight authority and the possibility of the data collection process, two independent authorities in two different environments are selected for investigation. These two authorities are Audit Inspection Unit in the UK as one of the developed markets, and the Quality Control Unit in Egypt as one of the developing markets.

Consequently, the audit firms face two new challenges related to decreased public trust and the additional requirements of the governmental audit regulators. As a result, three objectives have been set by the big four firms with these challenges in mind. The objectives are to regain the public trust, to protect their leading reputation, and to
mitigate the risk of litigation (see, for example, the annual reports of KPMG and PWC in 2004 and 2005). Further, in 2006 the CEOs of the global audit networks published a report for the global society in which they stress that they are keenly aware of mistakes made by some members of the profession in recent years, and have instituted significant changes in both their operations and their focus, so as to assure that history is not repeated. With this in mind, the problem is related to how they go about achieving their objectives.

The big four firms are four global networks of member firms offering audit and non-audit services around the world. The global networks provide information and guides for their members and do not provide any client services. Each member firm of the global network has its separate legal entity whilst its assets and liabilities have separate owners. The literature (see, for example, ICAS, 2009; U.S Treasury department, 2008; Oxera, 2006) provides evidence that the big four are similar in their organisational structure, objectives, strategies and the prospective of their clients.

As a result, this thesis aims to explore the role of independent audit regulators in promoting confidence in the audit profession, and seeks to analyse the big four firms’ views regarding these regulatory changes in the audit markets. This study mainly focuses on increasing knowledge regarding the importance and effectiveness of the governmental oversight of the audit profession from the auditors’ perspectives. Further, it aims to identify the strategies which have emerged from the big four firms when it comes to reacting to the new requirements of the governmental regulators. To achieve the study aim the following research objectives are identified:

1- To gain a better understanding of the role and the importance of the independent audit oversight in promoting confidence in the profession and protecting public interests.

2- To identify and analyse a set of key factors for establishing an effective audit oversight authority, and to examine the extent to which these factors have been applied in different environments.
3- To analyse the different ways in which audit regulators achieve their objectives (promoting confidence and protecting public interests) and how auditors are committed to – or resist – the proposed regulations.

4- To explain the emerged strategies which have been developed by the big four firms to react to the new changes of the regulatory audit framework.

As a result, the following research questions are addressed:

*RQ1*: How do the big firms evaluate the current performance of the independent audit inspectors? What are the key factors in an effective inspection process? How do the audit regulations protect the public interests and promote confidence in the audit profession?

*RQ2*: How do the big four firms react to the new changes in the regulatory framework of the audit profession? What are the main strategies which have emerged to protect their leading reputations?

1.2 Significance of my research

Achieving the study aim can be useful for auditors, audit regulators, researchers and other related parties. Indeed, my theory can help these parties to understand the extent to which the big four audit firms are satisfied with the new governmental regulators, and how these firms react toward the additional requirements of the governmental inspectors. Governmental regulators can receive feedback regarding their performance from the views of the inspected firms. They can also know the effectiveness of the proposed audit regulations and whether auditors have other suggestions which can improve the audit’s quality. Applying these suggested regulations assists in improving the quality and the acceptance of issued regulations in the audit market as they are initiated from the auditors themselves. Further, auditors can understand how the governmental regulators work, and to what extent the audit regulations can increase the quality of the audit process.
Moreover, much of the prior research\textsuperscript{1}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{example.png}
\caption{How could the emerged theory be interesting for many audit parties?}
\end{figure}

1.3 Structure of my thesis

This thesis is divided into 9 chapters as follows. Chapter 1 is the introductory chapter. It discusses recent changes in the audit market in most of the countries after the

\textsuperscript{1} See the prior research section in Chapter 2.
conversion of the regulatory framework from a self-regulated profession to a governmental oversight profession.

Chapter 2 addresses the prior research as it is relevant to the recent governmental audit oversight system. The study of prior research aims to develop a better understanding of the audit environment after the issuing of the SOX Act in the USA and similar regulations in other countries. This assists me in determining the gap of literature and directing the research questions in areas which have not been previously investigated.

In Chapter 3, the main paradigms of social science research are reviewed in order to determine which of them are more relevant for this study. I provide a justification for employing the interpretive approach and choosing the grounded theory as a research methodology in this research.

Furthermore, Chapter 4 explains the main codes and categories of the emerged theory which have been developed during the different stages of the analysis and coding process. It further discusses the relations between developed categories and how they interact together to develop a meaningful theory.

Chapter 5 explains the first main category of the emerged theory. It explores the main values of the audit oversight authorities. It further discusses the main factors which contribute to the successful establishment of an independent audit oversight system.

Chapter 6 analyses the second main category of the emerged theory. It discusses the effects of the current audit regulations on the audit market. Chapter 6 also identifies the views of the big four firms regarding the common audit regulations of the audit markets and the extent to which they improve the audit quality.

Chapter 7 discusses the main strategies which have emerged from the big four firms when it comes to facing the new challenges of the regulatory audit environment. A total of 6 strategies are identified during the analysis process and suggested by the emerged theory.

Moreover, Chapter 8 validates the emerged theory using one of the literature’s current theories, namely the globalisation theory. A discussion is put forth in order to analyse
the extent to which my emerged theory “globalization of auditing” is compatible with the main suggestions of globalisation theory.

Chapter 9 consists of my conclusions and the main outcomes of this theory. It also sheds light on what should come next. How could my theory add to the literature? What are the main areas of further research required? All of these questions have been answered in Chapter 9.
Chapter 2: Prior research

2.1 Introduction

In this chapter, I use the literature to guide my research questions by identifying the gap in said literature as well as the areas which are in need of further research. In accordance with the research methodology employed, namely the “Grounded Theory” methodology (Strauss & Corbin approach, 1998), the purpose of this chapter is not to review the literature pertaining to the development of a theoretical framework, but more to test the reliability of an already developed framework. According to grounded theory (Strauss & Corbin approach, 1998), the data is gathered from the field to develop a theoretical argument which considers the views of the research participants. The methodology aims to answer the questions asked by academics/theorists and professionals who are working in this field. Accordingly, the aim of this chapter is to develop a better understanding of the area of research, thus allowing me to efficiently determine the reasons behind the lack of literature and sufficiently address the research questions. Moreover, it is noted that the main part of the literature review process is carried out after completing the analysis stages of grounded theory. Strauss & Corbin (1998) state that literature can be used to validate the emerged theory.

The remaining sections of this chapter are organised as follows. Section 2.2 reviews prior research which has studied the creation of independent audit oversight bodies in different countries. Section 2.3 investigates the effectiveness of the independent audit oversight system and the extent to which it enhances the audit’s quality. Section 2.4 analyses the effects of the new oversight system on the audit market including the audit fees, audit risk, audit competition, and auditors’ independence. The following section (Section 2.5) discusses the literature which is related to the global networks of the big four audit firms. It further discusses the organisational resistance toward the governmental audit regulations. Finally, my conclusion is added at the conclusion of this chapter in Section 2.6. The conclusion justifies how the literature is used to guide the research questions.

2.2 The establishment of a global independent audit oversight system

Many prior research studies (see, for example, Gunny & Zhang, 2009; Bather & Burnaby, 2006) study the audit market after the collapse of Enron and the failure of Arthur Anderson. The
accounting researchers aim to understand the new stage of governmental audit oversight which has followed the major accounting scandals and ended the self-regulated stage of the audit profession. For example, Malsch & Gendron (2011) argue that the independent audit oversight system is viewed as one of the most substantive and fundamental changes in the history of contemporary public accounting. Furthermore, Bather & Burnaby (2006) study the creation of the Public Company Accounting Oversight Board (PCAOB) in the USA as a reaction to the many failures of major corporations. They argue that regulation per se may not be sufficient to stop large corporate failures as there is no way to regulate individual integrity. This argument is supported by the action taken in 2008; the existence of the independent regulators did not protect the capital markets from the financial crisis. This could possibly raise a question regarding the extent to which we can trust in the effectiveness of the independent audit supervision and what we actually need to prevent more accounting collapses.

Continuing investigations into the subject, Gunny & Zhang (2009) examine whether PCAOB inspection results are objective and fair. They investigate its ability to distinguish between high and low quality auditors compared with the peer review system. Their findings suggest that PCAOB reports are able to discriminate audit quality, while no evidence is found for the peer review system. Moreover, some of the literature (see, for example, Cuebas, 2010; Ojo, 2007) stated that the SOX Act aims to regain the trust in financial markets by increasing corporate accountability, strengthening corporate governance, and enhancing public disclosures of financial statements. It has been argued that auditors are not the only party responsible for the accounting collapses. Indeed, light should be shed on the role which management and financial accountants play in preparing the financial reports. However, auditors are always the most blamed party.

It seems as though governments depend on independent regulators for the audit profession to protect the public interests and regain the public trust. However, the question is to what extent the public trust in those regulators? Lennox & Pittman (2010) indicate that audit firms’ market shares are insensitive to the content of the PCAOB reports. They argue that these reports are not reliable for many of the audit clients. However, Defond (2010) states that this does not mean the PCAOB inspection fails to improve the audit’s quality. He differentiates between “informative value” according to which the audit clients take their decisions when choosing their external
auditor, and the quality of the audit process which has been improved as a result of the PCAOB inspections. Tsau (2011) argues that the PCAOB’s inspection has three advantages when it comes to better protection of public interests than the peer review inspection which is conducted through the American Institute of Certified Public Accountants (AICPA). The first advantage is the independence of the audit inspectors. Second is the greater power of enforcement, whilst third is the confidentiality of information. Moreover, Gunny & Zhang (2009) stress that under the peer review system, inspectors cannot access documentations which clients refuse to disclose, and this is not the case in the PCAOB inspection.

In Europe, the EU eighth directive (2008) recommends that all members should establish an independent supervision of the audit profession. The commission strictly requires that all of the participating members be independent of the audit profession. The EU eighth directive has led to the establishment of the European Group of Auditors’ Oversight Board (EGAOB) (Tsau, 2011). The EGAOB is composed of representative public audit oversight authorities in European countries, or national ministries in countries which have not yet established the governmental audit oversight system. Further, the European countries which have an independent oversight of the audit profession establish the European Audit Inspection Group (EAIG) to share the best practice among their independent audit regulators. The EAIG has established a number of sub-groups including the European Group of International Accounting Networks and Associations (EGIAN). The EGIAN (2011) states that an audit regulatory change is urgently needed to protect the public interests and enhance the choice in the audit markets.

Van de Poel et al. (2009) investigate the association between the governmental audit inspection and peer review outcomes, as well as the audit clients’ accruals quality in the European countries. Their results suggest that when compared to peer reviews, independent inspections are more effective in detecting audit quality. However, Jeppesen & Loft (2011) analyse the implementation of the EU Eighth Directive in Denmark. They argue that the local implementation of the Eighth Directive disturbs the balance of the “system profession” in Denmark and gives rise to an intra-professional conflict over the statutory audit jurisdiction. Local regulators should consider the special nature of their local markets when implementing global or regional principles. In addition, EGIAN (2011) argues that local changes in audit regulatory frameworks should be gradually made. The group argues that to better organise the
audit market, changes should be visionary, proportionate, pan European Union, progressive, growth oriented, and quality driven.

These intensive movements toward regulating the audit market among the US and Europe indicate that it is not a local phenomenon which is related only to the US; it is a global trend of supervising the role of auditors inside the capital markets in different countries. Hazgui et al. (2011) examine how the creation of PCAOB influences the institutional construction of the European auditing oversight authorities, particularly in the UK and France. Their findings indicate that the regulatory regime of PCAOB constitutes a “strong driver” to shape the structure of European inspectors’ authorities. Nevertheless, they argue that auditing traditions and national professional issues play a major role in defining the audit oversight institutions in the two countries.

Reviewing the literature indicates that much of the prior research focuses on explaining the structure and the mechanism by which the new regulators are working. Further, a number of other studies are concerned with the mutual influences among audit regulators in different countries and how these influences lead to similar audit regulatory frameworks in different countries. However, there is a lack of literature when it comes to studying the main factors which should be considered to establish an effective audit oversight authority. Thus, a research question can be addressed as follows.

**RQ: What are the key factors that should be considered for establishing an effective audit oversight process?**

The above question assists governments in different countries to understand the main factors which should be considered when they develop an independent oversight system for the audit profession. It further aids the current audit regulators in evaluating their performance and deciding to what extent their current working systems need to be improved.

Globally, Tsau (2011) emphasises that the International Forum of Independent Audit Regulators (IFIAR) is considered as a communication tool and a learning platform for audit regulators worldwide. The regulators gain more experience and share the best practices through which to protect the public interests. Moreover, Samsonova (2009) studies the globalisation of the legislative framework for the audit profession by investigating the development of the legal
framework of auditing in Russia, and how it has been affected by international audit regulations as a result of the desire of local audit regulators to learn from the experiences of their foreign counterparts. This supports the similarity of the governmental oversight system in different countries, and the efficiency of studying this system at the global level. The establishment of the IFIAR and the EAIG supports the notion that different countries are willing to share their experience and cooperate together to regulate the audit profession through a number of unified rules and regulations which improve the audit quality and the reliability of capital markets. However, each government has its own authorities when it comes to issuing its own regulations which might be different to other countries. Therefore, the global organisations (such as IFIAR and EAIG) aim to share experience and to offer recommendations and advice regarding how to conduct a sufficient inspection. Regulators in different countries can take this advice into consideration when issuing their national regulations.

Reviewing the literature indicates that although many studies have investigated the new stage of audit regulatory framework, there is a lack of literature in terms of considering and analysing the auditors’ views toward the new audit oversight system. Thus, one of the research questions can be addressed as follows.

RQ: How do the audit firms evaluate the current performance of the independent audit inspectors?

Furthermore, by reviewing the literature, it seems that the governmental audit supervision through independent regulators is a global trend which has been established in different countries around the world with similar missions, strategies, and structures. Those regulators conduct periodical meetings through regional or international organisations (such as the IFIAR, EGAOB, and EAIG) in order to share their experience of inspecting their national auditors, especially the public audit firms. One of the main motivations behind sharing their experiences is that they inspect similar audit firms, particularly the big four firms. Simons & Zein (2008) state that more than 75% of a developed country’s listed companies are audited by the big four firms. The literature (see, for example, ICAS, 2009; U.S Treasury department, 2008; Oxera, 2006) stresses that the big four audit firms dominate most of the big listed companies in many countries around the world. Moreover, the Financial Reporting Council (FRC) emphasises that,
“The continued emergence of independent audit regulators in many countries around the world, together with the continuing dominance of the major global audit networks in the audits of public interest entities, has led to an increased focus on international cooperation amongst audit regulators” (FRC: plan and Budget 2011/2012, 2011).

This global domination of audits, and the largest listed companies all over the world by the big four audit networks, guides the research questions to focus on the big four firms as the main players in the global audit market. Thus the research question can be modified as follows.

**RQ: How do the audit firms, particularly, the big four firms, evaluate the current performance of the independent audit inspectors?**

The above question assists different audit parties (such as regulators, researchers, or auditors themselves) in understanding how the big four firms see the current audit regulatory environment, and how they evaluate the performance of the audit regulators. It is difficult for auditors to comment on what regulators do. However, it is important to understand the auditors’ feedback on regulators’ performance as this can enhance cooperation between the two parties. Such effective cooperation, if carried out, can improve the audit quality.

### 2.3 The effectiveness of the independent audit oversight system

Reviewing the literature in Section 2.2 suggests that the main aims of establishing the independent audit regulators are to restore the public confidence and to enhance the audit quality of the audit profession. Thus, this section focuses on studies which investigate the effectiveness of the new regulators in achieving their objectives.

#### 2.3.1 Promoting the public confidence

Some of the prior research (see, for example, Rezaee, 2004; Gates et al., 2007; Barlaup et al., 2009) studies the different efforts of auditors and audit regulators to regain the public’s trust in the audit profession. Barlaup et al. (2009) state that increased focus is required on ethical behaviours of the audit professionals so as to restore the public trust and avoid more fraudulent financial reporting. Gates et al. (2007) examine the effects of the audit firm and audit partner rotation on the public trust of the financial reporting of the capital market. Their findings suggest that individuals trust in the audited clients who periodically rotate their audit firms greater than
clients who only rotate their audit partners. Further, Edge (2005) stresses that the public feel auditors have failed to live up to their responsibilities because their independence has been impaired by performing increased non-audit services for their audited clients. He argues that the basic challenge for audit firms is to identify how ethical behaviours can be restored.

Rezaee (2004) puts forth a number of suggestions with regards to restoring public trust in the audit profession. He suggests that audit firms should be more involved in the business and local community activities, particularly the colleges and universities’ events. He further suggests that more effective and objective audit procedures should be used to improve audit effectiveness. Additionally, auditors must focus on teaching anti-fraud training programs for their audit staff and clients. In contrast, Rennie et al. (2010) explore the factors which influence the auditors’ trust in their clients’ management. They find that a client representative’s openness of communication and demonstration of concern during an auditor-client disagreement are factors which have a positive relationship with the auditors’ trust toward their clients’ management. However, they argue that this trust in the auditor-client relationship does not negatively affect the audit scepticism or the auditors’ independence.

2.3.2 Improving the audit quality

Many prior studies (see, for example, Defond & Lennox, 2011; Duff, 2009; Tsau, 2011) examine the effects of the new audit regulations on the audit quality. Duff (2009) studies the changeable views of the audit quality definition in the UK after the major accounting scandals. His findings indicate a significant change in the views of the stakeholders (auditors, audit clients, and investors) toward the term of audit quality during the period from 2002 to 2005. He further emphasises that four main measurements are identified to define the audit quality: competence, independence, relationship, and services qualities. Further, Tsau (2011) examines the relation between countries which are members of the IFIAR, as an indicator of having governmental audit oversight system, and the quality of audit process inside these countries. His findings support the notion that countries which have a governmental oversight system are more able to achieve greater audit quality than non-IFIAR member countries. Moreover, Groff & Hocevar (2009) argue that the new governmental inspectors hold the auditors to highly restricted standards by taking concrete actions against felonious auditors and imposing costly penalties.
Additionally, they suggest that auditors have become more conservative when it comes to complying with additional governmental requirements.

On the contrary, Casterella et al. (2009) examine the effectiveness of the peer review system which is conducted by the professional bodies to provide signals regarding audit firms’ quality. Their results indicate that the peer review system provides effective signals about the audit quality in the audit firms. Furthermore, Feldmann & Read (2010) study whether the auditors’ high levels of conservatism, which were established after Enron and the major accounting scandals, continue or are fading as time passes. They examine the proportion of the going concern opinions that were issued from 2000 to 2008 in 565 American companies. Their findings emphasise that although the proportion of the modified going concern opinions sharply increases in 2002 and 2003 compared with 2000 and 2001, it decreases in the following periods and returns to its pre-Enron level. Their results indicate that the changeable audit regulatory environment has positively affected the audit quality for a limited time. Further, Pierce & Sweeney (2004) argue that there is a conflict between the audit costs and achieving the required quality of the audit process. This conflict appears significant when auditors try to achieve their time targets and with them higher performance evaluation. It seems that prior studies have different conclusions when it comes to the effectiveness of the independent audit oversight system and the extent to which it succeeds in enhancing the audit quality. This refers to the need of further research to examine the effects of the current audit regulations regarding the quality of the audit process. Studying the literature identifies three factors which have important impacts on the quality of the audit process and which are discussed in many prior studies. These factors are the size of the audit firm, the non-audit fees, and the human resources.

2.3.2.1 Audit quality and audit firm’s size

During the last decade, many studies (see, for example, Defond & Lennox, 2011; Francis & Yu, 2009; Francis et al., 2005) have examined the effects of the audit firm’s size on the audit quality. Defond & Lennox (2011) investigate the high number of small audit firms which exit the audit market following the SOX Act. The number of small audit firms (which audit fewer than 100 clients) decreases from the 1,233 small audit firms active in 2001 to 626 firms in 2008; the majority of these exits occur in 2002–2004. They find that these auditors have lower quality than their peers who have not exited the market. Three measures are used to evaluate the quality of
exiting auditors, their compliance with PCAOB rules, the findings of the independent inspection reports, and the quality provided for the audit clients from exiting auditors compared with non-exiting auditors. Their findings suggest that the PCAOB inspections improve the audit quality by incentivising low quality auditors to exit the audit market.

Furthermore, Ebrahim (2010) argues that after the SOX Act, small clients are most likely to switch to smaller auditors as a result of the increased fees offered from the big audit firms. Moreover, Defond & Lennox (2009) argue that the SOX Act imposes higher costs on all public audit firms by increasing regulatory scrutiny, demanding stricter compliance with auditing standards, and raising the penalties for auditor misconduct. They stress that small audit firms are more influenced by the increased required costs than big firms. This is because there is a fixed cost component of complying with the stricter regulatory standards demanded by the PCAOB. Small auditors, who have a smaller audit fee base, are less able to recover these fixed costs through higher fees whilst also remaining competitive.

Stava (2003) stresses that big audit firms are less influenced by losing their people because they have a huge number of experts who can cover any shortages when it comes to serving specific clients. Moreover, the big firms are less influenced by the mandatory auditors’ rotation as they have a great number of highly skilled partners who can gain the clients’ trust and keep them engaged with their firms. Francis & Yu (2009) investigate the relation between the size of the audit firms and the audit quality for the period 2003 to 2005. Their findings suggest that larger offices are more likely to provide higher quality audits. However, there is no evidence to suggest that smaller firms provide unacceptable levels of audit quality. They argue that the big firms have more experience in dealing with multinational companies. Therefore, the big four auditors are more likely to detect significant errors in the financial statements or ask their clients for adjustments before their issuance. In contrast, Francis et al. (2005) and Vera-Munoz et al. (2006) assume that the big audit firms, particularly the big four firms, are unable to provide a unified level of audit quality through their offices. Further, Gaeremynck et al. (2008) examine the relations between the size of the audit firms’ portfolios and the audit quality. Their findings provide evidence that the size of the audit firm and the audit firm’s portfolio have less effect on audit quality than the clients’ characteristics.
This debate regarding the effects of the auditor’s size on the audit quality guides me in thinking about the size of audit firms which this study will investigate. I argue that the intensive changes in the audit regulatory framework cannot be faced by small auditors who do not have the power or the experience to strongly react regarding the new regulatory changes. Moreover, even the new governmental oversight system – which creates the research problem of this study – focuses on inspecting the big audit firms. For example, the PCAOB in the US and the POB in the UK are only responsible for inspecting the large audit firms which audit listed or public interests companies. Smaller firms are still inspected by professional bodies such as the American Institute of Chartered Public Accountants (AICPA) in the US, and the ICAEW, the ACCA, or the ICAS in the UK. Therefore, the research questions are set to reflect this argument by focusing on the big four audit firms rather than other mid-size or smaller audit firms. This can be an example of how the literature is used to guide the research questions.

2.3.2.2 Audit quality and non-audit fees

The auditors’ provision of non-audit services to the audited clients has been an issue of much concern among public and audit regulators after the collapse of Enron. It is argued that providing non-audit services impairs the auditors’ independence. Much of the previous research (see, for example, Lu & Sapra, 2009; Kinney et al., 2004; Larcker & Richardson, 2004) has investigated the effects of providing non-audit services to the audit clients on audit quality. For example, Kinney et al. (2004) study the effects of the provision of non-audit fees on the audit quality and audit independence. Their findings support the notion that increased non-audit fees – which are perceived by audit clients – significantly impair the audit independence and the quality of the audit process. Other studies (see, for example, Firth et al., 2002; Basioudis et al., 2008) report negative relationships among the perceived non-audit fees and the quality of audit reports. Conversely, Lu & Sapra (2009) emphasise that the mandatory restrictions on the provision of non-audit services for audited clients impair the quality of the audit process. Further, Larcker & Richardson (2004) provide evidence that non-audit fees do not affect the level of audit quality and auditors are constrained with their reputations rather than the increased audit or non-audit fees. Consistently, further studies (see, for example, Callaghan et al., 2009; DeFond et al., 2002; Geiger & Rama, 2003) fail to find negative associations among the provision of non-audit services and the quality of audit opinions.
Moreover, Ojo (2009) argues that while the provision of non-audit services does not necessarily impair the auditors' independence, it sometimes increases the audit’s quality as the auditors are assumed to have more expertise when it comes to the clients’ business. However, he emphasises that the negative effects of providing non-audit services for audited clients can be raised when the proportion of non-audit fees is considerably high compared with the perceived audit fees from the same client, with the absence of sufficient safeguards to protect the auditors’ independence. Furthermore, Lennox (1999) finds that when non-audit fees are disclosed, the provision of non-audit services does not reduce audit quality. Additionally, Eilifsen & Knivsfla (2008) examine the views of investors regarding the audit quality in the post-Enron years 2003-2006 in Norway. Their findings provide evidence that investors perceive the provision of non-audit services as problematic whilst the regulatory initiatives also relieve such negative perception.

2.3.2.3 Audit quality and human resources

The human resource is the most important input for productivity (Banker et al., 2003). Cheng et al. (2009) investigate the association between human capital and audit quality following the era of audit regulatory changes. Their findings indicate that the higher the investment in human resources, the higher the level of audit quality provided by the audit firms. They argue that after the governmental audit supervision of the audit profession, the audit firms need more well educated and well trained professionals to complete the additional and complicated tasks which are required by the new regulations of the audit profession. Moreover, many studies (see, for example, Cheng et al., 2009; FRC, 2006; SAG, 2004) stress that the audit firm’s human resources management is a significant driver of audit quality. Additionally, Yilmaz & Chatterjee (2003) stress that audit firms should choose employee performance measures which lead to the enhancement of the firm’s performance and the achievement of its goals. If this happens, then the objectives of the employees and the firm are aligned.

Further, Flint (2005) argues that the auditing firms are not fostering the required quality of human resources to provide individuals with integrity, accountability, responsibility, commitment, and trustworthiness. He emphasises that public accountants are well aware of ethical issues and have their codes of ethics; however, they prefer to maximise their wealth rather than being committed to their ethical codes. He believes that the audit failures will continue until
the audit firms create positive environments where the quality of human resources values is developed and promoted inside the firms. He further suggests six areas of human values which must be enhanced. The suggested values include human capital, human abilities, aesthetic capital, human potential, moral capital, and spiritual capital. This is not consistent with claims made by the audit firms, namely that “doing the right things” is one of their core values. Chen et al. (2008) investigate the effects of professional training and manpower on the quality of audit firms’ performance. They provide evidence that professional training programs are positively associated with the quality of the audit provided by the audit firms. Chung et al. (2008) argue that different mood states can lead to different professional judgments in the performance of an ambiguous task. They emphasise that positive mood auditors are less likely to make conservative judgements than natural and negative mood auditors.

Following an examination of prior research it is evident that different results have been found regarding the effectiveness of the independent regulators’ role in enhancing the quality of the audit profession and regaining the public’s trust. While some studies (see, for example, Groff & Hocevar, 2009, Duff, 2009; Tsau, 2011) support the importance of this new system in improving the quality of the audit process, other studies (see, for example, Pierce & Sweeney, 2004; Casterella et al., 2009) find no evidence that real improvement has been achieved. These different arguments emphasise the importance of conducting further research to investigate the importance of the new regulatory system as well as assessing what are the main values of such a system and who are the main beneficiaries. Thus, an additional research question is formulated as follows.

*RQ: What are the main values of the independent audit oversight system?*

The above question provides a great understanding of the role played by the independent oversight system in promoting public confidence in the audit profession. It also aims to explain how investors, auditors, governments, and the public have been benefiting from such a system. This analysis can help the audit parties in conducting the cost-benefit analysis of such a system and deciding the extent to which the audit profession still needs the independent regulators.
2.4 The effects of the independent audit oversight system

This section analyses the effects of appointing the independent audit regulators on different issues related to the audit profession, such as auditors’ independence, audit risk, audit fees, and audit competition. It aims to provide a comprehensive understanding of how the new regulators affect the audit market, and the extent to which such effects can change the relations among different audit parties.

2.4.1 Independent oversight and auditors’ independence

Ojo (2007) argues that the governmental oversight of the audit profession and the increased attention toward auditor independence are two of many results which have followed Enron and other major accounting scandals. Further, Hope & Langli (2010) examine the auditor’s independence impairment in private client firms and a low litigation environment in which the risk of losing reputation is lower than other environments (see, for example, Johnstone & Bedard, 2004; Bell et al., 2002). Their results provide evidence that auditors do not compromise their independence through fee dependence. They argue that two factors aid auditors in maintaining their independence despite the incentive audit and non-audit fees. Auditors are afraid of the risk of lawsuits and the risk of losing their reputations.

Different factors which affect the auditors’ independence are discussed in the literature. For example, Law (2010) studies the impact of the Certified Public Accountants (CPAs) employment with their audit clients following the issuance of the SOX Act. He finds that independence is impaired when a senior level professional such as a partner or manager joins a former audit client. Furthermore, Hoitash & Hoitash (2009) examine the association between the new role of audit committees which follows the establishment of the SOX Act as well as the external auditor’s independence and the audit’s quality. They find that the increased roles of audit committees in the SOX Act enhance the auditor’s independence and audit quality. Further, Ruiz-Barbadillo et al. (2009) investigate the association between the mandatory audit firm rotation and the auditor’s independence. They find no evidence to suggest that the mandatory audit rotation can enhance the auditors’ independence. They argue that the auditors’ incentives to protect their reputation are greater than their incentives to keep their current clients. Khurana & Raman (2004) argue that this greater conservatism and the higher audit quality provided by the big audit
firms comes in order to mitigate the risk of litigation rather than to protect their leading reputations.

2.4.2 Independent oversight and audit risks

Much of the prior research (see, for example, Clatworthy et al. 2009; Rainsbury 2008; Defond & Francis, 2005) investigates the impacts of the new regulations (SOX and similar laws) on the audit risks and other factors which affect the audit opinions (such as the strength of internal control system of audited clients). Geiger et al. (2005) find evidence for increasing the issuance of going-concern opinions after SOX, compared with earlier periods. Further, Patterson & Smith (2007) argue that as a result of Sarbanes-Oxley, the strength of the internal control strength increases and the amount of fraud decreases. Their findings suggest that the audit risk increases as a result of the SOX act. Further, Landsman et al. (2009) examine the sensitivity of the big audit firms’ switches to client risk and misalignment changes pre and post Enron periods. They find an increase in the sensitivity to clients’ misalignment and a sensitivity reduction toward clients’ risk. They argue that the big four firms have revised their clients’ portfolios in response to the regulatory constraints of the auditors’ capacity. Further, they argue that the Arthur Anderson auditors’ supply shock has affected the big four’s switching behaviours greater than the Sarbanes-Oxley auditors’ demand shock. Other studies (see, for example, Patterson & Smith, 2007; Hoitash et al., 2008) investigate the effects of the SOX Act on the internal control strength of public companies. Their findings emphasise that the SOX Act has the desired effect of providing stronger internal control systems and less fraud.

Chen et al. (2010) examine the relation between the clients’ importance and the probability of issuing a modified audit opinion, which is an indicator as to the level of audit quality. They find that changes are made in the nature of this association according to the changeable audit regulatory environment in China after Enron and other major accounting scandals. Their findings support the notion that, while the probability of issuing modified opinion was negatively associated with the clients’ importance prior to the era of change (before 2001), there is a positive association among the two variables after the era of change (after 2001). They argue that this change is justified by the more friendly relationship which has been established between audit institutions, such as auditors and regulators, and investors of capital markets. Additionally, Johnstone & Bedard (2004) examine the association between the audit risks and the clients’
acceptance and continuity decisions after the more restricted audit regulatory framework. Their findings indicate that auditors are less likely to accept or continue with high risk clients, and that they prefer to be more conservative toward their clients’ portfolios. Their results provide no evidence that audit pricing affects the clients’ acceptance or continuity decisions. Lu & Sapra (2009) examine the determinants of auditors’ conservatism in the capital market. Their findings indicate that clients’ business risks are positively associated with auditors’ conservatism.

Charles et al. (2010) examine the relationship between the financial reporting risk and audit fees which are paid to auditors after the changeable audit environment as a result of SOX Act. Their results support the notion that the financial reporting risk is positively associated with the audit fees. They argue that this relation is significantly strengthened in 2002 and 2003. Further, Jeppesen (2007) analyses the organisational risk in large audit firms. Her findings suggest that the standardisation of the work process and the hierarchy of the partnerships, as the common legal structure of the audit firms, can be effective ways by which to organise the audit work in a stable environment. However, this becomes very risky in a volatile environment.

Reviewing the above studies indicates that auditors face higher litigation risks after the era of independent regulators and decreased public trust in auditors. These increased challenges of the audit firms guide me to address one more research question regarding the actions of the big four firms when it comes to protecting their leading reputations.

2.4.3 Independent oversight and audit fees

Ebrahim (2010) analyses the effects of the SOX Act on the audit fees premium. His findings support the notion that the significant audit regulatory changes increase the audit fees as a result of the additional efforts which are required from auditors. However, these new regulations have led to an improvement in the audit quality and the internal control system in public companies. Clatworthy et al. (2009) argue that large auditors are charging significantly higher audit fees as a result of higher audit quality and a lack of competition in the audit market. Further, other studies (see, for example, Solomon, 2005; Raghunandan & Rama, 2006) stress that the audit fees have been significantly increased as a result of the SOX Act. Venkataraman et al. (2008) examine the relation between auditor exposure to legal liability and audit quality and audit fees. Their
findings indicate that a positive association exists between audit quality and audit fees from one side and the litigation regime from the other side.

Some studies (see, for example, Vermeer et al., 2009; Kealey et al., 2007) investigate the association between the familiarity of the audit partner and the audit fees. They find that a negative relationship does in fact exist. The more familiar the client-partner relationships, the lower the audit fee which is charged. Krishnan & Yu (2011) examine the relation between audit and non-audit fees and how this affects the audit costs. Their results suggest that there is a strong negative association between audit and non-audit fees. They further argue that the provision of non-audit fees for audited clients can reduce the audit cost. This audit cost reduction can be passed to the audit client by reducing their bills. Further, Hoitash et al. (2008) emphasise that audit fees have been increased as a result of the additional auditors’ efforts which are required by the SOX Act. It is noted that most of the previous studies investigate the effects on the audit fees inside the US as result of the additional requirements of the SOX Act. It seems as though there is a gap in the literature when it comes to Europe and other regions.

2.4.4 Independent oversight and audit competition

Many governmental reports which have studied audit markets after the failure of Arthur Anderson (See for example, ICAS, 2009; U.S Treasury department, 2008; Oxera, 2006), refer to the low competition in the audit markets. They indicate that listed companies have no effective choice of auditors in the short term. Barrett (2008) emphasises that the independent audit oversight aims to increase competition in the audit market. The high competition in the audit market improves the audit quality and offers a greater incentive for the audit firms to hire highly skilled people. Furthermore, many studies (see, for example, FRC, 2007; Oxera, 2007; ICAEW, 2010:b) focus on the structure of the audit market and the level of effective choice of auditors between listed companies. For example, Oxera (2006) stresses the high degree of concentration in the UK audit market after the dissolution of Arthur Anderson in 2002. Indeed, the big four firms now dominate 99% of the largest 100 listed companies in the UK market in 2005. Moreover, the study finds evidence regarding the ineffective choice in the audit market, and believes that the loss of another big four firms would increase problems around auditors’ choice and require regulators to make exceptions to auditor independence rules.
However, Simons & Zein (2008) argue that governmental audit regulators might refrain from sanctions against the big four firms, because they are afraid of further dissolving one of the major suppliers of the audit service. Additionally, despite many efforts made by the audit regulators to reduce the audit market concentration from 2006 to 2010, there is little indication that concentration in the audit market is reducing or is likely to reduce in the near future (FRC, 2010). Further, Singh & Van der Zahn (2010) investigate both the existence and extent of competitive audit pricing in the Australian audit services market during a five-year time frame. This is to determine whether there is any evidence of cartel pricing and, hence, anti-competitive behaviour by the big four firms. The findings of this study indicate that audit fee variation is not driven by supply-side features of an audit engagement but rather is determined by demand-side features such as auditee size, complexity and risk. Their findings reveal no evidence to suggest the existence of cartel pricing or anticompetitive conduct by the big four firms. Kallapur et al. (2008) examine the relation between the audit market competition and the audit quality after Enron. Their findings show that the two variables are negatively associated. They claim that following Enron the competition in the audit market is decreased, and the audit quality is increased as a result of SOX and governmental audit oversight.

Certain previous studies (see, for example, ICAEW, 2010:b; U.S Treasury department, 2008) provide evidence that the audit market has been highly concentrated, in different countries, by the big four firms after the major accounting scandals. The following are three types of concentration strategies which have been identified through the literature. The first type involves big audit firms which are highly concentrated in specific industries. Many studies (see, for example, Maister, 2003; Mayhew, 2002; Carrera et al., 2003; Cahan et al. 2008) argue that this concentration strategy creates a competitive advantage for audit firms in the audit market. The U.S. General Accounting Office (2003) stresses that one of the critical factors when it comes to the selection of auditors has to do with auditors' industry expertise.

The second type of concentration is concentrating on international clients. This new strategy is conducted to better service the global clients, and to stop competitors encroaching on their clients (Gray et al., 2001). It positively affects the audit quality (Francis et al., 2010). Holding companies and all of their subsidiaries and branches are audited by one global audit network which follows the same audit approach through all their member firms. Finally, the third type of concentration is
the geographical concentration. Carson (2009) argues that differences between accounting regulations and practices across countries are often less pronounced than differences between industries. The big audit firms are classified into specific geographical regions around the world.

Table 2.1 presents the total revenues of three big audit firms for each geographical region. For example, PWC is more focused on Europe, Australia and Africa, while Deloitte focuses on America. It is agreed that a highly concentrated audit market and insufficient choice of auditors among large companies are global phenomena which threaten audit quality in many countries. Much of the literature (see, for example, ICAS, 2009; FRC, 2007) seeks to suggest different solutions without considering the views of auditors. This lack of literature guides me to consider the views of the big four firms when it comes to governmental efforts to enhance the choice in the audit markets.

<table>
<thead>
<tr>
<th>Audit firm</th>
<th>America</th>
<th>Asia</th>
<th>Africa</th>
<th>Australia</th>
<th>Europe</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>KPMG</td>
<td>7.2608</td>
<td>3.1766</td>
<td>12.2526</td>
<td></td>
<td></td>
<td>22.690</td>
</tr>
<tr>
<td>PWC</td>
<td>10.023</td>
<td>2.601</td>
<td>0.715</td>
<td>1.366</td>
<td>13.480</td>
<td>28.185</td>
</tr>
<tr>
<td>Deloitte &amp; touché</td>
<td>12.9</td>
<td>3.2</td>
<td>11.3</td>
<td></td>
<td></td>
<td>27.4</td>
</tr>
</tbody>
</table>

Compiled from the annual reports of the big firms 2008.

Much of the previous research in Section 2.4 is concerned with discussing the role of the new audit regulations and how they affect the audit market. However, there is a lack of research when it comes to analysing the audit regulations which have recently been issued. Thus, the following research question is addressed in order to analyse the common regulations of the audit markets; and to understand the extent to which these regulations can assist the audit regulators in achieving their objectives.

*RQ: How do the current audit regulations protect the public interests and promote confidence in the audit markets?*

The above question aims to analyse the recent audit regulations so as to provide a better understanding of the main purposes of these regulations and how they can achieve some of the regulators’ objectives.
2.5 The role of global audit networks in structuring the current audit regulatory framework

A number of previous studies (see, for example, Lenz, 2005; IFAC, 2006; Cooper & Robson, 2006) analyse the global structure of the big four networks and their effects on the audit profession. The network strategy of the audit firms can be defined as medium- to long-term, with contractual forms of cooperation between legally and economically autonomous entities for the joint task fulfilment (Lenz, 2005). Audit network is also defined by the International Federation of Accountants (IFAC Code of Ethics for Professional Accountants, 2006) as a larger structure which is aimed at co-operation, and which is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources. Whilst the first definition focuses on the nature of the legal relationship between the member firms of each network, the second one has defined the purposes for which these networks are established.

Carson (2009) investigates the role of global audit networks in the audit markets. She assumes that the global networks enable national member firms to expand efficiently through the global audit market. Further, global audit networks benefit their member firms by developing global industry specialisations through the creation of industry specialist teams supported by global knowledge management databases and common industry-specific work programs and training.

Sikka (2008) provides evidence that the globalisation of major accounting firms assists them in using their resources to secure conditions necessary for the smooth accumulation of private wealth and power. He uses a case study relating to the enactment of limited liability partnership (LLP) in Jersey – a UK Crown Dependency – to explain how the legislation has been financed and developed by two of the major UK audit firms in collaboration with a network of advisers.

Further, Suddaby et al. (2007) examine the role of large accounting firms in the emergence of a transnational regulatory field in professional services. Their findings provide evidence that there are new actors who influence the audit regulations, particularly the big four firms and non-governmental organisations (such as the professional institutions). They argue that more concerns have been raised by the profession regarding public interests rather than commercial practices. Further, it is argued that post-Sox, there have been consultations through the big firms’ networks to achieve a higher quality audit process (Francis & Yu, 2009). Additionally, Carson
argues that global audit firm networks have been developed as a result of the concentration strategy in global companies, and to better serve global clients who have multinational operations and demand consistent auditing throughout the world. The key activities of the global network include quality assurance across their member firms and the implementation of the network international strategy (Oxera, 2007).

Additionally, Cooper & Robson (2006) provide evidence that professional firms are increasingly important in professionalisation and regulatory processes. Barrett et al. (2005) investigate the effects of the globalisation of audit firms’ structures on the process of coordinating a multinational audit. They suggest that the increased risk of litigation and the commercialisation of the audit industry affect the audit work by changing the level of documentation, new technologies and methodologies, requiring new skills and client relationships.

The increased role of the global networks in structuring the current regulatory audit framework has been discussed in many previous studies. Studying the literature of this section indicates that most previous studies are concerned with the effects of the global networks of the big four firms in affecting the regulatory authorities of the audit profession. However, there is a lack of research in terms of the organisational strategies which have emerged from the big four audit firms to manage the current challenges of the audit market. Therefore, the following research question is addressed to cover the gap in this area of research.

*RQ: What are the main strategies which have emerged from the big four audit firms to protect their leading reputations?*

In another context, some of the audit literature (see, for example, Hill et al., 2005; Thornburg & Roberts, 2008; Shapiro & Matson, 2008; Jelinek & Jelinek, 2008) investigates the effects of the new changes, especially in the USA, on the audit environment post Enron and other major scandals. Jelinek & Jelinek (2008) identify three types of changes which affect the audit firms. The identified effects are SOX effect, which increases the work load, market effect which leads to increased demand for talented people, and public effect, which creates intensive clouds over the profession. They argue that such effects create more job stress and increase deviant workplace behaviour. Firms should understand these behaviours and how they affect the efficiency and effectiveness of the audit process. Hill et al. (2005) study the auditors’ reactions
toward the SOX Act and emphasise that the big audit firms are more likely to agree with the prohibition of non-audit audit services provision to audit clients than small audit firms. They believe that it is rare for the profession to be as deeply divided on an issue as seems to be the case for SOX. They stress that such differences justify the complexity of the Act’s implementation.

Thornburg & Roberts (2008) conclude that post SOX, the public accounting profession in the USA strategically manages its relationships with federal government through direct involvement in the financing of political campaigns. They have doubts regarding the primacy of public interests orientation of the audit firms, as it does not appear to be politically neutral when attempting to influence public policy. Further, Baker et al. (2006) examine the interactions between the accounting profession (including the audit firms and the accounting associations), the Securities and Exchange Commission (SEC), and the Congress. Using institutional theory perspective, they find that post Enron, the legitimacy of SEC has been enhanced, and the quality of the accounting profession has been positively affected. The politicians are supported by the voters since they have reacted to protect the public interests from further collapses. Oliver (1991) identifies a set of organisational resistance strategies toward institutional regulations. These strategies range from passive to active respectively, as follows: acquiesce, compromise, avoid, defy, and manipulate. Shapiro & Matson (2008) study the US organisational strategies used to resist the mandatory internal control regulations which have been enforced by the SOX Act. They argue that the on-going dramaturgical exchange between regulators and regulatees could significantly weaken the internal control requirements of SOX.

Further, Sweeney & Pierce (2004) investigate the management control system in the audit firms themselves. They argue that there is a conflict between the business of auditing and the profession of auditing, particularly at the audit senior level. Their findings indicate that auditors’ behaviours have been affected by three factors which threaten the audit’s quality. Such factors include time pressure, participative target setting, and style of performance evaluation. The authors suggest specific procedures which should be set by the audit firms to reduce the cost-quality conflict. Adequate time should be provided for the audit staff to complete their audit tasks. Other delay factors which are out of the staff’s control should be considered in their
performance evaluation. Moreover, firms should carry out performance evaluation processes after each major audit assignment (Pierce & Sweeney, 2004).

It is argued that there are different types of organisational actions toward changes in the regulatory environment. Many studies investigate the relations between the big audit firms and the new regulators after the new changes of the audit regulatory framework. However, only few studies have focused on investigating how the audit firms, especially the big four firms, react to the new changes in the regulatory system. Thus, the following research question is addressed.

**RQ: How do the big four firms react toward the new changes in the regulatory framework of the audit profession?**

### 2.6 Conclusion

This chapter reviews the literature as it relates to the new stage of the governmental audit oversight system. This literature is classified into four groups of prior research. The literature is used for two main purposes: guiding the research questions as in this chapter, and validating the emerged theory, which will be achieved in Chapter 8 of this study. In this chapter, the literature guides me in addressing the research questions as follows.

By reviewing the literature, it is argued that the big four audit firms are dominating the audit markets in most countries. This guides the research questions to focus on the big four firms rather than mid-size or smaller firms. Small auditors do not have enough power or experience to face the new threats of the audit profession, and usually follow the strategies of the big four companies as they are the leaders of the audit market.

Further, much of the prior research emphasises the similarity between the independent audit oversight systems of different countries. It is agreed that the big four audit firms also follow similar objectives, structures, and strategies. This similarity among the two parties of my research problem, guides me to study the research point and address the research questions at the global level. This is done by considering the views of audit partners in the big four firms and the independent audit regulators, regardless of their nationalities or their resident countries.

However, although the major audit oversight authorities in different countries follow similar trends when it comes to regulations and inspection systems, there are some differences in the
names and times of the issued regulations. For example, while the USA rules are more restricted regarding the provision of non-audit services for audit clients than its peers in the UK, the British regulators have made recent progress in issuing a number of audit regulations to improve the quality of the audit profession (such as allowing the audit liability limitation agreements in 2006, and issuing the audit firms’ governance code in 2010). Therefore, and according to the practicality of studying specific independent audit oversight systems and the possibility of the data collection process, two independent authorities in two environments have been selected for investigation in this study. The two authorities are the Audit Inspection Unit in the UK as one of the developed capital markets, and the Quality Control Unit in Egypt as one of the developing capital markets.

A main concern for the UK government, post Enron, was the adequacy of the UK framework for auditor independence (Fearnley and Beattie, 2004). Although there had been no comparable failures in the UK, where the regulatory framework has been claimed to be more effective (Hinks, 2002), the regaining of public trust and enhancing the quality of the audit profession were needed. As a result, the UK government established the coordinating group on audit and accounting issues that was responsible for reviewing the key areas of auditor independence and for making relevant recommendations. The review team’s report that was issued in 2003 recommended enhancing the monitoring of the audits of listed and other major public interest entities through a new independent inspection unit reporting to a professional oversight board within an integrated independent regulator.

Accordingly, in 2004, the Financial Reporting Council (FRC) became the unified independent regulator for corporate reporting and governance. The main aim of the FRC is to promote confidence in corporate reporting and governance. It sets standards for corporate governance, enforces accounting and auditing standards, and prevents the public interests from any manipulation. The FRC exercises its functions through six operating bodies: Accounting Standards Board (ASB), Auditing Practices Board (APB), Board for Actuarial Standards (BAS), Professional Oversight Board (POB), Financial Reporting Review Panel (FRRP), and Accounting and Actuarial Discipline Board (AADB). The APB and the POB are the most relevant FRC’s bodies to regulate the audit profession (FRC, 2009). The Auditing Practices Board (APB) consists of 15 members and three observers. It is committed to lead the
development of auditing practice in the UK to establish high standards of auditing, meet the developing needs of users of financial information, and ensure public confidence in the auditing process. It works to achieve these objectives through setting auditing standards and guidance of its applications in different sectors, setting ethical standards in relation to independence and objectivity of external auditors, and verifying public understanding of the roles and responsibilities of the external auditors (FRC, 2009).

The POB was established in 2003 and consists of 11 members. It aims to increase the public’s trust in the audit profession by an independent oversight of the audit profession’s regulations and monitoring the quality of the audit firms’ annual performance. To achieve these objectives, the POB established the Audit Inspection Unit (AIU) in 2003 to be responsible for monitoring the audits of all listed and other major public interest entities (FRC, 2009). The POB is responsible for approving the AIU’s work programme and, in particular, determining audited entities that fall within the scope of the AIU’s work. The importance of the AIU comes from its ability to understand how audit firms are interpreting and applying the requirements of both the auditing and ethical standards, and to suggest changes to the standard setters where it believes these would enhance overall audit quality. Since 2006 there has been a demand from a number of stakeholders for the AIU’s inspection reports on individual audit firms to be made public. In 2008, the AIU published the first public reports on all individual audit firms which had been subject to a full-scope review in 2007/2008 (FRC, 2009).

Moreover, since 2005 the UK government has been concerned about increased concentration of the big four firms in auditing the large listed companies in the capital market (FTSE 100, and FTSE 350); the big four audit 99% of the largest UK listed companies and their audit fees represent 99% of the audit fees in the FTSE 350 companies (Oxera, 2006). Accordingly, in 2006, the FRC established the Market Participants Group (MPG) to provide recommendations on possible actions that could be taken to mitigate the risks arising from the current characteristics of the audit market, and specific projects and regulations have since been applied to increase the choice in the UK audit market.

In Egypt some studies investigated the Egyptian audit environment and analysed the main problems and expectation gaps. For example, Federation of Mediterranean Certified Public Accountants (FCM, 2007) conducted a comparative study between the Public Oversight System
in 15 Mediterranean countries. Out of these 15 Mediterranean countries, only 8 countries have a public oversight system (five of them are EU members). The Egyptian participants of the audit profession believe that they need such system to enhance the profession as a whole and to enhance the quality of auditing firms. Samaha et al. (2008) aimed to provide inputs for an all-inclusive development plan for accountancy reform. They suggest that enhancing professional education and continuous professional development (CPD), strengthening the professional bodies, and establishing efficient and effective regulatory framework for the audit profession are the main factors to improve the compliance to the international standards. Wahdan et al. (2005:a) study the main diagnoses of the auditing profession in Egypt. Their results suggest that shortage of experience and expertise, lack of professional ethics, and auditor’s role in relation to the expected role by the public are the main diagnoses of the Egyptian profession.

Awadallah (2006) examines the effects of four factors (provision of non-audit services, level of competition among audit firms, size of audit firm, and client's corporate governance structure) on auditors' ability to withstand client management pressure. His findings show that the effect of providing non-audit services was much greater than any of the other. Wahdan et al. (2005:b) investigated the main challenges and problems of an automatic formulation of auditors’ report in Egypt. Their findings suggest that the development of the proposed system of automated the reporting process may be helpful to overcome the lack of experience and expertise among Egyptian auditors, but it may be restricted by the cost-fees analysis. Further information on the Egyptian and the UK contexts is provided in Chapter 4.

Moreover, by reviewing the literature, I argue that only a limited number of studies consider the views of the big audit firms toward the new independent oversight system. Indeed, the present study fills this gap in the literature, and provides a theory which has emerged from the field. The views of participants are gathered, analysed, developed, discussed, validated, and criticised in order to build up a meaningful theory which is agreed upon by all of the professionals and regulators.

An examination of the prior research indicates that most of the literature pays greater attention to studying the audit firms as professionals rather than as services’ organisations. Only a few of the previous studies investigate the audit firms per se. This study is concerned with the big four firms as organisations which are faced with a changeable regulatory environment and dynamic
markets. Thus, this research studies the views of these firms toward these new threats, and how they react toward such regulatory changes.

In another context, most of the previous research uses quantitative methods to analyse their collected data. Only a few studies use qualitative methods for their data analysis. Moreover, to the best of my knowledge, very few auditing studies have used grounded theory as a research methodology. My argument is that this lack of grounded theory-based auditing literature is due to the difficulties encountered when attempting to conduct in-depth or semi-structured interviews with auditors who are always busy with the more numerous and complicated tasks required by applicable rules and standards.

While this chapter aims to demonstrate how the literature guides the research questions as alluded to above, it further aims to identify the gap in the literature, as well as areas which are in need of further research. These areas are considered when addressing the research questions of this study. To sum up, the relevant previous literature focuses on the global trend of governmental oversight of the audit profession without considering the views of the big firms toward those governmental regulators. Other studies are concerned with the global networks of the big audit firms without studying how these audit firms react toward the governmental regulations stage of the audit profession or the emergent strategies with which to tackle the new audit regulations and requirements. This literature gap motivates me to address the following research questions.

RQ1: How do the big firms evaluate the current performance of the independent audit inspectors? What are the key factors of an effective inspection process? And how do the current audit regulations assist audit regulators in achieving their objectives?

RQ2: How do the big four firms react toward the new changes in the regulatory framework of the audit profession? What are the main strategies which have emerged to protect their leading reputations?

The lack of literature and the fact that the research questions begin with “How” and “What” support the use of grounded theory as a relevant methodology in this study. The research methodology of this study is discussed in the next chapter (Chapter 3).
Chapter 3: Research paradigm, methodology, and methods

3.1 Introduction

“Research is a systematic and methodological process of inquiry and investigation with a view to increasing knowledge” (Collis & Hussey, 2009).

This chapter provides a discussion regarding the research paradigms, research methodologies, and the research methods of data collection and analysis. Understanding the research paradigms and related philosophical issues helps the researchers to determine their aims and priorities regarding alternative ways of studying the research phenomena.

“There are three main reasons why an understanding of philosophical issues is useful to the research design process:

1. The knowledge of philosophy can help to clarify research designs. This not only involves considering what kind of evidence is required and how it is to be gathered and interpreted, but also how this will provide answers to the basic questions being investigated in the research.

2. The knowledge of philosophy can help the researcher to recognise which designs will work and which will not. It should also enable him or her to avoid going up too many blind alleys and should indicate the limitations of particular approaches.

3. The knowledge of philosophy can help to identify, and even create, designs that may be outside the researcher’s past experience. And it may also suggest how to adapt research designs according to the constraints of different subject or knowledge structures” (Kongsamut, 2010, p.53).

The remaining parts of this chapter are classified as follows: Section 3.2 discusses the research paradigms, and explains the purposes and the main assumptions of each of them. Further, it also focuses on two main frameworks which study the main assumptions of the social science research: Burrell & Morgan’s framework (1979) and Laughlin’s framework (1995). A justification in terms of how these frameworks are applied in this study is included at the end of Section 3.2. Section 3.3 explains the research methodology used for this study and justifies the main reasons behind the selection of grounded theory as a research methodology. Section 3.4 analyses the history of grounded theory in accounting research.
Section 3.5 discusses certain which should be considered in qualitative research. Section 3.6 discusses the main approaches of grounded theory and analyses the differences between each approach. Finally, Section 3.7 explains the process of collecting and gathering required data. Section 3.8 discusses the process of data analysis according to the Strauss & Corbin approach (1998) of grounded theory, whilst Section 3.9 explains how this study fills the ethical commitments. My conclusion is also added in Section 3.10.

3.2 Research paradigms

“The process of scientific practice based on people’s philosophies and assumptions about the world and the nature of knowledge” (Collis & Hussey, 2003).

“The research paradigm is the net that contains the researcher’s epistemological, ontological, and methodological premises” (Denzin & Lincoln, 2005).

“A research paradigm is a philosophical framework that guides how scientific research should be conducted” (Collis & Hussey, 2009, p.55).

Before researchers embark on the path of investigating a specific phenomenon, they determine how the analysis will be conducted (Alberti-Alhtaybat, 2007). It is important to recognise and understand the researcher personal paradigm which is associated with the research problem (Kongsamutr, 2010). Further, Collis & Hussey (2009) argue that the researchers’ beliefs about the social world reflect the manner by which the research is designed, as well as how the data is collected and analysed.

Many social studies have investigated the methods used in business and accounting research. For example, Collis & Hussey (2009) differentiate between two main paradigms: positivism and interpretivism. However, they emphasised that this classification is very simple and researchers must develop a better understanding of different types of paradigms as well as science and society’s assumptions. Sociological positivism attempts to apply the natural sciences’ models and methods to the social sciences. It looks to the social science as if it were a natural science. The interpretivism or idealism places emphasis on the subjectivity of the human world to which the natural sciences’ models and hypotheses cannot be applied. Creswell (1994) sets out three assumptions to differentiate between the two paradigms: ontological assumptions, epistemological assumptions, and axiological assumptions. Moreover, Johnson & Clark (2006) argue that determining the assumptions of the research
paradigm will create a commitment for the researchers when they choose their research methodology, as these assumptions have a direct impact on what the researchers do and what should be investigated.

Sounders et al. (2009) differentiate among four types of research paradigms: positivism, realism, interpretivism, and pragmatism. Differences among the four paradigms are summarised in Table 3.1. They recommend that researchers who are concerned with facts are more likely to follow the positivistic paradigm. This differs from other researchers who pay more attention to the study of feelings, attitudes or human behaviours; the latter will be keener to follow the interpretivism paradigm. The differences between the two types of researchers will not only appear in their research strategies and methods of data collection. Indeed, the most important differences appear in their priorities and in their analysis of gathered data.

In this study, two original studies are discussed, with the hope of explaining the different types of research paradigms which are followed in the accounting research. The first study is the study of Burrell & Morgan (1979) which is the first study to categorise social science into four paradigms; the second, is the study of Laughlin (1995), which is one of the common studies which focuses on the accounting research and is considered an extended study for the Burrell & Morgan framework.
Table 3.1: Comparison of four research paradigms in management research

<table>
<thead>
<tr>
<th></th>
<th>Positivism</th>
<th>Realism</th>
<th>Interpretivism</th>
<th>Pragmatism</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ontology: the researcher’s view of the nature of reality or being</td>
<td>External, objective and independent of social actors</td>
<td>Is objective. Exists independently of human thoughts and beliefs or knowledge of their existence (realist), but is interpreted through social conditioning (critical realist)</td>
<td>Socially constructed, subjective, may change, multiple</td>
<td>External, multiple, view chosen to best enable answering of research question</td>
</tr>
<tr>
<td>Epistemology: the researcher’s view regarding what constitutes acceptable knowledge</td>
<td>Only observable phenomena can provide credible data, facts. Focus on causality and law like generalisations, reducing phenomena to simplest elements</td>
<td>Observable phenomena provide credible data, facts. Insufficient data means inaccuracies in sensations (direct realism). Alternatively, phenomena create sensations which are open to misinterpretation (critical realism). Focus on explaining within a context or contexts</td>
<td>Subjective meanings and social phenomena. Focus upon the details of situation, the reality behind these details, subjective meanings motivating actions</td>
<td>Either or both observable phenomena and subjective meanings can provide acceptable knowledge dependent upon the research question. Focus on practical applied research, integrating different perspectives to help interpret the data</td>
</tr>
<tr>
<td>Axiology: the researcher’s view of the role of values in research</td>
<td>Research is undertaken in a value-free way, the researcher is independent of the data and maintains an objective stance</td>
<td>Research is value laden; the researcher is biased by world views, cultural experiences and upbringing. These will impact on the research</td>
<td>Research is value bound, the researcher is part of what is being researched, cannot be separated and so will be subjective</td>
<td>Values play a large role in interpreting results, the researcher adopting both objective and subjective points of view</td>
</tr>
<tr>
<td>Data collection Techniques most often used</td>
<td>Highly structured, large samples, measurement, quantitative, but can use qualitative</td>
<td>Methods chosen must fit the subject matter, quantitative or qualitative</td>
<td>Small samples, in-depth investigations, qualitative</td>
<td>Mixed or multiple method designs, quantitative and qualitative</td>
</tr>
</tbody>
</table>

Source: Sounders et al. (2009, p. 119)

3.2.1 Burrell & Morgan (1979) framework

“The issue of paradigms in social sciences was raised by Burrell and Morgan (1979)” (Tillmann, 2003).

“The alternative research approaches in accounting build on research paradigms in the social sciences” (Gaspar, 2006).

Burrell & Morgan (1979) emphasise that the researcher should make several core assumptions concerning two dimensions: the nature of society and the nature of science. Four assumptions have been determined regarding the nature of science, including ontological, epistemological, human nature, and methodological assumptions. In contrast, two assumptions have been recognised with regards to the nature of society, including regulatory society assumption or radical change society assumption.
With regard to the first dimension of assumptions of the nature of science, four categories are recognised. The first category is the ontology which refers to a great discussion regarding the nature of reality. It discusses whether reality is objective and independent of human consciousness, or subjective and dependent on human consciousness. Realists believe that there is only one objective reality. They argue that the social world is independent of individuals and it is a world into which individuals are born and live without creating or changing its structure.

“For the realist, the social world has an existence which is as hard and concrete as the natural world” (Burrell & Morgan, 1979, p.4).

On the contrary, nominalists assume that the social world consists of statistical components such as: names, concepts, and labels. Such components mean nothing by themselves and are only used to structure the reality. Nominalists believe that reality is created by individuals and that everyone creates his or her own reality.

Further, the second type of assumption regarding the nature of science is the epistemology. It refers to different assumptions about the nature of knowledge. It is highly influenced by the ontological assumptions; the researcher’s views on reality significantly affect his views on knowledge.

“For example, it entails ideas about what forms of knowledge can be obtained, and how one can sort out what is to be regarded as ‘true’ from what is to be regarded as ‘false’ ... it is possible to identify and communicate the nature of knowledge as being hard, real, and capable of being transmitted in tangible form, or whether ‘knowledge’ is of a softer, more subjective, spiritual or even transcendental kind, based on experience and insight of a unique and essentially personal nature” (Burrell & Morgan, 1979, p.4).

Positivists consider knowledge as hard and tangible, while anti-positivists believe that knowledge is softer and subjective according to individual arguments. Therefore, positivistic researchers seek to study what happens, depending on a prior theory. In contrast, anti-positivistic researchers are more concerned with studying why the phenomena happen, and what the individual’s views are. The theoretical framework for interpretive studies is less important, as these studies attempt to develop a theory without predetermined theories or assumptions. Moreover, positivistic research is highly concentrated on the nature and
physical sciences, as they attempt to explain and predict different events in the social world. Indeed, this depends on analysing the casual and regularities relationships among constituent elements. Conversely, anti-positivistic research is highly concentrated in the social sciences. They believe that the social world can only be understood from the point view of the individuals who are directly involved in the activities which are under investigation (Burrell & Morgan, 1979).

Human nature is the third category of assumptions regarding the nature of science. Human nature assumptions describe the relations between the human beings and their environment. This assumption differentiates between determinism and voluntarism. The former believes that external environment affects humanity. A determinist considers that people and their activities are completely determined by the environment in which they are located, whilst the latter assumes that individuals are creating their own environment by themselves. The fourth and last type of assumption, according to the Burrell & Morgan approach (1979) for the nature of science is the methodology assumption. It refers to the way in which the researcher tries to obtain knowledge about reality. The methodology assumptions differentiate between ideographic and nomothetic approaches. While the ideographic approach stresses the need to understand and analyse subjective individual behaviours and experiences, the nomothetic approach places emphasis on explaining and discovering the objective reality.

“The nomothetic approach to social science lays emphasis on the importance of basing research upon systematic protocol and technique. It is epitomized in the approach and methods employed in the natural sciences, which focus upon the process of testing hypotheses in accordance with the canons of scientific rigor” (Burrell & Morgan, 1979, p.6).

Burrell & Morgan (1979) argue that the four sets of assumptions regarding the nature of science provide an extremely powerful tool for the analysis of social theory. Further, Abdel-Kader (1997) stresses that each approach leads the researcher to adopt a certain research methodology. For example, while positivists seek objectivity, and as such need to apply a methodology which includes statistical analysis for quantitative data, phenomenological researchers aim to examine human behaviours. Indeed, the latter are more concerned with analysing qualitative data which is more relevant to reflect the feelings and perceptions of their participants.
The other dimension of assumptions, according to Burrell & Morgan (1979), is the assumption regarding the nature of society. Two approaches have been identified and have received a great deal of attention from social theorists. Indeed, this has come to be known as the order-conflict debate. Order theorists believe that society is a well-integrated and stable structure of elements, whilst each element has a function and each function is based on a consensus of values. In contrast, the conflict theorists argue that every society at every point is subject to processes of change and based on the coercion of some of its members by others (Burrell & Morgan, 1979). However, Burrell & Morgan (1979) stress that as a result of the failure of the 1968 revolution in France, the theorists have become more interested and concerned with individual problems rather than problems related to the structure of the society in general. Thus, the conflict-order debate is more or less dead when compared with discussions regarding the philosophy and methods of social science. Burrell & Morgan (1979) suggest that the order-conflict debate should be replaced with another two assumptions regarding society, which include regulatory society and radical change society.

“The term ‘sociology of regulation’ refers to the writings of theorists who are primarily concerned to provide explanation of society in terms which emphasise its underlying unity and cohesiveness. It is a sociology which is essentially concerned with the need for regulation in human affairs” (Burrell & Morgan, 1979, p.17).

According to the first assumption, society is viewed as standardised, consistent, and developed intellectuality. It tries to explain why society tends to hold together rather than fall apart. Conversely, in terms of the second assumption, society is in constant conflict as humans struggle to free themselves from the domination of societal structures (Burrell & Morgan, 1979). It is concerned with alternative options rather than the acceptance of the status quo.

As a result of the two dimensions of assumptions regarding social science and society, four common paradigms are identified on the two dimensions of the objective – subjective and regulatory – radical change matrix. The four paradigms are: “Functionalism paradigms”, “Interpretive”, “Radical structuralism”, and “Radical humanism”.

“The four paradigms thus define four views of the social world based upon different meta-theoretical assumptions with regard to the nature of science and of society” (Burrell & Morgan, 1979, p.24).
Alberti-Alhtaybat (2007) emphasises that the functionalist paradigm is the most strongly represented in sociological and organisational research. She argues that the objective analysis of the status quo, which mainly involves investigating how and what the situation is, appeals to many academics and is therefore the most recognised. Realism, positivism, determinism and a nomothetic methodology approach are distinctive for this paradigm (Burrell & Morgan, 1979). Furthermore, according to the interpretive paradigm, researchers are looking forward to understanding why a set of specific relations has developed. They aim to explain and describe the meaning of certain phenomena rather than verifying pre assumptions. These subjective assumptions are associated with nominalism, anti-positivism, voluntarism and ideographic (Alberti-Alhtaybat, 2007).

The radical structuralism paradigm also takes an objectivistic perspective of a phenomenon of study, but assumes that society is characterised by structural differences and conflicts which represent potentialities for radical change. The radical humanist paradigm aims to radically change societal aspects with regard to how the human beings are constrained. Gaspar (2006) stresses that both the interpretive and radical humanist approaches emphasise subjectivism; they stress explanations within the realm of individual consciousness and subjective experience. The main difference between the two paradigms is that the former assumes that society is cohesive and need not be changed, whereas the latter seeks change. Figure 3.1 summarises the two dimensions and the four paradigms of Burrell & Morgan’s assumptions.

However, Burrell & Morgan’s (1979) framework has been criticised in the literature of accounting research (see, for example, Laughlin, 1995; Ryan et al., 2002; Kamla, 2005, Gaspar, 2006). For example, Ryan et al. (2002) argue that the distinction between the subjective and objective dimension is problematic. Although the human being is subjective, individuals can create social structure which becomes capable of objective analysis. Further, Burrell & Morgan (1979) stress that the four paradigms are mutually exclusive as they provide alternative views of social reality and different ways of thinking; thus, a synthesis is not possible.

“They are alternatives, in the sense that one can operate in different paradigms sequentially over time, but mutually exclusive, in the sense that one cannot operate in more than one paradigm at any given point in time, since in accepting the assumptions of one, we defy the assumptions of all of the others” (Burrell & Morgan, 1979, p.25).
This argument has been criticised by a large number of researchers (see, for example, Laughlin, 1995; Ryan, 2002; Gaspar, 2006) who notice a contradiction between the argument that the four paradigms are mutually exclusive and the view that the two matrix’s dimensions constitute continua. This contradiction has led many researchers who follow different paradigms away from engagement in such dialogue (Gallhofer & Haslam, 1997). Moreover, Gaspar (2006) emphasises that Burrell & Morgan’s framework does not provide clear justification of the differences between the radical humanism and the radical structuralism paradigms. This unclear distinction has prompted the following theorists, especially in the accounting research, to combine both the radical humanism and radical structuralism into one paradigm (Tillmann, 2003).

For accounting research, Ryan et al. (2002) stress that although the Burrell & Morgan framework provides a useful overview and a primary classification of sociological research, it ignores other factors which should be considered when discussing methodologies, particularly in accounting research. Moreover, Kamla (2005) stresses that, according to Chua (1994), it is difficult to apply the Burrell & Morgan categorisation in accounting research as the four sub-dimensions of the subjective – objective dimension are not well integrated or related to each other. However, Gaspar (2006) argues that the Burrell & Morgan (1979) framework is still useful.

“Despite the criticisms, the framework is still useful for at least two main reasons. Firstly, it reminds researchers of the need to consider critically the fundamental assumptions underlying any research activity and their implications on research methodology as well as methods. Secondly, it proposes that there are different research approaches in the social sciences” (Gaspar, 2006, p.44).
3.2.2 Laughlin (1995)

“A framework worth discussing in detail was proposed by Laughlin (1995). It is the most useful of the three frameworks proposed by accounting researchers” (Tillmann, 2003, p.23).

Instead of the four paradigms framework of social research which is suggested by Burrell & Morgan (1979), Laughlin (1995) provides a three dimensional framework to classify the different types of accounting research. Laughlin’s (1995) framework avoids the unclear subjective – objective dimension which is included in the Burrell & Morgan (1979) approach. Laughlin’s framework consists of the following three dimensions: theory, methodology, and change. According to Laughlin (1995), researchers should take three types of choices before undertaking their empirical research. These choices are related to theory, methodology, and change. The choices of theory include assumptions for the world and the knowledge, which are closed to ontological and epistemological assumptions in the Burrell & Morgan framework. The theory choices refer to the level of prior theories which can guide the stage of empirical study. If the researchers believe that the reality and knowledge are facts which are determined out of the human being, they can depend on prior research and build their theoretical framework which should not be changed after that time. However, for the researchers who believe that individuals affect reality and gain their knowledge through their...
experience, a low level of prior research is assumed and the empirical study is expected to add values and build up a new theory.

The second dimension of Laughlin’s framework relates to the methodology choices. It is related to the nature and role of the researcher in the process of collecting and analysing data. The first methodological choice is to isolate the researcher’s beliefs from the method of collecting and analysing data. This view is closer to the positivistic paradigm and suggests quantitative data to be collected and analysed. Conversely, the second choice of the methodology dimension is to believe that there is an interactive relationship between the research and the researcher as an observer who affects the collected and analysed data by his own experience. The second choice is close to the interpretive paradigm and proposes qualitative data analysis. The third and last dimension of the Laughlin’s framework (1995) relates to the change choices. The main choices in the change dimension are whether the purpose of conducting the research is to investigate the current phenomenon, which is close to the regulation society assumption, or to achieve change in the phenomenon itself, which is close to the radical change assumption. The following section discusses which paradigm (according to Burrell & Morgan, 1979) or dimension (according to Laughlin, 1995) this study embraces.

3.2.3 Philosophical assumptions of this study

This study aims to explore the role of independent audit regulators in promoting confidence in the audit profession, whilst also analysing the big four firms’ strategies to react to these regulatory changes in the audit markets. I believe that this should be studied by considering the organisational perceptions toward the recent challenges in the audit environment. This can be achieved by getting involved with individuals who are working inside the organisations so as to build up theoretical relationships which analyse and explain the research phenomenon rather than pre-defining a set of research hypotheses depending on the literature. Moreover, the literature gap in this area of research supports the materiality of conducting a field study to contribute to the current literature. In this study, and according to the theory level of Laughlin’s framework (1995), I assume that individuals (who are the audit partners and regulators) affect the reality and gain their knowledge through their experience, thus meaning that it is important to study their perceptions and behaviours so as to understand how they react toward the challenges of their environment (which is the changeable regulatory environment). This supports the notion that the outcomes of this study should be
built up depending on a new empirical study to investigate the views of participants rather than depending on certain arguments concluded by prior research.

At the methodological level, the researcher believes that to understand the auditors’ perceptions, the researcher should interact with those auditors from the big four audit firms to discuss how they manage their organisational challenges. This requires the researcher to act in accordance with his experience and knowledge to explain and analyse his understanding of the main strategies of the big four firms with regards to the changeable regulatory framework of the audit profession. Thus, in this study, the researcher cannot be isolated from the research which suggests the qualitative research to be more relevant for the process of collecting and analysing required data.

For the third dimension of Laughlin’s (1995) framework, change level, it is assumed that this study investigates the current phenomena of the changeable regulatory audit environment and how the audit firms manage these challenges rather than aiming to change a current status. From the above analysis, and as this study explores the perceptions of the research participants, it is argued that the phonological approach is the more relevant approach for this study whilst qualitative data analysis is the most appropriate way in which to achieve the study’s aim.

Further, by applying the Burrell & Morgan framework (1979), and for the ontological assumptions, this study explores how the research participants affect and are affected by the reality. Different groups of participants reflect different views of reality and the role of the researcher is to explain, discuss, and analyse these views from his own view, whilst also reacting in a critical manner to these perceptions. For the epistemology assumptions, the knowledge of this study is obtained through interaction and direct debate between the researcher and the research participants. For the human nature assumptions, this study assumes that individuals have an important role in creating changes and challenges within their environment. For example, in this study the audit regulators add highly restricted regulations for the audit works whilst auditors also play an important role in determining the way in which these regulations have been applied. Moreover, for the assumptions related to the methodology, the methodological assumptions are concerned with adopting the most appropriate methods of gathering data and approaching the research questions (Kamla, 2005). This study explores and analyses the individual behaviours and perceptions of auditors toward the challenges of the audit environment rather than explaining or discovering an
objective reality. Thus, it is argued that this study follows the ideographic approach rather than the nomothetic approach.

In addition, for the society’s dimension, this study aims to understand and analyse organisations’ reactions toward regulatory changes in their environment rather than seeking to change the current status or make radical changes. Furthermore, Alberti-Alhtaybat (2007) stress that, according to Ferreira & Merchant (1992), the studies can be arranged according to their aims into three categories: description, theory building and hypothesis testing studies. This study is classified in the second category as it aims to build a theory which suggests a number of strategies emerging from the big audit firms to manage the current challenges of the audit environment.

To sum up, I argue that this study is located in the interpretive paradigm as it is close to the nominalists, anti-positivistic, voluntarism, and ideographic assumptions of science and regulatory assumption of the society. This supports the choice of one of the qualitative methodologies as they are more relevant to such a paradigm.

3.3 Argument for the choice of grounded theory as a research methodology

The choice of methods will be influenced by prior assumptions regarding ontology, epistemology and human nature (Kamla, 2005). As explained above, the subjective trend of this study suggests that the qualitative approach is more relevant for achieving the study’s aim. The term research methodology refers to a way of thinking about the reality of a phenomenon and the manner of studying that reality (Ryan et al., 2002). The literature (see, for example, Strauss & Corbin, 1998; Ryan et al., 2002; Laughlin, 2004) argues that the choice of the research methodology can be affected by specific factors such as research aim and questions. Further, Ryan et al. (2002) differentiate between the research methodology and research methods as follows:

"It is important to distinguish between methodologies from research methods. The latter are the particular techniques used in the research. In this sense, statistical techniques are methods, not a methodology".

Methodology recognises the way by which a researcher studies social reality (Burrell & Morgan, 1979), while methods are related to the various ways of gathering and analysing data (Parker & Roffey, 1997; Strauss & Corbin, 1998). Therefore, grounded theory is selected as a research methodology for this study for specific reasons. The absence of prior research
(LoBiondo-Wood & Haber, 1994) and the nature of the research questions which start with what and how (Strauss & Corbin, 1998), support the use of grounded theory as the research methodology for this study. The choice of research methodology should be based on the research questions which are to be addressed by the empirical study (Abdel-Kader, 1997). Furthermore, this study depends on the perceptions of the main participants in order to analyse the independent audit oversight and the strategies which have emerged from the big audit firms with regards reacting toward this new supervision\(^1\). Parker & Roffey (1997) argue that studies which begin with pre-defined operational variables exclude the possibility of identifying new variables or categories of data or a more meaningful analysis of the relationships between variables, which is an important consideration when conducting research involving complex human interactions in organisational or professional settings. However, the use of grounded theory methodology does not mean that other theoretical approaches are not valid. Other theories (such as institutional theory and globalization theory) are recently used in studying the audit market\(^2\). The previous theories are used to study different aims and research questions. The main reasons for selecting grounded theory methodology are to cover the lack of literature in exploring the views of participants in the audit market.

Grounded theory provides systematic inductive guidelines for collecting and analysing data to build a theory which explains the collected data (Charmaz, 2000). Locke (2001) emphasises that the objective of grounded theory is to construct a theory by grounding it in the collected data. Moreover, the aim of Grounded theory lies within the attempt to close the gap between rigorous, structure-focused quantitative and less regimented, individual-oriented qualitative research philosophies and methodologies (Charmaz, 2006). Further, Glaser & Strauss (1967) recognise the need to combine the rigors of quantitative methods and the ability of inductive research from qualitative methods. The authors focus on emerging theory from gathered data in systematic procedures of analysis, contrary to verifying a prior theory. This is in order to present a more accurate picture of the status quo and to let the data tell the story (Glaser & Strauss, 1967).

Discovering theory through grounded theory offers the opportunity of direct contact with the social world, whilst constantly bearing in mind the theoretical perspective (Charmaz, 1994).

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\(^1\) Goddard and Assad (2006) argue that grounded theory approach was adopted to achieve a similar purpose (understanding the perceptions of the research participants).

\(^2\) See, for example, Cooper and Robson, 2006; Humphrey et al., 2009.
The emphasis of grounded theory lies on research and discovery. Knowledge is conceived as an emergent process. The theory itself is developed through empirical observation, and one of the most important aspects of theory generation is the joining of data collection, coding and analysis as the underlying operation (Glaser & Strauss, 1967; Locke, 2001). This allows for theory generation related to the substantive area under investigation (Glaser & Strauss, 1967).

Qualitative research methodologists emphasise the need for researchers to address issues of reliability and validity during the entire research process, so as to ensure that potential threats are properly managed (Hall & Callery, 2001; Morse et al., 2002). Nevertheless, grounded theory procedures do not address all of the threats to reliability and validity (Hall & Callery, 2001). For instance, grounded theory methodology does not detail data collection techniques, and hence lacks strategies regarding how issues of reliability and validity can be dealt with at this particular stage (Charmaz, 2000; Hall & Callery, 2001). Section 3.5 explains how this study addresses issues related to reliability, validity, and the generalisation of suggested outcomes.

3.4 Grounded theory in accounting research

Grounded theory is defined as "a theory derived from data, systematically gathered and analyzed through the research process" (Strauss & Corbin, 1998). It is originally developed by Glaser & Strauss (1967), although different approaches have now been developed by Strauss & Corbin (1990, 1998) and Glaser (1992). LoBiondo-Wood & Haber (1994) suggest that grounded theory can be used when there is little known about a phenomenon and when there is no prior theory to explain what has happened or existing theories fail to explain a particular set of circumstances. Both situations could be applied in this study as explained above.

Smith (2003) states that grounded theory has been increasingly adopted as the preferred qualitative approach in accounting field studies. One of the main advantages of using grounded theory is to bridge the gap between theoretically ‘uninformed’ empirical research and empirically ‘uninformed’ theory by grounding theory in data (Goulding, 2002). Recently, Parker & Roffey (1997) review the progress in accounting research using grounded theory as a qualitative research method and conclude that grounded theory offers itself as an under-utilised and potentially valuable addition to future accounting theory development; indeed, it should be encouraged to germinate in the accounting and management research literature in order to evaluate its contributions in the management and accounting research. It is the first review of grounded theory in accounting research (Gurd, 2008). Later, Gurd (2008) re-
evaluates and analyses the grounded theory approach in accounting research. He stresses that most of the accounting researchers use the grounded theory as a label for their research and do not apply the core canons of grounded theory established by Glaser & Strauss (1967). In the same year Elharidy et al. (2008) explain the role of grounded theory in interpretive management and accounting research, arguing that grounded theory can offer a valuable tool for interpretive management accounting researchers.

To assist accounting researchers in using grounded theory, Elharidy et al. (2008) suggest the following guidelines for interpretive researchers who use grounded theory: researchers should attempt to understand the phenomenon in terms that the actors in the field use to give meaning to it rather than testing scientific hypotheses. Further, researchers need to stay as close as possible to the field in order to be able to develop theories which reflect the local contexts. Moreover, researchers should remain open to the field, sensitive to data and willing to modify initial preconceptions, assumptions, and interpretations as new evidence is collected. Indeed the researcher should adhere to these guidelines in order to increase trust in the findings and credibility of the conclusions. Additionally, to investigate the unknown in areas where there has been little research, researchers must begin with the data in order to develop a new theory.

Furthermore, Elharidy et al. (2008) warn the users of grounded theory of potential obstacles as follows. First, premature saturation depends on incomplete data collection or analysis. Secondly, “using a coding recipe book” researchers must try to understand the field from the perspective of the social actors before theorising about this particular field. Lastly, using too much literature can prevent new understandings from emerging out of the field. In this thesis, the researcher considers the previous recommendations to guide him when applying the research process.

The following are examples of how grounded theory is used in management and accounting research. Tillman & Goddard (2008) use grounded theory to explore the meanings of sense-making, and how the large multinational companies use management accounting in the process of strategic management accounting. They discover two sets consequences of sense-making; consequences for making strategy, and consequences for management accountants. They argue that grounded theory attempts to assume responsibility for interpreting the data instead of simply reporting it. Research data is collected through the conduction of in-depth interviews complemented by elements of observation and collection of documents.
Goddard & Assad (2006) use grounded theory to understand the accounting and reporting processes in non-governmental organisations (NGOs) from the perspectives of organisational actors. They find that accounting has a minimal role to play in internal decision making, and is only used for navigating legitimacy. They argue that grounded theory allows the actors’ own perceptions and meaning to emerge, thus resulting in the construction of a new theory. Parker (2003) investigates the decision-making processes of a charitable organisation's board, and employs participant observation methods. Parker's approach is informed by Glaser because the issue of organisational actors leads the study. Abdul-Rahman & Goddard (2003) investigate the financial management and accounting in religious public service organisations, particularly in Islamic organisations. They aim to provide an example of how grounded theory is used in practice to encourage its use in other research. They suggest that the broader social, historical and religious contexts in the Islamic organisations are working together to provide unique accounting practice. Their study is one of the good examples of accounting research and provides a significant contribution to inductive theory development (Gurd, 2008). In auditing, none of the articles found which relate to the audit profession use grounded theory as a research methodology.

3.5 Special considerations regarding grounded theory and qualitative research

“Interpretive studies should discuss the limitations in the research design, making reference to generalizability, reliability, and validity” (Collis & Hussey, 2009, p.304).

This section discusses certain issues which are concerned with the literature of research methods (see, for example, Strauss & Corbin, 1998; Corbin & Strauss, 2008; Collis & Hussey, 2009) regarding the validity and reliability of qualitative research. This is particularly true for grounded theory, whilst it is also important to know the extent to which the outcomes of this type of research can be generalised.

“Reliability refers to the absence of differences in the results if the research were repeated” (Collis & Hussey, 2009, p. 64).

It is argued that reliability is one of the main criteria of the research findings. Reliable findings mean that repeating the study should produce the same findings even if it is conducted by other researchers. Reliability tends to be high in positivistic research (Collis & Hussey, 2009). In the interpretivism approach, the researcher is expected to influence the
research activities, and thus is expected to provide different findings by different researchers. For this study, as an interpretive research, different researchers can provide different outcomes. However, for qualitative research, some procedures should be taken to reach an acceptable level of reliability. For example, researchers should be open and have a willingness to listen to the participants regardless of their own experiences (Strauss & Corbin, 1998); this helps them to avoid bias in the analysis process. In addition, they must also think comparatively. In this study, comparatives are made among different views of auditors and regulators. The comparison process assists the analysis to develop more properties and dimensions for the developed categories.

Considering different views of participants also helps to maximise the reliability of the research findings. Further, during the analysis, a discussion is conducted to compare the views of participants and what is argued in the literature. This does not mean using the literature as data per se; it is about using examples to simulate the thinking about certain dimensions or properties for a specific category (Strauss & Corbin, 1998).

Moreover, to reach a high level of reliability regarding the research findings in qualitative research, it is useful to consider the views of different types of participants in different places, events, and times (Strauss & Corbin, 1998). In this study, the data is gathered from different resources, different types of data collections (interviews and document analysis), different places (the UK and Egypt), and different types of participants (audit partners and audit regulators). This variation of data sources assists the analysis to build up a more generalised and reliable theory.

“Validity is the extent to which the research findings accurately reflect the phenomena under study” (Collis & Hussey, 2009, p. 65).

Research findings must meet the research questions and achieve the pre-addressed research objectives before the process of collecting and analysing data. It is argued that qualitative research usually results in findings with a high degree of validity (Collis & Hussey, 2009). In Chapter 9 of this study, Section 9.4 discusses the extent to which the study’s outcomes achieve the research objectives.

“Generalization is the extent to which the research findings can be extended to other cases or other settings” (Collis & Hussey, 2009, p. 65).
Quantitative researchers are more likely to generalise their research findings as they have selected a representative sample of the whole society. However, according to Collis & Hussey (2009), many previous studies (see, for example, Denzin, 2006; Gummesson, 2000) conclude that using statistics is not the only way to generalise the research findings. Qualitative researchers can also generalise their findings from their own data or can reference a wide range of previously investigated case/s. This can only happen if the study provides in-depth analysis regarding the interactions, behaviours, and features of a certain phenomenon which can be applied in other societies. This is certainly the case with the present study, which provides a better understanding of the interactions among different parties (auditors and regulators) of the audit market. The study is concerned with how the audit regulators act and what type of regulations have been issued. It also discusses how auditors evaluate the regulators’ performance and what types of strategies have emerged with which to face the new challenge of the audit oversight system. Understanding such interactions and relations among those two parties can be applied in different societies as the big four firms act globally, and the audit regulators share their experiences among their peers through global forums of regulators. The global nature of the audit market supports the notion that the outcomes of this study can be globally generalised.

3.6 Strauss & Corbin (1998) approach

Many studies (see, for example, Niekerk & Roode, 2009; Elharidy et al. 2008; Gurd, 2008) differentiate between the Glaser (1992) approach and the Strauss & Corbin (1998) approach. The main differences can be addressed as follows: according to the research questions, Glaser (1992) states that researchers should avoid addressing the research questions at the beginning of the research as gathered data should assist the researchers in generating these questions. In contrast, Strauss & Corbin (1998) allow for the use of research questions at the beginning of the research to guide the following stages of the study. Further, while Glaser (1992) focuses on the concepts which must be generated from data, Strauss & Corbin (1998) focus on describing the area under research. Moreover, related to the approach taken to the generation of core research issues and to the emphasis given to theory induction versus theory verification, Glaser (1992) is more concerned with the emergent nature of theory through the process of induction.

Furthermore, when it comes to the use of existing literature to guide the process of data collection and analysis, Strauss & Corbin (1998) suggest that existing literature could be
reviewed to get a better understanding of collected data. Glaser (1992) stresses that researchers should not review literature prior to conducting the empirical part of the study. One more difference is related to whether grounded theory is a research method or research methodology. In their definitions, whilst Strauss & Corbin (1998) define grounded theory as a qualitative research method, whilst Glaser (1992) defines it as a general methodology of analysis. Elharidy et al. (2008) argue that the researchers need to be aware of the nature of the particular version of grounded theory that they are using to build their grounded theories and to interpret the field.

Accordingly, in this thesis, the researcher believes that accounting research cannot ignore the literature, and that it should be reviewed to improve the awareness of the researcher when it comes to the area in question, thus in turn leading to a better understanding of the research problem. I argue that the approach employed by Strauss & Corbin (1998) is more relevant to this research. Moreover, this research aims to explore and explain the changes which have been made in the audit firms’ strategy after the new regulation stage rather than to build new concepts as per the Glaser (1992) approach. Gurd (2008) stresses that the Strauss & Corbin approach (1990, 1998) of grounded theory is the favourite approach among accounting and management researchers who have used grounded theory in recent years.

According to the Strauss & Corbin approach (1998), there are four main stages of grounded theory. First, data is gathered from participants by conducting in-depth or semi-structured interviews (open questions). The second stage involves the analysis of data gathered through three processes of coding analysis: open coding, axial coding, and selective coding. The third stage involves the gathering of additional data to reach the saturation level (in which no new ideas could appear). Fourth, suggested theories are generated which achieve the aim of the research. Finally, participants and previous literature are used to validate the generated theory. Figure 3.2 summarises the main stages of grounded theory (Strauss & Corbin approach, 1998).
3.7 Gathering data

“In field studies, theoretical sampling usually requires reading documents, interviewing, and observing at the same time, since all slices of data are relevant” (Glaser & Strauss, 1967, p. 75).

Two methods are used for data collection in this study: face-to-face interviews and analysis of documents and reports. Patton (2002) (as cited by Gaspar (2006)) argues that the complicated nature of human beings and their behaviours necessitates the use of different and multiple methods for data collection in order to develop a better understanding of how they react toward their environment.

“Since qualitative data need to be understood within context, you need to collect some background information first” (Collis & Hussey, 2009, p. 143).

In this study, the data are collected from two different audit environments. The first is the UK audit market as one of the developed environments for the audit profession, whilst the second
is the Egyptian audit market which is considered as one of the emerging environments for the audit profession. Initial data are initially collected to understand the background of the audit market in both countries. The WebPages of the audit oversight authorities and the big four audit firms, in both countries, are used to collect the initial data. The initial data identifies the main institutions of the audit market, the audit regulators, the main regulations which affect the audit profession, and the most recent and important changes in the audit market. Published reports, rules, standards, and feedbacks are discussed so as to develop a better understanding of the main characteristics and changes of the audit market – in both countries – during the last decade.

It is important to note that for the UK market, all the required data are available online through the FRC’s website (www.frc.gov.uk). However, for the Egyptian market, many of the required data are not available online through the EFSA’s website (www.efsae.gov.eg). Chapter 5 of this study discuses the transparency of information in both countries as one of the main criteria with which to evaluate the audit regulators’ performance. The remaining data – which are not available online – are collected through the interviews conducted with the audit regulators in Egypt. More information about the study’s contexts is discussed in Chapter 4 of this study (see Section 4.5 in Chapter 4).

Further, the interviews are one of the most preferred tools to collect data of research in the grounded theory methodology. Data are collected for the purpose of developing a theory (Corbin & Strauss, 2008). This should be kept in the mind of the researcher throughout the entire data collection process.

“Interviews are a method for collecting data in which selected participants (the interviewees) are asked questions to find out what they do, think, or feel” (Collis & Hussey, 2009, p. 144).

The grounded theory methodology aims to explore an unknown area of research which is mainly related to understanding the feelings, perceptions, or behaviours of specific groups of participants regarding certain phenomena. This study aims to provide a greater understanding of the main perceptions and actions which are taken by both audit regulators and firms toward the global changes and challenges of the regulatory frameworks of the audit profession in many of the audit markets. These feelings, perceptions, and behaviours are determined by conducting thirty two semi-structured interviews with the top management of audit regulators and partners of the big four firms in the UK and Egypt.
“Their main weaknesses are the intentional or unintentional biases of the people interviewed. Some interviewees, having a focal position aim to provide not only data but also guidance to the researcher in performing the study” (Albahloul, 2003).

In this study, each interview lasts from 1.5 - 3 hours. Interviewees are asked open questions to explore their views on the global trend of governments supervising the audit profession and how the big four firms react toward this changeable regulatory framework. The grounded theory methodology is flexible in the process of asking the questions. The questions are modified for each interview to reflect the process of developing the theory. Unstructured interviews are initially conducted, following which a number of meaningful categories are formulated following the analysis of the early interviews. More questions are also asked to better understand the developed categories. Notes are taken during all interviews to assist the researcher in identifying ideas and dimensions from the participants’ answers and perceptions.

Data analysis and collection are two parallel processes which are carried out simultaneously. It is noted that the subsequent analysis guides the questions which are asked to the audit regulators so as these questions are more focused on the regulatory changes in the audit market, the importance of the independent audit oversight system, its success factors, the reasons and the ways in which they regulate the audit profession, the main findings of their inspections for the audit firms, and the recent rules and standards which regulate the audit market. With regard to the audit partners’ interviews, the in-parallel analysis guides the questions to be more focused on their views toward the audit regulators’ performance and what they need from regulators, their perceptions of the current audit regulations and their suggestions to improve the audit quality, as well as the strategies which have emerged from the big four firms to manage the regulatory challenges of the audit environment. Furthermore, Strauss & Corbin (1998) differentiate between two types of questions which have been asked during the research: “practical questions”, and “theoretical questions”.

“Some questions are directed at substantive matters ..... Others are directed at more theoretical issues” (Strauss & Corbin, 1998, pp.75-76).

Theoretical questions assist the researchers in the process of developing certain categories which help to build up a theory. While practical questions help in identifying more dimensions, properties, and relationships among the developed categories, the questions
asked in the interviews of this study are a mix between practical and theoretical questions. Usually, the interview starts with open questions which focus on theoretical issues, following which more practical questions are asked to get a more detailed and better understanding of these issues. Table 3.2 provides examples for some of the structured questions\(^3\) which are asked for audit partners and regulators, as well as the type and the purpose of each question.

Most interviews are audio recorded, whilst only seven participants decline my request to record the interview. All UK interviews are in English, whereas the Egyptian interviews are a mixture of English and Arabic in the same interview. During the transcription process, the non-English statements are translated into English. The transcriptions of the interviews are analysed, coded, and categorised into a number of dimensions and properties for each category. The identified codes and categories in the early interviews affect the questions in the subsequent interviews and more questions are asked (guided by issues emerging from the previous interviews) in order to focus on the new concepts and discover further dimensions and properties. For the non-recorded interviews, the researcher takes extensive detailed notes during the interviews about the participants’ arguments. Once the interviews are finished, the researcher records all his written notes and his impressions during the interviews in audio files in order to assist him in the analysis processes.

Further, Table 3.3 provides a list of all interviews including the positions of the main participants for each interview. The interviews are arranged in Table 3.3 according to the time at which they take place. This helps to understand how the analysis process is done. In the grounded theory methodology, data collection and analysis occur in alternating sequences (Strauss & Corbin, 1998). During the study, I intend to conduct the interviews with audit partners, followed by regulators, then partners and so on. This assists me in formulating a valuable debate between what both auditors and regulators say and also enables me to ask each of them about what the others have said regarding their performance.

In Table 3.3, it is evident that the 32 interviews are classified into 20 interviews with the big four audit partners and audit regulators in the UK, and 12 interviews with audit partners and regulators in Egypt. The interviews are also classified into 21 interviews with the big four audit partners, and 11 interviews with audit regulators. Another classification for the

---

\(^3\) The unstructured questions are changed in each interview according to the different answers that I got from the interviewees.
interviews (according to their dates) is that 11 interviews are conducted in 2010, 10 interviews are conducted in 2011, and 11 interviews are conducted in 2012. It is noted that this study is established in November 2009. The above numbers indicate that there is a reasonable balance between the interviews which are conducted in each country, with each group of participants, and for each year during the study. This balance assists the study in updating and to reflecting on the issues which have recently been debated in the global audit market.

The number of the interviews needed to build a theory depends on the nature of the research problem and the gathered data which may be limited due to relevant costs and time (Strauss & Corbin, 1998). Therefore, as this study aims to analyse the big four audit firms’ perceptions toward the governmental efforts to oversight the audit profession and how these firms react toward these new challenges, the researcher believes that conducting interviews with audit regulators and executive partners in the big four firms is enough to explore a sufficient theory which can achieve the main objectives of this study. The interviews are complemented by analysing available information on the Web pages of the big four firms. Further, published reports related to the independent audit regulators are also examined. This documentary evidence is collected and analysed in order to facilitate comparisons with the perceptions of the interviewees and validate the developed theory.
<table>
<thead>
<tr>
<th>The interviewees</th>
<th>Examples of the structured questions</th>
<th>Type of question</th>
<th>Question’s purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Audit regulators</strong></td>
<td>How does the independent audit oversight affect the audit market?</td>
<td>Theoretical</td>
<td>To explore the main values of the new audit oversight system</td>
</tr>
<tr>
<td></td>
<td>What are the main problems in the audit firms that require an independent reviewer?</td>
<td>Practical</td>
<td>To understand extent to which the audit market still needs independent regulators</td>
</tr>
<tr>
<td></td>
<td>What are the main criteria that should be applied in the audit regulator?</td>
<td>Theoretical</td>
<td>To explore the success factors of establishing audit oversight authority</td>
</tr>
<tr>
<td></td>
<td>After Enron and the major accounting collapse, how are the audit regulators facing the lower public trust in auditors?</td>
<td>Practical</td>
<td>To understand how the audit regulators achieve their objectives</td>
</tr>
<tr>
<td></td>
<td>How do you evaluate the quality of the audit processes after the new oversight system?</td>
<td>Practical</td>
<td>To understand the effects of the audit oversight system on the audit firms</td>
</tr>
<tr>
<td><strong>Audit partners</strong></td>
<td>After the end of the self-regulated stage of the audit profession, how do you evaluate the current efforts of the audit regulators?</td>
<td>Practical</td>
<td>To explore the auditors’ perceptions of the independent regulators</td>
</tr>
<tr>
<td></td>
<td>What do you need/expect from the audit regulators?</td>
<td>Theoretical</td>
<td>To explore the success factors of establishing audit oversight authority</td>
</tr>
<tr>
<td></td>
<td>What do you think about “specific audit regulation or standard”? How do you evaluate its effects on the audit profession?</td>
<td>Practical</td>
<td>To explore the auditors’ perceptions of the common audit regulations</td>
</tr>
<tr>
<td></td>
<td>After Enron and the major accounting collapse, how are the big four firms facing the lower public trust in auditors?</td>
<td>Practical</td>
<td>To explore the strategies which have emerged from the big four firms to regain the public trust</td>
</tr>
<tr>
<td></td>
<td>What are the main challenges which are faced by the big audit firms?</td>
<td>Theoretical</td>
<td>To identify the main challenges of the audit profession</td>
</tr>
<tr>
<td></td>
<td>What are the main strategies which have emerged from your firm in terms of facing these challenges of the audit profession?</td>
<td>Theoretical</td>
<td>To explore the strategies which have emerged from the big four firms to manage the current challenges of the audit market.</td>
</tr>
<tr>
<td>Interview no.</td>
<td>Main participant</td>
<td>Company</td>
<td>Country</td>
</tr>
<tr>
<td>--------------</td>
<td>-----------------</td>
<td>-------------------</td>
<td>---------</td>
</tr>
<tr>
<td>1</td>
<td>Audit partner</td>
<td>Big audit firm C</td>
<td>UK</td>
</tr>
<tr>
<td>2</td>
<td>Audit regulator</td>
<td>FRC</td>
<td>UK</td>
</tr>
<tr>
<td>3</td>
<td>Audit regulator</td>
<td>EFSA</td>
<td>Egypt</td>
</tr>
<tr>
<td>4</td>
<td>Audit partner</td>
<td>Big audit firm A</td>
<td>Egypt</td>
</tr>
<tr>
<td>5</td>
<td>Audit partner</td>
<td>Big audit firm A</td>
<td>Egypt</td>
</tr>
<tr>
<td>6</td>
<td>Audit partner</td>
<td>Big audit firm A</td>
<td>Egypt</td>
</tr>
<tr>
<td>7</td>
<td>Audit partner</td>
<td>Big audit firm A</td>
<td>Egypt</td>
</tr>
<tr>
<td>8</td>
<td>Audit regulator</td>
<td>EFSA</td>
<td>Egypt</td>
</tr>
<tr>
<td>9</td>
<td>Audit partner</td>
<td>Big audit firm B</td>
<td>Egypt</td>
</tr>
<tr>
<td>10</td>
<td>Audit partner</td>
<td>Big audit firm C</td>
<td>Egypt</td>
</tr>
<tr>
<td>11</td>
<td>Audit partner</td>
<td>Big audit firm A</td>
<td>UK</td>
</tr>
<tr>
<td>12</td>
<td>Audit partner</td>
<td>Big audit firm A</td>
<td>UK</td>
</tr>
<tr>
<td>13</td>
<td>Audit partner</td>
<td>Big audit firm B</td>
<td>UK</td>
</tr>
<tr>
<td>14</td>
<td>Audit partner</td>
<td>Big audit firm B</td>
<td>UK</td>
</tr>
<tr>
<td>15</td>
<td>Audit partner</td>
<td>Big audit firm D</td>
<td>UK</td>
</tr>
<tr>
<td>16</td>
<td>Audit partner</td>
<td>Big audit firm D</td>
<td>UK</td>
</tr>
<tr>
<td>17</td>
<td>Audit regulator</td>
<td>FRC</td>
<td>UK</td>
</tr>
<tr>
<td>18</td>
<td>Audit partner</td>
<td>Big audit firm C</td>
<td>UK</td>
</tr>
<tr>
<td>19</td>
<td>Audit partner</td>
<td>Big audit firm D</td>
<td>UK</td>
</tr>
<tr>
<td>20</td>
<td>Audit regulator</td>
<td>FRC</td>
<td>UK</td>
</tr>
<tr>
<td>21</td>
<td>Audit regulator</td>
<td>FRC</td>
<td>UK</td>
</tr>
<tr>
<td>22</td>
<td>Audit partner</td>
<td>Big audit firm C</td>
<td>Egypt</td>
</tr>
<tr>
<td>23</td>
<td>Audit partner</td>
<td>Big audit firm B</td>
<td>Egypt</td>
</tr>
<tr>
<td>24</td>
<td>Audit partner</td>
<td>Big audit firm D</td>
<td>Egypt</td>
</tr>
<tr>
<td>25</td>
<td>Audit partner</td>
<td>Big audit firm C</td>
<td>UK</td>
</tr>
<tr>
<td>26</td>
<td>Audit regulator</td>
<td>FRC</td>
<td>UK</td>
</tr>
<tr>
<td>27</td>
<td>Audit regulator</td>
<td>FRC</td>
<td>UK</td>
</tr>
<tr>
<td>28</td>
<td>Audit regulator</td>
<td>FRC</td>
<td>UK</td>
</tr>
<tr>
<td>29</td>
<td>Audit regulator</td>
<td>FRC</td>
<td>UK</td>
</tr>
<tr>
<td>30</td>
<td>Audit regulator</td>
<td>FRC</td>
<td>UK</td>
</tr>
<tr>
<td>31</td>
<td>Audit partner</td>
<td>Big audit firm A</td>
<td>UK</td>
</tr>
<tr>
<td>32</td>
<td>Audit partner</td>
<td>Big audit firm B</td>
<td>UK</td>
</tr>
</tbody>
</table>

The second method for collecting research data is analysing available documents which are related to the study. Gaspar (2006) argues that related documents provide a useful source of data for the research. Most of the analysed documents of this study are available on the WebPages of the audit oversight authorities and the big four audit firms in both the UK and Egypt. Further reports – which are analysed in this research – are available on the WebPages of the global networks of the big four firms and many of the global organisations which regulate or affect the regulating process of the audit markets (such as IFIAR and IOSCO). The documents are collected, downloaded, studied, and analysed during all stages of the coding processes. Other documents and reports are collected from the interviewees themselves. Certain issues do emerge during the interviews and the participants recommend certain documents in order to add more detail regarding my questions. Studying the available documents contributes to the analysis process by adding more properties and dimensions for
the developed categories. From the studied documents emerge some issues which are considered during the subsequent interviews in order to elicit responses from participants.

3.8 The process of data analysis

Gathered data are analysed using coding procedures suggested by Strauss & Corbin (1998) comprising open, axial and selective coding. Open coding is the analytic process through which concepts are identified, and their properties and dimensions are discovered in data (Strauss & Corbin, 1998). Open coding has been carried out by using the line-by-line analysis method to provide certain concepts, following which the data is then grouped into specific categories.

The process of axial coding is followed by undertaking relationships between developed categories. At this stage, more interviews are conducted to reach a saturation level at which no ideas are developed. Table 3.4 provides an example of the progress of analysis to reach the saturation level. The third and last coding stage is selective coding, which is the process of integrating and refining the grounded theory (Strauss & Corbin, 1998). Developed theory is validated by the literature according to the Strauss & Corbin approach (Elharidy et al., 2008).
### Table 3.4: example of how the saturation level is reached in one of the open categories

<table>
<thead>
<tr>
<th>Interview no.</th>
<th>The key success factors of the inspection team (open category no. 4.2.9 in Chapter 4)</th>
<th>No. of newly developed ideas</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st interview</td>
<td>- Inspectors should have extensive experience.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- They also have to be robust in their dealings with people and to have confidence in what they are doing and having credibility in the eyes of the firm.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- They should have understanding, and strong interpersonal skills.</td>
<td></td>
</tr>
<tr>
<td>2nd interview</td>
<td>- They have to be independent and have high levels of expertise.</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>- The best inspector is the one who knows the nature of the business being audited, as he can effectively evaluate my opinion.</td>
<td></td>
</tr>
<tr>
<td>3rd interview</td>
<td>- They have to pay much attention to the security of information; our files include very confidential data for our clients.</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>- Inspectors must achieve objectivity and fairness in their evaluation to gain the auditors’ confidence.</td>
<td></td>
</tr>
<tr>
<td>4th interview</td>
<td>- They have to achieve a high level of security especially for the confidential information of auditors’ clients.</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>- They must not be competitors or parties related to the competitors of reviewed auditors (independent).</td>
<td>1</td>
</tr>
<tr>
<td>5th interview</td>
<td>- They could also be specialists in their activities so as they are able to understand and evaluate the auditors’ judgments.</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>- The best inspectors are the retired partners, as they are independent and at the same time possess high levels of expertise.</td>
<td></td>
</tr>
<tr>
<td>6th interview</td>
<td>- They have to be experts so as they are able to review the performance of listed auditors.</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>- Inspection teams must be aware of the nature of the business of the companies they inspect.</td>
<td>(Saturation level)</td>
</tr>
</tbody>
</table>
The following example explains how one of the open categories has been developed from the data gathered. When participants are asked about their opinion regarding the independent oversight of the audit profession, some of the answers are quoted as follows:

“It enhances the quality of audit”,

“It increases our quality”,

“It improves the quality of the audit process”

The line-by-line analysis identifies “Increased Quality” as a new code which reflects the importance of the independent audit oversight. However, it is not the end of the process; more analysis is conducted to identify the main characteristics of such quality. The question is: quality of what? The audit quality has several dimensions and indicators, so which of them is positively influenced by the independent oversight system? Coming back to the transcriptions, the following answers are coded:

“Now, the quality of our audit reports are better than six years ago”;

“Everything now has to be filed, it enhances our documentation system”;  

“It gives us more power in the clients’ negotiations, we are now saying, we have to get sufficient evidence to provide it to our reviewers”.

The previous codes provide additional information and dimensions regarding which type of “quality” is “increased”. There is a “quality of reports”, “a quality of documentations”, and “a quality of evidence”. These dimensions are interrelated as the good evidence can be documented and enhances the quality of auditors’ judgements, thus improving the quality of the audit reports. Further, good documentation supports the quality of the audit reports. Thus, this analysis identifies a number of codes which represent different characteristics and properties of the audit quality. These codes are grouped together – during the open coding process – within an open category called “Assuring the audit quality”. Assuring the audit quality is one of the other open categories which interact together and which are classified into an upper level of categorisation during the axial coding analysis process.

A specific open category can contribute to the development of more than one axial category. For example, the open category “serving global clients” shares in the development of the
following axial categories: “Reviewing the audit methodologies”, “Becoming closer”, “New people strategy”, and “Competing in aggressive markets”.

In grounded theory, categories are unified around a core category which represents the central phenomenon of the study; it is capable of explaining what the research is all about. However, in some cases a set of core categories reacts together to tell the whole story and to build the theory (Strauss & Corbin, 1998). In this study, a total of three main categories are developed to build the emerged theory. The three main categories are the big four firms’ perceptions of the audit regulators, the big four firms’ perceptions of the audit regulations, and the big four firms’ strategies which have emerged with regard to the audit regulatory changes. From the analysis emerges a core category which represents the global challenges of the audit environment as the central phenomenon of this study. The core category is "globalization of auditing". The grounded theory suggests a number of features of the current global audit environment. Both audit regulators and global networks are following strategies which achieve a high degree of standardisation, centralisation, communication, and specialisation. The emerging strategies aim to protect the audit profession from further accounting collapses by assuring an acceptable level of quality and auditors' independence.

3.9 Research ethics

“The goal of ethics in research is to ensure that no one is harmed or suffers adverse consequences from research activities” (Cooper & Schindler, 2006).

Ethical considerations are one of the most vital issues which should be considered by researchers when conducting research. Honesty, fairness, and objectivity are some of many ethics which should be followed by the researchers. When collecting data through different types of data sources (experiment, interview, survey, or observation), the participants always have the right to be safeguarded. They have the right to know the purpose of the collecting data process; to understand how this data will be used; to know who will have the right to access the gathered data; and to be aware of whether the data is collected for commercial use or will be used for research purposes only.

An interviewer should begin an introduction with his or her name, the name of the research organization, and a brief description of the purpose and benefit of the research” (Cooper & Schindler, 2006).
Most, if not all the UK universities have research ethics committees which require all of the PhD researchers to complete a research ethics scrutiny form before they start the process of data collection (Cooper & Schindler, 2006). These forms must be approved by both of the supervisors and the research ethics committees. The research ethics scrutiny form which is completed for this study is inserted in the appendix. Further, in the case of this study, the research participants are fully informed of the research purposes, the required data, and the main uses of the gathered data in written letters. These letters are sent by email prior to the conduction of the interviews. Copies of these letters are also inserted in the appendix. The letters vary according to the different participants and the different stages of research (data collection stage or validation stage).

Collected data is used for the research purposes only. No names or positions are disclosed in the main thesis, nor in any of the publications which are written for the analysis of the gathered data. Further, a few number of research participants (only seven) refuse to record the interviews even after I explain the extent to which the recorded data helps me with the analysis process and that their recorded data is strictly confidential.

3.10 Conclusion

This chapter discusses the process of selecting the research methodology for this study. A discussion is put forth for the main research paradigms according to two of the most famous approaches in the accounting and social science research (Burrell & Morgan, 1979 and Laughlin, 1995). It is clarified that this study follows the interpretive research paradigm. The lack of literature and the nature of the research questions – as discussed in Chapter 2 – suggest that grounded theory is the most relevant methodology for this research.

Further discussion takes place during the chapter in terms of grounded theory methodology and its different approaches. Consistent with much of the prior research (see, for example, Parker & Roffey, 1997; Gurd, 2008; Elharidy et al., 2008), I argue that the Strauss & Corbin approach (1990, 1998, and 2008) is the most relevant strategy for the conduction of accounting and management research. Moreover, this chapter discusses the main sources of collecting data in this research and how the gathered data is analysed during the analysis process, in accordance with the main stages of the Strauss & Corbin approach (1998) to grounded theory methodology. The following chapter, Chapter 4, discusses the main codes and categories of this study. It explains how these codes and categories are identified, analysed, and developed during the analysis process to build up the emerging theory.
Chapter 4: Developed codes, categories, and emerged theory

4.1 Introduction

This chapter discusses how the grounded theory methodology is applied in this study. Discussion is presented regarding the three stages of the coding analysis, as well as how the categories are developed in each stage. Section 4.2 discusses the first coding analysis “open coding” and provides details of the 28 open categories which are developed from data gathered. Section 4.3 presents the axial coding process and discusses the relations between the developed open categories and how they interact and are grouped together to develop a number of sub-categories for the main categories of this study. The selective coding process is discussed in Section 4.4, which explains how the core category of the grounded theory has emerged. A brief of the study’s context is provided in Section 4.5, whilst my conclusion follows in Section 4.6.

4.2 Open coding process

“Open coding: The analytic process through which concepts are identified and their properties and dimensions are discovered in data
Concepts: The building blocks of theory
Categories: Concepts which stand for phenomena
Properties: Characteristics of a category, the delineation of which defines and gives it meaning
Dimensions: The range along which general properties of a category vary, giving specification to a category and variation to the theory” (Strauss & Corbin, 1998).

The research problem of this study relates to investigating the phenomenon of independent audit oversight which has been globally established in different countries over the last decade. It is also important to establish how the big audit firms react toward this changeable regulatory environment.

“The first step in theory building is conceptualizing. A concept is a labeled phenomenon .... The purpose behind naming phenomena is to enable researchers to group similar events, happenings, and objects under a common heading or
classification ... although events might be discrete elements; the fact that they share related meanings enables them to be grouped” (Strauss & Corbin, 1998).

The questions of semi-structured interviews focus on deducing the different views of the main participants, the big four partners and the audit regulators, when it comes to the new oversight system and the extent to which the audit profession still needs an independent oversight. The questions also focus on ascertaining the key factors to establish an effective audit oversight authority. Further, the interviews investigate whether the more restricted audit regulations are sufficient enough to improve the reliability of the audit reports and enhance the choice in the audit market. Moreover, the study extends the analysis to explore how the big four firms manage the changeable regulatory environment of the audit profession. During the analysis process, the transcriptions of the recorded interviews are analysed using the line-by-line method to identify a number of codes and group them together into related open categories.

Table 4.1 presents how the identified codes are allocated and linked together to suggest 28 meaningful open categories; it also identifies the main dimensions for each open category. It is noted that Table 4.1 only provides examples of codes which have developed the open categories of this study. The full codes are discussed in more detail in the following three chapters which analyse the three main categories of this study. Further, certain codes share in the developing of more than one open category, whilst some open categories are developed according to a number of codes. This depends on the importance and the substance of such codes which can present a new dimension which contributes to the development of the analysis.
### Table 4.1: Developed open categories and examples of their identified codes and dimensions

<table>
<thead>
<tr>
<th>Codes</th>
<th>Dimensions for each open category</th>
<th>Open categories</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Our audits are better than six years ago”</td>
<td>Quality of audit reports, Quality of documentation, Quality of evidence, Quality of regulations, Quality of available information, Quality of capital markets</td>
<td>Assuring the audit quality</td>
<td>4.2.1</td>
</tr>
<tr>
<td>“We document things very fully and then we’ve got something to demonstrate that we’ve complied with all the standards and we’ve reached our conclusion appropriately. And I think it is done because there is an external review”</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>“We document things very fully”</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>“We welcomed to the new regulators who will make the profession more credible”</td>
<td>Credibility of auditors, Credibility of regulators, Credibility of capital markets</td>
<td>Adding creditability</td>
<td>4.2.2</td>
</tr>
<tr>
<td>“They improve the public trust in the quality of the audit process”</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>“We are not worried about the new structure; it helps the external credibility of our organization”</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>“I think it is a good thing that people understand what our processes are, procedures, results, everything”</td>
<td>Transparency of audit firms, Transparency of oversight authorities, Transparency of capital markets</td>
<td>Providing more information for public</td>
<td>4.2.3</td>
</tr>
<tr>
<td>“It could be part of advertising, no problem”</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>“We are supportive of having liability limitations; we think it is a very important piece as it stops the meltdown on auditors being blamed”</td>
<td>Risk of litigations, Risk of repeated collapse, Risk of losing market shares</td>
<td>Mitigating the audit risks</td>
<td>4.2.4</td>
</tr>
<tr>
<td>“Liabilities limitation agreements are likely to make positive contributions to audit quality”</td>
<td></td>
<td></td>
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<tr>
<td>“The Financial Reporting Council (FRC) created the Market Participants’ Group which issued 15 recommendations in 2007 aimed at reducing risk and bolstering competition in auditing”</td>
<td>Providing more information, Auditors’ rotation, Debate for further regulations</td>
<td>Enhancing the choice in the audit market</td>
<td>4.2.5</td>
</tr>
<tr>
<td>“Audit firms governance cod is a good thing; I think it is dangerous</td>
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</table>
Table 4.1: Developed open categories and examples of their identified codes and dimensions

<table>
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<tr>
<th>Codes</th>
<th>Dimensions for each open category</th>
<th>Open categories</th>
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<tbody>
<tr>
<td>“for an organization to become too insular”</td>
<td></td>
<td></td>
</tr>
<tr>
<td>“We are following the new global trend of governmental oversight of the audit profession in the developed countries”</td>
<td>Increased foreign direct investments, Raising fund in the capital markets</td>
<td>Enhancing the whole economy</td>
</tr>
<tr>
<td>“We have to protect the investors of the Egyptian capital market”</td>
<td></td>
<td></td>
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<tr>
<td>“Their inspection process is very thorough and very detailed”</td>
<td>Highly test of details procedures, Lack of materiality</td>
<td>Criticism of the inspection methodology</td>
</tr>
<tr>
<td>“I want them to take a risk based approach, I do not want them to just be ticking boxes”</td>
<td></td>
<td></td>
</tr>
<tr>
<td>“Sometimes they concentrate out of the key risks”</td>
<td>Management and press pressure, Repeated issues, Lack of materiality, Lack of independence</td>
<td>Criticism of the inspection team</td>
</tr>
<tr>
<td>“It is difficult for them to walk away and say I have no issues to report”</td>
<td></td>
<td></td>
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<tr>
<td>“They are doing their best, but they need the right people”</td>
<td></td>
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<tr>
<td>“Audit regulators should be transparent and accountable”</td>
<td>Financial independence, Transparency, Power of investigations, Power of sanctions, Successful team and methodology</td>
<td>Inspection authority’s success factors</td>
</tr>
<tr>
<td>“Audit regulators should be operationally independent”</td>
<td></td>
<td></td>
</tr>
<tr>
<td>“The best inspector is the one who knows the nature of the business being audited”</td>
<td>Independent, Experts, Specialists, Cooperative, Competence, Fair and objective</td>
<td>Inspection teams’ success factors</td>
</tr>
<tr>
<td>“They have to give high attention to the security of information”</td>
<td></td>
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<tr>
<td>“The main success factor of the QCU’s work is the inspection’s methodology, how they will do their work”</td>
<td>Assuring the commitment to standards, Assuring the quality of audit process, Assuring the quality of risk based process management</td>
<td>Inspection methodology’s success factors</td>
</tr>
<tr>
<td>“Personal relationships, it’s all about relationships. I’ll have on-going relationships”</td>
<td>Quality of people, IBM factor, Size and geographical networks, Brand and reputations Specialisations</td>
<td>Determining the main drivers of the audit quality</td>
</tr>
<tr>
<td>“Big firms attack by providing non audit services first to make strong</td>
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Table 4.1: Developed open categories and examples of their identified codes and dimensions

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<tr>
<td>relationships with the clients and gain his trust”</td>
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<td></td>
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<tr>
<td>“I do not think that the provision of NAS for audit clients affects the audit quality”</td>
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<tr>
<td>“I think the problem is the risk that it could be perceived that they exercise undue influence on the auditor to give a certain opinion on a set of accounts”</td>
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<tr>
<td>“The more you increase regulation and the more you’ve got to deal with regulation, does that make the profession less attractive to new entrances”</td>
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<tr>
<td>“Rules based, rather than principle based, auditing standards could result in a tick box mentality to auditing”</td>
<td></td>
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<tr>
<td>“We go back to our systems to provide evidence of our compliance with various regulations”</td>
<td></td>
<td></td>
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<tr>
<td>“We review our audit methodology .... We try to standardize everything anywhere”</td>
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<tr>
<td>“Existing clients are re-evaluated, at a minimum, every 12 months if the relationship with the client is intended to be continued”</td>
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<tr>
<td>“One of the main changes after Enron was the establishment of the risk management department”</td>
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<tr>
<td>“We have fully separated systems of our audit and non-audit staff”</td>
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<tr>
<td>“We are committed to delivering consistently high levels of audit quality around the world”</td>
<td></td>
<td></td>
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<tr>
<td>“We made sure that our quality control procedures were being</td>
<td>Assuring quality, Assuring regulations &amp; standards commitments, Clients’ acceptance and continuity</td>
<td></td>
</tr>
<tr>
<td>Assuring regulations &amp; standards commitments, Clients’ acceptance and continuity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unified procedures, Unified systems and software, Online approval, Centralised training programs, Global opportunities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unified audit approaches</td>
<td>Establishment of risk management departments</td>
<td></td>
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<tr>
<td>Highly restricted regulations, More check lists, Unattractive for talent people, Threats to the audit quality</td>
<td></td>
<td></td>
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<tr>
<td>Reasons for resistance, Times of resistance, Ways of resistance</td>
<td></td>
<td></td>
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<tr>
<td>Rules based instead of principle based</td>
<td>Resisting proposed regulations</td>
<td></td>
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<tr>
<td>Rules based instead of principle based</td>
<td>4.2.14</td>
<td></td>
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<tr>
<td>Unified audit approaches</td>
<td>4.2.15</td>
<td></td>
</tr>
<tr>
<td>Serving global clients</td>
<td>4.2.17</td>
<td></td>
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<tr>
<td>4.2.13</td>
<td>4.2.14</td>
<td>4.2.15</td>
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<tbody>
<tr>
<td>“consistently applied everywhere”</td>
<td>Specialisation in markets, Specialisation in industries, Specialisation in businesses, Specialisation in transactions</td>
<td>Maximising the value of specialisation</td>
<td>4.2.18</td>
</tr>
<tr>
<td>“One of the main requirements of our global network is the creditability of our staff, we cannot provide services that we have not provided before”</td>
<td>Assuring consistency, Assuring quality, Assuring conservatism</td>
<td>Installing new online software programs</td>
<td>4.2.19</td>
</tr>
<tr>
<td>“If we do not provide the service, we ask our members in other countries to support us with experts in this service”</td>
<td>Global competition, Increasing market shares, Assuring quality, Assuring consistency Assuring conservatism, Protecting the leading reputation, Serving global clients</td>
<td>New ELLPs structures</td>
<td>4.2.20</td>
</tr>
<tr>
<td>“We go back to our systems to provide evidence of our compliance with various regulations”</td>
<td>Managing audit risks, Protect the leading reputation</td>
<td>Avoiding high risky clients</td>
<td>4.2.21</td>
</tr>
<tr>
<td>“We have to have systems, not only because our increased scale of operation, but also we have got to demonstrate that we have a process to our regulators”</td>
<td></td>
<td></td>
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<tr>
<td>“The drivers for us in coming together were, one about quality and one about appropriate investment”</td>
<td></td>
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<tr>
<td>“We are trying to bring the network closer together, to get us into one partnership”</td>
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<tr>
<td>“We have very rigid policies for risk management and clients’ acceptance and continuity policies”</td>
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<tr>
<td>“There are certainly much more stringent procedures, predominantly around client acceptance”</td>
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<tr>
<td>“We focus on mentality, education, presentation skills, communication skills and social level”</td>
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<tr>
<td>“We want to ensure that we have the right people in the right place to support our clients at the right time”</td>
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</table>
We are fully committed to recruiting the very best talent. To develop outstanding talent within our Audit practice we have launched a new school leavers”
“We constantly look beyond the traditional routes to make sure we capture outstanding graduate talents”
“We encourage our people to go out and get more experience in different countries”
“As well as developing their skills, our people will be able to build long-lasting relationships, both within and outside the firm”
“If someone comes to London and English is not his first language, it is difficult for him of having the necessary writing and communicating skills”
“When they come back, they do not wish to work in the audit profession as they face culture shock”
“We were successful for a few years in increasing audit fees, for the additional work we were being asked to do according to the new auditing standards and Sarbanes Oxley requirements”
“You are looking of how complex is the business, what are the controls like within the business”

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<tr>
<td>“We are fully committed to recruiting the very best talent. To develop outstanding talent within our Audit practice we have launched a new school leavers”</td>
<td>Hiring highly skilled people, Investing in people</td>
<td>New educational programs with ranked universities</td>
<td>4.2.23</td>
</tr>
<tr>
<td>“We constantly look beyond the traditional routes to make sure we capture outstanding graduate talents”</td>
<td></td>
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<tr>
<td>“We encourage our people to go out and get more experience in different countries”</td>
<td>Assuring consistency, Sharing the best practice, Investing in people, The right people in the right place at the right time</td>
<td>Offering global opportunities</td>
<td>4.2.24</td>
</tr>
<tr>
<td>“As well as developing their skills, our people will be able to build long-lasting relationships, both within and outside the firm”</td>
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</tr>
<tr>
<td>“If someone comes to London and English is not his first language, it is difficult for him of having the necessary writing and communicating skills”</td>
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<tr>
<td>“When they come back, they do not wish to work in the audit profession as they face culture shock”</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>“We were successful for a few years in increasing audit fees, for the additional work we were being asked to do according to the new auditing standards and Sarbanes Oxley requirements”</td>
<td>Additional work hours, Increased audit costs, Increased fixed costs</td>
<td>Increased fees</td>
<td>4.2.25</td>
</tr>
<tr>
<td>“You are looking of how complex is the business, what are the controls like within the business”</td>
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<tbody>
<tr>
<td>“It is a highly competitive market .... I know people say there are only four and such like, but it is very competitive”</td>
<td>Global completion, Cooperation against further regulations, Quality as a main driver People as a main driver, Relationships as a main driver, Prices coming later</td>
<td>Aggressive but fair competition</td>
<td>4.2.26</td>
</tr>
<tr>
<td>“We do not behave as a cartel, and we do not breach the fair competition”</td>
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<td></td>
<td></td>
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<tr>
<td>“It is strong competition, so obviously there are credible players”</td>
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<td></td>
</tr>
<tr>
<td>“We can ask banks or layers to recommend us for their clients and vice versa”</td>
<td></td>
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</tr>
<tr>
<td>“We are investigating our peers in the USA and UK, and one of the British consultant companies is preparing a study about the Audit Inspection Unit in the UK to advise us about its activities and how they monitor auditors’ performance”</td>
<td>Dialogues with IFIAR, Sharing the best practice of audit oversight, Establishment of global groups of professionals</td>
<td>Global audit regulatory framework</td>
<td>4.2.27</td>
</tr>
<tr>
<td>“We spent much more time in dealing with all the regulations, and that’s cost us”</td>
<td>Lack of independence, Lack of transparency, Lack of full power of sanctions, Lack of cooperation</td>
<td>Criticism of the inspection authority</td>
<td>4.2.28</td>
</tr>
<tr>
<td>“They have their inspection process; it is very thorough and very detailed; they probably pick up on things that we do not think are key”</td>
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</table>
In total 28 open categories are developed within the open coding stage of analysis. Sections 4.2.1 to 4.2.28 provide a brief of the 28 open categories. The properties of each category refer to the important features of a particular phenomenon emerging from the data analysis (Strauss & Corbin, 1998).

4.2.1 Assuring the audit quality (value of quality)

The independent audit regulators aim to protect the public interests from further accounting collapses, and to promote confidence in the audit profession. One of the main open categories which has developed during the analysis of the role of independent regulators for the audit profession is assuring the quality of the audit process. This category is an open category which includes a number of dimensions under which many codes and concepts are grouped. One of these dimensions relates to the effects of the independent inspection process on the audit quality. For example, it is argued that the quality of the documentation system inside the audit firms has been enhanced. The quality of evidence which support auditors’ judgments is also improved. The quality of internal control systems inside the inspected firms is enhanced as a result of the additional requirements of the independent inspectors. Further, the increased quality of the audit reports positively affects the quality of the financial reporting of listed companies; this, in turn, directly improves the quality of information in the capital markets.

Another dimension of this category is related to the effects of audit regulations – the audit oversight authorities have the right to inspect audit firms and set audit regulations – regarding the quality of the audit process. The audit quality framework identifies a set of audit quality drivers and requires the audit firms audit public listed companies to disclose how they apply such drivers. The framework improves the ability of individuals to understand what the audit quality means and how it can be achieved. Further, current debate about the professional skepticism is conducted to discuss whether further steps are needed to mandate the skepticism as an essential procedure which should be part of the audit process. Although auditors believe that no further regulations for the professional skepticism are required, they argue that differentiating between good practice and bad practice as being skeptical enhances the quality of audit judgment. The line-by-line analysis of gathered data provides different dimensions regarding the audit quality and suggests that the professionals have positive perceptions about the quality of audits after the
establishing of independent audit oversight. A direct relationship can be deduced between independent audit oversight and audit quality from the analysis of this open category.

4.2.2 Adding credibility (value of trust)

Trust in auditing firms has been questioned following Enron’s failure as well as accounting scandals at WorldCom and other companies. The independent inspection of the audit firms sends positive messages to society that auditors are subject to governmental reviews in order to assure that they do perform their tasks with an acceptable level of quality. This can add credibility to the role of auditors and restore public trust in the profession. Financial reports of listed companies, especially the audit reports, become more reliable than before the independent inspections. Indeed, at the very least, the public feels that there are people who aim to protect their interests by assuring that auditors are doing the right things.

Credibility not only means the credibility of auditors, but also refers to the credibility of capital markets. Foreign investors must receive positive messages about the reliability of information provided in the capital markets. This can only encourage them to invest their savings in a certain market rather than other markets. A further dimension of credibility is the credibility of inspectors themselves. Inspectors’ credibility is a logical result of their independence. If the public doubt the independence of the inspectors, then this means that they no longer trust them. It seems like credibility is the solution which governments have provided to the public to protect their interests and promote confidence in the capital markets. However, the question is, what if further collapses occur? Would the trust be lost in the independent oversight system? Indeed, after all, were further collapses to occur this would mean that they are not more able to protect the public’s interests.

4.2.3 Providing more information to the public (value of transparency)

Transparency is one of the key issues which the public need to feel confidence in the audit oversight system. The independent audit oversight has been established to serve the public interests. Thus, audit regulators should be transparent and make all information available for the public who can take the desired action depending on the information. Audit inspection authorities publish their annual reports which include the main findings of their inspection process. Such reports have been published on an individual basis whilst there are also
accumulated annual reports for the common findings of the inspection process during the entire year. Further, the audit regulators publish discussion papers available for the public to get their feedback on such papers. All the feedback and a summary of the common arguments are also available for all users. This transparency in issuing regulations and taking further decisions enhances the quality of information in the capital markets and increases their credibility.

An additional dimension of the “transparency” category relates to the transparency of inspected firms. The public, especially investors and audit committees, need more transparency when it comes to their external auditors; in particular, the big four audit firms and their global networks. More data are required which details the audit firms’ structures, objectives, quality assurance systems, and financial positions. A set of audit regulations has been issued to increase the transparency of the audit firms, especially those which audit public and listed companies. The big audit firms are forced to publish annual transparency reports that include information about their governance, key drivers of audit quality, and financial results. Further, independent non-executives have been mandatorily appointed inside the audit firms to be responsible for creating dialogue with stakeholders and protecting their public interests. Such regulations enhance the efficiency of the capital markets’ decisions as they depend on reliable information which is available for all.

4.2.4 Mitigating the audit risks (value of protection)

This open category includes different sources of risk which are mitigated by the independent audit oversight. The audit regulators believe that the scenario of the big three firms represents a risk which will damage the structure of the audit market. The independence rules would not be implemented in a sufficient way and the audit market choice will be insufficient as a result of the decreased number of the service’s providers. One of the main aims of the independent inspections of the audit firms’ performance is to protect their brands from the risk of repeating further accounting collapse by assuring the quality of their audit works. Once the independent inspection reports success in restoring the public trust, this can reduce the risk of litigation toward the audit firms. At least the public know that independent people are reviewing the auditors’ works. Further, not only does the external inspection mitigate the audit risks, but the audit firms themselves have also established a number of restricted procedures in accepting and
continuing their audit clients. These procedures reflect the highly conservative strategy which has emerged from the audit firms to protect their reputations and reduce the risk of audit.

4.2.5 Enhancing the choice in the audit market (value of fair competition)

There is a high concentration level in the audit market. This is particularly so after the failure of Arthur Anderson’s audit firm and the domination of the global networks by the big four audit firms for the global markets. As a result, the audit regulators set a number of regulations and projects to enhance and increase the choice in the big audit market. Enhancing choice in the audit market category has four dimensions. The first dimension relates to providing more information about the drivers behind the choice or decision. Reviewing the audit proposals of the big firms shows that quality, size, and reputation (the IBM factor) are the main drivers upon which the big audit firms focus their proposals. Providing this information assists both auditors of the mid-size firms and investors of listed companies to take relevant action to increase the competition and the number of audit firms which are able to compete in the big audit market.

The second dimension of this category pertains to reducing the financial barriers of entering the big audit market. The big four firms have invested heavily in order to build and improve their global networks. Thus, the question is, to what extent do the mid-size firms need more financial resources to be encouraged to expand their global networks and be able to compete in the big market? With regards to this issue, the debate is on a global level. Indeed, a number of discussion papers have been issued by IOSCO, IFIAR, and the European Commission to study the extent to which the ownership rules of audit firms need to be changed to allow non-professionals to invest their savings in the audit firms, and how these changes, should they come to fruition, affect the independence and the quality of the audit process. Further, a revision is made to the auditors’ rotation rules whilst the maximum number of years to act as an engagement partner is increased, in special circumstances, from five to seven years.

The third dimension of this category is related to reducing the risk barriers of entering the big audit market. The high risk of litigation which faces auditors as a result of their unlimited liabilities is one of the main barriers which limits the mid-size firms when they audit the big companies. The UK company act 2006 allows auditors to sign limited liabilities agreements with their clients after the approval of the clients’ shareholders. However, only few clients agree to
enter in to such agreements. The fourth and last dimension which is suggested by the big four partners themselves is to enhance the quality of people. The most important barrier which faces the mid-size firms when it comes to entering the big audit market is getting the right people in whom the global companies can place their trust. Auditing is a technical service and human resource is the main driver for providing a high quality service.

The analytical process shows that there is a conflict which should be considered and that a balance must be struck between reducing the barriers of the big audit market and maximising the auditors’ independence. For example, changing the owners’ rules of independence and allowing non-professionals to invest in the audit firms can threaten the auditors’ independence. Further, increasing the rotation period can create long relationships between auditors and the clients’ management which threaten the auditors’ independence. To sum up, it is argued that to enhance the choice in the audit market, better information should be provided to the audit clients to take more relevant decisions. Further, mid-size firms should be encouraged to enter the big audit market to increase the number of service providers.

4.2.6 Enhancing the whole economy

An effective independent audit oversight system can send positive messages to investors about the efficiency of the capital market. This can in turn increase the foreign investments which enter the country, which can enhance the whole economy. The more transparent and reliable the information in the capital market, the higher amounts of foreign direct investments which will exist. This indicates that governments are not only establishing the audit oversight system on behalf of investors to protect their interests, but also have their own interests in mind as the audit oversight system has positive effects on the whole economy and increases the number of foreign investments which enter the capital markets. A more enhanced economy indicates more efficiency in the governmental performance and increases its opportunities in continuity. Nevertheless, political discussions are out of the scope of this thesis.

4.2.7 Criticism of the inspection methodology

Many of the auditors’ comments regarding the independent inspectors’ performance are grouped together in this open category. Inspectors are carrying out detailed procedures rather than employing analytical procedures. This allows them to spend more time in immaterial issues. A
further dimension of this category relates to the cost benefit analysis of establishing such authorities. Although the additional tasks which are required from auditors increase the audit quality, the audit costs have also been increased and only the investors paid. Here the question arises regarding the extent to which it is valuable for investors to pay the increased audit costs. Moreover, in order to fill the additional requirements of the audit regulators, auditors feel that they waste most of their time ticking boxes rather than discussing technical issues. This raises the debate regarding the transition of the audit regulations from principle based to rules based and also questions the extent to which this can negatively affect the audit quality and the attractiveness of the profession, especially for the talented people.

4.2.8 Criticism of the inspection team

A lack of materiality in the inspection findings is one of the main comments regarding the big four partners when it comes to the inspectors’ performance. Another feedback is that inspectors are working under press and management pressure. They have to find something to criticise the audit firms’ performance. It is argued that inspectors feel if they report that everything is well, it means that their reports will be invaluable for the public. Further, when inspectors evaluate the auditors’ judgments, they have to consider the circumstances which exist at the time of the judgments, rather than the other circumstances which apply at the inspection time.

4.2.9 Inspection authority’s success factors

In this category a number of factors are suggested as key for establishing an effective audit oversight authority. The views of two different groups of participants (audit regulators and audit partners) are considered and combined by the researcher to develop a suggested category. For example, the authority should be independent of any financial pressures, especially from the professional bodies which are dominated by the inspected audit firms. Governments should guarantee a source of financial income which is fully separated from the profession.

Furthermore, an acceptable level of transparency should be applied. Published inspection reports are valuable for investors and audit related parties. Indeed, these assist them in evaluating the performance of inspected firms. Moreover, the inspection units should have applicable power of sanctions to help them in enhancing the inspected firms’ performances. To sum up, it is argued that independence, transparency, and power of sanctions are the main dimensions for
establishing an effective audit oversight organisation.

4.2.10 Inspection teams’ success factors

This category is related to the main features which should be available in the inspection team for individuals rather than the inspection unit as an organisation. The inspectors of the audit firms’ performance should be independent and free from any conflict of interests. Furthermore, inspectors should be objectives so as they can provide a fair evaluation of the quality of the audit processes inside the inspected firms. Additionally, they must be competent and maintain a high degree of confidentiality when it comes to the companies’ data. Information about listed companies is very confidential and they must be highly conservative, whilst also having to cooperate with other parties. Such parties include professional bodies and accounting associations, investors, auditing and accounting standards setters, and inspected audit firms themselves. Such cooperation can result in a better understanding of the audit parties’ comments for the suggested audit regulations. This means that they can take them into consideration when issuing such regulations. It also improves the quality of the inspection processes. Moreover, the inspection teams have to be aware of the nature of the business conducted by the companies they inspect. They should also be specialists in the inspected activities to be able to understand and evaluate the auditors’ judgments. They must also be robust in their dealings with people and have confidence in what they are doing so as they have credibility in the eyes of the firms.

4.2.11 Inspection methodology’s success factors

Audit firms which audit listed and public interests companies should be periodically inspected. The inspection process should include the following: achieving acceptable level of assurance that auditors and companies are committed to applicable auditing and accounting standards (and other related laws or regulations, if applicable); assuring the existence of an acceptable level of risk management processes during the clients’ engagement; and assuring the quality of the audit files.

4.2.12 Determining the main drivers of audit quality

This category consists of a set of identified codes which represent the main drivers of the audit quality. Firms’ size, brands, direct relationships with clients’ management, and the quality of
people are the main codes which have been identified during the analysis process. The current drivers can be seen as the main challenges for the mid-size firms when it comes to entering the big audit market. This category is related to a number of audit projects which have been established by the audit regulators. For example, the audit quality framework sets a number of factors that should exist in the audit firms to support the quality of their internal control systems. Further, the project of reviewing the audit proposals aims to identify the main competitive advantages on which the big four firms are focused to attract their potential clients. These advantages can also be considered as the main drivers behind the quality of the audit process.

Moreover, this category can also be interpreted to the independent audit regulators as they depend on these drivers in the evaluation of the audit firms’ performance during the inspection process. One more dimension for this category pertains to its relations to the competition in the audit market. These drivers of audit quality assist in developing a better understanding of the criteria on which the competition is concentrated in the big audit market. Understanding these drivers assists the mid-size firms with increasing their market shares.

4.2.13 Resisting proposed regulations

The big four firms resist any further restrictions in the audit regulations. Auditors feel that auditing becomes routine work rather than a profession which requires specialists who provide a technical judgment. Transforming the audit regulations and standards from principle based to rules based makes the profession highly complicated and distractive to talented people. This can threaten the quality of the audit works. The analytical process shows that auditors are resistant when it comes to regulations in the discussion stage through their documented feedback which is sent to the regulators. However, once the regulations have been issued, the big four firms are working in compliance with these regulations. Comparisons have been made between the feedback of the big four firms toward the proposed projects of regulations and their transparency reports, in which they welcome the same regulations after issuance.

Another dimension for this category is discussed during the analysis process, namely the domination of the big four partners when it comes to the regulation setting process, and the extent to which this can affect the quality of the audit profession. It is noted that many of the standards and regulators setters, in the UK for example, come from the big audit firms. It could
well be that they are not the majority of the member boards; however they could be the most influential members. This may raise an issue regarding the independence of audit regulators and the extent to which they give their firms’ interests – instead of the public interests – the highest priorities in their decisions.

4.2.14 Rules based instead of principle based

Transforming the audit regulations and standards from principle based to rules based makes the profession highly complicated and distractive to talented people, which can in turn threaten the quality of the audit work. One more dimension of this transition is the highly detailed rules which are set by the global networks of the big four firms. A number of check lists must be followed by the audit team in all areas so as to assure the quality of the service provided. These checklists assure the implementation of the unified audit approaches through the national member firms in different countries. This guarantees an acceptable level of quality which is provided everywhere. It is argued that such checklists represent a transition in the audit procedures from principle based to rules based. This makes auditors less interested in their daily work as they feel that they are just ticking the boxes rather than using their experience and knowledge to provide technical opinions about the audited financial statements.

4.2.15 Unified audit approaches have been established

A set of unified and standardised policies and procedures has been established. All member firms are forced to apply these procedures to assure that they are sharing the globally approved best practice. These standardised methodologies protect the leading reputations of the global networks of the big four firms. They also reduce the risk of litigation by applying a number of procedures which achieve an acceptable level of quality.

4.2.16 Establishment of risk management departments

The global networks of the big four firms make it mandatory for all their member firms to establish risk management departments. The risk management partners are appointed to be responsible for assuring that highly restricted policies and procedures which are set in the audit approach have been effectively applied to guarantee a high level of auditors’ independence. For example, the audit partner cannot continue as an engagement partner for more than seven years.
according to internal policies which are set by the global networks. This policy has been set in order to mitigate the risk surrounding the effects of long relationships which threaten the auditors’ independence. Furthermore, the risk management partners are responsible for assuring that the firm, at all levels, is in compliance with all national standards and regulatory requirements which are applicable in their countries. In addition, the national firms are committed to all of the international accounting and auditing standards.

4.2.17 Serving global clients

The audit service is very unique in nature; it does not serve the end consumer and rather serves companies which provide services and products for customers and is also listed in different capital markets. This means that demand for the audit service is strongly affected by the development and the expansion of its clients. The more branches and subsidiaries held by the audit clients, the higher the demand and work hours required from auditors. The increased number of multinational companies, over the last decade, represents an opportunity for the big audit firms to increase their market shares and profits. However, it can be considered – at the same time – as a challenge which must be faced by the audit firms, especially the big four firms. The special and complicated needs of the global companies encourage the audit firms to pay greater attention to the quality of their people and their systems so as to meet the special need of their global clients. Global clients are competing everywhere; this requires the audit firms to assure the quality of provided services around the world, by focusing on the emerging markets. Serving global clients also requires hiring highly skilled people to provide advices and solutions for advanced and complicated problems which take place in different capital markets.

4.2.18 Maximising the value of specialisation

To improve the quality of the provided audit service, the big four firms pay more attention to the value of specialisation. Specialists are capable of providing a high quality service as a result of their greater knowledge and experience in a certain type of business. The big four firms stress that all of the audit staff in all member firms must have previous experience in the service which they provide. They are no longer able to audit a business which they have not previously audited. Member firms which do not have staff and who are not specialists in a specific business, can be supported by specialists from other member firms. The specialisation can be achieved at different
levels, specialists in business, industry, specific transactions (such as the derivatives agreements or the due diligence operations), and specific markets (especially the emerging markets such as the fast east markets). This can give the big four firms a competitive advantage in the competition of the big audit market.

4.2.19 Installing new online systems and software programs

New internal software programs, databases, and online systems have been installed in the intranets of the global network and their member firms. The new programs help to achieve a high degree of centralisation in managing and monitoring the strategies’ implementation in different member firms, and achieving high speed of communication among the global networks and national firms everywhere. The new advanced systems assist auditors to be fully informed regarding certain industries, companies, or the market of any country at any time. These data are added by specialists and experts in different types of industries and capital markets. A number of committees and centres have been established at the global level and are responsible for supporting the member firms by offering technical advice and information regarding different industries and capital markets. This can enhance auditors’ judgments and guarantee the consistency of auditors’ judgments all over the world. The consistency of the audit judgment provides a high degree of professional skepticism which enhances the quality of the audit reports. Further, another type of software program has been installed to assure the compliance with applicable standards and regulations in different countries.

4.2.20 New ELLPs structures

Recently, a number of local member firms, in different global networks, both in Europe and other non-European countries, have merged together to create new European LLP firms. The ELLPs’ role is to set strategies which are related to quality, people, and financial growth. The large amount of resources which have been invested in the new ELLPs’ structures strengthens their ability to achieve a better quality of provided audit services for their global clients. This is achieved through investment in their human and technological resources so as they are more able to provide a higher degree of specialisation in specific industries, businesses, and capital markets.
4.2.21 Avoiding high risk clients

In order to mitigate the risk of litigation and protect their leading reputations, the member firms of global networks re-evaluate the risks which are associated with all of their clients and rearrange their clients according to their risk level. High risk clients with weak internal control systems have been excluded from their portfolios. Highly rigorous policies for clients’ acceptance and continuity have been set, and a number of risk management departments - in each member firm - have been established. The new risk management partners determine the areas of risk for each client, and approve the clients’ acceptance and continuity for each engagement.

A set of factors are elected to determine the clients’ level of risk. For example, listed companies and public interest entities are considered – by default – to be risky clients. Moreover, industrial nature is another factor when it comes to the level of risk, with banks and petroleum companies representing clients which are high risk by nature. Further, the size of a company and the complexity of its transactions both affect the level of risk. All of the risky clients require intensive audit procedures to assure the reliability and fairness of their financial statements.

4.2.22 Hiring highly skilled people

The big four firms have now placed more emphasis on hiring talented people who are able to effectively understand and meet the needs of the increased number of global clients. The big four firms focus on recruiting highly skilled people who are experts in other industries or fresh graduates from the top ranked universities. A number of advanced training programs have been established for their people at all levels. Further, and to assure that updated knowledge and information have been continually provided, audit teams must achieve a certain number of Continue Professional Development (CPD) hours every year.

4.2.23 New educational programs with leading universities

The big four firms have started a set of educational programs in cooperation with different leading universities in the UK and Egypt. The programs aim to train the students on actual cases from the work field, to provide graduates who are able to understand the working field, and to assure that the students learn what audit firms actually need.
4.2.24 Offering global opportunities for audit staff

An increased number of global opportunities have been provided for audit staff to work in other member firms in different countries. People are strongly encouraged by the member firms to apply for these opportunities to share with their peers the best practice of auditing. These opportunities meet the global clients’ requirements in different countries by providing them with the right people at the right time. Auditors are commonly looking for diversity and integrity, thus they can work with different systems, people, and cultures which develop their skills in different areas. This can in turn enhance their professional international credentials for the multinational marketplace. Another dimension of benefits which can be achieved using this strategy relates to the benefits for audit firms themselves. The audit staffs who take these opportunities are more able to get a better understanding of the global audit approach as this approach is consistently applied in different countries.

However, there are some restrictions and difficulties when it comes to this strategy. Indeed, language and political barriers are the main challenges which hinder the wide implementation of this strategy. Further, feeling lonely and cultural differences can also reduce the effectiveness of applying such a strategy.

4.2.25 Increased fees

The additional requirements of the new audit regulations (SOX Act, UK Company Act, and similar laws in other countries) is one of the main drivers for the global and intensive increases in the audit fees. However, the changeable regulatory framework of the audit environment is not the only reason for the increased audit fees. Other developed factors are suggested. These factors are classified into two groups: factors which increase the number of hours of the audit process and other factors which increase the rate of audit fees per hour at all levels of the audit firms. It is suggested that restricted audit regulations, intensive number of cross-border clients, and lower public trust are the main factors which motivate the big audit firms to make a concerted effort, and make larger investments in people, technology, and networks to protect their market shares. By the end, the big four are profitable organisations, and investments should be returned.
4.2.26 Aggressive but fair competition

The large audit market is a strongly competitive and aggressive market. However, no evidence has been found regarding any breaches of fairness. The quality of provided services, the quality of people especially the top level management, good direct relationships with clients, and communicating with the key traders in the society (such as layer firms, and banks) are the main drivers behind competing in the big audit market. Further, despite this aggressive competition, the big four are communicating together to protect their organisational interests and discuss the future of the audit profession, especially on the governmental agenda.

4.2.27 Global audit regulatory framework

The audit profession is one of the most regulated professions. The increased number of global companies that are listed in different capital markets allows the audit regulators in different countries to share their practice together to avoid further accounting scandals which negatively affect all of the capital markets. The global debate among regulators on how to regulate the audit firms which audit listed and public interests entities, has led to the establishment of similar audit regulatory frameworks in different countries. Further, according to the increased number of cross-border companies, the national audit firms have been affected by other regulatory frameworks in different countries. For example, the big four audit firms in Egypt are committed to the Egyptian auditing and accounting standards. However, as they are auditing companies which are listed in the US capital market, they have to be committed to the US GAAP and the requirements of the SOX Act.

4.2.28 Criticism of the inspection authority

A lack of independence in some cases and a lack of transparency in other cases are two of the main sources of weakness in the audit inspection authorities’ performance. In order to effectively serve the public interests, the inspection findings should be available for the public to enhance the effectiveness of the external auditor’s decision. Further, the audit oversight authority should be fully financial independent of the profession. This is not the case in the UK, as 50% of the auditing and accounting costs of the FRC are funded by the profession. It should also have a full power of sanctions. This is also not the case for the FRC. The professional bodies’ approval must be gained before any action can be taken against the inspected audit firms. For the Egyptian case,
the QCU should have more independent members. This can be done by excluding auditors from its board of directors. Further, more cooperation is required with the professional bodies and the audit firms. Moreover, more information should be available to the public regarding the inspections’ findings.

4.3 Axial coding process

“This purpose of axial coding is to begin the process of reassembling data that were fractured during open coding…. In axial coding, categories are related to their sub-categories to form more precise and complete explanations about the phenomena” (Strauss & Corbin, 1998, p.124).

This section discusses the second stage of analysis, of grounded theory methodology, namely the axial coding process. Both open coding and axial coding analytical processes focus on transferring and grouping the codes – which represent the raw data – into meaningful categories which have specific properties and characteristics; they also involve identifying the relationships between these categories to understand how they interact together. The two stages of coding analysis are completed in order to achieve the study’s aim by providing a better understanding regarding specific phenomena. Open and Axial coding processes are sequential and in parallel with analytical stages (Strauss & Corbin, 1998).

The main difference between open and axial coding is that the open coding process identifies codes from gathered data, classifies the related codes into a number of open categories, and identifies the main features and properties for each developed category. With regard to the axial coding process, the analysis is more concerned with the developed open categories themselves. It identifies the relationships between each category, groups related categories into a number of axial categories, and analyses the main dimensions and properties for each axial category. It is a continuous process at a higher level of data. However, in some cases, the axial categories can be developed directly from the raw data. The categorisation is a continuing process which has made till reaching the saturation level in which no more relations can be identified through the developed categories.

As explained in the Strauss & Corbin approach, axial coding is the act of relating categories to sub-categories along the lines of their properties and dimensions (Strauss & Corbin, 1998, p.
In this study, the 28 open categories which are developed during the open coding analysis process are grouped into 13 axial categories during the axial coding analysis process. Table 4.2 shows the open categories and how they are grouped into axial categories. In many cases, some of the open categories are related to more than one axial category. For example, the open category “providing more information available for public” is related to the axial category “importance of independent audit oversight”, as it increases the transparency level which should be provided for the public. Further, the same open category is related to another axial category called “increasing the transparency level” in which it explains how the audit regulations force the big audit firms to provide more detailed information, which is available to the public, regarding a set of issues related to their structures, strategies, internal control systems, and financial positions. The transition from open categories to axial categories is completed according to the analysis process which identifies and explains how the open categories are interrelated and what the main dimensions and properties are for each category.

Further, the axial categories are regrouped into a number of main categories, with each axial category representing a sub-category for one main category and answering one or more questions related to the developed main category. During the coding analysis process, the developed axial categories (13 categories) are reclassified according to their interactions into the following three main categories: big four’s perceptions toward audit regulators, big four’s perceptions toward audit regulations, and emerged audit firms’ strategies.

Table 4.3 shows the three main categories and their axial sub-categories which answer a number of questions so as to provide further and in-depth analysis of each main category. For example, to understand the big four’s perceptions toward the audit regulators (the first main category), the following three questions are addressed: Why does the audit profession need to be overseen by independent regulators? How can governments establish an effective audit oversight authority? How can auditors evaluate the regulators’ performance? These three questions are answered through the following axial categories respectively: 4.3.1, 4.3.2, and 4.3.3. The following subsections of Section 4.3 explain each axial category and how it is developed. Further, each subsection analyses the relationships between the developed axial categories in the axial coding stage.
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### Table 4.3: Developed main categories and their sub-categories

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4.3.1 Importance of independent audit oversight

This category consists of a set of open categories which represents a number of values and benefits added for a certain group of beneficiaries as a result of applying the independent audit oversight.
oversight system. These open categories interact and have interactive relationships with each other in a way which explains the importance of the independent audit oversight. They further explain the extent to which this new system adds value to different groups of the audit related parties. This is the common feature of this axial category which combines all of its open categories. It analyses the extent to which the audit profession still needs to be supervised and regulated by independent regulators rather than the self-regulated system. For example, this axial category includes a number of values that have been added by the independent regulators for a number of audit related parties. These values (such as: quality, trust, transparency, reliability, effectiveness, and credibility) interact in a way whereby each of them can be a reason or a result of the others.

Moreover, according to Strauss & Corbin’s approach of grounded theory (1998), in the axial coding analysis process, the researchers are looking for answers to questions such as “why, how come, where, when or how” in order to determine the main properties and characteristics for each category through a number of interrelated sub-categories. This category provides answers to a specific question, namely why must the audit profession be overseen by independent regulators? Answering such questions is considered as a dimension of the first main category in this study, specifically the big four’s perceptions of the audit regulators.

4.3.2 Key factors of establishing an effective audit oversight authority

This category includes a number of open categories which represent a multitude of features and factors which should be considered when governments decide to establish an independent oversight system for the audit profession. Three interpreted factors develop this category: factors related to the authority, factors related to the inspectors, and other factors related to the inspection methodology. The three categories are linked together in different ways; for example: the independent authority will select independent inspectors to inspect the audit firms. Further, the competence and specialist inspectors will conduct a sufficient methodology.

This category is a sub-category of the first main category of the emerged theory which is the “big four’s perceptions toward the audit regulators”. It answers the question of how governments can establish an effective audit oversight authority. It also suggests a number of factors which assist
governments in sufficiently overseeing the audit profession, depending on the auditors and other regulators’ perceptions.

4.3.3 Criticism of the current performance of the independent audit oversight authorities

This category consists of a number of open categories which represent a number of auditors’ criticism, notes, and comments regarding the inspectors’ performance. The main comments are concentrated on two dimensions: criticism of the inspection process, and other comments on the inspection team. Many of the comments focus on the lack of materiality in the inspections’ findings and the lack of independence of the regulations’ setters. This axial category represents the third dimension of the main category, namely “big four’s perceptions toward audit regulators”. After understanding the importance of the independent oversight system and how an effective oversight authority can be established, this category provides answers regarding the extent to which the current performances of the audit inspection units are acceptable and satisfied.

4.3.4 Improving the audit quality

This category represents the first sub-category of the second main category in this study, namely the “big four’s perceptions toward audit regulations”. The main category focuses on understanding how the independent regulators promote public confidence in the audit profession. The analysis provides the following three dimensions or sub-categories which answer this question: “improving the audit quality”, “increasing the transparency level”, and “reducing the barriers of the big audit market”. This axial category analyses the different ways in which the independent regulators attempt to enhance the quality of the audit processes. Improving the audit quality inside the audit firms increases the reliability of the audit reports which in turn restores public trust in the audit profession and promotes confidence in the financial reporting systems of the capital markets.

4.3.5 Increasing the transparency level

This axial category is concerned with the main projects of audit regulations which aim to increase the transparency of information provided in the audit market. A set of regulations has been established and proposed to encourage and force the big audit firms to provide increased
information about their structures, strategies, internal control systems, and financial positions. Another dimension for this category is to enhance the choice in the audit market. Companies in the audit market need more information about the big audit firms in order to effectively evaluate their performance and select one of them as an external auditor. Providing more reliable information can promote confidence in the capital markets. The users of financial reports and the investors are seeking for more information according to which they can take their financial decisions. The entire axial coding is the second sub-category for the main category “big four’s perceptions toward audit regulations”. It explains how the independent regulators promote confidence in the audit profession by providing more information which is available to the public regarding the auditors’ performance and the internal control systems inside the audit firms.

4.3.6 Reducing the barriers to entering the big audit market

The main focus of this axial category is to analyse how the audit regulations assist in increasing the number of main competitors in the big audit market, in particular, the big four firms. This can be achieved by reducing the financial and risk barriers which limit the ability of mid-size audit firms when it comes to competing in such a market. Reducing the existing barriers can enhance the choice in the audit market and promote investors’ confidence in the audit reports of the financial statements of companies which are listed in these markets. This axial category represents the third sub-category of the main category, namely the “big four’s perceptions toward audit regulations”.

4.3.7 Auditors’ resistance toward regulations

The axial categories number 4.3.4, 4.3.5, and 4.3.6 discuss the main three ways in which the regulations promote public confidence in the capital markets. They further analyse the big four’s perceptions of the audit regulations. In this axial category, the analysis is extended to discuss how and why auditors resist audit regulations, and to what extent this can affect the quality of the audit profession. The highly restricted and complicated regulations as well as the transition from principle based to rules based are the main reasons for resisting such regulations. Auditors, especially in the big four firms, are strongly resisting the regulations during the discussion stage when the regulators issue a proposed version and wait for the public’s feedback. Further, many of the board members who set the regulations are partners in the big audit firms. This threatens
the independence of the issuing process and raises questions regarding the extent to which the issued regulations protect the audit firms’ interests rather than the public interests.

4.3.8 Reviewing the audit methodologies

This axial category is one of the sub-categories linked to the third main category in this study, namely “emerged audit firms’ strategies”. This category analyses the relations between a set of open categories which interact together to achieve the same objective which is to explain how the audit firms review their audit methodologies and what are the main criteria upon which they are focused. For example, unified audit approaches have been applied through all their member firms. New software programs and networks have been installed to assist the member firms in effectively communicating with their regional offices. New and highly specialist committees have been appointed to assist the national partners when it comes to making the right judgments in certain technical cases. All of these new policies and procedures have been established to reflect a new audit firms’ strategy to assure the quality and consistency of provided audit services.

4.3.9 Establishing highly closed communications

This axial category is the second sub-category of the main category “emerged audit firms’ strategy”. It reflects a new strategy adopted by the member firms of the global big four networks to become more closed in organising their investments, setting their structures, managing their strategies, and even distributing their financial results. The last three years have seen a number of merging processes between many European member firms of the global big four networks to establish new legal structures working through Europe and the Middle East region. The new European LLPs’ structures give the merged firms the opportunity to strongly compete in other emerged capital markets such as the far-east markets. The new structures increase the competitive advantages of the merged firms and increase their capability in terms of providing the right people in the right places at the right time. The high and advanced technology programs which have been established in the big firms positively affect the effectiveness of the internal communications between the merged firms, and allow them to share the best practice of the audit profession.
4.3.10 A stringent conservative strategy

The third sub-category of the main category “emerged audit firms’ strategy” is the stringent conservative strategy. It has been adhered to by the big four firms following the collapse of Enron and the failure of Arthur Anderson. The big four firms feel that they are not free from accountability and that there is an increased risk of litigation toward the audit firms. The public lose trust in the auditors. As a result, governments issue highly restricted regulations toward their audit works. In order to mitigate the risk of litigation and to protect their leading reputation, the global networks of the big four firms establish a number of restricted policies and procedures which should be applied and implemented through all of their national member firms. The new policies reflect the highly conservative strategy which has started to emerge from the big four firms. These policies also reflect exactly how keen they are to protect their reputations and assure that no more collapses will be repeated in the future. Highly centralised procedures have been applied by the global or regional partners to assure the quality of provided services through all the national firms. Higher attention is paid to the auditors’ independence and the provision of the non-audit services to audit clients. Full compliance with applicable national and international accounting and auditing standards and regulations has been required, so as to avoid the risk of further scandals.

4.3.11 Global mobility: a new people strategy

Focusing on the quality of people is another axial category which represents the fourth sub-category of the main category “emerged audit firms’ strategy”. In order to better serve the highly technical needs of the increased number of cross-border companies, and to be committed to the additional requirements of the new audit regulators which are related to hiring and training highly qualified people, the big four firms pay more attention toward the quality of their people. For example, they focus on hiring graduates from top ranked universities and sharing educational programs with those universities to guarantee acceptable levels of quality when it comes to fresh graduate employees. Further, a new strategy has been established to offer global opportunities to the audit staff to work in other outsider member firms. This means that the global networks can ensure that different teams from different countries apply the unified audit approach in a similar way so as to support the consistency of applying the audit approach in different places around the world.
4.3.12 Increased audit fees

As a result of the previously mentioned axial categories, it is a logic reaction from the big four firms to dramatically increase their audit fees. The fee is an output of two inputs: number of hours required to complete the audit process and rate of hours which is related to every staff member at different levels. The open coding analysis identifies a number of factors which increase the number of hours and other factors which increase the rate of hours. This axial category represents the fifth sub-category in the main category “emerged audit firms’ strategies”. The previous axial categories interact with each other to create this category. These categories, for example, consist of factors such as the increased costs of training and qualifying people, the increased costs of setting advanced software programs, the costs of establishing technical committees for providing technical advices for the national member firms, and the increased costs of setting highly restricted internal control systems and quality assurance programs. All of these costs have been increased and require further increasing in the audit fees.

4.3.13 Competing in highly competitive markets

The revised audit regulations require additional efforts and reports form auditors, especially those which audit listed and public interests companies. These additional requirements increase the demand of the audit services, especially for the big four firms’ partners who are experts in providing such complicated requirements. As a result, the competition between the big firms becomes highly aggressive. Each of the four competitors has its own leading network which can globally compete in a wide number of capital markets. This increases competition between the big four firms and makes it a global competition rather than competition in a specific country or specific region. The global competition results in the establishment of the other previously used strategies, such as offering global opportunities for the audit staff and applying highly centralised strategies by the global or regional partners.

4.3.14 Big four’s perceptions of audit regulators

The previous 13 axial categories are regrouped together during the analysis process into three main categories as shown in Table 4.2. The first main category relates the perceptions of the big four firms toward the independent regulators of the audit profession. The emerged theory suggests that the independent audit oversight system provides a number of added values and
benefits for a set of different groups which are related to the audit profession. Suggested values support the notion that the quality of the audit profession has been increased and encourages governments in different countries to establish such systems to enhance the reliability of information provided on the capital markets.

Further, the emerged theory suggests a number of success factors for establishing an effective audit oversight authority. Proposed factors can be considered by governments when establishing an independent oversight system for the audit profession. Both professionals and regulators’ perceptions are considered when developing such factors. Moreover, the emerged theory provides a better understanding of the inspected big four firms’ criticisms of the independent inspection units’ performance. This can assist the audit inspection units in understanding how they can enhance their performance to effectively improve the quality of the audit processes.

4.3.15 Big four’s perceptions of audit regulations

The second main category in the emerged theory completes another part of the whole story. The first core category provides a clear image regarding how the big audit firms evaluate the independent audit regulators; it suggests that the new oversight system increases the quality of the audit processes and adds credibility to the audit profession. Thus, the question here is how do those regulators achieve their objectives? And how do the big four firms evaluate the effectiveness of the audit regulations which were issued or proposed by such regulators?

The second main category provides a better understanding of the previous questions. It suggests that the audit regulators promote confidence in the audit profession through three dimensions: improving the quality of the audit firms’ performance, increasing the transparency level of provided information, and reducing the barriers to entering the big audit markets. The emerged theory suggests that the issued regulations succeed in positively affecting the audit quality and make available more useful information to the public. However, an increased number of varied steps are still needed to increase the number of audit firms which can compete in the big audit market. The big four firms still dominate the auditing of most of the biggest companies in a vast number of capital markets around the world. Increasing the number of the big audit firms cannot be achieved in the short term. Mid-size firms should invest more funds in people, technology,
networks, branches or member firms which cover the majority of geographical areas around the world, with a focus on emerging markets, and other competitive drivers.

Moreover, the emerged theory suggests that the big four audit firms resist the issuance of further audit regulations which add further restrictions and complications for the audit processes. Currently, the audit profession is intensively regulated and no more restrictions are required. Any further restrictions can negatively affect the attractiveness of the audit service for talented people. Detailed rules transfer the audit work from a profession which depends on providing technical judgment, to a routine work which depends on ticking blind boxes. The big four firms resist the regulations during the discussion stage through their feedbacks of the proposed regulations. Further, the big four partners who are members of the regulations’ setters’ boards raise the question regarding the extent to which they influenced by the regulators’ decisions to consider the auditors’ interests rather than the public interests.

Analysing and understanding the perceptions of the big four firms toward the audit regulators (the first part of the story) and the audit regulations which are issued by the regulators (the second part of the story) contributes to the audit literature. It also adds value to the audit regulators by assisting them in enhancing the effectiveness of inspecting the audit firms and issuing audit regulations in the future. However, it is argued that to complete the story, the analysis must be extended to explore the strategies which have emerged from the big four firms to manage these recent challenges of the audit environment. Thus, the third core category answers the question of how do the big four firms react toward the changeable regulatory environment of the audit profession?

4.3.16 Emerged audit firms’ strategies

This main category is the third and final main category which builds up the emerged theory. This category completes the story and provides a clear image regarding recent challenges for the big audit firms and the reaction of these four firms when it comes to managing and facing their new challenges. The emerged theory suggests a number of strategies which have been employed by the big four firms to manage the recent challenges of the audit environment. The big four networks review their audit approach and establish a number of policies and procedures to assure the quality of provided services through different member firms. This is achieved by setting a
unified audit approach for each network which should be applied by all national member firms in all countries. The standardised programs and procedures of the audit processes have been forced to ensure that an acceptable level of quality and consistency is provided to the global clients by all national member firms in different countries. The implementation of such approaches is controlled and managed by upper levels of partners, including at regional and global levels.

Further, the global networks of the big four networks follow highly centralised strategies for managing and controlling the quality assurance systems of their national member firms. The high degree of centralisation at the global level reflects the networks’ desire to protect their reputations through self and online assurance of the implementation of the unified audit approaches which have been set by a number of highly skilled and specialists partners. These centralised strategies are established in parallel with the stringent conservative strategies toward risky clients which have been followed by the global networks. National member firms are no longer allowed to accept new clients or continue with current clients without online approval from upper level partners (regional or global level according to the potential risk level). Moreover, the centralisation also encourages the consistency of applying the audit approaches by all members. Thus, the audit staff have been encouraged, at all levels, to join global job opportunities in other member firms in different countries. This assists them in developing a unified understanding of the global approaches and sharing the best practice with their peers in other areas.

Moreover, not only are the audit staffs in different member firms becoming closer through global opportunities, but the member firms’ structures are also becoming more closed through a number of mergers among regional member firms in closed geographical areas. For example, the European member firms in two of the big four networks have merged together to create new European LLPs structures which are more able to compete in the global audit market. The new LLPs structures include the majority of European countries and some countries from the Middle East. This supports the standardised and centralised global strategies which have been followed by the global networks of the big four audit firms.

The intensive trend of standardisation and centralisation in managing the member firms of the global big four audit networks – over recent years – has assisted them in protecting their reputations and ensuring the quality and consistency of provided services, especially for the
cross-border clients. However, the new strategies require intensive investments in technology, people, databases, and advanced systems and programs. All of these requirements need high degrees of specialisation. Serving global clients and competing in global markets requires excellent understanding of the nature of different markets, industries, people, cultures, economics, and transactions. This can only be achieved by establishing a number of “global” committees and centres for providing technical advice to national member firms. A number of highly skilled specialists in all disciplines are appointed in these centres to provide advanced technical solutions for problems related to specific markets, industries, or even national regulations of certain countries.

4.4 Selective coding process

“Selective coding: the process of integrating and refining the theory............
Theoretical saturation: the point in category development at which no new properties, dimensions, or relationships emerging during analysis” (Strauss & Corbin, 1998, p.143).

In open coding, the data are analysed and categorised into open categories. With regard to axial coding, the relations are identified among developed categories and the 28 open categories are grouped into larger axial categories. The 13 axial categories are then sub-categorised into three main categories during the axial coding process. The developed axial categories determine the main dimensions and properties of the emerged three main categories. During the selective coding analysis, the emerged theory is refined; it is the transition process of a set of interpreted categories into a set of interrelated concepts and relational statements. These concepts represent many views of different groups of participants rather than reflecting the exact words of one respondent (Strauss & Corbin, 1998).

“If theory building is indeed the goal of a research project, then findings should be presented as a set of interrelated concepts ..... By constructed, we mean that an analyst reduces data from many cases into concepts and sets of relational statements that can be used to explain, in a general sense, what is going on” (Strauss & Corbin, p.145).

According to the Strauss & Corbin approach (1998), the first step in integration is deciding on a central or core category which represents the main theme of the research.
The main emerging categories of this study suggest that the big four audit firms have followed a number of strategies to protect their leading reputations, to better serve the increased number of global clients, to compete in the global markets, and to manage the global regulatory challenges of the audit environment. These intensive global movements of the main audit parties in the audit environment (including: audit firms, audit regulators, audit standards and regulations, audit clients, audit staff, and even the capital markets) push the analysis process. This means that "globalization of auditing" emerges as the core category of this study and illustrates its central phenomena. Table 4.4 explains how the main categories in the axial coding process are linked to the core category of the emerged theory during the selective coding process.

This study aims to explore the role of independent audit regulators in promoting confidence in the audit profession, and analyses the big four firms' strategies when it comes to reacting toward these regulatory changes in the audit markets. The analysis process develops a number of strategies and procedures which have emerged from both audit regulators (to promote confidence in the audit profession) and the big four firms (to manage these regulatory challenges). The common theme of such strategies is that they have been globally acted and applied. The emerged theory suggests a number of findings which can be applied in different audit markets.

The main features of the emerged core category have emerged during the stage of selective coding analysis. The emerged theory suggests that both audit regulators and big audit firms are acting to avoid a repeated accounting collapse. Thus, a number of global strategies have been followed to guarantee an acceptable level of independence and quality assurance systems inside the audit firms. For example, there are intensive movements toward standardisation through revised global audit approaches which must be followed by all member firms. Further, managing national firms and monitoring the quality processes has become more centralised through the regional or the global networks. Additionally, faster and closed communications have been established through new online systems and internetworks to assure faster responses to the audit clients. Moreover, special centres and committees with highly skilled specialists in specific markets, industries, transactions, and businesses have been appointed to provide highly technical advice to different member firms. It seems that the value of specialisation has been maximised to
ensure a high degree of quality in the provided services. More discussion regarding the emerged core category of this thesis is provided in Chapter 8.

Table 4.4: The core category of the emerged theory and its main categories

<table>
<thead>
<tr>
<th>Core category</th>
<th>The main components in the audit market</th>
<th>Main categories</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.4 Globalisation of auditing</td>
<td>Regulators who are globally cooperating with their peers, Common regulations that are globally applied, Global networks of regulated firms</td>
<td>Big four’s perceptions toward audit regulators 4.3.14, Big four’s perceptions toward audit regulations 4.3.15, Emerged audit firms’ strategies 4.3.16</td>
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Furthermore, Table 4.5 explains how the developed categories are linked to the following chapters of this thesis.

Table 4.5: The developed categories and related chapters

<table>
<thead>
<tr>
<th>Developed categories</th>
<th>Related chapter of this thesis</th>
<th>Chapter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Main category 4.3.14</td>
<td>4.3.1 Section 5.2</td>
<td>Chapter 5</td>
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<td></td>
<td>4.3.2 Section 5.3</td>
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<td></td>
<td>4.3.3 Section 5.4</td>
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<tr>
<td>Main category 4.3.15</td>
<td>4.3.4 Section 6.2</td>
<td>Chapter 6</td>
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<td>4.3.5 Section 6.3</td>
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<td>4.3.7 Section 6.5</td>
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<tr>
<td>Main category 4.3.16</td>
<td>4.3.8 Section 7.2</td>
<td>Chapter 7</td>
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<td>4.3.9 Section 7.3</td>
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<td>4.3.13 Section 7.7</td>
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<tr>
<td>The core category 4.4</td>
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<td>Chapter 8</td>
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4.5 The study contexts

It is argued that the global networks of the big four audit firms are faced with regulatory challenges in the global audit market, and have entered a new stage, with new regulators setting new regulations. The global trend of independent oversight of the audit profession in many of the developed and developing capital markets guides me to study the research problem at the global level. Indeed, I do this by considering the perceptions of participants, regardless of their nationalities or resident countries. However, there are some local differences when it comes to
the names and times of issued regulations and audit regulators in different countries. Therefore, and according to the practicality of studying certain oversight authority and the possibility of data collection processes, two audit regulatory oversight authorities in two different environments are selected for investigation in this study. The two authorities are Audit Inspection Unit in the UK as one of the developed markets, and Quality Control Unit in Egypt as one of the developing markets.

4.5.1 Understanding the UK audit environment

Scott (1995) differentiates between two institutions which have an impact on the organisational elements and processes; the states (governments) as regulative institutions, and the professions as cognitive and normative institutions. This classification can be applied in the UK audit environment, for example, the FRC and its operating bodies are the unified regulator of the audit profession. The FRC is considered as a regulative institution which has the power to set audit regulations and inspect the quality of the audit firms’ performance.

Further, the regulative institutions are not the only players in the audit regulatory environment. There are many professional associations which are concerned with developing and enhancing the audit profession. They are independent experts, and are trusted by society as they are non-profit-making bodies. Whilst they do not have the authority to regulate, they do have the power to influence by expressing their unbiased technical opinions. In addition, they are also responsible for issuing licenses which qualify auditors in accordance with the law. For example, the Institute of Chartered Accountants in England and Wales (ICAEW), the Institute of Chartered Accountants in Scotland (ICAS), and the Association of Chartered Certified Accountants (ACCA) are three of the main accounting bodies which are concerned with the accounting and auditing profession. These institutions are considered as cognitive and normative institutions in the institutional theory framework.

4.5.2 Understanding the Egyptian audit environment

In 2008, the Egyptian Financial Supervisory Authority (EFSA) has established a new governmental unit called Quality Control Unit (QCU). QCU aims to monitor the quality level of the Egyptian auditors of listed companies in the Egyptian Capital Market, and to undertake
periodical reviews of their performance. This is the first time that the government has sought to oversee the audit profession in Egypt.

The QCU is responsible for monitoring the work of auditors who are registered in its own registers. It aims to verify the compliance with relevant professional quality standards, decisions and systems. It also seeks to verify the auditors’ compliance with the applied auditing and ethical standards. The new unit’s board consists of seven members (six of whom represent governmental bodies with one academic or non-participant expertise), and four observers (professional bodies such as the Egyptian society of accountants and auditors and the Egyptian capital market association). The board members of QCU should not be participants in the audit profession (more details about the QCU available at: www.efsagov.eg). They should conduct meetings at least every three months, and must also issue an annual report to summarise their activities during the year and provide it to the EFSA’s board of directors.

In addition, Egypt has greatly benefited from reforms to open up and liberalise its economy in recent years and has quickly become a dynamic market economy led by the private sector and well integrated in the global economy. It has achieved excellent GDP growth rates of 7.1% in 2006/07 – up from 4.6% in 2004/05 and 6.9% in 2005/06 – and a rate of approximately 7% has been predicted by the International Monetary Fund for the next few years. This performance has been accompanied by a record foreign direct investment (FDI) of more than US$6 billion in 2006. There have been improvements in most economic and social indicators. Private investment has increased from an average of 8% of GDP in fiscal years 2001–2004 to 13.1% in 2007. Moreover, FDI has increased from an average of 0.6% of GDP during 2001–2004 to 8.6% in 2007 (UNCTD, 2008). These statistics indicate that Egypt has been undergone significant changes. Indeed, these changes could make Egyptian audit firms a good example to investigate their strategies when it comes to reacting to the recent changes in the Egyptian economy.

4.6 Conclusion

This chapter explains the analysis processes of the emerged theory by applying the Strauss & Corbin approach (1998) of grounded theory methodology. The main outcomes of this chapter

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1 This study was established before the Egyptian revolution in January 2011 that may affect the current Egyptian economy.
assist in providing a better understanding of how the gathered data is analysed and developed to build up the emerged theory. A total of 28 open categories are developed in the open coding process. The axial coding process develops 13 axial categories which are sub-categorised into three main categories. During the selective coding process, a core category is selected to represent the central phenomenon of the study. The main phenomenon of this research is the recent and global regulatory challenges of the audit profession. The emerged core category illustrates the global movements of both of audit regulators and audit firms in the audit markets. Furthermore, this chapter sheds light on the study contexts by providing an explanation of the audit environment in both the UK and Egypt.

The following three chapters (5, 6, and 7) focus on explaining the three main categories respectively. Chapter 8 focuses on the "globalization of auditing" as the core category of the emerged theory, and explains how it can be linked to the globalisation theory. Indeed, it is part of validating the grounded theory as instructed by Strauss & Corbin (1998).
Chapter 5: The main themes of the independent audit oversight system

5.1 Introduction

Chapter 5 discusses the first main category of the emerged theory. The main aim of this chapter is to analyse the role of the independent audit inspection authorities. The PCAOB – as the first and most famous independent audit regulator – has been established in the US since 2002. Following this, the FRC became a unified regulator of the audit profession in the UK in 2004. Thus, my main questions are: after approximately 10 years of the establishment of these independent audit inspection units, to what extent do they succeed in promoting public trust in auditors? Does the audit profession still need their oversight? And how do the audit firms, particularly the big four firms, evaluate the performance of such regulators? Another question asks, what are the key success factors for any independent audit inspection unit? In order to address such questions, the remaining part of this chapter is divided into four sections.

The first section (Section 5.2) discusses the first sub-category which analyses the importance of the independent oversight system and the extent to which it is necessary to monitor the audit quality. The audit literature studies the effectiveness of the independent inspection of audit firms’ performance compared with the peer review system which was applied prior to the Enron collapse. Different results are revealed. Indeed, whilst many studies (see, for example, Van de Poel et al., 2009; Gunny & Zhang, 2009; Tsau, 2011) provide evidence that the independent inspection system has positive effects on the audit quality, other studies (see, for example, Casterella et al., 2009; Lennox & Pittman, 2010) fail to prove the differences between the two systems. However, the majority of these studies use the audit reports, specifically the ongoing concern opinion as indicators of audit quality.

Section 5.2 explores the views of the big four partners toward the importance of the independent audit oversight system. It provides a better analysis regarding the extent to which the audit profession needs to be independently regulated. This can increase the understanding of why the independent inspection processes have been established and applied everywhere. Analysing the importance of the audit oversight system assists the society in effectively conducting cost-benefit analyses of such an independent system. Further, Section 5.2 assists governments, investors, and stakeholders in making better decisions regarding whether they are satisfied and ready to make additional investments to
establish, develop, and improve the quality of the independent regulators’ performances.

The second sub-category is discussed in Section 5.3, which identifies and explains the key success factors of the governmental inspection process. The IFIAR provides some guides for governments to establish an effective independent audit oversight system. Section 5.3 considers the views of the big four firms in terms of what they need from the independent inspectors to effectively cooperate with them. Considering these views could reduce the resistance of inspected firms toward their inspectors and improve the quality of the inspection process.

The third and last sub-category is discussed in Section 5.4, which evaluates the current performance of the independent inspectors (in particular, the performance of the AIU in the UK and the QCU in Egypt). Moreover, Section 5.4 identifies and criticises the current performance of the independent regulators in both countries by examining the extent to which the key success factors for an effective audit oversight authority are implemented in both countries. In this section, I identify and analyse the feedbacks from the big four audit firms relating to their regulators. My findings assist the inspectors in enhancing their performance and clearly understand why auditors occasionally fail to cooperate with them. For example, auditors cannot say to the inspectors,

“You waste your time in many tests of details; you can do more analytical procedures”

Or,

“You findings are not the key issues in this company; you have to understand first, what is the core business of my client”.

However, my participants understand the confidentiality of their recorded data and use them only for research purposes. They talk freely and clearly about all of their feelings, comments, and feedback regarding the independent inspection processes and criticise the performance of their inspectors. My conclusion follows in Section 5.5 at the end of this chapter.
5.2 The Importance of the Independent Audit Oversight System

“It is a natural reaction of government for the accounting failures that aims to increase layers of regulation and that is effectively what happened” (Audit partner, company A).

One of the open questions which I put to my participants relates to why the independent audit oversight has been established? And does the audit profession still need such external inspections? The common argument is that the independent inspections of the audit firms, especially the big firms which audit listed or public interests entities, are a logical governmental reaction to the massive accounting failures in Enron, WorldCom, and other multinational companies. The public are shocked that they suddenly lose millions or billions of dollars and do not understand the reasons. Trust has been lost in capital markets and auditors who are responsible for ensuring the quality of financial reports of listed companies. As a result, one of the fastest and strongest reactions toward such collapses has been the establishment of the PCAOB as an independent inspector of the audit firms’ performance in the USA and the establishment of the AIU, with a similar purpose, in the UK in 2004.

The AIU, as one of the audit inspection units, comprises a review of the firms’ policies and procedures supporting audit quality, as well as a review of the quality of selected audits of listed and other public interest entities which fall within the scope of independent inspection. The independent inspectors focus on audit firms which audit listed or public interests entities so as to restore the public’s confidence in the capital markets. Smaller audit firms are still self-regulated by professional bodies which are annually inspected by the independent audit regulators.

“We have the big 4, maybe 10 mid-size firms, and then a huge number of very small firms …. So it was felt that it would be beneficial to split the work into those looking at public interest audits and focus only on public interest entity audits and leave the rest to the profession” (FRC’s member).

This presents independent regulators with the opportunity to work more effectively by concerning themselves only with the big audit firms and reviewing their strategies, policies, and performance so as to assure their compliance with applicable auditing and ethical standards.
“It is not relevant to review a one man audit firm and PWC that employed about 3000 or 4000 audit staff by the same team” (FRC’s member).

Every year the AIU selects specific areas, in the financial statements of audited clients, to focus on in its inspection.

“They change over the years, but this year maybe 60% of the areas are the same of the previous year, next year maybe 60% of it is not like what we do this year ... and so on” (FRC’s member).

However, the following areas are covered by the AIU’s inspection every year: tone at the top and internal communications, transparency reports, independence and ethics, performance evaluation and other human resource matters, audit methodology, training and guidance, client risk assessment and acceptance/continuance, consultation and review, audit quality monitoring, and other firm-wide matters (see, for example, the annual report of the AIU’s inspection 2009/2010 at www.frc.org.uk). These areas are inspected annually, in compliance with the audit quality framework, as they are considered as the core drivers behind audit quality (more details about the audit quality framework are discussed in Chapter 6).

The AIU’s inspection aims to identify the areas in which improvements are required in order to enhance the audit quality or to comply with related standards. It further aims to ensure that an action plan is designed by the inspected firm to achieve the required developments. The inspection team assesses the extent to which the inspected firms have addressed the findings arising from the previous inspection. Although the AIU’s reports state that they are not intended to be a balance scorecard or rating tool for inspected firms, these reports provide comparable information about the inspected firms and the quality of audits inside such firms. This can be used to differentiate between the audit firms when companies need to select their external auditor.

Additionally, the independent inspection process adds credibility to the audit firms’ performance and sends positive messages to stakeholders regarding the quality of the audit process. This can increase the public’s trust in what auditors do and reduce the expectation gap between auditors and investors.

“Having governmental regulators has actually been helpful” (Audit partner, company D)
“We welcomed to the new regulators who will make the profession more credible through the independent reviewers” (Audit partner, company C).

Moreover, the independent inspection process protects the big four firms as they can claim that their regulators know what auditors do and agree about it.

“The governmental audit oversight improves public trust in the quality of the audit process, gives the audit firms a stamp of approval that says they are doing a good job, and removes any doubt that we aren’t doing what we should do” (Audit partner, company A).

The big four partners agree with this argument and stress that their performance has been improved in response to the external examiners. Auditors know that they have to justify their judgments with documented evidence to the independent inspectors. Therefore, they are keener to carry out their work in the most accurate way.

“We are happy with the unified regulator (FRC). We are also happy with the AIU, our audits are better than six years ago (especially in the quality of documentation)” (Audit partner, company A)

“The overall conclusion is the quality of audit work is good” (Audit partner, company D)

“The AIU has done a good job, they are added value” (Audit partner, company A).

The requirement of more documents helps them to support their views and to give evidence to justify the decisions which have been taken in the past. Some circumstances will be forgotten in the coming years, and as such, they feel that documented files are needed.

“We document things very fully and then we’ve got something to demonstrate that we’ve complied with all the standards and we’ve reached our conclusion appropriately. And I think it is done because there is an external review” (Audit partner, company A).

“The difficulty is when you go back, and someone is reviewing something you did a year ago, but actually if you’ve got that documentation, it aids your memory of what it is you did and why you did it. If you’ve got contemporaneous evidence, then trying a year later to remember what you did, knowing that you want through processes at the
time. But actually having that documentation enables you to communicate with the regulator to support what you did and make sure that you don’t admit something that you might have forgotten to mention because it was some time ago” (Audit partner, company A).

One more value for the independent oversight system is that it also gives auditors some power of negotiations with their clients when they are looking for additional evidence. Auditors can now say we have our external reviewers, and we have to show them some evidence. All of these issues support the importance and the added values of the independent oversight of the audit profession.

“I also think that it helps the dialogue I have with a client, when I say something like, you may well believe that this is an appropriate stance to take, I actually may agree with you but I need evidence, and if I don’t have the evidence, then bluntly I have somebody over my shoulder who’s going to say how can you make that decision? It actually helps you have a dialogue with a client, that says, don’t just tell me it’s this way, you are going to have to show me. So if that means third party evidence or whatever, you and I are going to have to work together to get it, because it is in both our interests. So that has been helpful” (Audit partner, company D).

Accordingly, I argue that the independent audit oversight system in developed countries (such as the UK) plays an important role in ensuring the audit quality inside firms which audit public interests entities, restore public trust in capital markets by sending positive massages regarding the quality of the audit firms’ performances, and protect the big four firms themselves from the scenario of another failure of one of them. This is the case for developed countries where most multinational companies are listed in their capital markets. So, what about developing countries? Could the previous factors be applied in developing countries? Why has the independent audit oversight system been established in developing countries?

In Egypt, as one of many developing countries, auditors of listed companies in the Egyptian capital market are not under attack like their peers in developed countries. Indeed, there are no serious problems regarding the public’s trust in the audit profession. Many Egyptian investors still do not have enough awareness of the role of external auditors in the financial reporting. Usually, when a financial problem has occurred, the investors litigate the board
of directors rather than the external auditors.

“The investors of the Egyptian capital market are not aware enough of the responsibilities of the external auditor, that explains why we do not hear in Egypt about litigations against auditors as investors are not aware of their responsibilities therefore they do not litigate against them” (the Chairman, QCU).

“There is no crisis of confidence in the Egyptian auditors. The Egyptian investors are not aware enough of the role of the auditors and the importance of their audit report” (the executive manager, QCU).

Partners of the big four firms in Egypt provide additional evidence for the absence of awareness when it comes to the role of auditors among the Egyptian investors.

“The Egyptian investors are not aware of the role of auditors and the financial reporting system” (Audit partner, company A).

“Many of the Egyptian investors are not aware of the role of auditors and do not care to read the whole audit report” (Audit partner, company C).

“Only few clients are aware of the auditors’ responsibilities” (Audit partner, company A).

This absence may lead to the absence of accountability for Egyptian auditors. Thus, the QCU is established to assure the audit quality and protect the public’s interests.

“We have to protect the investors of the Egyptian capital market” (The chairman, EFSA).

However, is this the only reason for establishing an independent audit oversight system in developing countries? I argue that the main reason behind the Egyptian government’s establishment of the QCU is to be compatible with the main membership requirements of the International Organization of Securities Commission (IOSCO) and the International Forum of Independent Audit Regulators (IFIAR) of which Egypt became a member in 2009.

“We are committed to the IOSCO principles and the main requirements of IFIAR in which Egypt has been a member since 2009” (the Chairman).
The consensus of the Egyptian regulations to be committed to such international bodies’ requirements and recommendations reflects the notion that EFSA is assiduous in its desire to participate in the international forums and multinational organisations, with the aim of sending a clear and positive message regarding the Egyptian investment environment.

“We are following the new global trend of governmental audit oversight in developed countries, especially the United States” (the executive manager, QCU).

In 2008, the EFSA issued the Egyptian Auditing Standards (EAS), consistent with the International Auditing Standards (IAS) to confirm the same message and to encourage foreign investments to enter the Egyptian market. This is another reason to establish the QCU in Egypt.

“We are investigating our peers in the USA and UK, and one of the British consultant companies is preparing a study about the Audit Inspection Unit in the UK to advise us about its activities and how they monitor auditors’ performance” (the Chairman, QCU).

An additional reason for establishing the independent oversight in Egypt relates to the QCU’s aims to eliminate non-skilled and corrupted auditors from auditing listed companies. It further encourages the mid-size auditors who have sufficient quality systems to expand and hire more people to audit more clients.

“We also aim to eliminate non-skilled auditors who have a license to audit listed companies according to the Egyptian regulation, but without having any quality system. They just sign the financial statements and get their fees” (the executive manager).

“One of our objectives is to encourage the midsize firms to become one of the big firms; actually we have about 10 big audit firms in the Egyptian capital market” (the chairman).

The QCU aims to assure that auditors are committed to the Egyptian accounting and auditing standards by conducting periodical inspection for auditors’ performance.
“We aim to enhance and improve the profession; we are not against auditors, we aim to ensure that Egyptian Auditors have a minimum level of quality and fulfil their auditing and ethical standards’ obligations” (the executive manager).

This can protect the investors from significant errors in the financial statements in listed companies, whilst also increasing trust in the Egyptian capital market and attracting foreign investments.

“We would like to protect the investors in the Egyptian Market from any potential risks through reviewing the audit reports and the auditors’ works of the listed companies” (the Chairman).

The big four audit firms believe that the audit profession in Egypt currently needs to be governmentally regulated as they are not satisfied with the quality of information provided in the financial statements of listed companies. They are however happy to allow new governmental inspectors to mitigate the bad practices of some of the Egyptian auditors.

“We need a “Dad” to control the performance of the Egyptian auditors” (Audit partner, company B).

“I am not happy with the current information that is provided in the financial statements of listed companies, we need someone to control our behaviour” (Audit partner, company A).

“Many of the Egyptian auditors do not have enough experience, skills and facilities to audit listed companies; however they are qualified (by the law) to audit them. So we need the government to limit the numbers of unskilled auditors” (Audit partner, company C).

To sum up, it seems as though the independent audit oversight system plays an important role in enhancing the audit profession in both developed and developing capital markets. Wherever we are, external and independent reviewers add values. It is a natural human behaviour for people to be more conservative and do things in a more accurate way when they know that someone else will come and ask “why do you do this in that way?” Partners of the big four firms welcome the independent inspection system and argue that the quality of the audit profession has been improved. Further, the independent inspection of the audit
profession promotes confidence in auditors and capital markets by sending positive messages to investors and stakeholders regarding the quality of listed companies’ financial reports. It seems like independent audit inspection units are essential for many groups of stakeholders in different ways, as shown in Table 5.1.

Table 5.1 identifies four groups of stakeholders which need the independent audit firms’ inspection: governments, auditors, investors, and society. Each group needs the independent system for different reasons. Table 5.1 further identifies and analyses eight different values which are added to those groups of stakeholders. The same value can be useful for different groups in different ways. For example, the value of adding transparency regarding the big four firms’ performance can be useful for governments, and society as it enhances the choice in the audit market. In contrast, investors can use the inspection reports as a balance scorecard for audit firms when selecting their external auditors. The published inspection reports can be useful for the big four firms as it increases the credibility of their performance and can also be used by their layers as a defender tool in the case of litigation. At the very least, auditors have documented evidence which has been reviewed by their independent inspectors.
<table>
<thead>
<tr>
<th>Stakeholders</th>
<th>Benefits</th>
<th>Values added</th>
</tr>
</thead>
<tbody>
<tr>
<td>Governments</td>
<td>Enhance the national economy</td>
<td>Avoid risks of potential losses</td>
</tr>
<tr>
<td>Auditors</td>
<td>Potential opportunities for making profits</td>
<td>Protect their reputations</td>
</tr>
<tr>
<td>Investors</td>
<td>Secured market for their investments</td>
<td>Add reliability for financial reports</td>
</tr>
<tr>
<td>Society</td>
<td>Enhance the national economy</td>
<td>Avoid the scenario of big 3</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Enhance the national economy</td>
</tr>
</tbody>
</table>

Table 5.1: The Importance of the Independent Audit Oversight System
5.3 The key success factors of the Independent Inspection Process

As argued in Section 5.2, the independent inspection of the audit profession is important and has widespread benefits for many groups of stakeholders. So, the question now is how can governments establish a useful and successful independent authority to inspect the audit firms’ performance? Insufficient reviews of the audit firms threaten the quality of the audit process and the reliability of the capital markets.

“The effect of regulations and regulators can be constructive and supportive to the reputation of capital markets or it can be extremely damaging” (PWC response to promote audit quality, 2007).

To answer such a question, different views can be considered: the views of the audit inspectors and the views of the inspected firms. This develops a set of key features which constitute a successful independent audit oversight system. In this section, I analyse the different perceptions of inspectors and inspected firms. Section 5.3.1 analyses the views of the independent audit inspectors toward the key success features of establishing an effective independent oversight of the audit profession. The IFIAR, as an international forum for the audit oversight authorities, has issued a number of principles for establishing an effective audit oversight system. These principles are suggested for all countries across the world. Furthermore, Section 5.3.2 explores and analyses the views of the inspected audit firms (focusing on the big four firms) toward such features. Section 5.3.3 discusses the developed success factors and how each of them contributes to the efficiency of the inspection processes.

5.3.1 The IFIAR core principles of an effective independent audit oversight

In 2011, the IFIAR stresses that a set of 11 core principles for independent audit regulators should be applied to have an effective audit oversight system.

“The Core Principles are intended to promote the common goal shared by IFIAR Members: to serve the public interest and enhance investor protection by improving audit quality globally, including through independent inspections of auditors and/or audit firms” (IFIAR, 2011).

The principles provide useful guidance to governments (who are not members of the IFIAR)
to explain how to establish an effective independent audit oversight system and assist other
governments (who are members of the IFIAR) in enhancing their current oversight systems.
The IFIAR (2011) stresses that in order to apply an effective independent oversight of the
audit profession, a set of preconditions should be excited. Such preconditions include the
existence of well-developed legal and corporate governance frameworks which support high
quality auditing.

“Elements of this framework will cover the following:

- Comprehensive and well defined accounting and auditing principles and
  standards that are generally accepted;
- Legal requirements for the preparation and publication of financial
  statements according to those principles and standards;
- An enforcement system for the preparers of financial statements to ensure
  compliance with accounting standards (e.g. fines, shareholder redress or
  penalties on responsible managers for non-compliance);
- Corporate governance arrangements and practices which support high
  quality corporate reporting and auditing practice; and
- Effective educational and training arrangements for accountants and
  auditors” (IFIAR, 2011).

The 11 core principles of the IFIAR are classified into 3 groups according to the areas which
they cover. The first group includes principles which discuss the structure of audit oversight.
The second group focuses on the operations of audit regulators. The third group analyses the
inspection process. A list of these principles as well as their key features in terms of an
independent audit oversight system is provided in Table 5.2. Table 5.2 identifies three main
categories of features which are required for the establishment of an effective independent
audit oversight system.

The first category includes four features related to the independent authority which oversees
the audit profession. The independent authority should aim to serve and protect public
interests. It should be independent of any financial pressures, especially from the profession.
This is crucial in order to avoid repeating the scenario of establishing professional bodies
and accounting associations which are financially supported by the professional firms.
Governments should guarantee sources of financial income which are entirely separated
from the profession.

Further, to better promote public confidence, transparency is another feature which should be applied. The main findings of the inspection processes should be available to the public so as to achieve such transparency. Moreover, oversight authorities should have applicable power of sanctions in order to assist them in making changes to the inspected firms’ performances. The ability to enforce a gradual level of sanctions for non-compliance auditors should also exist.

The second category consists of five features related to the independent inspectors themselves. Audit inspectors should be independent and avoid any conflict of interests. They must achieve a high level of competence to evaluate the auditors’ performance. They should also maintain acceptable levels of objectivity to provide fair opinions on the audit quality. They must also maintain a high degree of confidentiality regarding their inspected data. The information of listed companies is very confidential and they have to be highly conservative. One more feature which a successful audit regulator must possess is an ability to cooperate with other parties. Such parties include professional bodies, standards setters, investors, and inspected audit firms themselves. Striking up dialogues and communicating with those parties can enhance the effectiveness of the inspection process.

The third category is a set of five features which are related to the inspection’s methodology. Audit firms which audit listed and public interests companies should be periodically inspected. Three particular issues should be assured during the inspection processes: auditors and companies’ compliance with applicable auditing and accounting standards (and other related laws or regulations, if applicable), an acceptable level of risk management process during the clients’ engagement, and the quality of the audit files. Further steps should be taken by inspectors to follow up the implementation of recommended actions.
<table>
<thead>
<tr>
<th>IFIAR Core Principles</th>
<th>Codes</th>
<th>Categories</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principle 1: The responsibilities and powers of audit regulators should serve the</td>
<td>Serving public interests</td>
<td>Features of an effective audit oversight authority</td>
</tr>
<tr>
<td>public interest and be clearly and objectively stated in legislation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Principle 2: Audit regulators should be operationally independent</td>
<td>Financial Independence</td>
<td></td>
</tr>
<tr>
<td>Principle 3: Audit regulators should be transparent and accountable</td>
<td>Transparency</td>
<td></td>
</tr>
<tr>
<td>Principle 4: Audit regulators should have comprehensive enforcement powers which</td>
<td>Powers of sanctions</td>
<td></td>
</tr>
<tr>
<td>include the capability to ensure that their inspection findings or</td>
<td></td>
<td></td>
</tr>
<tr>
<td>recommendations are appropriately addressed; these enforcement powers should</td>
<td></td>
<td></td>
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<tr>
<td>include the ability to impose a range of sanctions including, for example, fines</td>
<td></td>
<td></td>
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<tr>
<td>and the removal of an audit license and/or registration</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Principle 5: Audit regulators should ensure that their staff are independent from</td>
<td>Interests’ Independence</td>
<td>Features of an effective audit regulators</td>
</tr>
<tr>
<td>the profession and should have a sufficient number of staff with appropriate</td>
<td>Competence</td>
<td></td>
</tr>
<tr>
<td>competence</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Principle 6: Audit regulators should be objective, free from conflicts of interest,</td>
<td>Objectivity</td>
<td></td>
</tr>
<tr>
<td>and maintain appropriate confidentiality arrangements</td>
<td>Maintaining confidentiality</td>
<td></td>
</tr>
<tr>
<td>Principle 7: Audit regulators should make appropriate arrangements for cooperation</td>
<td>Cooperative with other parties</td>
<td></td>
</tr>
<tr>
<td>with other audit regulators and, where relevant, other third parties</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Principle 8: Audit regulators should as a minimum, conduct recurring inspections</td>
<td>Focusing on public interests</td>
<td>Features of an effective audit oversight</td>
</tr>
<tr>
<td>of audit firms undertaking audits of public interest entities in order to assess</td>
<td>entities</td>
<td>methodology</td>
</tr>
<tr>
<td>compliance with applicable professional standards, independence requirements and</td>
<td>Assuring compliance with</td>
<td></td>
</tr>
<tr>
<td>other laws, rules and regulations</td>
<td>applicable regulations and</td>
<td></td>
</tr>
<tr>
<td>Principle 9: Audit regulators should ensure that a risk-based inspections program is</td>
<td>Assuring sufficient risk</td>
<td></td>
</tr>
<tr>
<td>in place</td>
<td>management process</td>
<td></td>
</tr>
<tr>
<td>Principle 10: Audit regulators should ensure that inspections include effective</td>
<td>Assuring quality of audit files</td>
<td></td>
</tr>
<tr>
<td>procedures for both firm wide and file reviews</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Principle 11: Audit regulators should have a mechanism for reporting inspections</td>
<td>Following up the inspection</td>
<td></td>
</tr>
<tr>
<td>findings to the audit firm and ensuring remediation of findings with the audit</td>
<td>results</td>
<td></td>
</tr>
<tr>
<td>firm</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
It seems that independence, the power of taking certain sanctions, and applying the right inspection methodology are three core features of the effective independent audit oversight authority from the perceptions of audit regulators.

5.3.2 The views of the big four audit firms

The big four firms have different views when it comes to the optimal inspection process for the audit profession. They suggest two factors as being key to a successful inspection: factors related to the inspection team and other factors related to the inspection process.

The big four partners stress that a set of minimum conditions, qualifications, and skills must be achieved by inspection teams so as to ensure the success of the inspection process. For example, the inspection teams have to be aware of the nature of the business conducted by the companies they inspect. They should also be specialists in these activities so as they can effectively understand and evaluate the auditors’ judgments. Further, they must also be experts so as they are able to review the performance of listed auditors.

“The best inspector is the one who knows the nature of the business being audited, as he can effectively evaluate my opinion” (Audit partner, Company A).

The inspectors must achieve objectivity and fairness in their evaluation to gain the auditors’ confidence. They also have to achieve a high level of security especially for the confidential information of auditors’ clients. They must not be competitors or parties related to competitors of inspected auditors.

“They have to give high attention to the security of information; our files include very confidential data for our clients” (Audit partner, company B).

Furthermore, the inspection methodology must effectively focus on three areas of inspection. First, inspect the commitments to ethical standards and independent policies. Auditors should implement a quality assurance system in order to prevent and discover any conflicts of interests or other issues which threaten their independence (such as providing non audit services by the same audit partner). Secondly, inspect the engagement management process at different stages from the audit planning stage to the stage of clients’ acceptance. Thirdly, inspect the quality of audit work by reviewing the audit files of the companies to decide the
extent to which auditors fulfil their obligations. Inspectors should also investigate the audit reports to evaluate their conformity with the auditing standards.

“The main success factor of the inspectors’ work is the inspection’s methodology, how they are doing their work” (Audit partner, Company A).

Audit inspectors must not surprise auditors when it comes to the criteria of their evaluation. Auditors have to know what they should do to achieve high evaluation marks prior to the inspection process. Furthermore, inspectors should cooperate and periodically communicate with the audit firms of the listed companies in the capital markets (especially the big firms). Such cooperation aims to develop a better understanding of the audit parties’ feedback for the proposed audit rules and regulations so that they can be taken into consideration when issuing such regulations.

“If the new inspectors would like to encourage us to cooperate with them, they have to not surprise us” (Audit partner, Company B).

In parallel, the audit regulators emphasise that inspection teams should have extensive experience, understanding, and strong interpersonal skills. They must also be robust in their dealings with people and have confidence in what they are doing as well as creditability in the eyes of the firm.

“So I can send someone to KPMG, for example, who can say: well look when I was a partner in PWC we would never have done this. Or my experience of being partner in Deloitte we would have done it in a different way” (Audit regulator).

Figure 5.1 summarises the key success factors of the inspectors’ work from the views of the big audit firms.
5.3.3 The emerged key success factors

The previous two sections analyse the main features of an effective independent audit oversight system from two participant perspectives (regulators and auditors). I argue that governments and regulators pay more attention to factors related to the independence, objectivity, and transparency of the audit inspection authorities. Independence is the main differentiator between the independent audit oversight system and the peer review system which was prohibited for the public audit firms after the major accounting scandals. Russell & Armitage (2006) investigate the effectiveness of the peer review system in detecting the financial statements’ errors. They identify a number of potential loopholes which can harm the accounting profession as a result of the self-regulation process. Further, Anantharaman (2012) compares the outcomes of the self-regulation and the independent regulations systems. His findings support the higher effectiveness of the independent regulation system. Differently, auditors emphasise specialisation and professionalism as the key success factors for the audit inspectors. Audit firms’ inspectors should understand and speak the same audit language with auditors in order to effectively evaluate the audit judgements and opinions.

So, the question now is how can the two views be combined together? What is the optimal
solution to achieve a high degree of independence and expertise at the same time? The governmental inspection units in many countries depend on retired audit partners to participate in and lead the inspection process (see, for example, the recruitment policies of the AIU, in the UK, available at: www.frc.org.uk, and the PCAOB, in the USA, available at: www.pcaob.org). Retired partners (especially those who work in the big audit firms) are experts, specialists, and have professional backgrounds which assist them in sufficiently evaluating the audit firms’ performance. However, what about their independence? Are they independent enough to evaluate colleagues in the same firm or even their past competitors in other big firms?

“Yes, I think they are professional enough to split among their individual and organisational interests .... However, they cannot inspect their original firms” (Audit partner, company B).

“We do not mind ... we already used to apply the peer review system, so no problem with us at all ... but at least we will have a sufficient inspector who will better understand our language ... and who have a sufficient audit programs” (Audit partner, company D).

To guarantee their independence and to mitigate the risks of any conflict of interests, the inspection units have to sign confidentiality agreements with the inspected firms. These agreements stipulate that the independent units have the right to obtain any information about the inspected firms, or their clients, and to gain access their systems. In parallel, all inspectors have to maintain confidentiality when it comes to all non-public information. For example, the AIU’s staff must follow a set of operating procedures for maintaining confidentiality.

“All the staff are employees of the Financial Reporting Council (FRC) and required to observe FRC-wide Guiding Principles on independence, confidentiality and conflicts of interest ...

The FRC-wide Guiding Principles provide, inter alia, that staff members must:

Keep confidential all non-public information they acquire through their role at the FRC, unless the disclosure of that information has been properly authorised; and

Not derive, or seek to derive, any personal benefit, or enable any other person
to do so, as a result of such non-public information obtained by them”
(FRC: operating procedures for maintaining confidentiality, 2008).

These agreements can increase the inspectors’ independence and support the use of retired partners as one of the good solutions for hiring effective audit inspectors.

To sum up, Section 5.3 suggests specific factors as key success factors for the governmental inspection process. These factors can be categorised into three groups: the independent authority itself, the inspection team, and the inspection methodology. Figure 5.2 presents the developed success factors for the independent audit regulators after combining and analysing the views of audit regulators and the audit partners of the big four firms.
Figure 5.2: Developed Key success factors for independent audit oversight authorities
5.4 Criticism of the current performance of independent audit oversight authorities

This section sheds light on the current performance of the independent audit oversight authorities in two different environments: the AIU in the UK and the QCU in Egypt. Section 5.4.1 examines to what extent the key success factors of an independent audit oversight system (identified in Section 5.3) are applied in these two oversight authorities. Further, Section 5.4.2 analyses the main criticisms of the independent inspectors from the viewpoints of the big four audit partners.

5.4.1 The implementation of the key success factors in two of the independent authorities

In this section, I analyse how the proposed factors for an effective audit oversight authority are applied in two different environments. This can be achieved by analysing the working systems of the AIU in the UK as a developed capital market and the QCU in Egypt as an emerging capital market. My analysis provides a better understanding of the areas which require further improvements in both inspection units.

Table 5.3 presents how these key factors have been applied in both the AIU and the QCU.
Table 5.3: How the factors of an effective audit regulator are applied in different countries

<table>
<thead>
<tr>
<th>Groups of factors</th>
<th>Developed success factors</th>
<th>AIU (UK)</th>
<th>Notes</th>
<th>QCU (Egypt)</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Authorities factors</td>
<td>Financially independent</td>
<td>No</td>
<td>About 50% of its costs funded by the profession.</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Transparency</td>
<td>Yes</td>
<td>No</td>
<td>Poor data available for public.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Power of sanctions</td>
<td>No</td>
<td>Recommendation to the FRC to take actions after the agreements of the professional bodies.</td>
<td>Yes</td>
<td>Recommendations to the EFSA to take actions.</td>
<td></td>
</tr>
<tr>
<td>Serving public interests</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Staff factors</td>
<td>Independent</td>
<td>Yes</td>
<td>No</td>
<td>Some of the board of directors are professionals however, they only observers and do not attend the sanctions meetings</td>
<td></td>
</tr>
<tr>
<td>Specialists</td>
<td>Yes</td>
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<td>Objectives and fairness</td>
<td>Yes</td>
<td>Yes</td>
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<td>Maintaining confidentiality</td>
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<td>Yes</td>
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<tr>
<td>Cooperative and competence</td>
<td>Yes</td>
<td>Not full</td>
<td>More dialogues are required with the profession</td>
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<td>Methodologies factors</td>
<td>Compliance with standards</td>
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<td>Risk based management process</td>
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<td>Quality of files</td>
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<td>Follow up procedures</td>
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<td>Yes</td>
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It is evident that the following are factors which need further improvement in one or both of
the analysed units.

Financial independence

The audit inspection units must be fully independent, transparent, and have sufficient power
of sanctions for violator auditors. In the UK, the AIU is reported to the FRC which is
assumed to have an acceptable level of independence from the profession. Listed and public
interests companies, and the UK government are the main sponsors of the FRC’s costs.
However, approximately 52% of the accountancy, audit, corporate governance and other
AIU’s inspection costs are funded by the professional bodies, including the Recognised
Supervisory Bodies (RSBs) with which the inspected firms are registered1. This raises doubt
regarding the extent to which the FRC is fully independent of the accounting and audit
profession.

“The FRC is the oversight regulator by virtue of the powers delegated to the POB and
the monitoring and discipline arrangements with the AADB and AIU. However, the
independence of the FRC in this role is still governed by complex agreements with the
profession that sometimes inappropriately limit its independence and therefore its
ability to pursue the public interest” (FRC’s proposals to reform the FRC, 2011).

Another example of an independent audit oversight authority is the QCU in Egypt. The QCU
reports to the EFSA which is funded by the Egyptian government and listed companies’
annual subscriptions. All of the QCU’s costs are funded by the EFSA which is not funded by
any of the Egyptian professional bodies or auditing firms. This represents a good example of
an authority which is fully financially independent of the profession. Financial independence
assists regulators in making the right decisions, regardless of any pressures. This in turn
increases the credibility and reliability of their findings.

Transparency

The FRC’s annual meetings are available to the public, meaning that anyone can attend these
meetings. All of the AIU’s inspection reports for individual firms are available to the public
whilst there is also an annual report which explains the AIU’s annual activities and the main
findings of the inspection works. Further, the FRC publishes consultation papers for proposed

1 This is one of the areas that should be changed in the new reform of the FRC. For more details about funding
resources of the FRC, see the “FRC’s annual report and Accounts 2010/2011” available at: www.frc.org.uk.
regulations, as well as their feedback from the society and how these responses affect the final version of such regulations. All of this available information supports the high transparency level of the FRC’s activities. It also increases its efficiency as an independent organisation which aims to serve the public interests.

In contrast, the information available on the QCU’s webpage is very limited and there are no published reports about their inspection work. The QCU’s webpage consists of its structure, authorities, responsibilities, objectives, and its powers of sanctions. It also includes records of registered auditors and other registration and annual forms for listed auditors (more details about the QCU are available at: www.efa.gov.eg, last accessed July 2012). For example, on the QCU’s webpage there is discussion regarding the board’s decision to remove a violator auditor from the QCU’s records; the decision is entitled “decision no. 3 for year 2010”

\[2\]

The researcher failed to find decisions number 1 and number 2 within all the webpage. No answers are found when asking the QCU’s employees about the board of directors’ meetings, and the only answer is,

“You can ask the chairman and you will find answers for all your questions” (QCU’s employees, 2011).

Although the chairman agrees to conduct an interview with the researcher in 2010, more data are required during the study in 2011 and he is too busy to conduct another meeting, whilst nobody else can answer these questions. So, the question is what about the public? These reports should be available to the public according to the transparency factor. Further steps are recommended to increase the transparency level of the QCU’s findings.

**Power of sanctions**

The QCU has the power, by law, to suggest one of multiple specific sanctions to the EFSA board of directors in terms of taking relevant action. These sanctions are gradually increased from issuing an alert regarding an existing violation, and preventing violating auditors from accepting new clients, to completely removing an auditor in violation from listed auditors. The power of sanctions is an effective tool with which to facilitate the implementation of decisions. During the last four years, since 2008 when the QCU was established, three sanction decisions have been taken regarding listed auditors. Indeed, two have been removed

\[2\] See the QCU’s webpage available at: www.efa.gov.eg, (last accessed: July 2012).
from the records whilst a third has been prevented from auditing listed companies for a specific period of time. However, no one knows why these decisions have been taken and what these auditors have done to be prevented from auditing listed companies in the Egyptian market. This refers back again to the lack of transparency in the QCU’s work system.

So, what about the AIU? The AIU do not have complete power of sanctions for the inspected firms.

“If the AIU, following an audit inspection, is of the view that further action should be considered against the relevant firm, it must refer its concerns to a committee of the relevant professional body which is currently chaired by an audit partner, has no lay majority and includes partners who have significant responsibility at their respective firms for dealing with AIU inspections” (FRC’s proposals to reform the FRC, 2011).

The lack of sanctions’ power threatens the AIU’s effectiveness and further negatively affects its independence. Further actions are recommended to increase the power of the FRC to impose sanctions on violator auditors without the need for agreement from the professional bodies.

Independent inspectors

The oversight authority should mitigate any risk of conflicts of interests between the audit firms and their inspection team. The AIU depends on retired partners and members who are fully independent of the audit profession. In some cases, the AIU requires people who are fully independent of a specific audit firm. This indicates that the AIU’s members can be a good example of independent regulators.

“Team Inspectors participate in inspections of major UK audit firms and review the firms’ processes and procedures and audits of listed and major public interest entities. Due to conflicts, management candidates must not have worked recently for KPMG” (FRC, flexible working opportunities in the AIU, 2010).

In Egypt, the QCU’s board of directors consists of 7 members, and 5 observers. One of the current members of the QCU is a partner of one of the big four audit firms. This could possible raise a question regarding the board’s independence and the extent to which this can affect the quality of their decisions. However, the QCU’s chairman emphasises that the unit
depends on fully independent members to conduct the inspection work. The Egyptian market
does not have enough retired partners as it is unusual for the Egyptian audit partners to be
retired; they prefer to continue their audit work until the end of their life. Therefore, to
practice their inspection activities, the QCU depends on experts from the Central Auditing
Organisation (CAO) instead of retired partners.

“There is no professional retirement in Egypt, the Egyptian professionals prefer to
practice their work and sign their financial statements till the last time of their life. As
a result, we appoint governmental experts from the Central Auditing Organization”
(QCU, the Chairman).

“We depend on governmental experts coming from the Central Auditing Organization
to carry out our review process” (QCU, the executive manager).

The CAO is a governmental organization responsible for reviewing the financial performance
of the governmental bodies and authorities. The governmental experts may not be considered
as participants due to the fact that they practice their review activities on behalf of the CAO
rather than by themselves so as to avoid any conflict of interests.

“The experts of the CAO are not participants as they do not do their work
individually but they do it as representatives of the CAO, therefore there is no conflict
of interests in their work” (QCU, the Chairman).

The governmental experts have intensive training courses in developed countries to
understand the nature and the aims of the audit firms’ inspection, and to be qualified for this
technical process, which may well differ from reviewing governmental bodies. This can
achieve the competence as another factor for effective audit inspectors.

“The governmental experts get international training courses in the process of the
regulators’ inspections” (QCU, the Chairman).

The views of the big four firms toward the CAO’s members differ significantly. Indeed one
of the big four firms has refused to cooperate with CAO’s members, as it believes that CAO’s
members are employees rather than professionals. It claims that the CAO’s members do not
care about the materiality and take a very long time to rigorously test the documents rather
than conducting analytical procedures.
“The CAO’s members are not professionals; they are employees in a governmental authority. How can they evaluate our opinions?” (Audit partner, Company A).

The other firms are happy to communicate with CAO’s members and believe that although they need some training, ultimately all of them (CAO’s members and auditors) speak the same language.

“Some of them are highly skilled auditors” (Audit partner, company C).

It is argued that the structure of the QCU’s board of directors needs to be reconstructed to achieve higher levels of independence from the audit profession.

Cooperation with professional bodies

The AIU cooperates well with all stakeholders and audits related parties including professional bodies. This can be linked to transparency, as each proposed regulation is published and public feedback is required. Moreover, any proposed sanctions by the AIU for inspected audit firms must be discussed and agreed upon by the professional bodies. Although this can threaten the FRC’s independence, it is considered a form of cooperation among the FRC and the professional bodies. The Audit Firms’ Governance Code project (issued in the UK in January 2010) is one of many examples which present how the FRC cooperates with the professional bodies when setting audit regulations. The FRC has invited the ICAEW to draw up a desirable code. The ICAEW has formed its independent working group in order to carry out and complete the new code; the working group consists of 15 members, 5 of whom are working for the big four firms (ICAEW, 2010:a).

“The FRC invited The Institute of Chartered Accountants in England and Wales (ICAEW) to draw up the recommended code and the ICAEW formed its independent Audit Firm Governance Working Group (the Working Group) under the chairmanship of Norman Murray (Chairman of Cairn Energy PLC) to carry out and complete this work” (FRC, Audit Firm’s Governance Code, 2010).

In Egypt, The QCU believes that it can depend on the professional bodies and cooperate with them to improve the quality of the audit profession. This can be done by preparing a number of training courses for auditors and encouraging them to undertake continued professional
development, with the aim of updating their knowledge with the recent and revised professional standards.

“We would like to encourage the Continue Professional Development (CPD), we have signed memos of understanding with Cairo University, Syndicate of Commercial Profession, Egyptian Society of Accountants and Auditors, and Ministry of finance to prepare training courses for all the listed auditors to improve the quality of the audit profession” (the executive manager).

The QCU sends its proposed projects to the Egyptian accounting associations to get their feedback.

“We have already called for feedback from the professional bodies and public on our projects and we receive their responses through our website. Usually, we share it with six associations: Egyptian Capital Market Association, Egyptian Insurance Federation, Egyptian Society of Accountants and Auditors, General Authority for Investment, and Ministry of Investment” (the Chairman).

Moreover, four of the Egyptian professional bodies are observers on the QCU board of directors (Egyptian Society of Accountants and Auditors, Egyptian Institute of Accountants and Auditors, Egyptian Capital Market Association, and Syndicate of Commercial Professions). However, the QCU believes that the representatives of professional bodies may negatively affect the board’s members when they take sanctions decisions and accordingly they should be prevented from attending these meetings.

“We discuss technical issues with the professional bodies such as ESAA and they can send us their feedback on our rules, we can depend on them to make training courses for the current participants (CPD) or they can prepare studies on the audit profession in Egypt. However, they must not attend the meetings of our board of directors so as to avoid any conflict of interests and bias when issuing our decisions as these bodies consist of the main participants of the profession in Egypt and they can affect the members of board of directors even if they are only observers. Therefore, when we have any important decisions related to one of the listed auditors we do not invite these bodies or their members to attend our meetings” (the Chairman).
Further, the big firms suggest that QCU should cooperate directly with the big audit firms and consider their feedback regarding the new regulations projects before issuing them.

“The EFSA have to cooperate with the big four firms to know the actual problems of the audit profession and provide effective solutions” (Audit partner, Company B).

Despite the current cooperation between the QCU and the Egyptian professional bodies, the big four firms feel that more discussion is required to enhance the quality of the audit profession. This can be achieved by increasing the transparency of their proposed regulations and inspection findings.

5.4.2 How the big four firms criticise the independent inspectors

“I think they were ticking a box in many cases, but now they are better” (Audit partner, company D).

Despite the advantages of the governmental audit oversight, auditors spend a lot of time ticking boxes or filling in forms. The big four partners have some concerns about the performance of the AIU’s inspection team. The partners argue that some areas of the inspectors’ approach need to be changed.

“We spent much more time in dealing with all the regulations than we did in the past; that’s cost us” (Audit partner, company A).

“It would be good if they were concentrating all the time on what are the key risks in this audit, and what could really have gone wrong that would have impacted audit quality, financial statements. Sometimes they concentrate outside of that” (Audit partner, company A).

“The AIU’s teams are doing their best, they fulfil the necessary function. But they need the right people” (Audit partner, company C).

The big four stress that there is a lack of materiality in the AIU’s work. The inspection team have spent a long time dealing with things which are not key issues in the audit process.

“They have their inspection process; it is very thorough and very detailed; they probably pick up on things that we do not think are key” (Audit partner, company A).
“I think they will tend to pick up on something quite minor and make a bigger deal of it” (Audit partner, company A).

On the contrary, the FRC’s regulators emphasise that it is easy for audit partners to say this as they have known their clients very well for many years. However, the inspection teams only have a limited time period during which to review glossy financial statements which are well produced.

“Very rarely will auditors actually say to us, the most difficult issue was this because we did not get all the confirmations we required …. They are very defensive ..... They may in certain circumstances say: this was the really difficult issue and this is how we dealt with it and that demonstrates we did a wonderful job” (FRC’s member).

It seems as though there should be more cooperation between auditors and regulators. Auditors should clearly explain to the inspectors what they have done in the audit files, and provide all documented evidence to justify their decisions. Further, regulators should be open minded and take into consideration the circumstances at the time of the audit rather than the time of inspection.

The partners argue that the inspectors are very detailed in their work and once they have found something – regardless of its materiality – they keep it in their mind at all times.

“You will get a reviewer spending several weeks reviewing a file, coming out with a list of challenges. And what we found is that once they made a point, be it a valid one or not, they find it difficult to let it go” (Audit partner, company A).

However, two reasonable issues justify this criticism. The first issue is that the AIU starts to look at the audit files after the archiving period has finished because firms have two months from the date of signing the audit reports to archive and finalise everything on the files. In addition, the AIU cannot look at all the audits simultaneously; they have to spread out these audits over the year. This means that the AIU may look at some audits at the end of September or October of the next year. Thus, when the AIU’s inspectors come back in the next year, they do not see any changes and write the same comments.

“If you look at the whole firm procedures, look at their staff appraisal process, we obviously look at the staff appraisal process after it has been finished. As it may have
been finished for six months and after discussion we agree that the firm should make some changes to the procedure. But we are already half way through next year’s process, so the changes will have to happen later” (FRC’s member).

The second issue is that there are certain behaviour issues which firms find it very difficult to rectify and they have not improved a great deal during the years.

“Quality of substantive analytical review would be one that seems very difficult for people to do well enough. Some firms have now said it is just too difficult, every time the AIU comes along and says we have not done it well enough” (FRC’s member).

Moreover, it feels like the inspection team intends to pick up something as they are accountable and they have to find some issues, they cannot publish a report in which they write that everything is well done in the inspected firm.

“I think because they are also being held to account as to whether they have been doing a good job, psychologically, it is difficult for them to walk away and say I have no issues to report. So, they’ll always try to find some issues” (Audit partner, company A).

The inspection teams have many headings which they are required to write something about, even if it is good; therefore, they simply write that problems are not found in this area. Recently this approach has changed, meaning that they now only focus on areas where improvements are required. As a result of such change, better performance is expected when it comes to this criticism.

Further, the big four firms compare the British approach and the American approach of inspection, and feel that the American approach is better. The American inspectors start their inspection by conducting interviews with the audit partners before then turning their attention to the documents. Conversely, in the UK, the inspectors spend a great deal of time with the documents and then ask the partners about their findings. The partners believe that time and effort can be saved if the inspectors ask them from the beginning about their process, then they can review the files to ensure that they comply with the standards.

“You will get a reviewer spending several weeks reviewing a file, coming out with a list of challenges” (Audit partner, company A).
“I want them to take a risk based approach, I do not want them to just be ticking boxes ... they have to understand of the realities of life, and the constraints within which people are working” (Audit partner, company D).

“It may be because we were unable to have a meeting. Our standard approach is to start with the financial statements, we have an opening information request list and a request for an opening meeting. The information request list is provided and the opening meeting is held” (FRC’s member).

Furthermore, the big four believe that instead of paying attention to auditors, more attention should be paid to the corporate governance and what happens inside companies themselves. They stress that the accounting expectations gap when accountants prepare the financial statements is higher than the auditing gap when auditors review such statements.

“Before trying to improve auditing, we should improve corporate governance first ... I think that the accounting expectation gap is higher than the auditing gap” (Audit partner, company C).

“The FRC could develop a means to apply external pressure to a company and/or its audit committee (other than a qualified audit report) it either would considered to be falling short of its responsibilities” (E&Y, response to promoting audit quality project, 2007).

The audit firms are concerned that audits depend on personal judgments in many aspects, and the views of the inspectors may be different in some cases. The partners believe that inspectors should consider the circumstances which exist when the auditors make the judgment rather than after.

“Audit is about judgment in a lot of cases; often, we’re going to have different views on judgment” (Audit partner, company A).

The big four partners can change their audit procedures or their documentation system as a result of the AIU’s inspection. However, their audit opinions have never been changed as a result of the new regulators.
“There are things that we do and we tell teams to do just to keep our regulator happy and whether that is something we wouldn’t do normally if we were not regulated” (Audit partner, company A).

“I don’t think we change our opinion because there is a regulator review” (Audit partner, company A).

Once there is a different view between the audit partner and the inspection team regarding a specific issue, the audit partner attempts to justify why he or she has taken this decision and what he or she has considered according to the accounting and auditing standards. The partners provide all documents and evidence which supports their view. Auditors stress that they are doing what they believe is right.

“I think we would always go with our judgment, what we think is right. Yes, we discuss some of those things, our processes, and our policies with the AIU and sometimes we think, well, we’ve got to change it slightly because it is not clear or our teams are not following it in detail and we do that. But I am not sure we get completely swayed on that the regulator is looking at it this way, we say, right, we’re going to do it this way. We do what we think is right” (Audit partner, company A).

“I think what it has done is that we have increased our documentation to support the views that we reach; we have increased the documentation around each subjective issue, about how we document our audit approach; how we make sure our files are closed off on a timely basis; how we’ve consulted with the concurring partner” (Audit partner, company A).

The big four firms are concerned that the AIU’s inspection reports emphasise the weaknesses of the audit firms in their findings rather than the strengths. Auditors argue that more balance should be considered to focus on both areas (strengths and weaknesses) in order to rebuild the public’s confidence.

“We believe that the AIU has a very important role in providing balanced reports which emphasise strengths as well as weaknesses and which provide a balanced overall assessment of audit quality in the UK. Reports that dwell only on any negative aspects of a firm undermine the very confidence in the firms that we all wish to achieve” (KPMG, response to promoting audit quality project, 2007).
“Reinforcing and encouraging good performance is a very important driver of audit quality” (E&Y, response to promoting audit quality project, 2007).

Some partners raise questions regarding the rotation of regulators in different positions and how this could improve the quality of the audit oversight system. They stress that different positions give the regulator more experience which can improve his or her understanding of the nature of the audit process and why the partner has taken particular decisions.

“I think it is important that you don’t get stuck for too long without a new experience. You can get experience in different ways. So you can be a regulator and then move into an institution for a period and then come back again” (Audit partner, company C).

To sum up, the findings indicate that partners of the big four firms are satisfied with the existence of the external inspectors and believe that the inspection process increases the audit quality and adds credibility to the profession. This does not mean that they do not have some concerns regarding the performance of governmental inspectors. A set of changes should be made in the inspection methodology and the performance of their people.

5.5 Conclusion

Understanding the main outcomes of this chapter provides a clear image of the global independent audit oversight systems which were established for the first time in 2002 in the USA through the PCAOB and continue to be applied in different countries around the world. This chapter explores the perceptions of the big four firms’ partners regarding the importance of such systems and to what extent they improve the quality of the audit profession.

The analysis suggests eight values of the independent audit oversight system, and identifies four groups of stakeholders for each value. Examples of these values include: increasing the audit quality, adding credibility for auditors, mitigating the risk of litigations, avoiding the scenario of the big three audit firms, and increasing the transparency of the global networks of the big four audit firms. These values suggest that governments should be encouraged to apply the new system to improve the quality of financial reporting in the capital markets.

Suggested values could be useful for audit regulators and researchers to encourage the establishment of such a system in different countries. Furthermore, the views of the big four
audit firms toward the independent audit inspectors have been considered. Understanding the auditors’ perceptions can be useful for the audit regulators, as this will increase their awareness regarding the views of the inspected firms, which can in turn reduce any expectation gaps between audit inspectors and inspected firms.

Furthermore, the analysis proposes a set of key success factors of an effective audit inspection authority. Three groups of factors have been developed in the emerged theory to assist governments in establishing an effective authority. The IFIAR’s principles of effective audit regulators are combined with the factors developed from the interviews which are conducted with a number of the big four firms’ partners. The findings suggest that regulators are keener to achieve independence as the key feature of an effective audit inspector. However, auditors pay more attention to the inspector’s experience and specialisation as the main factors which should exist in the inspection team. The analysis suggests that retired partners of the big audit firms can be provide a good solution to balance between the two requirements. However, they cannot conduct inspection work for their past firms.

Moreover, the analysis is extended to examine how two independent audit inspection authorities apply the key factors of effective audit regulators. The findings indicate that further actions should be taken by both the AIU in the UK and the QCU in Egypt to enhance the quality of their performance. Further, one of the main criticisms of the independent inspection is that it increases the cost of audits through a number of new requirements such as the requirement of more documented works. Lack of materiality and spending too much time on the files instead of conducting more interviews with the audit partners are the main criticisms noted by the big firms when it comes to the inspection teams.

To sum up, the outcomes of this chapter provide a better understanding of the main features of the independent audit oversight system. It explains the importance and the main outcomes of such a system, analyses the key factors of establishing an effective audit oversight authority, and criticises the current performance of two independent authorities to provide the main shortcomings which should be avoided by audit regulators in the future. By understanding the main features of the new audit regulators, the following questions are related to how those regulators affect the audit profession. What are the main regulations which have been issued by the new regulators? What are the main objectives of these regulations? How can these regulations improve the quality of the audit profession? All of
these questions can be answered in the following chapter. Chapter 6 sheds light on the main projects of the audit regulations, which aim to enhance the quality of the audit processes.
Chapter 6: The audit regulations: How do audit regulators achieve their objectives?

6.1 Introduction

Chapter 6 explains the second main category of the Emerged theory. This chapter analyses the main efforts of the audit regulators to achieve their objectives by setting a number of audit regulations. It discusses the different views of participants (auditors and regulators) in order to understand how and to what extent these regulations affect the quality and the reliability of the audit profession.

Audit regulators are concerned about the high level of concentration in the audit market. The big four firms dominate auditing the largest listed companies in most of the capital markets. In 2005, the FRC and the Department of Trade and Industry (DTI) have commissioned an independent consultancy (Oxera) to assess the competitive environment for audit services. They aim to contribute to the understanding of the audit market by analysing the factors which affect companies’ choice of auditors, and the dynamics of the evolution of the audit market structure. In 2006, Oxera published its final report with certain findings. Oxera (2006) stresses that there is a high degree of concentration in the audit market after the dissolution of Arthur Anderson in 2002. Their findings indicate that reputation is an important driver of choice. It also states that the big four firms are better advised to offer three key components of the audit product which are value-added services, insurance against reputational risks, and greater capacity and international coverage.

Oxera (2006) emphasises that higher concentration and changes in regulations have led to higher audit fees. Their findings provide evidence that there is no effective choice in the audit market in the short run; this elimination of choice is driven by high market concentration, auditor independence rules, big firms’ entry constraints, and the need for sector expertise. In addition, they stress that the significant barriers preventing entry into the big firms market include perception bias against non-big firms, and significant business risks when competing with the big audit firms. The study is concerned with the notion that the loss of another big four firm would increase problems around auditor choice and would require regulators to make exceptions to auditor independence rules.
As a result, in 2006, the FRC established the Market Participants Group (MPG) to provide recommendations on possible actions which can be taken to mitigate the risks arising from the limitation of choice in the UK audit market. The MPG consists of individuals from stakeholder groups in the audit market which include the entities being audited, the audit firms, shareholders, and other users of audit services. The main objectives of the MPG are to simplify the financial barriers and other requirements to be one of the big audit firms, to reduce the potential risks of selecting a non-big four firm by the companies’ directors, and to improve choice within the big four firms (FRC, 2007). The MPG’s first report (2007) sets out 15 recommendations for actions which could enhance the efficiency of choice and mitigate the risks associated with a firm leaving the market (the recommendations of the MPG’s first report are summarised in the appendix). As a result, the FRC has initiated several projects and issued specific regulations to enhance the efficiency of choice in the audit market. Figure 6.1 summarises the main projects of the FRC when it comes to increasing the choice in the audit market and improving audit quality.

This chapter analyses the FRC’s projects, and develops three groups of projects according to their objectives. The following sections discuss the three groups of FRC’s projects, with a view to understanding the perceptions of the big four firms toward these projects and the extent to which these regulations achieve the objectives of the independent audit regulators. Section 6.2 analyses the first group of projects which aim to enhance the quality of the audit process inside the audit firms. Section 6.3 discusses the extent to which the second group of projects increases transparency and provides useful information about the big audit firms. Sections 6.4 explores the perceptions of the big four firms toward the last group of projects which aim to reduce the barriers standing in the way of entry to the big audit market. It also seeks to enhance the choice of auditors inside the global companies. The following section (Section 6.5) includes examples of auditors’ resistance toward the audit regulations and analyses how and why such resistance exists. The last section in this chapter is Section 6.6, in which my conclusion can be found.
Lot of accounting scandals and the failure of Arthur Anderson

High degree of concentration in the UK audit market

Lower public trust in the audit profession and capital markets

Limited choice of auditors for listed companies

New regulations and procedures to promote the confidence in the UK capital market and to increase the choice in the audit market

Debate on changing the ownership rules of the audit firms

Greater Professional scepticism is required

Review the audit proposals

Review the transparency reports

Audit Firms’ Governance Code: non-executives and stakeholders’ dialogue

Revised Ethical Standards and debate on preventing non-audit services for audited clients

Permitting the Audit liability limitation agreements

More financial resources

Eliminate the financial barriers of the big audit market

Increase the audit quality

Increase the public trust

Add more credibility

Decrease the risk of one big firm leaving the market

Understand the drivers of choosing the auditors to enhance the mid-size firms to focus on these factors:

Firm’s size and brand

Increase the transparency of the audit firms

Increase the credibility of the audit firms

Increase the credibility and the public trust of audit profession

Increase the transparency of the audit firms

Reduce the risks of one big firm leaving the market

Increase the auditors’ independence

Increase the audit quality

Increase the public trust

Reduce the risks of one big firm leaving the market

Reduce the audit risk

Reduce the audit fees

Encourage the mid-size firms to enter the big market

Figure 6.1: framework summarises the progress of the audit profession’s regulations in the UK
6.2 Improving the audit quality

Improving the quality of auditors’ performance is one of the main tools which can be used to promote public confidence in the profession. This can be achieved by identifying the meaning of quality and how it can be measured. However, it is difficult to come up with one general definition for audit quality.

“There is no single agreed definition of audit quality that can be used as a standard against which actual performance can be assessed” (FRC, Promoting Audit Quality, 2006).

A number of authorities and prior research attempts to provide different definitions for audit quality (see, for example, Knechel, 2009; AIU, 2005; ICAEW, 2002; DeAngelo, 1981). However, they do not provide an independently defined or objectively variable measure of the quality of an audit (FRC, 2006). Knechel (2009) stresses that any definition of audit quality should reflect the fact that it is a professional service which may differ from other types of service. For example, professional services are obsolete, at least for a certain period of time. In addition, the audit service can be used simultaneously by multiple persons. Further, perceptions of audit quality vary amongst stakeholders depending on their level of direct involvement in audits and on the lens through which they assess audit quality (IAASB, 2011). One of the main efforts to define the audit quality is to identify the key drivers that determine to extent to which the audit quality is applied inside the audit firms. This approach has been followed by the FRC which has issued the Audit Quality Framework (AQF) project in 2008.

“The Audit Quality Framework is designed to support effective communication between auditors, audit committees, preparers, investors and other stakeholders on audit quality” (FRC, the Audit Quality Framework, 2008, available at: www.frc.org.uk).

The AQF discusses five key drivers which can measure the quality of the audit process inside the audit firms. The framework identifies a number of variables which measure the extent to which the audit firm achieves each driver.

“The framework is intended to be complementary to existing regulations and guidelines and promotes the following key drivers of audit quality:
• The culture within an audit firm;
• The skills and personal qualities of audit partners and staff;
• The effectiveness of the audit process;
• The reliability and usefulness of audit reporting; and
• Factors outside the control of auditors affecting audit quality”

(FRC, the Audit Quality Framework, 2008).

Audit committees, regulators, and stakeholders can use this framework as a comparable tool among the audit firms when selecting their external auditors or even when inspecting the auditors’ annual performance. Audit firms themselves can use such drivers for self-assessment. However, Knechel (2009) argues that the FRC’s framework is vague and subject to interpretation as it replaces one opaque term with four hard-to-define concepts. Indeed, he doubts whether the quality of an audit process can ever be defined. Moreover, IAASB (2011) argues that variations in stakeholder perspectives of audit quality suggest that no single driver should have a dominant effect on audit quality.

Further, the International Standards on Quality Control (ISQC 1) determines seven areas which represent the main elements of a quality control system inside the audit firms. ISQC 1 (2009) emphasises that,

“Firms that perform audits and reviews of financial statements shall establish and maintain a system of quality control that addresses the following components:

• Leadership responsibilities for quality within the firm
• Relevant ethical requirements.
• Acceptance and continuance of client relationships and specific engagements.
• Human resources.
• Engagement performance.
• Monitoring.
• The firm shall document its policies and procedures and communicate them to the firm’s personnel”

(IFAC, ISQC 1, 2009).
Sanusi (2008) depends on the elements of ISQC 1 to provide a self-assessment checklist for audit firms, to assist them in evaluating their current performance. Further, analysing the transparency reports of the big four audit firms in which the firms disclose information regarding the implementation of each quality’s driver, indicates that the big four firms’ transparency reports are organised to be committed to the ISQC1 as well as the FRC’s Audit Quality Framework. This supports the notion that the two approaches are compatible and seek similar themes of audit quality. The analysis combines the two approaches together in four areas: firm’s values, quality of people, audit methodologies, and other external factors. For example, the Audit Quality Framework emphasises that audit firms’ culture strongly affects audit quality.

“Audit quality can be driven by audit firms creating an environment where achieving high quality is valued, invested in and rewarded” (FRC, Promoting Audit Quality, 2006).

Three key values are identified regarding the big firms’ culture (see, for example, the annual transparency reports of KPMG and PWC in 2010 and 2011, available at: www.kpmg.eu, www.pwc.co.uk). Doing the right things, acting with integrity, and tone at the top are key values which are adhered to by the big four, and help them to deliver a high quality of service for their clients without conflicts with public interests.

However, the AIU’s inspection findings stress that audit firms do not always consistently apply their policies and procedures for all aspects of individual audits. Further, approximately 44% of reviewed engagements of the big four firms during 2009 and 2010 need more than minor improvements (significant improvements are required in around 9% of them)\(^1\). The AIU stresses that,

“While firms are willing to provide additional training to staff, such actions will be insufficient without effective behavioural change which is more difficult to achieve” (AIU’s annual report, 2010).

Another example of the key drivers behind audit quality is related to the other factors which are outside of the auditors’ control. The big four firms stress that regulators and audited clients are the main parties which can affect the audit quality and fall outside auditors’

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\(^1\) See the public reports of the AIU for the big four firms in 2009 and 2010 at: www.frc.org.uk.
control. Audit laws and regulations and corporate governance are issued out of auditors’ control, and strongly affect the audit quality. The strong internal control system of the audited client increases the quality of the audit process.

IAASB (2011) determines three factors as the most important influences on audit quality. The three factors are shown in Figure 6.2, which explains how the audit quality is affected by context factors, inputs of the audit process, and outputs of the audit process.

![Figure 6.2: Influences of Audit Quality](image-url)

Independent inspection units depend on such quality indicators to assess the quality of audit firms’ performance when issuing the annual inspection reports (for example, in the UK, the AIU depends on the FRC’s Audit Quality framework; and similarly in Egypt, the QCU
depends on the Egyptian ethical standards, which are consistent with the ISQC, when assessing the quality of the auditors’ performance).

“Over the past six years, the APB introduced standards that are directed at reinforcing the key components of an effective culture. It has also been a primary focus of the monitoring work of the AIU” (FRC, promoting audit quality, 2006).

It seems as though determining such drivers of audit quality assists regulators in sufficiently assessing the quality of auditors’ performance, companies to effectively choose their external auditors according to relevant basis, and auditors themselves to enhance the quality of their services. This can better restore the public’s trust in auditors.

Furthermore, the AIU’s inspection reports recommend further changes in the UK’s audit regulations in order to continue enhancing the quality of the audit process. Such recommendations are developed as a result of the inspection findings of inspected audit firms’ performance. The following are two examples for AIU’s proposed regulations which aim to improve the quality of the audit process.

6.2.1 Preventing the provision of non-audit services to audit clients

The first example is related to the auditors’ provision of non-audit services to their audit clients. The POB finds that the ratio of non-audit fees to audit fees for audit clients in the UK has declined over the years. However, this rate of decline has become smaller in recent years.

“One major firm has embarked on a growth strategy where a key driver is the development of non-audit services to be provided to audit clients” (AIU’s annual report, 2010, p.23).

In some firms, implicit messages have been identified which hint that auditors will be rewarded for their contributions in obtaining non-audit services from their audit clients. This is inconsistent with the ethical standards which do not allow firms to reward their auditors according to their success in selling non-audit services to audit clients. This could raise questions regarding the efficiency of preventing auditors from providing non-audit services.

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2 See the “Key Facts and Trends in the Accountancy Profession” report issued in 2010 at: www.frc.org.uk.
3 See the revised UK ethical standards (ES 5) issued by the POB in 2010 at: www.frc.org.uk.
for their audit clients. In addition, the AIU identifies inadequate reporting to the audit committees of significant audit findings or independence threats regarding the provision of non-audit services without applying related safeguards.

Furthermore, cases have been found in which the big firms focus on their internal communications with their audit employees on the importance of maintaining or improving their financial performance. This could lead the employees to believe that the importance of audit quality has been reduced to maintain or improve the financial performance of their firms. The AIU stresses that clearer messages should be delivered regarding the essentiality of audit quality, and that these should be achieved by all of the audit firms.

“The importance of audit quality should be reinforced, and its achievement appropriately rewarded at all levels within audit firms” (AIU’s annual report, 2011, p.6).

In order to respond to the AIU’s recommendations, a consultation paper is published by the Auditing Practices Board (APB) to elicit feedback regarding whether or not to introduce further restrictions on the provision of non-audit services. The general view of respondents is there should be no outright prohibition on non-audit services (APB, 2010:c). It is argued that applying relevant safeguards can mitigate the threats to auditors’ independence (the potential threats to the non-audit services and the possible safeguards are summarised in the appendix).

The big four partners state that no more restrictions for the provision of the non-audit services are required. The current safeguards approach is enough to protect the public interests. The provision of non-audit services neither affects the quality of the audit work nor the auditor’s independence.

“It has no negative impact on independence” (Audit partner, company C).

“I do not think that the provision of NAS for audit clients affects the audit quality” (Audit partner, company A).

Audit partners do not provide their opinions according to how many non-audit services they provide to a specific client. The acceptance and continuity processes are very restricted and isolated from any financial considerations.
“I don’t think there is any evidence about the negative effect of NAS on independence. No one has ever proven that an audit partner makes a decision based on it” (Audit partner, company A).

“For any client, if reputational we don’t want to be involved with them from an audit perspective, and then we might well reach the same decision from non-audit perspective. Non-audit providers have to go through the same client acceptance procedure that auditors do. So NAS will not affect our independence or quality” (Audit partner, company A).

Moreover, Chinese walls are applied to protect the confidentiality of clients’ information. The current UK ethical standards have many restrictions which limit auditors and provide a lot of safeguards to protect the public’s interests. According to the ethical standards (ES 5), partners should not be awarded for what they are selling when it comes to non-audit services, and this is another safeguard which is applied in the big firms (APB, 2008).

“The UK ethical standards are full of restrictions. You can’t do evaluation work, you can’t do certain types of services” (Audit partner, company C).

“There are Chinese rules. We have a requirement not to share any client information, and that’s an ethical requirement rather than a commercial issue that says: client information is confidential. So it shouldn’t be shared between teams” (Audit partner, company A).

“The audit partner is not allowed to be assessed or remunerated based on the non-audit services that they provide” (Audit partner, company A).

Sometimes, auditors and consultants who are providing the non-audit services are carrying out duplicated work. This can raise questions regarding the cost benefit value of preventing auditors from doing this work although they are already doing it.

“For some services, the auditor has already done that work, should be allowed to trash his opinion and do it again, otherwise you will have two audit firms doing exactly the same procedures that will drive them crazy” (Audit partner, company A).
Another question can also be addressed regarding the extent to which the profession affects the regulators’ decisions. Indeed, the AIU’s findings do indicate that there are certain issues which threaten the auditors’ independence when it comes to the provision of non-audit services. However, the APB argues that no further restrictions on providing non-audit services are needed. The APB’s board consists of 13 members, 4 of whom are partners in the big four firms. So, does it matter? Further discussion regarding the power of the big audit firms to affect the audit regulators and how they resist the audit regulations is provided in Section 6.5.

6.2.2 Professional scepticism

The second example of improving the quality of the audit process is related to enhancing the professionals’ scepticism. Situations are identified during the AIU’s inspection, where differing and conflicting judgments are accepted by the same firm for clients operating in similar industries. This gives an indication that the big firms seek to obtain evidence to support their opinion rather than challenge the judgment made by their clients. Although some firms have procedures in place to confirm the consistency of key judgments across their client base, the AIU emphasises that audit firms should apply greater professional scepticism.

“The AIU’s findings identify the need for firms to ensure that both partners and staff exercise appropriate professional scepticism” (AIU’s annual report, 2011, p.6).

In August 2010, the APB issued a “Discussion Paper ‘Auditor Scepticism: Raising the Bar” with the objective of exploring the nature of auditor scepticism and how it is developed and promoted within audit firms. It also sought to ascertain whether more steps are required to assure that an appropriate degree of scepticism is applied in practice (APB, 2011). This debate follows the wave from the banking crisis and is in parallel with one of the key messages of the AIU’s annual report 2009/10 which stresses the need for audit firms to exercise greater professional scepticism (APB, 2011). The APB (2011) reviews the UK auditing standards to ensure that it has sufficient requirements and guidance relating to the need for audit firms to have appropriate policies and procedures which underlie professional scepticism.

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4 See the AIU’s Annual Report, which was published on 21 July 2010, at: www.frc.org.uk.
Professional scepticism is “An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence”⁵. Nelson (2009) argues that professional scepticism is indicated by auditor judgments and decisions which reflect a heightened assessment of the risk that an assertion is incorrect, conditional on the information available to the auditor. His findings stress that audit evidence, provided by the management, combines with auditor’s knowledge, traits, and incentives to produce a judgment which reflects professional scepticism. Audit firms can influence professional scepticism through hiring policies, training, performance appraisal, incentives, and changes in tasks and institutions.

The level of professional scepticism which is applied in the audit market differentiates between good and bad practices. It refers to how much evidence or support an auditor needs to be satisfied about what the management have done.

“I think scepticism differentiates between a good firm and a bad firm because a weak firm would accept what they are told, tick the box, get a bit of paper that supports the number and move on” (Audit partner, company A).

“Even if the management has done everything they should be doing, auditors still need to stand back and say: does it make sense” (Audit partner, company A).

“That is the difference really; how much evidence and support do you need to be able to sign something off and that’s the bit, professional scepticism it is grey as to what is an acceptable level of evidence” (Audit partner, company A).

However, auditors believe that, when it comes to scepticism, no more regulations are required. Auditors must be sceptical according to the accounting and auditing standards which stress that a sceptical attitude of mind is essential if an audit is to be rigorous and performed with due professional care.

“There are audit standards already say, when you are auditing, count values. You even have the accounting standards that say accountants have got to do this, this and this; and it is expected that auditors check every bit of the way that they’ve done” (Audit partner, company A).

⁵ International Standards of Auditing ISA (UK and Ireland) 200, paragraph 13.
Despite this, there is still a debate regarding to what extent the audit profession needs further restrictions when it comes to professional scepticism. While the AIU recommends further steps to mandate the professional scepticism among auditors, the big four partners argue that the current accounting standards have enough rules and no more regulations are required. This seems like an additional example of how the big audit firms have the power to affect the audit regulations, thus making them compatible with their interests.

To sum up, this section presents one of many different ways in which the independent audit regulators promote public confidence in auditors by improving the audit quality through a number of regulations. It analyses how the big audit firms apply (or resist) the issued (or proposed) regulations.

6.3 Increasing the transparency level

One of the main objectives of the independent regulators is to increase transparency when it comes to the big audit firms’ performance. This is another way of promoting public confidence by providing more information about who the big four networks are and how they are work. The audit firms need to be more transparent about their structures and relationships between the global networks and their member firms.

“Major external audit firms have globalised and, as a result, their structures are complex and governance within the firms lacks transparency” (Basel, 2008, p.8).

Moreover, developing a better understanding of how the big four firms work enhances the choice in the audit market and encourages the mid-size firms to enter the big market. This section provides three examples of FRC projects which increase the transparency level of the audit firms’ performance. Further, this section provides a better understanding of the views of the big four firms towards such projects.

6.3.1 Annual transparency reports

The first example relates to the mandatory annual transparency reports of the audit firms. The Statutory Auditors Instrument (2008) requires all auditors of UK companies with securities traded on a UK regulated market to produce a transparency report every financial year starting on or after 6th of April 2008 (POB, 2010: a). In 2010, The POB published its review of the first set of mandatory transparency reports produced by the audit firms. Their findings
support the notion that the quality of reports is higher than the previous year’s voluntary reports. However, the POB encourages audit firms to enhance their disclosures in specific areas which include international networks, independence issues, and financial information (POB, 2010: b).

The big four are satisfied with publishing these reports. Some of them have already published them for several years on voluntarily basis. Auditors ask their clients to disclose all valuable information; they must, at least, do the same.

“We’ve been doing it for a long time. We are the first to publish financial statements and the first to have them audited” (Audit partner, company A).

“It is sort of double standards to say we are keeping everything about us secretive, at the same time insisting that clients disclose this, that and the other. We’ve got to be prepared to show what we are all about” (Audit partner, company A).

Many argue that it is valuable for all parties that the public develop a better understanding of the audit processes, procedures and even the financial results of audit firms. The partners argue that more work is required to enhance the quality of these reports in the future.

“I think it is a good thing that people understand what our processes are, procedures, results, everything” (Audit partner, company C).

“We are very happy to provide financial information, views on our processes; I think there are more we can do on our transparency report, and we are working on that” (Audit partner, company A).

The Egyptian partners do not mind issuing such reports. They are already published in many countries, and can be used for advertising. The financial results are already known by their competitors. However, the pricing rates per hour are the most confidential data, and should not be published.

“Our peers in different countries publish transparency reports, so why not?” (Audit partner, Company B).

“It could be part of advertising, no problem” (Audit partner, Company A).
“As it will be mandatory and our competitors will publish them, no problem” (Audit partner, Company C).

“We can publish all the information except our policy to price our hours’ rate” (Audit partner, Company A).

6.3.2 Reviewing the audit proposals of listed companies

The second example reviews the audit proposals of a number of listed companies. In 2009, the POB carried out an exercise to understand how auditors and audit committees assess audit quality in a tendering process. This exercise includes a review of recent audit proposals for a selection of listed companies and interviews with some of those companies’ audit committees. It is clear from the exercise that the big firms focus heavily on their size. The firm’s size and brand are the main drivers for audit quality (FRC, 2010: b).

The big firms focus on the importance of audit committees to improve the audit quality and the entire governance process. They stress that the audit committees’ performance has been improved over the years.

“I think the major issue with the audit committee is getting them engaged. Like anything else, you’ve got good audit committees and bad audit committees, good ones, when they are good they work very well and the whole governance process and the way the audit works is much easier” (Audit partner, company C).

“They are many good committees, and they have gotten better over the years” (Audit partner, company A).

“With the APB or the FPC, there is the combined code, there is the Audit Committee guidance, what audit committees do, and audit committees have to assess the effectiveness. All those kinds of things are very good things. And I would say that I think the UK is at the forefront of that” (Audit partner, company C).

The audit partners are happy with reporting to the audit committees, which should be enhanced to add more values for their corporation.
“Technically our clients are the shareholders and I think there is an issue, or a perception out there that people think that we think that managements are clients’” (Audit partner, company C).

“We said the audit committee is very important and something that should be enhanced and we are happy reporting to audit committees” (Audit partner, company A).

However, the big four partners provide other group of drivers of the audit market rather than the firms’ size and brand.

“The mid-size firms need to get the right people to serve global companies which are seeking for experts in their business” (Audit partner, company D).

“Personal relationships, it’s all about relationships. I’ll have on-going relationships with clients that have no intention of putting their audit out just now, but I am there either helping them with other services, or building relationships so that if something goes wrong with their existing audit relationship, they have already got a known relationship and trust which we can work from” (Audit partner, company D).

The quality of people and good relationships with the clients are other drivers which can attract clients to choose specific auditors. Understanding such drivers assists the mid-size firms in changing their strategies and being more competitive in the big audit market. It further enhances the choice decision in the audit market.

6.3.3 Audit firms’ governance code

The third example relates to the audit firms’ governance code project. In January 2010, the FRC and Institute of Chartered Accountants in England and Wales (ICAEW) published the audit firm governance code. This applies to the 8 audit firms which together audit approximately 95% of large listed companies in the UK. The code should be applied to financial years commencing on or after the first of June 2010. The code aims to provide a formal benchmark of good governance practice which audit firms must comply with as regulated professional partnerships. Furthermore, the code should play specific roles such as enhancing the stature of firms as prime examples of best practice governance; improving
firms’ transparency reports, and encouraging changes in governance which improve the way that audit firms are run (FRC, 2010: a).

One of the key features of the code is the mandatory appointment, by the audit firms, of independent non-executives who can be witnesses to a firm’s commitment to the public interest. Indeed, the involvement of people who are independent of the firm and its owners could play an important role in enhancing public confidence. Monitoring of the firms’ decisions by outsiders can assure that the firms take the public interests into consideration. New non-executives can act as an additional safeguard of a firm’s reputation; and they are responsible for creating periodical dialogues between audit firms and stakeholders (FRC, 2010: a).

Non-executives can add value for the audit firms’ governance and help the board of directors with their experiences. Moreover, it is a good opportunity for audit firms to be closed to the society. Striking up dialogues with stakeholders may well enhance the credibility of auditors.

“We welcome with the new structure: we work with non-executives with our large clients; they add values and bring experiences” (Audit partner, company A).

“We are not worried about the new structure; it helps the external creditability of our organization” (Audit partner, company A).

“It is a good thing; I think it is dangerous for an organization to become too insular” (Audit partner, company C).

Certain audit firms have had non-executives in their structure for a long time; they have different committees in their governance structure playing similar roles.

“There is no huge change, the structure already exists: beside the board of directors, we have different committees similar in their nature to the new non executives” (Audit partner, company A).

However, this is not what regulators mean by non-executives, the code’s setters believe that non-executives should be independent individuals who are fully outsiders of the firms.

“Probably the big four mean Partners who are not executive partners in charge of running the firms, what we mean by non-executives is outside people who are not
partners, so completely external people outside the board or governance structure ...

Only one firm out of the eight firms (and not one of the big four any way) that did have outside people who outside independent non-executives on the board or the governance structure before the code was issued” (Audit regulator)

Time is still needed to evaluate the non-executives’ performance and to what extent they can help the quality of the audit process and protect the public interests.

“It is only just, in a way, starting. So, we just need to see how it goes and see what it does because we don’t know when we will first do report on it. I think it is a good thing” (Audit partner, company C)

“The whole area is brand new; it will take time to be developed. Who knows what will happen in the future?” (Audit regulator)

However, a question arises here, namely the independence of the non-executives and to what extent they can provide reliable information. By the end, they are appointed by the firms and receive salaries\(^6\). How can they issue negative or undesired opinions? This can also support my view regarding the resistance of the professionals toward proposed regulations. The audit firms’ code is prepared by a working group consisting of 12 members; 4 of whom are partners in the big audit firms\(^7\).

“I think on the remuneration probably, the proportion of their total remuneration they get from this particular job will be small ..... You would hope their reputation would be more important and that if there was a real problem that they would either sort it out or would resign” (Audit regulator)

“It would be wrong at this early stage to say that regulators should appoint the individuals because they are primary responsible to the firm, who knows what things go overtime, but this is a new concept and we have to see how it works. Who knows what will happen later?” (Audit regulator)

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\(^6\) For example KPMG ELLP announces in 2011 that it appoints four non-executives in compliance with the UK audit firms’ governance code. Each of those individuals takes €100,000 annually (www.kpmg.eu, accessed on Feb. 2012)

\(^7\) For more details see “The Audit Firms’ Governance Code”, 2010, available at: www.frc.org.uk
Further research can be conducted to analyse their reports and the extent to which they add value for society. This research can also reveal whether their reports truly reflect their independence.

In Egypt, the audit partners believe that it is too early to appoint non-executives to provide reports to the Egyptian capital market. The Egyptian investors still do not have enough awareness when it comes to the role of auditors, meaning that they do not need public reports from non-executives. However, this may add value for the firms and could have positive effects when it comes to increasing the objectivity of the audit firms.

“We need first to improve the culture of our investors to understand the role of auditors” (Audit partners, Company A, B).

To sum up, it is argued that a number of effective actions have been taken to provide a better understanding of the big audit market. The big audit firms are mandated to provide clearer information about their structures and networks, objectives, strategies, values, quality assurance and risk management departments, related parties, and their financial results. Further, they must also appoint independent non-executives who are responsible for assuring that no decisions are being taken by the firms in conflict with the public interests. They have further responsibility when it comes to striking up dialogues with stakeholders. This can protect the public interests and restore the public’s trust in auditors. Moreover, the analysis suggests that quality of people, personal relationships, firm’s size, and reputations are the main drivers of competition. Further discussion regarding how the big four firms compete in the audit market is put forth in Chapter 7.

6.4 Reducing the barriers of entering the big audit market

The third way in which independent regulators promote the public’s confidence in auditors is by reducing the barriers which prevent entry into the big audit market. Two types of barriers face the mid-size firms when it comes to entering the big audit market: financial barriers and risk barriers (Oxera, 2006). In the UK, the FRC have established a number of projects to reduce the current barriers of the big audit market and encourage the mid-size audit firms to compete with the big four firms. The following three projects are examples of this.
6.4.1 Audit liability limitation agreements

The first example relates to audit liability limitation agreements. The UK companies Act 2006 allows audit firms to limit their liabilities to their clients after the approval of the clients’ shareholders. Previously, auditors were prohibited from entering into arrangements to limit their liability to the proportion of losses which they were directly responsible. However, the permission has come as a result of many reasons (London Economics, 2006): the companies have become larger and their activities more global, whilst society has become more litigious and the auditors are being faced with an increasing number of claims which would be beyond their financial resources. The previously mentioned factors lead to a significant increase in the audit risk and the audit fees which direct the mid-size audit firms not to enter the big audit market. Furthermore, a high number of claims increases the risk of one of the current big four audit firms leaving the market (Oxera, 2006).

The FRC (2008: d) provide guidance regarding auditor liability limitation agreements which explains how these agreements could be implemented to provide valuable assistance to companies’ directors and shareholders. In addition, in 2008, the European Commission issued a recommendation to member states asking them to limit auditor liability (FRC, 2010:b).

Despite the legal permission of these agreements, no major listed companies are known to have entered into a limited liability agreement (FRC, 2010:b). The big four partners argue that the largest listed companies do not enter these agreements as most of them are listed in the US capital market, which does not allow auditors or managers to enter such agreements. As a result, when the largest companies do not have these agreements, the next group of listed companies will be unwilling to play the role of leader.

“Listed companies would not do it because the US priorities won’t allow auditors and managers to enter those agreements locally, so you have problems. So if the largest like Shell, the BPs, and Vodafone won’t have it, the next group of companies will look up at the very big companies and say if they are not doing it, we won’t do it either” (Audit partner, company A).

“But because it required approval from those companies, there were very few, I think there were one or two, who were willing to be the leaders in changing the market practice” (Audit partner, company A).
It is argued that these agreements are very useful for all parties of the audit market. As it is not fair that auditors are responsible for errors of managers or other parties, they have to be responsible for their errors only.

“It is for everyone’s benefit to do this. We wrote to all the chairman of all committees and the chairman of all the listed companies and said we want to discuss this with you, and we had various conversations” (Audit partner, company A).

“The point of liability caps is not that we shouldn’t have liability. It’s that we shouldn’t have others’ liability as well as ours” (Audit partner, company B).

“We are supportive of having liability limitations; we think it is a very important piece because it stops the meltdown on the auditors being blamed” (Audit partner, company C).

The limitation agreement does not transfer liability from one firm to another. Instead, it cancels the liabilities which have already shifted to auditors on behalf of others. Further, auditors’ limited liability could increase the effectiveness of choice in the UK audit market. The EC (2008) stresses that by introducing the auditors’ liability limitation, companies should have a wider choice beyond the current big four firms.

“So the point of liability limitation is not so much to shift the burden from one to the other, but to limit the already shifted burden away from the auditors” (Audit partner, company B).

“The auditors have the biggest pockets, so even though it’s the directors who could have done some of the things wrong, so we think it is adequate and fair to have this limitation” (Audit partner, company C).

“Liabilities limitation agreements are likely to make a positive contribution to audit quality, and we believe they will play an important role in bolstering competition and choice in the market” (Formal response, company C).

Limited liabilities will not affect the quality of the audit process because the audit regulatory framework will not be changed according to these agreements. Auditors still have to be committed to all standards and audit regulations regardless of the scope of liabilities.
“I don’t think it would affect the quality, at the end of the day it doesn’t change our regularity environment that says we have to comply with these standards. I don’t think it changes our professional scepticism or independence” (Audit partner, company A).

Auditors believe that it is better to mandate these agreements by law. Otherwise managers or shareholders will not voluntarily enter such agreements. In some European countries, such as Germany, auditors have limited liability as a part of the law (Weber et al., 2006)

“The majorities were much happier to stay in a body and not having something that could be an issue with their shareholders or investors. So the majority wouldn’t really entertain being voluntarily moved across” (Audit partner, company A).

“All is not common because at the moment none of the shareholder groups are willing to adopt it. We can’t push it in unless shareholders agree” (Audit partner, company C).

“The market doesn’t want to do it. I think there is a bit of: we don’t want to be the first to go for it. From the clients’ side, they are saying they don’t want to be the forerunner for it and whether the procedures and the company’s act are appropriate” (Audit partner, company C).

“Where limited liability regimes exist in countries, they are mandated by law and so where they are not mandated, who is going to take it up?” (Audit partner, company C).

“Our view would be it is much better for all to be a change in regulation, then it could be a limited liability as opposed to doing it on a piece by piece basis” (Audit partner, company A).

One of the main reasons which may prompt companies to enter into these agreements is to enable the company to obtain audit services at an acceptable price (FRC, 2008: d). However, the big four partners stress that they do not provide insurance services in which the risk is correlated to the price. The scope of liabilities will not affect their efforts as it does not change the required work. Therefore, liability is not an input in the cost equation. The costs are determined by the efforts which should be exerted to complete the audit process, and the market circumstances, regardless of auditors’ liabilities.
“We never reduce our fees for the limited liability. This is not an insurance policy, this is for work done, and we won’t do it anyway. I don’t think we will be just martyring fees for liable protection. I don’t think liable protection is on the table” (Audit partner, company A).

“Lower liability doesn’t mean lower fees. We specifically went out and said this was not a question of fees. Fees and liabilities don’t come together. The fees are the work we do. It is not a risk premium, it corresponds to the work we do; never any discussions on fees, in fact, we will do the opposite saying we will never go down the route of reducing fees for clients” (Audit partner, company C).

“It never affects our fees; I don’t think we necessarily get a liability premium in our fees at the moment to give away” (Audit partner, company A).

“In Egypt we already take a lower level of fees’ (Audit partner, company C).

Audit liability limitation is already applied to the big firms in Egypt as their contracts with their clients state that no fines can exceed the audit fees (one to one). However, this is illegal, as the Egyptian audit law does not allow auditors to limit their liabilities. Many local clients in Egypt are not sufficiently aware of this issue and sign the contract without raising this point. Only some multinational clients make an objection regarding this issue and after negotiations auditors agree to change the agreement to state that maximum audit fines cannot exceed a specific amount of money. Once again, it is a limited liability.

“We already have liability limitation in our agreements” (Audit partners, Company A, B and C)

“It is illegal, however we cannot leave it to be opened” (Audit partner, company C).

6.4.2 Changing the ownership rules of the audit firms

Another example of how the FRC’s projects aim to reduce the big audit market’s barriers is the debate with regards to changing the owners’ rules of the audit firms. Oxera (2006) finds that one of the significant barriers to entering the big audit market and auditing the large listed companies is the need for substantial resources and expertise to attract large and international companies. The ability of existing audit firms to raise their financial resources is restricted as the UK Companies Act stipulates that audit firms can only be controlled by
qualified auditors. Oxera (2007) suggests that changing the ownership rules would create the possibility that alternative structures may encourage the mid-size firms to increase their investments. It seems as though there is a debate with different views about the importance of changing the ownership rules of audit firms when it comes to the choice of auditors and the audit quality.

In 2008, the FRC issued a discussion paper which analyses the possible effects of the changes in the audit firms’ ownership rules on the audit market choice. The principle findings of this analysis are that (FRC, 2008: c) while changes to the ownership rules could make it easier for existing non-big four firms to enter the big audit market, any changes in the current rules need to be considered as part of a package of measures to improve audit choice. The paper identifies three areas of risk which threaten the audit market. The first risk relates to changes, which can lead to increased concentration in the market. The second risk is financial considerations associated with outside ownership, which can drive down audit quality. The third risk is that outside ownership can lead to a shortage of highly skilled partners and staff. The FRC stresses that existing UK regulations and market practice should prevent possible conflicts of interest associated with proposed rules.

In addition, the International Organization of Structure Commissions (IOSC) (2009) argue that alternative structures to the current restrictions of ownership for audit firms could be needed to mitigate concentration in the marketplace for large auditing services firms. Allowing non-participants ownership may support the audit firms’ human capital with relevant technical expertise which can enhance the audit quality. Regardless of this, regulators should consider whether new or enhanced safeguards could mitigate associated risks. Conversely, the European Commission (2009) suggests that there is a need to open up the international audit market and to decrease the market share which is held by the biggest four players. They assert that for the audit firms, human capital is more important than financial capital to expand internationally. The EC argues that changing rules on control structures is not the most significant barrier preventing the emergence of new players. Allowing a majority of external investors would have negative effects on the independence of auditors. Careful analysis is needed in case of a further relaxation of the rules regarding control of audit firms.
The big four partners argue that if non participants are allowed to invest in the audit firms, more safeguards are needed and a large number of clients should be added to mitigate potential effects on independence. It is not easy to accept the proposed rules as they will affect audit independence rather than audit quality.

“I think the problem is the risk that it could be perceived that they exercise undue influence on the auditor to give a certain opinion on a set of accounts” (Audit partner, company A).

“If you did let it happen, you’d have to layer on enormous amount of extra clients to avoid any risk that there would ever be one shareholder who could exercise that influence” (Audit partner, company A).

“If the fiancée of one of our partners is a shareholder in a company, we can’t audit that company” (Audit partner, company A).

Moreover, I argue that if the rules allow non-participants to invest in audit firms, they will invest in the big four firms rather than the medium firms. This will not solve the higher concentration problem in the audit market. Further, in addition to the financial barrier, there is another barrier which prevents the mid-size firms from entering the big audit market, namely hiring the right people who are experts in a wide range of industries.

“The main constraint is having the right people, at the end of the day; for medium-sized firms: do they have the people with the right skills and experience? You can try and compete, but you are more likely to win work if you’ve got people who understand the sector and have experience in the sector” (Audit partner, company C).

“If you were trying to win an oil company, major, you’ve got no partners who have been auditing oil major clients; it is very hard to break it. The clients are looking for people with the experience. It’s chicken and egg. You can’t get experience until you win the audits and you won’t win the audits until you get the experience” (Audit partner, company C).

The big firms’ partners are refusing the idea of allowing non-professionals to invest in the audit firms. They argue that money is money and if this happens the profits will become the main driver of the audit profession. It will have negative effects on the audit quality and
independence which would finally threaten the quality of financial reporting in general when it comes to the capital markets. They stress that auditing is an ethical profession rather than a profitable business.

“Business is business; if this will happen the investors will manage our performance and affect our opinions” (Audit partner, Company A)

“In this case the profits will be the main driver of our firms, while our main driver is ethics not profits” (Audit partner, Company B)

However, one of the big four partners states that,

“Non-professional investments could be permitted and managed in the same way as pension funds in which there is a full separation between the managers and investors” (Audit partner, company c).

6.4.3 Modifying the Ethical Standard ES 3

The third example is modifying the ethical standards to extend the rotation period for the engagement partner in special circumstances. The ethical standard (ES 3) stresses that no one shall act as an audit engagement partner for UK listed companies for more than 5 years, and no one shall act as the engagement quality control reviewer or a key partner involved in the audit for a period longer than 7 years (APB, 2009). The MPG (2007) identifies the 5-year rotation period as a potential barrier to increased participation by non-big four audit firms (FRC, 2007). The big four firms argue that 7 years is more relevant than 5 years when it comes to enhancing the learning process of auditors and improving the audit quality.

“I think five years is very quick. You have attained a lot of understandings of the company; seven years help with that continuity and there is no evidence that there are more threats” (Audit partner, company A).

Auditors take a long time to understand companies’ transactions and audit teams are usually changing. This means that the current period is very short. More time will assist auditors in developing a better understanding and will positively affect the quality of the audit reports. The international ethical standards support this view; they give auditors 7 years as a
maximum period for engagement partners. Partners stress that there is no evidence which shows that 7 years threaten the auditors’ independence.

“We do believe that the five years could be seven years; you could carry on if it was felt that the audit committee wanted, the global ethical standards are seven years” (Audit partner, company C).

“The reason for rotation of course is bringing freshness, make someone not too cosy. I don’t think there is any evidence that countries that have seven years, they are any different from the UK that has five. The UK is one of the few that has five” (Audit partner, company A).

The big audit firms believe that rotation is very healthy as it increases corporate governance, independency and the efficiency of the audit process. Different auditors can uncover different problems which have not been uncovered in the past, and which positively affect the quality of the audit process. They add that 7 years is a reasonable period for Egyptian companies as the management suffer if the auditors are frequently changed.

“It is a good policy; it positively affects the auditors’ independence” (Audit Partner, Company B).

Furthermore, the audit rotation improves the quality of the documentation system in the companies as when the management knows there will be different auditors in the future they will assure that everything is properly documented.

As a result, the APB has published revised ethical standards allowing audit committees in certain limited circumstances to extend an engagement partner’s rotation period from 5 to 7 years, if they are satisfied that this is necessary to safeguard audit quality (APB, 2009).

However, this standard is applied for audit partners not for audit firms. This means that the audit firm could keep the same client for more than 7 years through conducting rotation among its partners. Gates et al. (2007) provide evidence that public trust in companies which rotate their audit firms is higher than their trust in companies which only rotate their audit partners with the same firm.

In Egypt, one of the main disadvantages of audit firms’ rotation is that there are few “good players” in the audit profession. Therefore, rotation will decrease the choice for the listed
companies to appoint a strong candidate (this problem is clearly shown with the Egyptian banks as the Central Bank of Egypt requires two auditors from different firms to audit the bank, and rotate them a maximum of every 5 years). The Egyptian ethical standards mandate auditors to be rotated for not more than 7 years (consistent with the international standards).

“Auditors’ rotation improves the documentation system in the companies as they know that everything have to be documented for the next auditor” (Audit partner, Company A).

It seems that despite the FRC’s efforts to increase choice in the audit market, the big four firms still dominate when it comes to auditing the largest companies in the capital market. Different thoughts are needed. For example, shareholders of audit clients will not voluntarily agree with limited audit liability agreements. The UK company act should mandate such agreements.

6.5 Auditors’ resistances toward regulations

Indeed, the big four firms emphasise that the AIU has increased the quality of their audit works and added credibility to their reports. However, analysing their responses toward projects of further audit regulations which have been proposed as a result of the AIU’s recommendations indicates that they do not agree with further restrictions for auditors’ work.

“Rapid change in auditing and reporting standards with the corresponding oversight requires internal departments of audit firms, who are responsible for training, quality, and risk management, to make, an occasions, significant demands of audit teams. These teams then have to spend more time completing documentations and compliance forms. This can create an extra challenge to delivering quality audits and, for some, additional pressure” (E&Y, response to promoting audit quality project, 2007).

“Huge pressures are created through having to cope with too much change simultaneously” (Deloitte, response to promoting audit quality, 2007).

These examples of auditors’ responses justify the extent to which the big audit firms are not satisfied when it comes to the more complex regulations which restrict their profession. They
feel that auditing has become routine work where they just have to tick the boxes rather than
a profession which needs experts to make technical judgements.

“Rules based, rather than principle based, auditing standards could result in a tick box mentality to auditing ... complex accounting standards in a significant amount of time being taken to ensure that the accounting is ‘right’ and erode the overriding principle of ‘true and fair’ ... inappropriate reviews of firms by regulators could also result in work being undertaken by audit teams just to satisfy the regulator rather than being necessary to perform a good audit” (KPMG, response to promoting audit quality project, 2007).

“The effect of regulations and regulators can be constructive and supportive to the reputation of capital markets or it can be extremely damaging. It is necessary only to look at how quickly the US capital markets have lost their attractiveness to understand this fact. Over regulation of financial reporting and auditing with a perceived excessive total cost burden to companies and auditors has made companies and indeed auditors vote with their feet and leave that market in favour of London” (PWC response to promoting audit quality project, 2007).

Auditors are concerned about the transition of audit regulations and standards from principle based to rules based. This makes the profession more complicated and distractive to talented people, which in turn threatens audit quality.

“The FRC should ensure that it does not take action that will reduce the attractiveness of the auditing profession to the brightest and best people as they are the foundation of audit quality. Any action which damages the attractiveness of auditing as a career to the UK’s brightest graduates should be resisted” (PWC’s response to promoting audit quality, 2007).

Insufficient inspection of the audit firms can damage the public’s confidence in auditors. Inspectors should not be under press pressure when they are writing their published reports. Auditors feel that on occasions, inspectors only make notes to clarify for their management or the public that they have valuable issues. Inspectors should understand that their work is valuable even if they do not have any comments; at least it is known that there is nothing to worry about.
Thus, the audit firms’ resistance is apparent in their responses to proposed regulations. In many cases, they succeed in convincing the regulators of their argument and stop the regulations from being issued. Allowing auditors to provide non-audit services for their audited clients with applicable safeguards rather than preventing them totally is one of many examples in which auditors, especially the big four firms, affect the regulators’ decisions. It seems as though the big four firms are very keen to resist the audit regulations during the discussion stage. However, once regulations are issued they do their best to show how they are committed to such regulations. This can be easily argued by comparing the formal responses of the audit firms toward a specific project during its discussion stage – in which they have a lot of objections toward the proposed project – with the audit firms’ annual transparency reports after the project has been issued. Indeed, at this point, the audit firms welcome the new project and present how they are completely and efficiently in compliance with such a project.

“The discussion paper fails to appreciate the very real interest that audit firms themselves have in obtaining the highest quality” (Response to promoting the audit quality, Company B).

“This report also incorporates the key drivers of audit quality set out in the Audit Quality Framework issued by the FRC in February 2008” (Transparency report, company B).

“We welcome this discussion paper ... we recognize that these matters are being explained internationally and the UK regulatory and professional bodies and audit stakeholders participating actively in this process ... such an approach was successfully adopted by the UK government post Enron and we see no reason why another approach should be adopted” (Response to promoting the audit quality, Company D).

“The AQF helps to ensure that every audit professional concentrates on and understands the skills and behaviours needed to deliver an appropriate, robust and independent audit opinion. It also helps us to identify those important processes which we need to focus on to help us monitor audit quality on an on-going basis” (Transparency report, company A).
A number of previous studies (see, for example, Thornburg & Roberts, 2008; Sweeney & Pierce, 2004; Baker et al., 2006) investigate the mutual effects between auditors and regulators following the establishment of the independent audit oversight system. They argue that the big audit firms have the power to influence the regulators’ decisions. Although most of these studies are conducted in the US, their results support my suggestions that the big four firms affect the process of setting standards and regulations.

6.6 Conclusion

Chapter 6 provides a better understanding of how the audit regulations are used by the regulators to achieve specific objectives. The current projects of the FRC in the UK are analysed and categorised into three categories: improving the audit quality, increasing the transparency of the big audit firms, and reducing the barriers to entering the big audit market. Appendix 4 presents the main projects of each category and its benefits. Chapter 6 further discusses the auditors’ perceptions of these projects and provides a number of suggestions which can improve the quality of the audit profession.

Although the big four firms stress that the independent audit inspections improve the quality of their audit works, auditors used to resist, in the hopes of better regulations. They worry that more restrictions can complicate the audit processes. Further research must be conducted to examine the extent to which the professionals, especially in the UK and Europe, influence the regulatory setting process.

Further, a set of projects has been established to increase the transparency of the big audit firms. Annual transparency reports of the big audit firms are mandated in order to add value for companies’ management, investors, and the public at large. Such reports can be used as balance scorecards, and are also considered as advertising tools for the audit firms themselves.

However, the current efforts of the UK audit regulators to increase the choice in the audit market are not adequately efficient. An increasing number of varied procedures are needed. For example, the audit liability limitation agreements should be forced low by the UK companies. However, the high concentration level of the big four in the audit market cannot be reduced in the short term. For example, audit liability limitation agreements are already forced in Germany, whilst the big four are still dominating the audit market (Weber et al.,
The results emphasise that mid-size audit firms should invest a great deal to support their global networks and hire the right people. Choosing the right people is the key factor when it comes to being one of the big firms. Further research is needed to explore additional long-term solutions to enhance the choice in the audit market.

Some of the current audit rules should be changed to improve the audit quality. For example, the managing partners need to be rotated every 7 years instead of 5 years which in the current low. Further, the big four partners stress that providing non-audit services positively affects the quality of audit reports as auditors gain more experience in the clients’ business, which in turn assists them in making the right opinion in the audit reports. These results are consistent with the literature (see, for example, Defond et al., 2002; Geiger & Rama, 2003; Basioudis et al., 2008; Callaghan et al., 2009) which provides evidence that no associations are found between providing non-audit services and the quality of audit reports. Conversely, other studies provide evidence that non-audit services negatively affect the quality and the independence of auditors (see, for example, lennox, 1999; Yet et al., 2006; Elifisen & Knivsfla, 2008). Causholli et al. (2011) suggest that providing non-audit services adversely impacts audit quality only when auditors experience significant pressure to obtain future non-audit services fees. Further research is needed to provide more evidence regarding the extent to which the provision of non-audit services threatens the quality of the audit work.

Furthermore, audit partners support the new audit firms’ governance code which forces them to appoint non-executives in their boards to protect public interests and strike up dialogues with stakeholders. They are also happy with publishing information about themselves and their annual performance in the transparency reports. Further research could be conducted to measure the extent to which these reports are reliable when companies choose their auditors. Additionally, there is a current debate on the UK level and the European level about changing the owners’ rules of the audit firms and allowing the non-professionals to invest in the audit firms. However, I argue that this could threaten the independence of auditors and lead to more complicated rules to prevent conflict of interests. This will also fail to increase the number of big firms, as the main barrier to entering the big audit market is hiring the right people rather than financial investments. Moreover, if the proposed rules are applied, this will encourage people to invest their money in the big four rather than the mid-sized firms seeking higher returns.
Chapter 6 discusses the big four firms’ resistance toward the audit regulations, and how such firms focus on the discussion stage of the proposed projects to affect the audit regulators and protect their private interests. However, the analysis indicates that once these regulations have been issued, the big firms become fully committed to such regulations. Figure 6.3 summarises the relationships between the developed categories of Chapter 6 and how such regulations promote confidence in auditors.

I have now developed a better understanding of the importance of the independent regulators in the audit profession, as well as how they achieve their objectives by issuing a set of audit regulations, and how the big four firms feel when it comes to such regulators. The question which now needs answering is how do the big four firms react toward these new changes in the audit environment? What are the main strategies which have emerged from the big four audit firms to manage the recent changes? The answers to such questions are discussed in the next chapter. Indeed, in Chapter 7, the analysis is extended to develop a number of strategies which have been followed by the big four firms to react toward the new changes in the audit market and to protect their leading reputations.
Figure 6.3: The main categories of audit regulations and how they interact together.
Chapter 7: Strategies which have emerged from the big four firms to react toward the changeable environment of the audit profession

7.1 Introduction

In this chapter, the analysis is extended to address the second research question of this study:

“How do the big four firms react toward the new changes in the regulatory framework of the audit profession? What are the main strategies that have emerged to restore the public trust and to protect their leading reputations?”

Post Enron, much of the auditing literature focuses on examining the quality of audit reports and to what extent independent regulators have succeeded in mitigating the risk of another huge accounting collapse (see, for example, Defond & Francis, 2005; Gunny & Zhang, 2006; Lennox & Pittman, 2010; Defond, 2010). However, only a few of the previous studies (see, for example, Thornburg & Roberts, 2008; Shapiro & Matson, 2008; Jelinek & Jelinek, 2008) investigate what the audit firms do to better serve their clients without repeating the history of accounting scandals1. This chapter identifies, analyses, and interprets the main strategies that are followed by the big four audit firms to achieve their objectives: restoring the public trust, protecting their leading reputation, and committing to the new audit regulations. In this chapter, I continue developing another part of my integrated theory by exploring and explaining what the big four firms do to react toward the global regulatory changes of the audit market and to play their leading role in the changeable audit environment.

A number of emerged strategies have been identified, explained, discussed, and analysed in the coming sections. In each section, I explain each strategy, as well as why and how each strategy has been followed by the big four firms. I also identify the main consequences of applying such audit quality affecting strategies. I further explain how the implementation of these strategies achieves the current objectives of the big audit firms. The remainder of this chapter is divided into 7 sections. Each strategy will be explained in a section, with the final section providing the conclusion.

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1 In 2006, the CEO’s of the global audit networks published a report for the global society in which they stressed that they are keenly aware of mistakes made by some members of the profession in recent years, and have instituted significant changes in both their operations and their focus to assure that history is not repeated. The full report, entitled ‘Global Capital markets and the Global Economy: A Vision from the CEOs of the International Audit Networks’ is available at: [www.globalpublicpolicysymposium.com](http://www.globalpublicpolicysymposium.com).
As a result of some accounting collapses and decreased public trust in the audit profession, the global networks of the big 4 firms have started to review their audit methodology to ensure that it has been efficiently and consistently applied within their member firms.

“The primary driver was how we ensure across our whole network that we have got the right quality of work being undertaken” (Audit partner, company D).

“We review our audit methodology .... We try to standardize everything anywhere” (Audit partner, company A).

“We go back to our systems to provide evidence of our compliance with various regulations” (Audit partner, company B).

A set of unified policies and procedures have been established to ensure that all member firms in all countries are sharing the same practice which has been globally approved. This standardised methodology aims to protect their brands’ reputations, and to reduce the risk of further collapses by ensuring that the same procedures have been followed to achieve a similar level of quality around the world. This can attract multinational companies by saying,

“Our firm has got consistency across the globe” (Audit partner, company A).

“We are committed to delivering consistently high levels of audit quality around the world” (PWC global annual report, 2009).

“We made sure that our quality control procedures were being consistently applied everywhere” (Audit partner, company D).

Global networks have increased the number of quality assurance reviews among their member firms. Two types of inspection are carried out: the first is an internal review conducted by the audit committees for every partner, whilst the second is an external review
conducted by other member firms in the same network. These annual reviews have been expanded after Enron and include most audit companies. The standardised level of quality supports the notion that the big four firms provide highly technical services with better objectivity and expertise. It further assists them in protecting their leading reputations from the increased risk of litigation.

“Recently, the QA review for the audit files has been increased and covered most of our clients and all our high risk clients” (Audit partner, company C).

“For listed companies and other high risk clients, an engagement quality review partner reviews important areas of accounting, financial reporting, independence and audit execution…. The nature, timing, and extent of reviews depend on factors including materiality, subjectivity, and complexity of subject matter” (E&Y LLP UK, transparency report, 2010).

“Within the audit business, the internal quality control systems include our dedicated professional standards review team (PSR) which provides a hot review before any audit or other opinion is signed. Together with engagement quality assurance reviews and annual practice reviews of a selection of completed engagements” (Deloitte, Audit Transparency Report, 2009).

In addition, the big four audit firms have applied a number of procedures to assure the level of audit quality among their member firms. For example, a number of centralised technical centres – with different names in each firm – have been established to be responsible for providing technical guidance on technical and professional issues through their internal networks. These centres enhance the specialisation, standardisations, and professional scepticism of audit judgment whilst also improving the efficiency and cost of audit services.

Another main issue, to which the global audit networks have been paying increased attention, is the independence of auditors from their audited clients. This trend comes as a result of the intense debate – among audit regulators and stakeholders – regarding the role of impaired auditors’ independence in the accounting scandals. The discussions have focused on

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2 In KPMG, it is called “Department of Professional Practice”. In PWC, it is called “Assurance delivery centers”. In Deloitte, it is called “National Accounting and Audit group”. In E&Y, it is called “Financial reporting and capital markets group”. For more details, see the transparency reports of the big firms in years 2010 and 2011.

preventing the provision of non-audit services for audited clients, and the mandatory rotation of auditors after a maximum number of years (5 years in some countries and 7 in others). This is done in order to strengthen the level of auditors’ independence from their clients. Further, negative association has been proved among non-audit fees and the auditor’s propensity to issue an adverse opinion on internal control during 2004-2006 (Li et al., 2011). Thus, the global networks have applied highly restrictive rules and procedures to mitigate risks which can impair their independence.

These rigid procedures have been set at the global level of the big four audit networks to ensure that they have been applied at all member firms in different countries. For example, no engagement partner can audit a client for more than 7 years according to a global policy. This policy comes to comply with the Code of Ethics for Professional Accountants set by the International Ethics Standards Boards for Accountants (IESBA), which is one of many organisations supervised by the International Federation of Accountants (IFAC).

“In respect of an audit of a public interest entity, an individual shall not be a key audit partner for more than seven years. After such time, the individual shall not be a member of the engagement team or be a key audit partner for the client for two years. During that period, the individual shall not participate in the audit of the entity, provide quality control for the engagement, consult with the engagement team or the client regarding technical or industry-specific issues, transactions or events or otherwise directly influence the outcome of the engagement” (IFAC, 2010:b).

Moreover, a member firm in country A cannot audit a client which is a subsidiary, a branch, or a related party for a non-audit client of another member firm in country B. Additionally, the national member firms in different countries must be committed to their national standards as well as to the internal policies of global clients if these standards/clients’ policies prohibit the provision of non-audit services by the external auditors. These procedures are managed globally by software programs to ensure the effectiveness of implementation. Chinese walls⁴ are used to guarantee a high level of independence by preventing communication between audit and non-audit partners and staff. This is another example of standardised policy which has been applied everywhere and has been set in a centralised way.

⁴ Chinese wall is a mechanism designed to stem the flow of confidential information between firms or between different units within the one firm and to reconcile conflicting interests and obligations more generally (McVea, 2000).
“We have fully separated the systems of our audit and non-audit staff” (Audit partner, company A).

“We enforce all the rules that prevent any flow of information between our audit and non-audit team for the same client” (Audit partner, company C).

Auditors’ independence problems have been addressed by a “threats and safeguards” approach which is widely accepted (Shaub, 2005). According to this approach, there are five basic categories of threat to auditor independence: self-interest, self-review, advocacy for clients, intimidation by clients, and trust or familiarity threats. The materiality of each of these threats varies based on the details of the individual audit firm-client relationship (www.pcaobus.org).

Further, to achieve a high level of audit quality, the global networks pay more attention to staff specialisation. Partners in the big four firms stress that all members of staff must have previous experience in the service which they are providing, or in the industry which they are auditing. In other words, they cannot audit a type of business which they have not audited before. In some cases, staff of a national firm who do not have enough experience in a specific business or service are supported by foreign staff from another member firm who are experts in this business or service. High levels of specialisation can ensure high levels of quality and mitigate the audit risk.

“One of the main requirements of our global network is the creditability of our staff; we cannot provide services that we have not provided before” (Audit partner, company A).

“If we do not provide the service, we ask our members in other countries to support us with experts in this service” (Audit partner, company B).

New software programs, databases, and online networks have been installed by the global networks to assist auditors in accessing the inquiries or information regarding a specific client, industry, or capital market in any country and at any time. These data are added by specialists and experts in different industries, regions, and capital markets. This can enhance auditors’ judgments by increasing their knowledge, thus meaning that they can share best practice when auditing a specific client or industry. This also achieves faster and easier communication among the member firms of the global networks in order to assist them in making the right judgment in a faster way.
Other software programs have been specifically designed to confirm that auditors are committed to different regulations and standards. For example, new systems are designed to properly record people’s confirmations that they are not related parties to any of their clients. Other systems aim to assure that there is compliance with the ethical standards related to performance appraisal and annual training records. The new programs ensure that the audit staff (at all levels) can be highly communicative with their global networks and their peers in other member firms. This can guarantee an acceptable and centralised level of quality and independence for all member firms.

“We have our standards – if the local regulations require more that’s fine, but not less” (Audit partner, company A).

Further, the big four global networks have designed specific checklists which auditors should use during the different stages of the audit process. These checklists aim to assure the unified approach of the audit through all their member firms in order to provide similar levels of quality in the audit process. This could reflect a new trend of transition from a principles-based to a rules-based audit methodology. This sometimes makes auditors less interested in the profession as they are doing more routine work than using their judgment to provide technical opinions for the audited financial statements. However, there are spaces for auditors to make judgments, as these checklists confirm that auditors take specific items into consideration when they make their decisions.

“Instead of saying here are your objectives, what professional judgment wants to do; we started to put in checklists with professional procedures, this must be done or at least explain why it is not done” (Audit partner, company D).

Moreover, after the governmental audit oversight, auditors have to provide evidence to clarify their judgments and decisions, to their independent inspectors. Everything has to be justified for the internal and external reviewers. Therefore, a highly restrictive policy has been developed, whereby auditors have to document everything they have done in the audit files. Anything not documented means it has not been done.

“If it is not filed, it is not done” (Audit partner, company B).

“What we did was work very hard to make sure that we complied with the regulatory environment that was imposed on us” (Audit partner, company D).
“We have to have systems, not only because of our increased scale of operation, but also we have got to demonstrate that we have a process to our regulators” (Audit partner, company A).

Accordingly, auditors now spend more time documenting everything in the audit files. Auditors believe that this documentation helps them to support their views in front of the external reviewers, to comply with the standards, and to find something to remind them about what happened in the past and why they are taking specific decisions. However, they spend a great deal of time completing the audit files and ticking boxes rather than carrying out the actual audit.

To sum up, following Enron, it seems as if the global networks of the big four firms have come back to themselves and said,

“We face increased risks of litigation and losing our reputations; therefore, we have to review our works at all levels inside different member firms”.

More centralised strategies have been applied in order to manage and assure similar levels of quality in different countries. This centralisation is applied through a number of unified software programs which automatically control issues related to maintaining the required level of auditors’ independence, mitigating high levels of audit risks, and assuring acceptable levels of documentation in the audit files. I argue that these highly centralised strategies enhance the performance of member firms, especially in developing and emerging markets. This is because auditors in developing countries will be more able to share best practice with their peers in the developed markets through unified procedures which have been applied everywhere. They will also have access to the Intranet of each global network and have all technical data which are required to make sufficient judgments. However, this also increases effort, hours and cost of the audit processes.

7.3 Establishing Highly Closed Communications

“Our goal is to encourage and foster closer cooperation across our global network ….. To become more nimble, responsive and effective in everything we do. To protect and enhance our market-leading brand, we will work to embed throughout the PwC network a culture of quality and excellent service that makes clients eager to work with us” (PWC global annual review, 2009, p.4).
Post-Enron, the global networks of the big 4 firms stress that they need to build firewalls between their members in different countries to protect their reputation from any further collapse which could result in threats to their global brand. The global networks’ reports emphasise that each local member firm has its own assets and owes its own liabilities (see, for example, the annual reports of PWC and KPMG in 2004 and 2005, available at: www.pwc.com and www.kpmg.com). As time has passed, partners have become more comfortable that they can manage their liabilities in their own ways. They believe that the advantages of coming together are more cohesive and outweigh the professional risks. Accordingly, in 2007, local member firms in Europe and in other countries merged to create one cross-border LLP firm. While this integration has been undertaken in two of the big four firms⁵, the other networks have approved new closed worldwide structures⁶. This new merging strategy has started to increase their competitive advantage and enhance their reputation which should improve their market share, especially among multinational companies.

“We are thinking about our clients. We are trying to organize our firm in a way that is pan-European, to meet the needs of the market” (Audit partner, company D).

“We are ideally placed to meet fast changing needs, especially in these difficult economic times” (www.kpmg.eu, accessed in Jan 2012).

“The most significant thing I talk about with my clients is that I have got a very direct chain of command to my peers everywhere” (Audit partner, company D).

Each European LLP firm is a limited liability partnership which controls a number of independent member firms, which have elected to enrol in it. The ELLPs are apart from their global networks, and do not provide any audit or non-audit services for the clients. Each member firm – which is a part of the ELLPs or even the global networks – does not have the authority to obligate or bind their ELLP or the global network or any other member firm vis-à-vis third parties. Similarly, the ELLPs do not have the authority to obligate any of their

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⁵ In October 2007, the UK and German member firms of KPMG merged to create KPMG Europe LLP that was registered in London (see the public report on the 2008/2009 inspection of KPMG LLP and KPMG audit PLC, available at: www.frc.org.uk). Further, in 2008, E&Y Europe took control of E&Y UK following which the partners of E&Y UK became members of E&Y Europe (see the transparency report of E&Y UK 2009 available at: www.ey.com.uk).

⁶ In 2008, PWC created three major clusters of PwC firms – East, Central, and West – led by the senior partner of the leading national firm in each cluster, namely, China, the United Kingdom, and the United States. For more details, see the global annual review of PWC in 2008, available at www.pwc.com.
member firms\textsuperscript{7}. This legal exemption from any obligation toward the merged member firms comes in order to protect each of them, and their global leading reputations, from any sudden collapse to any member firm.

\begin{quote}
\textit{“We are trying to bring the network closer together, to get us into one partnership”}\textsuperscript{} (Audit partner, company A).
\end{quote}

\begin{quote}
\textit{“Our new structure will improve the integrated services we offer and more closely align our strategy around the world”} (PWC global annual review, 2008).
\end{quote}

\begin{quote}
\textit{“The drivers for us in coming together were, (1) about quality and (2) about appropriate investment”} (Audit partner, company D).
\end{quote}

The ELLPs are responsible for setting strategies which are related to people, quality and financial growth. They also oversee their implementation in merged firms. The ELLPs have extended their responsibility to control non-European member firms as well. For example, E\&Y ELLP is a European holding company which controls 46 member firms in Europe, Middle East, India, and Africa (E\&Y UK, 2011). KPMG ELLP also controls member firms in Saudi Arabia, Jordan, and Kuwait, which are obviously non-European countries (KPMG ELLP, 2011).

\begin{quote}
\textit{“The Europe board has the authority and accountability for strategy execution and management of its operations under four dimensions being people, quality, growth, and operational excellence”} (E\&Y UK transparency report, 2010).
\end{quote}

\begin{quote}
\textit{“The ELLP board’s responsibilities include setting the strategy, overseeing its implementation by the executive committee, and considering the group’s overall financial performance and solvency”} (KPMG ELLP transparency report, 2010).
\end{quote}

The big firms try to use their skills and capabilities to increase their market share and attract a higher number of global clients. The large number of resources which have been invested in the new merged structure have strengthened its ability to provide better services. This is achieved through development programs to human resources to gain better knowledge, expertise, and specialisation in specific markets, industries, and businesses.

\textsuperscript{7} See, for example, the annual report of KPMG ELLP, 2011, available at: \url{www.kpmg.eu}. 
“We are making these changes for the most fundamental reasons: to ensure that our organization is positioned to provide clients with the distinctive, premier service they expect from our brand” (PWC, global annual review, 2008).

Further investments have been made to apply and develop IT assets - including the appointment of highly skilled staff and the acquisition of advanced programs to be applied by all member firms. The big firms stress that the new closed structure adds competitive advantage for its member firms, as they become more able to provide high quality support to their clients across countries, industries, and specialist areas. This assists their clients, especially their global clients, who are operating across borders and entering new emerging markets. The new European LLP structure makes it possible for the audit firms to invest on a larger scale and to provide a greater industry and product specialisation.

“You are unable to command the resources across Europe as a partner in the UK” (Audit partner, company D).

“This network structure provides member firms with the flexibility to operate simultaneously as local businesses, but on a global scale, creating a platform on which member firms share knowledge, skills and resources and deliver services of consistently high quality to international and local clients” (PWC global annual report, 2009, p.36).

By establishing the European LLPs, firms are able to provide larger investments in their people, systems and other related resources. The new cross-border structures are more relevant to the multinational companies which act in the market without borders and prefer consistency everywhere, in particular, with their auditors.

“After only two months post-merger we already formed multinational teams of professionals who are successfully winning in the marketplace” (KPMG LLP UK annual report, 2007).

“There is already a natural alignment between our firms, but by linking together in this way, we will have an even greater impact in meeting the needs of our clients in what is one of the fastest growing regions in the world. Our clients and employees increasingly are more internationally focused” (Audit partner, company A).
The new global structures offer unparalleled opportunities for their people to gain client experience, to share expertise and best practice with their peers in different countries, and to gain a higher degree of diversity and knowledge by meeting different people from different cultures.

“We provide greater international career mobility for our employees, to widen the breadth of our people's experience, skills and knowledge” (www.kpmg.eu, accessed in Jan. 2012).

“It is a way to spend less time on internal staff, to be quicker to respond to your clients' requests, and to get the right scope and the right people involved” (Audit partner, company A).

This strategy assists partners in speeding up their response to their clients everywhere, whilst also removing any infighting – to a certain extent – between local firms as they become one partnership rather than looking forward to how much they will get paid. It also assists firms in guaranteeing an acceptable level of quality wherever they are, which can enhance their global leading reputation.

One of the main challenges of the new ELLPs is to retain highly skilled staff who are able to effectively serve the needs of their leading clients.

“Our challenge is to continue harnessing the talents and expertise of our people and to bring those together, efficiently and effectively, to serve our global and national market clients in better ways” (KPMG ELLP, annual report, 2011).

“Serving the market better, improving quality, providing more consistent service, and being more transparent in our services” (Audit partner, company D).

The new structure also assists member firms in serving areas in which they anticipate growing clients’ needs. It also helps them to focus on emerging markets which will play an increasingly pivotal role in the global economy. The big firms give priority to helping their clients overcome the complex challenges of the current markets. The world’s changes, complexity, and uncertainty have been rapidly intensifying, whilst the global companies’ needs for experts and specialists have consequently developed. This demonstrates further the advantages of the newly expanded structure which gives big firms the opportunity to better serve their multinational clients. A more closed structure gives opportunities for the big firms
to provide better quality with little extra costs. This is achieved by following centralised strategies in their data collection, training programs, and managing unified IT assets.

“... Our aim is to create a virtuous circle in which the opportunity to help our clients overcomes their most complex challenges, and motivates and develops our talented people ... The continued expansion of our ELLP gives us tremendous scale and a unique perspective on the markets and sectors in which our clients operate” (KPMG ELLP, annual report, 2011).

“We are confident that the ELLP firms, connected across geographies and sectors, can really make a difference to clients as they confront these challenges” (KPMG ELLP annual report, 2010).

Some audit partners emphasise that although there are some advantages to this new strategy, they sometimes do not feel connected to other partners because of the large number of partners who are working at the European level.

“But my own view is that it is a timing matter, we do have things that will come across. I have been recently spending four days with people from all the practices” (Audit partner, company D).

“The value we bring lies not just in our scale, but in our ability to draw on an exceptional breadth and depth of expertise for the benefit of our clients” (KPMG ELLP annual report, 2010).

I argue that this new strategy is another part of the highly centralised strategies which are followed by the global audit networks of the big four firms. These global networks aim to maintain a similar and standardised level of quality to that provided by their member firms. This is achieved by ensuring that specific procedures have been applied in all member firms at all levels. Checklists and online software programs represent some ways to achieve this aim and control the quality of the audit process within each member firm.

I also argue that this new cross-border structure of audit firms needs to be supervised by a global, cooperative board of regulators in order to set global standards of audit oversight. Serious steps have been made among governmental audit regulators in different countries. The International Forum of Independent Audit Regulators (IFIAR) is an example of such cooperation between regulators at a global level. The main purposes of the IFIAR are to share
knowledge of the audit market environment and practical experience of independent audit regulatory activity with a focus on inspections of auditors and audit firms (IFIAR, 2010). However, the IFIAR and even national regulators do not have the authority/power to inspect the European LLPs. This issue warrants further research to examine how these ELLPs and their global networks can be inspected; i.e. nationally or internationally?

7.4 A Stringent Conservative Strategy

One of the main strategies which has emerged from the big four firms’ wish to restore public trust and ensure that an Enron-style collapse will not be repeated, is the exclusion of high risk clients – regardless of their fees. The global networks compel their member firms everywhere to re-evaluate their clients’ portfolios and exclude high risk clients. They have announced that more rigorous policies for clients’ acceptance and continuity have been set to protect their reputation and restore public trust in their opinions. It seems that the big four firms have become more conservative regarding litigation.

“*The global network requires specific procedures to reassess our clients according to three categories of risk management*” (Head of audit committee, Company C).

“We have very rigid policies for risk management and clients’ acceptance and continuity policies” (Audit partner, company A).

“There are certainly much more stringent procedures, predominantly around client acceptance and that is probably most evident in audit; we also have greater enhanced procedures around engagement acceptance” (Audit partner, company D).

As a result, risk management departments – in each member firm of the global networks – have been established. The risk management partners are responsible for determining areas of risk for each client, and approving the clients’ acceptance and continuity for each engagement.

“One of the main changes after Enron was the establishment of the risk management department” (Executive partner, Company A).

The risk management policies are the minimum standards which should be applied by member firms. These standards consider all international standards or principles related to

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8 The global networks do not deal with clients. They are brand names and support their member firms that are legally responsible for their clients (see, for example, the annual reports of the big four firms in 2009).
assuring the quality control and risk management systems. Any national member firm has to consider additional requirements by the local audit authorities or regulators.

“These policies are designed as a minimum standard and encompass the standards issued by the International Federation of Accountants (IFAC), including International Standard on Quality Control 1 (ISQC1), relevant to firms that perform statutory audits and assurance engagements. These policies and associated procedures are designed to assist our firms in complying with relevant expert standards, regulatory and legal requirements, and in issuing reports that are appropriate in the circumstances” (KPMG ELLP transparency report, 2010).

The risk management partners are appointed to be responsible for identifying, avoiding and managing all professional risks through a number of appropriate processes and procedures. Further, global quality control systems have been designed and implemented to ensure that member firms comply with professional standards and applicable regulatory and legal requirements (KPMG, 2008). However, Ryu et al. (2009) conduct performance comparisons for the audit firms between the pre- and post-SOX periods. They stress that although audit firms claim they have become much more conservative with respect to client retention and acceptance decisions, because the risks associated with auditing have increased significantly after the enactment of the SOX, there is no significant difference in the audit firms’ performance during the two periods.

“Risk management partners are responsible for setting overall professional risk management and quality control policies and monitoring compliance with applicable regulations and standards” (KPMG ELLP transparency report, 2010).

“Quality not only delivers regulatory compliance, but it also enhances the experience for all of our clients and staff” (PWC LLP UK annual report, 2011, p.31).

The global networks have emphasised that each member firm has to perform risk management and business decisions when accepting a new client or continuing with an existing client. Therefore, detailed assessment is required for each potential or current client or engagement to balance the risks and rewards involved. Software programs have also been used to manage and monitor the acceptance and continuity for every client in order to ensure
that there is no conflict of interest or a business relationship among the audit firms’ staff and their current/proposed clients anywhere. The clients’ acceptance or continuity decisions have been taken according to specific principles. These principles have been set to maintain quality, manage risks, and achieve compliance with regulatory requirements (E&Y, 2010).

“The client evaluation determines whether the firm will accept the client and identifies what steps need to be taken to mitigate risks identified by the evaluation .............. Existing clients are re-evaluated, at a minimum, every 12 months if the relationship with the client is intended to be continued. Earlier re-evaluation is required when a significant change relating to the risk profile of the client becomes known to the member firm” (Risk management manual of company A, 2008).

“The Global Tool for Acceptance and Continuance (GTAC) is an Intranet-based system for efficiently coordinating client and engagement acceptance and continuance activities in line with global, service line and member firm policies. GTAC takes users step by step through the acceptance and continuance requirements and connects to the resources and information needed to access both business opportunities and associated risks” (E&Y UK transparency report, 2010).

The decision to accept, or continue with, any client, the following criteria should be considered: achieving acceptable levels of compliance with applicable independence requirements, excluding high risk clients, avoiding and managing any conflicts of interest, and being committed to other regulatory or professional requirements. Further, the clients’ acceptance process is designed not only to evaluate the risk level, but also to ensure the firm’s ability to sufficiently deliver a high level of quality during the audit process – especially with complicated or highly technical industries (such as: petroleum or natural resources companies).

“This process involves a careful consideration of the risk characteristics of a prospective client and several due diligence procedures. Before we take on a new client or engagement, we determine if we can commit sufficient resources to deliver quality services, especially in highly technical areas” (E&Y UK transparency report, 2010).

These rigorous procedures for clients’ acceptance and continuity are implemented to ensure that the firm can sufficiently commit to delivering a specific level of quality service, meeting
applicable independence standards, identifying and declining high risk clients, and protecting the leading reputation of the big firms. The big four emphasised that a set of factors are considered through the acceptance process.

“We have our process that says: what about the risk associated to this client? Is it reputational? Listed? In which industry sector does the client lie? What about the management history?” (Audit partner, company A).

“Factors that may be considered during the acceptance process include, but are not limited to:

- Client-related matters such as financial strength, reputation and integrity of management personnel.
- Business-related matters such as industry, products and competitors.
- Service-related matters such as our competency and associated technical risk.
- Matters related to independence and conflicts of interest” (KPMG UK annual report, 2007, p.44).

The level of risk is determined according to specific criteria. For example, listed companies in capital markets and public interest entities⁹ are considered to be high risk clients. The nature of the industry affects the risk level as well. For example, banks and petroleum companies are considered as high risk clients by default. The clients’ size and the complexity level of their transactions also affect the risk level of the clients. Another factor which affects the level of risk is the high network risk. This includes risks which are related to clients’ subsidiaries or clients affiliated with other companies which are audited by other member firms around the world. The risks arise because any misstatements will threaten the reputation of the national firm among the global network.

“The criteria for high risk clients are: listed in capital markets or a subsidiary of listed companies, public interest entity, the nature of the industry (for example, banks, petroleum, insurance, or real states), size of company or complexity of transactions. The risks are identified through clients or through engagements with the same clients” (Audit partner, company B).

⁹ Public interest entities means entities that are of significant public relevance because of the nature of their business, their size or their number of employees – in particular companies whose securities are admitted to trading in a regulated market, banks and other financial institutions and insurance undertakings (KPMG, 2007).
“The risk management department classified our clients into three categories: normal risk, greater than normal risk, and much greater than normal risk. This classification is done according to some criteria such as: the clients’ industry, the rules that regulate the industry, listed companies and public interests entities” (Audit partner, company C).

The rigorous procedures of clients’ acceptance and continuity ensure that no clients’ management or financial pressures have been placed on the audit engagement team to accept any inappropriate reports.

“Consideration and conclusions on the integrity of clients’ management are essential to acceptance and continuance decisions” (E&Y UK transparency report, 2010).

Further, the complexity of the new regulatory requirements and the global companies’ transactions as a result of their expanded structure everywhere, have led to higher potential professional risks and an emphasis on the importance of performing a number of rigorous procedures when taking acceptance or continuity decisions. Such complexity puts pressure on the big firms to hire highly skilled people, and to better connect specialists in every industry sector to provide better services for their clients. This also dramatically raises the audit fees as a result of the increased hours which are required in the audit work.

“Change and complexity of regulations lead to increased professional activities and revenues; we become busier than before” (Audit partner, company C).

Clients are not always satisfied with these complicated procedures, which take a long time and require extremely detailed data about the clients. However, by the time they are accepted, clients understand that these procedures assist auditors in understanding their business, and determine high risk areas which can protect both auditors and clients from any sudden collapse or scandal.

“For multinational companies you are not just an auditor, you are adding value” (Audit partner, company A).

To sum up, I argue that, post-Enron, the big four audit firms have followed more conservative strategies when it comes to their potential business risks. Highly rigorous acceptance and continuity procedures have been applied to their potential and current clients to exclude high risk clients. Clients are reclassified according to their associated risks, and additional
requirements have been set to ensure the quality of the audit process of risky clients. A set of factors is identified to determine the level of client risk. These factors include a client’s public interests, business complexity level, its related parties, and the number of capital markets in which it has been listed. Moreover, intensive policies have been set to ensure the member firms’ compliance with all applicable standards and regulations. Software programs and Intranets have been installed to ensure that all regulatory requirements have been complied with on time and justifications have been provided for any delay or non-applicable requirements.

7.5 Global Mobility: a New People Strategy

“The best audit methodologies will not deliver the best audits unless you have got the right people doing the work” (Audit partner, company D).

“We focus on mentality, education, presentation skills, communication skills and social level” (Audit partner, company C).

“We participate in the employment fairs of the leading universities in Egypt, the audit partners talk directly with the fresh graduates to select candidates with the highest intellects” (Audit partner, company A).

Auditing is an expertise-intensive and labour-intensive service profession and human capital is its main resource (Chen et al., 2008). Maister (2003) argues that the big audit firms focus on recruiting the best graduate students as one of their human resource strategies. The big audit firms stress the importance of human capital for their business; highly skilled auditors are the key to delivering high quality services. The big four have emphasised that they give high priority to recruiting and retaining highly skilled and educated individuals to build up their highly skilled and talented human capital. The big four are seeking people who have the right intellect, right professional scepticism, and the right understanding of businesses with which to better serve their clients.

“We want to ensure we have the right people in the right place to support our clients ….. Understanding our client needs is the basis of our people strategy” (KPMG LLP UK annual report, 2007, p.28).

“To help us keep attracting top talent we strive to be known as a network that cultivates and develops individuals by fostering a culture of coaching and
development that provides all our people with the opportunity to achieve their potential” (PWC global annual review, 2009, p.6). “A strategic objective is to attract and build life-long relationships with talented audit professionals. Retained highly skilled individuals and making the audit practice an attractive place to build their career is key to the long term success of the business” (E&Y LLP UK transparency report, 2010, p.25).

Much attention has been paid to the hiring of highly skilled people to face the increased number of global clients which audit firms now serve. Serving multinational clients requires special people who can understand their different needs. Multinational clients are working in different markets which have various economic conditions and are associated with different types of high risk from different sources. One group of companies may invest in different types of business which requires highly specialised auditors to understand the features of these businesses and determine the risks associated with each business. Usually, multinational companies perform a number of complicated transactions during the year; mergers, acquisitions and derivatives are some of the most popular transactions which require experts and highly talented people to ensure that these transactions are effectively treated according to the applicable standards.

“Our priority during the year was, therefore, to widen our search for the best international talent, to strengthen our approach to recruitment and to continue developing a high performance culture within which our people, at all levels, can excel in serving our clients” (Global head of people, company A).

“We are looking for people who are not afraid to lead, no matter how junior they are, and who are passionate about the future and the part they can play in our continued success. We expect them to be highly mobile and to develop the sort of agility that comes from having an international mindset and a breadth, as well as a depth, of business skills” (KPMG E LLP annual report, 2010).

Global clients are working in different environments with different accounting and auditing standards. They need auditors who are able to understand the requirements of different applicable standards. Therefore, the increased number of global clients has motivated the big four firms to focus on recruiting highly skilled graduates from reputable universities to ensure the quality of their people.
“We constantly look beyond the traditional routes to make sure we capture outstanding graduate talent” (Audit partner, PWC, available at www.pwc.co.uk accessed in Jan 2012).

“By attracting and retaining the very best people we will win valuable and exciting work with high calibre international clients” (Global head of people, company A).

“I believe that working abroad and leaving your regular environment is enriching, because you gain insight into environments, people and cultures that take very different approaches from those you are used to in your home country” (Audit partner, PWC, annual review, 2009).

Some programs have been established between the big four firms and top ranked universities to train students on actual cases from the work field, with respect to the confidentiality of clients’ data, and to supervise their audit and accounting courses to ensure that the students learn what the firms need.

“We are fully committed to recruiting the very best talent. To develop outstanding talent within our Audit practice we have launched a new school leavers’ program” (Global head of people, company A).

“In 2010, Deloitte stepped up Deloitte21, the organization’s global education and skills initiative focused on preparing underserved young people for success in the 21st-century economy” (Deloitte annual review, 2010).

To develop the individual skills of their staff, the big four firms offer global opportunities for their people to share with their peers in other different countries around the world. These opportunities are to cover clients’ demands in different places with different expertise at the right time.

“We encourage our people to go out and get more experience in different countries” (Audit partner, company C).

“There are several key drivers that make a global assignment important for professional career development and for KPMG. Our client base, the capital markets and the regulatory environment are truly becoming global, and the harmonization of global accounting standards demands global resources to ensure consistent financial reporting” (The KPMG Go Guide, 2008).
“I believe that working abroad and leaving your regular environment is enriching, because you gain insight into environments, people and cultures that take very different approaches from those you are used to in your home country” (Audit director, company B).

“Mobility: moving the right people with the right skills to the right places at the right time to meet the needs of the business, clients, talent, and marketplace—is a competitive imperative” (Deloitte annual review, 2010).

This new strategy provides good opportunities for individual auditors. Working in different places with different systems, people and cultures can add value, experience and knowledge for auditors and develop their skills in different areas.

“One of the most exceptional things we can offer our people is the chance to work with many of the world's leading companies and organizations. As well as developing their skills, they'll be able to build long-lasting relationships, both within and outside the firm that will stay with them throughout their career” (Audit partner, PWC, available at www.pwc.co.uk accessed in Jan. 2012).

“A global experience helps our people to grow as individuals and as professionals. Going through this experience creates stronger bonds, lifelong memories and richer lives. And participants develop new skills that will make them even more valuable working with their clients and their teams, wherever they are” (The KPMG Go Guide, 2008).

“The talented people we wish to recruit are increasingly willing to move between countries. Individuals have become far more mobile and intent upon widening their level of professional experience by seeking opportunities to work worldwide” (Global head of people, company A).

Further, professionals are looking for diversity and integrity everywhere and in everything they do. Auditors return home feeling more confident, credible and having experienced new cultures, often also having mastered new languages and adapted to new working environments. This can enhance their professional international credentials for the multinational marketplace. Money is not only the most significant reward auditors look for –
gaining more experience, working internationally, and having a clear career path are also significant factors which many auditors seek.

“Flexible working arrangements, recognition, the chance to gain experience outside KPMG on secondment, clear career paths and the chance to work internationally are all among the issues they see as important. We actively promote all these practices” (KPMG ELLP annual report, 2010).

“It helps understanding, it helps blend cultures, it helps set common standards, shares better practice” (Audit partner, company A).

“It’s more than just coming here to implement programs that work in other countries, or looking for gaps in the system that we can fill with what we’ve done elsewhere. It’s about introducing entirely new approaches to the market that businesses haven’t seen here before …… One of the major changes to me personally from working abroad is that I’ve gained a lot of patience” (Audit director, company B).

“Working abroad provides a greater awareness of our rapidly changing world, and an appreciation for different cultures and different ways to successfully conduct business” (The KPMG GO Guide, 2008).

Such global opportunities help the big four firms to have people who better understand the global audit approach and to ensure that this approach is consistently applied by different people in different countries. Their people share best practice around the world to guarantee a minimum quality level for their audit works. Global clients also need multinational experts who can serve their needs in their branches everywhere. The annual report of KPMG in 2008 stresses that global opportunities or international job rotation programs serve the evolving needs of member firm clients throughout the world by having the right professionals in the right place at the right time.

“Clients want it, they are doing it, so why should not we?” (Audit partner, company D).

“Our clients increasingly demand international experience, making exciting opportunities ever more available” (PWC global annual review, 2009, p.21).
“We recognize that we will only enjoy success in the long term if we consistently share the tremendous skills and experiences of our people by providing them with opportunities outside their home countries …… Without doubt, those organizations that truly recognize the critical role played by diversity and mobility in sustaining a productive, loyal workforce gain a clear competitive advantage over those that do not.” (PWC global annual review, 2009, p.6).

Although there are several advantages of this new strategy, some constraints can affect its implementation. Languages restrict some auditors from traveling to many countries, especially countries which do not use English as their first language. For example, auditors who would like to go to Germany or France are expected to speak Dutch or French. Home sickness is another restriction which faces auditors in foreign countries. They leave all of their family, friends and colleagues and go to a different place, meeting new people, and experiencing a new culture and work system.

“If someone comes to London and English is not his first language, it is difficult for him to have the necessary writing and communication skills” (Audit partner, company D).

Another problem is the difficulty and complexity of obtaining a visa for people coming from specific geographical areas in some countries. Other cultural issues could restrict people from working with clients in different countries and threaten the relationship between auditors and managers who feel uncomfortable with foreign people who come to audit their companies.

“People coming from some parts of the world are much more direct in asking questions and looking for answers, for some people in the UK that’s not quite how we do things; so sometimes there is that kind of culture issue” (Audit partner, company D).

“One of the challenges of an international assignment is building a social network. As I move around from country to country, I have to build up a new social life…… but on the other hand it’s always exciting meeting new people. I now have friends all over the world. Of course, moving can be lonely sometimes, but every move brings a change – and change also brings excitement” (Audit director, company B).
In developing countries, auditors who have taken these opportunities come back with high levels of management and personal skills. They are more organised in their work, and more able to lead teams. However, they sometimes suffer a culture shock because of differences between the work systems in developed and developing countries. In some cases, they are not able to continue in the profession, and decide to change their career.

“Finally, we lose our people as they do not come back and prefer to stay abroad, even when they come back many of them do not continue with us” (Audit partner, company B).

“When they come back they do not wish to work in the audit profession as they face culture shock” (Audit partner, company C).

To sum up, I argue that as a result of the increasingly high trend of globalisation in the capital markets, which means that the big four firms may serve global clients within global audit regulatory changes, the big audit firms pay much more attention to recruiting highly skilled and talented people. A set of programs has been developed to apply such a strategy. Connections with top ranked universities have been established to hire their highly skilled graduates. Other training and educational programs have also been established to attract people from different backgrounds. In parallel, global opportunities have been offered to a large number of people from different member firms to work in different countries, cultures and working systems. Such opportunities aim to provide a wide range of openings for auditors to gain experience, develop their skills, and become more specialised in specific industries or markets. Further, the audit firms have more opportunities to better serve their global clients by gaining a competitive advantage through employing an increased number of highly skilled experts and specialists in different types of industries, businesses, and geographical areas. However, some difficulties arise as a result of applying such a strategy. Auditors sometimes suffer home sickness when staying in foreign places, whilst clients may also feel uncomfortable when working with foreign auditors.

7.6 Increased Audit Fees

The US Treasury Department (2008) reports that global revenue has doubled when it comes to the largest four networks over the previous 5 years. Ghosh & Pawlewicz (2009) indicate that after SOX the big four audit firms have increased audit fees by 42% more than their smaller counterparts. They state that while small and large audit firms discount fees on initial
engagements to attract new clients in the pre-SOX period, only small audit firms continue to offer fee discounts for the post-SOX years. Large audit fees may increase the efforts of auditors, which will in turn positively affect the audit quality (Hoitash et al. 2008). However, some big four partners argue that fees are dependent on exerted efforts and not vice versa.

“The fees are the work we do” (Audit partner, company C).

These increased fees have come as a result of a set of specific factors. The changes and complexity of the new audit regulations in many countries – such as the SOX Act in the USA and similar laws in other countries – require additional tasks to be completed by auditors. These new tasks increase the amount of time spent to complete the audit work and in turn the costs of the audit process.

“We were successful for a few years in increasing audit fees, for the additional work we were being asked to do according to the new auditing standards and Sarbanes Oxley requirements …… There was a period of time that 6, 7 and 8% increases in our audit fees were common and accepted” (Audit partner, company D).

“Our fees increased as a result of Sarbanes Oxley and the conversion to IFRS” (Audit partner, company D).

This is consistent with the literature (see, for example, Owen, 2003; Cosgrove & Niederjohn, 2006; Ciesielski & Weirich, 2006; Wilcox, 2007; Ghosh & Pawlewicz, 2009) which provides evidence that higher audit fees are required by audit firms resulting from the complexity of the SOX Act and similar laws. Seetharaman et al. (2002) find that audit fees of UK companies which are cross-listed in the US capital market are higher than the audit fees of other UK companies cross-listed in other countries, or others which are not cross-listed. They attribute their results to stronger regulatory environments leading to higher audit fees as they require more tasks and audit efforts. Choi et al. (2009) and Bronson et al. (2009) conclude that the higher audit fees of cross-listed companies can be positively associated with the stronger legal environment relative to the firms’ home countries. However, a more restricted regulatory audit environment is not the only factor which intensively increases the audit fees.

Certain other factors have also contributed to the fees increase. For example, new software programs and systems have been developed/acquired by the big four networks to ensure their compliance with the ethical and auditing standards. These systems need highly skilled IT
staff to moderate them and highly skilled auditors to use them. Such extra costs have resulted in increasing the audit fees.

“Our fees have grown year on year that is because the nature of the services we deliver has widened annually. The audit practice has tended to grow” (Audit partner, company A).

Owen (2003) and Oxera (2006) stress that the higher concentration in the audit market has led to an increase in audit fees and profit margins of the big audit firms. This high concentration has been a result of recent mergers among the big audit firms during the last two decades. Further, Her et al. (2010) believe that audit fees increase in response to clients’ financial restatements and the extent of this increase depends on the severity of the restatements as they increase the risk of audit. Audit fees are frequently modelled as a function of the cost of the audit effort and the auditor’s expected legal liability (Ghosh & Pawlewicz, 2009). Ghosh & Pawlewicz (2009) provide evidence that the SOX Act requires external auditors to make more of an effort, to pay more costs, and to bear greater liability which has led to increases in audit fees post-SOX. However, the big four emphasise that liabilities are outside any consideration when the audit fees decision is taken. They are not an insurance company; the fees are determined by work hours, market conditions and the nature of the client.

“You are looking at how complex is the business, what are the controls like within the business, how many locations the business operates out of, but you are not looking at limitation liability” (Audit partner, company D).

It must be noted that a particular set of factors is considered by the audit firms to determine the audit fees for every audit engagement. Some factors are related to the client’s business. For example, if the client’s industry suffers from temporary weakness, then that threatens the client’s profitability, and thus an increased margin is required for auditors to evaluate the going concern of this client. Such additional work increases the audit fees. Other factors are related to the clients themselves; higher risk clients and companies which have insufficient quality control systems are expected to pay higher fees. For example, if the client targets (or is being targeted) for an acquisition, fees are expected to be higher.
“So the fees will fluctuate with the nature of client. If they’ve got a particular accounting issue or they’ve got a fraud, then we’d expect to do more work and we’d expect to be paid for it” (Audit partner, company A).

Furthermore, some partners stress that clients have the power of negotiation and can always go to a competitor. The client’s size and financial position strengthens its power to negotiate (Swanson, 2008). However, for other, reputational reasons they usually select one of the big four firms.

“If they feel that we are overcharging them, then they will test the market” (Audit partner, company A).

Further factors are related to the market in which clients act. For example, listed companies and public interest entities are expected to pay higher audit fees as more hours are needed to complete the audit by audit firms.

“So you have concern issues where we have to do some work, we have evaluation issues where we need to do more work, you’ve got recoverability issue on debtors, so in those sort of circumstances, you would expect to say, we have to do more work because of the environment and therefore we need to be paid some more money and that’ll be perfectly reasonable” (Audit partner, company A).

The number of the client’s premises and the complexity of its transactions are other factors which are taken into consideration when the big four firms are determining the audit fees. Suwaidan & Qasim (2010) provide evidence that audit fees are positively affected by clients’ size and negatively affected by the reliability of internal auditors in the eyes of external auditors. Additionally, Zhang et al. (2011) find that audit fees are not immediately changed from one year to the next. They also suggest that audit fees respond to changes leading to a faster increase than changes leading to a decrease.

To sum up, it is argued that audit fees have been intensively increased post-Enron. Our findings are consistent with the literature in that the more complicated requirements of the new audit regulations (SOX Act, UK Company Act, and similar laws in other countries) are the main drivers of such increases. This seems to be applied almost everywhere according to the increased number of global companies which are cross-listed in many capital markets, especially the US and UK capital markets. However, the changeable audit regulatory framework is not the only factor which increases audit fees. This study highlights some other
factors which have contributed to the increase in audit fees such as the higher degree of concentration of the audit market after the transition from the big five to the big four firms following the collapse of Enron (Oxera, 2006).

In conclusion, factors contributing to the increased fees can be classified into two groups. The first group includes increasing the hours to complete the audit process (such as: the higher risk of litigation faced by the audit profession; the more conservative strategies which have been followed by the big four, and the increased number of global companies – and all their branches and subsidiaries all over the world – that are audited by the big four firms). The second group is factors which increase the rate of audit fees per hour at all levels of the audit firms (such as: the new software programs, databases, and Intranets which have been established to support all member firms; the new groups, centres and committees which are responsible to advise, approve and review different issues related to the audit process to ensure acceptable levels of quality provided by all member firms; the highly skilled experts and specialists in the IT staff and different industries who are hired to provide excellent degrees of specialisation in all businesses and markets to support and add valued advices for the multinational clients; and the increased costs of the global opportunities which have been offered to the auditors to serve in different countries to provide the audit clients with the right services by the right people at the right time).

I argue that changes in the audit regulatory environment, the increased number of multinational clients – with more complicated and highly specialised needs, requirements, and transactions – and the lower public trust with higher risk of litigation for the audit profession are the main drivers which motivate the big four firms to become more conservative, and more keen to protect their leading reputations and market shares. Such changes lead the big four firms to exert more effort and make larger investments in people, technology, and networks. There is no doubt that the big four are profit seeking organisations and are expected to achieve return from their audit engagements and as a consequence they charge higher fees.

7.7 Competing in a Highly Competitive Market

“It is a highly competitive market .... I know people say there are only four and such like, but it is very competitive – in particular, if a client decides it wants to change”
(Audit partner, company D).
The big four firms are working in a very competitive and aggressive market, in which firms always try to take clients from each other. All the four firms are leaders and have their global networks and leading reputations. This strengthens the competition and makes it more aggressive; all the players are good attackers and at all times, goals are expected.

“It is strong competition, so obviously there are credible players” (Audit partner, company A).

However, no evidence is found regarding breaches of the fair market. The Office of Fair Trading (OFT) in the UK has stressed that their investigation of the audit market suggests that audit firms have not acted to prevent, restrict or distort competition (OFT, 2002).

“We do not behave as a cartel, and we do not breach the fair competition” (Audit partner, company C).

“To this end we have conducted a preliminary inquiry into whether, given the current market structure, there are competition problems in this sector. We have not found evidence to suggest that firms have acted to prevent, restrict or distort competition. Nor have we had complaints that they may be doing so” (OFT, 2002).

It is difficult to differentiate between the big four firms, as each of them has its own global network that has a global reputation and covers most of the countries around the world. The literature (see, for example, ICAS, 2009; U.S. Treasury Department, 2008; Oxera, 2006) provides evidence that the big four are similar in their organisational brands, structures, objectives, strategies and even the perspective of their clients. The big firms’ partners have emphasised that the audit fee is not the main driver of competition in the audit market, especially for the multinational companies which are seeking quality in everything they do. However, for small clients, the fees may be their first priority and they therefore select non-big firms.

“It is difficult to differentiate between the firms maybe on quality, but I think that using audit quality as a differentiator and then trying to deal with this price matter” (Audit partner, company A).

“It depends on the buyer. For some buyers, we have one thing frequently where we have not been the cheapest but actually they are more convinced about our offering and they’re prepared to pay the extra” (Audit partner, company A).
The main drivers of attracting current or potential audit clients to the big four firms are the quality of services, the quality of people who provide these services, especially at the top level management, and good direct relationships with clients.

“You don’t directly attack your competitors. We will try and build relationships with companies in market places around each office, around each team” (Audit partner, company A).

“Personal relationships, it’s all about relationships. I’ll have ongoing relationships with clients that have no intention of putting their audit out just now, but I am there either helping them with other services, or building relationships so that if something goes wrong with their existing audit relationship, they have already got a known relationship and trust which I can work from. And people go out and offer all kinds of extra services and offer to do it for less and all sorts of things. It’s driven in many ways but the core to it is relationship” (Audit partner, company D).

The big four serve global and multinational companies which focus on receiving better services rather than anything else; global clients need auditors to add value to their businesses, rather than just signing required audit reports.

“Actually, we are feeding back other views that we are not required to do regulatory ….. it is about the values that come out” (Audit partner, company A).

Multinational clients are looking for experts and specialists who can suggest best solutions and advice for clients’ business in different markets. Employing the right people is one of the most significant differentiators among the big and mid-sized firms.

“The mid-sized firms need to get the right people to serve global companies which are looking for experts in their business” (Audit partner, company D).

Two decades ago, auditors would do all audit and non-audit services for their clients; but now it is normal that a global company has relationships with almost three of the big four firms. Building relationships is one of the key factors, for the big four to secure their clients.

“So I might be the auditor, somebody else is the internal auditor, somebody else is the tax advisor, and the fourth one may be doing transaction advisory. So at any point of time, while the client might have to change its external auditor, there will be a very good opportunity for the other three to provide their proposal depending on
their excellent relationships with the client; so everybody is kept on their toes” (Audit partner, company D).

“It is all about personalities and relationships” (Audit partner, company A).

Building relationships with clients can be achieved through providing non-audit services for those clients, to better understand the management and nature of the clients’ businesses. Indeed, the firm can then offer its audit services after having built good and effective relationships with the clients’ management over a long period.

“Big firms attack by providing non audit services first to make strong relationships with the client and gain his trust, then offer the audit service with a significant cost reduction” (Audit partner, company C).

Connecting the key traders in business communities (such as banks and lawyers’ firms) is one way by which audit firms are expanding their contacts. Firms build relationships with those traders to better understand if there are some of their clients who can benefit from their services and vice versa.

“We can ask banks or lawyers to recommend us to their clients and vice versa” (Audit partner, company A).

The audit market becomes more ruthless when clients decide to change their current auditors. Changing auditors normally comes as a result of regulatory requirements or clients’ internal policies. In this case, the clients have equal perceptions of the potential audit firms as their preferred auditor has had to be changed according to the audit regulations. Therefore, the decision choice is highly influenced by price.

“I don’t think price is a huge factor, because I think the market accepts the price will always be competitive. But really my concern is that if you get into mandatory rotation then price could become a factor, then that will have an impact” (Audit partner, company D).

“Changing auditors are not very often; normally it is a governance process or audit committee’s requirement” (Audit partner, company A).

The audit fees have the lowest priority among multinational clients when they choose their auditors. They look first for the higher quality services and the highly skilled people whom
they trust. For smaller clients, prices have more materiality. However, IOSCO (2009) stresses that audit firms compete on factors including reputation, size, industry expertise and audit fees, whilst Jensen & Payne (2005) emphasise that audit clients select the least expensive auditors, yet those who are equal in quality. Further, Chaney et al. (2004) argue that companies seek to receive higher quality audit services and that the audit market is classified along cost-benefit lines.

“I do not think necessarily that price is the driver – price is a factor” (Audit partner, company A).

Although the competition is stiff, the big four cooperate together to protect their interests, enhance audit quality, and discuss the future of the audit profession. The Public Policy and Regulatory Group was established for the big audit firms to get together and discuss different issues related to auditing, accounting standards, and the profession’s issues within the government agenda.

“Lawyers present these meetings to ensure that there are no cartel activities, but this does not prevent aggressive competition” (Audit partner, company C).

The big four firms are members of the professional bodies (such as the Institute of Chartered Accountants in England and Wales, ICAEW) and conduct periodic meetings to discuss, evaluate and respond to the current projects of the governmental audit regulations. Occasionally, the big four have different views and send different responses to the governmental projects, although on many occasions they have the same views and try to affect the regulators’ views to protect their organisational interests.

“The firms can lobby together inside the ICAEW ….. but at the end, the firm is going to be independent” (Audit partner, company A).

Another side of competition among the big four firms is the competition to recruit highly skilled people. The competition is identified in two stages: recruiting fresh graduates and hiring newly qualified auditors. Normally, very few numbers of auditors move between the big four firms.

“There’s a lot of competition between graduates, between the firms. But it is unusual for people to move between firms” (Audit partner, company A).
Auditors normally move from non-big firms to the big four firms, but rarely vice versa. In a few cases, some auditors can move between the big four firms for special circumstances (such as transferring to another geographical area). Mostly, when people consider moving, they usually decide to change career and go to work as accountants or internal auditors for other companies.

“I think it is rare in audit for people to move between the big four; unless they are moving geographically” (Audit partner, company A).

“People don’t tend to move at the highest level in audit …. if you look at most audit partners they have been lifers in the firm. Tax and advisory have more often moved from different firms all the way. It’s just harder to move audit people” (Audit partner, company C).

“The reason for leaving tends to be that they don’t want to be in the profession any more ….. There are lots that have come from smaller firms and moved on qualification, so we have a lot of those; but rarely do people move big four to big four” (Audit partner, company A).

7.8 Conclusion

In this chapter, six strategies which have emerged from the big four firms have been developed: reviewing the audit methodologies, establishing closer structures, following stringent conservative strategies, recruiting highly skilled people, gaining increased audit fees, and competing in a highly competitive audit market.

Developed strategies reflect a new trend which has been followed by the big audit firms to be more centralised in controlling and monitoring their member firms. The aim of this centralisation is to guarantee a minimum and acceptable level of audit. Examples are given in the present chapter to represent this centralisation. The unified procedures of accepting or continuing with any client’s engagement are considered as one of these examples. A further example relates to the larger and closer structures which have been created by a set of merged member firms to better control the quality of provided services.

Furthermore, this trend of centralisation reflects the notion that the networks’ boards become more conservative toward risks of litigation in order to protect their leading reputations. This conservatism has been mainly applied to the quality of the audit process, the auditors’
independence, and the compliance with applicable audit regulations and standards. A number of examples which are included in this chapter can justify this conservatism. Risk management departments have been established to be responsible for avoiding and mitigating potential audit risks.

Additionally, increased attention is being paid to the quality of their people. The big four firms focus on recruiting skilled graduates from top universities; building new generations of experts and specialists in specific and advanced industries, technologies, businesses, and capital markets; hiring highly skilled IT staff to install and maintain the advanced software audit programs; and providing training programs to all staff at all levels. Moreover, more restricted rules and procedures have been implemented regarding the auditors’ independence. These procedures are particularly relevant when it comes to the rotation of audit partners and the provision of non-audit services for audited clients. These rules are set to achieve compliance with applicable auditing standards in different countries.

I conclude that this chapter provides a better and different understanding of the big four audit firms as organisations rather than professionals. The big four audit firms are profitable organisations which are owned by a number of professionals with a great deal of experience. They also have long lasting leading reputations in providing professional services to global and cross-border companies all over the world. Commonly, people who are hired by the big firms are talented and ambitious people who are looking to achieving excellence, and diversity in everything they do. Money is not the first driver for their selection. Increasing their knowledge and improving their personal and professional skills are given the highest priority. Therefore, they are the best people to serve the global clients of the big four firms. Multinational clients always seek to lead the markets. Innovation in everything they do is one of their main tools to stay on top. This can only be achieved by requiring high levels of quality from all their suppliers and services providers (including banks, layers, auditors, and consultants). The effective management of high investments always leads to high returns. Therefore, they are happy with the quality and values added by their suppliers, regardless of any financial issues.

As a result of competing in the biggest markets around the world, the competition between the main players of the audit market is very aggressive. However, there is no evidence to suggest that this is unfair competition. Each player is doing their best and using all of their financial and non-financial resources (non-financial resources include their brands, and
personal relationships) to achieve a new goal (by attracting new global clients). The match is very hard and interesting. It is also watched by many multinational viewers (including global investors and public interests parties). Therefore, the referees are in a very difficult and sensitive situation. They must be highly independent, with a good level of expertise and patience. Red cards are not desired at the moment, as regulators know that red flags can be very harmful for the capital markets. An increased number of yellow cards (through a number of fines and other disciplinary orders\(^{10}\)) have been used to balance between making tough sanctions to the audit firms and promoting the trust in capital markets. Regulators of the audit professions are responsible for restoring public trust in the audit profession, mitigating the risk of another major accounting collapse, and assuring the quality of the audit processes inside firms which audit listed and public interests companies. To promote confidence in the audit profession, regulators decide to broadcast the matches online (by publishing the inspection reports of the audit firms for the public, and forcing the audit firms to issue annual transparency reports about their performance). Accordingly, the coaches of each team give their rigid instructions to all the players to be highly committed to the new rules which are issued during the match. The coaches (the owners) become more conservative toward any offside, fouls, or penalties which can be taken against them. They learn the lesson of the Enron collapse. Indeed, they know that it is not a joke and that one of them can be fired at any time during the match if he or she breaches the rules.

So what? This is my next question. In the following chapter, Chapter 8, the core category of this study, namely "globalization of auditing" is discussed. I validate the emerged theory by conducting further interviews with the main participants of this study to assure that my findings reflect and consider their views. Further, I also use a current theory from the literature as an alternative way to validate the emerged theory of this study. The globalisation theory is elected to analyse the main suggestions of the grounded theory. The validation process is conducted according to the Strauss & Corbin approach (1998) of grounded theory.

\(^{10}\) For example, in February 2012, the Public Company Accounting Oversight Board announced a settled disciplinary order censuring Ernst & Young LLP, imposing a $2 million civil money penalty against the firm, and sanctioning four of its current and former partners for violating PCAOB rules and standards. For more details see the following link: [http://pcaobus.org/Enforcement/Decisions/Documents/Ernst_Young.pdf](http://pcaobus.org/Enforcement/Decisions/Documents/Ernst_Young.pdf).
Chapter 8: Globalisation of auditing

8.1 Introduction

The previous three chapters (5, 6, and 7), illustrate the main categories which have emerged from the gathered data. According to Strauss & Corbin’s (1998) approach to grounded theory, the analysis should be expanded to reach a core category which represents and provides a clear image about the central phenomenon of this research, namely to assess the main challenges in the audit market and how the big four firms react to protect their leading reputations. This chapter discusses the core category of this theory which is the “globalization of auditing”. It further interprets the emerged theory with one of the current theories in the accounting literature.

“What do we mean by theory? For us, theory denotes a set of well-developed categories (e.g., themes, concepts) that are systematically interrelated through statements of relationship to form a theoretical framework that explains some relevant social, psychological, educational, nursing, or other phenomenon. The statements of relationship explain who, what, when, where, why, how, and with what consequences an event occurs” (Strauss and Corbin, 1998, p.22).

According to Strauss & Corbin’s (1998) approach to grounded theory methodology, the emerged theory might be compared by the literature. This step aims to validate the grounded theory and propose a more formal theory. The formal theory is built on studying more than one population or a certain case study. This can ensure that the findings (the grounded theory) can be more generalised. Further, Gaspar (2007) stresses that, according to the Glaser & Strauss (1967) approach to grounded theory, a comparative analysis can be conducted between the emerged theory and a current theory from the literature to validate the grounded theory and provide a more generalised theory. Corbin & Strauss (2008) argue that the ability to be generalised is one of the criteria used to evaluate the effectiveness of the emerged theory.

Globalisation theory is selected from a number of different theories as the grounded theory of this study analyses the global regulatory challenges of the global big audit firms and how they face these challenges using a number of strategies which have been globally applied. The literature (see, for example, Cooper & Robson, 2006; Humphrey et al., 2006; Humphrey & Loft,
2009; Loft et al., 2009) stresses the importance of studying accounting and auditing at a global level in the current era of globalization.

Section 8.2 explains the main themes of the global audit environment. It identifies and analyses four features of the current global strategies which have been followed by the main players in the audit market (including audit firms and audit regulators). Section 8.3 sheds light on the relations between this core category and the other main categories of this study which are illustrated in the last three chapters. It analyses the global behaviour of the main players in the audit market. It further discusses the interactions between these players and how these interactions push each player to establish a number of strategies, procedures, and rules to act with other players. The audit regulators are cooperating globally to achieve a higher level of quality, independence, and public interests protection. Further, the global networks of the big audit firms need to protect their leading reputation, mitigate the risk of litigation, and increase their market shares. Section 8.3 also explains how these parties are interacting to achieve the different objectives in the global audit markets.

Section 8.4 presents the extent to which grounded theory is comparable with the current research of the global practice of the accounting profession. It also explains how the suggested theory contributes to the globalization theory by suggesting a new wave of globalization process which can avoid national resistance to changes. These national resistances are considered as the main challenge when it comes to applying the globalization theory in a wide range of countries (Diaconu & Coman, 2006). Finally, Section 8.5 provides my conclusion.

8.2 The main themes of the global audit environment: how do the audit parties act?

The grounded theory suggests a number of themes or features which describe and analyse how the main players of the audit environment act. The analysis of the main values of the independent audit regulators, the common audit regulations, and the main strategies which have emerged from the big four firms and which are discussed in chapters 5, 6, and 7 respectively, indicate that both the audit regulators and regulated firms are following a number of strategies and procedures which have similar themes or characteristics. Four themes have been identified during the selective coding processes. These four themes are “Standardization”, “Centralization”, “Faster communication”, and “Specialization”. The features of each theme are discussed as follows.
8.2.1 Global trend of standardisation (following standardised strategies and procedures)

A number of standardised strategies and procedures have been intensively followed by audit parties over the last decade. For example, the IFIAR was established in 2006 and aims to share the best practice between national regulators of audit in different countries. Diaconu & Coman (2006) stress that the most important benefit of the harmonisation of the accounting standards is that international financial information can be easily and sufficiently compared. This would provide more reliable information regarding the cross-border companies which are listed in different capital markets. The national countries will be able to have adequate accounting and auditing standards, which in turn assists them in promoting their capital markets and encouraging foreign direct investments to enter their listed companies. However, one of the main criticisms of the global standards is the lack of flexibility when it comes to the accounting standards which cannot be relevant to a wide range of different national circumstances (Diaconu & Coman, 2006).

Moreover, the annual or periodic inspections of the audit firms' performance, especially the big four audit firms, have been globally applied by different national audit regulators. Further, most of the national standards' setters have been encouraged (by global organisations such as the World Bank and IFAC) to apply the international standards of auditing and the international accounting standards in order to assure unified treatments for similar transactions in different places across the world. Consistently, the global networks of the big four firms have issued unified audit approaches which have been followed by all of their national member firms. Global opportunities and training courses have been offered for the audit staff to ensure the consistent understanding and unified implementation of such approaches among different people and cultures. Unified software programs and computer-based checklists have also been installed in all of the devices.

The unified approaches, programs, and even standards have been proposed, reviewed and updated by a number of highly skilled experts and specialists from a wide range of geographical areas. These standardised applications ensure that an acceptable level of quality is provided in different places and practices. They also assist in managing risk of further collapse in capital markets. Figure 8.1 explains the main points of the standardised strategies.
Global trend of centralisation (following centralised monitoring and quality assurance)

The standardised strategies have been followed by the national firms; however, they have been set by the global networks. The global networks become more centralised in managing and monitoring the quality assurance systems and the appropriate implementations of their unified approaches through their national firms. All the acceptance and continuing procedures have to be approved by an upper level of partners (regional or global levels). Any exceptions in applying the audit procedures have to be sent online and approved by an upper level of partners. Intensive annual reviews have been conducted among different member firms. Clients have been re-evaluated according to their risk level by new standardised systems. High risk clients must be reviewed and signed off by the regional risk management partners.

Furthermore, new ELLPs’ structures and regional mergers have been established to sufficiently monitor and manage such globalised strategies. The regional level firms do not provide audit services for the audit clients. However, they are responsible for managing and monitoring people, financial and quality assurance strategies through their member firms. All of these examples show to what extent the big four audit firms have become highly centralised in taking their decisions. This high degree of centralisation reflects their intention to protect their leading
reputations and avoid the risk of litigation. It also reflects to what extent they need to assure high levels of quality of the services provided for their global clients to increase their market share, especially in the emerging markets.

Moreover, the annual inspections of the big audit firms' performance represent another type of centralisation. According to the agency theory, external auditors assure the truth and fairness of the financial statements on behalf of the shareholders. As a result of the auditors' independence, shareholders delegate them to audit the financial reports as trusted parties. However, trust in auditors has been thrown into doubt after the collapse of Enron and the failure of Arthur Anderson. Thus, governments (as the main servers of public interests in society) follow a set of centralised strategies in assuring the quality of financial statements. Auditors are no longer allowed to work without governmental inspections of their reports. Further, they are no longer allowed to provide a certain number of non-audit services for their audited clients. The audit firms' cultures, values, strategies, and performances must be inspected annually. The previous rules reflect a governmental attention to be more centralised in managing and controlling the audit firms' performance. However, governments are not technically a party and might not be fully trusted by the whole of society. Thus, they delegate independent authorities (regulators) to oversee the audit profession. Such authorities include highly skilled independent regulators who can provide technical judgments for the audit reports. It seems that both auditors and regulators follow high degrees of centralisation in their actions, decisions, and further movements. In the absence of trust and the existence of increased risk of litigation and potential losses, most things have to be highly centralised. Figure 8.2 explains the main points of the centralised strategies.
8.2.3 Global trend of faster communications (achieving faster responses to global clients)

As much as the new ELLPs and other regional structures reflect high degrees of centralisation, they also provide a higher ability to conduct faster communications among the merged firms. The fast communication among the member firms allows partners to provide quicker responses to their global clients' requirements. The updated Internetworks and the new electronic audit programs assist auditors and keeps them working closer together meaning that they are able to communicate in an immediate way in order to respond to clients more quickly and provide a better service. Further, the global opportunities provide chances for people to know their peers in different places. This can make communications easier among different member firms in different countries.

Moreover, the audit regulators conduct periodic meetings together to share best practice and exchange their experiences in regulating the global networks of audit firms. Such communications aim to provide effective regulations which can enhance the quality of the audit service and protect the public interest. Thus, it is argued that faster and greater communication
and debate among the member firms or regulators of different countries aims to provide a high level of quality for audit service provision. Further, an online forum has been established through the IFIAR’s website which is available only to its members who can conduct dialogues and share experiences with each other. Moreover, continuing dialogues have been conducted between the audit regulators and other parties of the audit market such as auditors, investors and standard setters. Figure 8.3 shows the main points of the more closed and communicated strategies.

![Diagram](image)

**Figure 8.3: The main outlines of the more closed strategies**

8.2.4 Global trend of specialisation (sharing best practice)

Specialisation is a key factor in auditing as it aims to provide technical opinions about the truth and fairness of the financial statements. The global networks of the big four have established global centres and committees to provide technical advice for the audit staff in national audit firms regarding different markets, industries, businesses, and transactions. Specialists have a greater knowledge which assists them in providing better judgment of highly technical and complicated issues related to the audit clients. Managing these centres at the global level aims to
ensure that the right people are provided in the right place and at the right time. All national member firms can contact such committees and obtain their advice at any time. The communications have been conducted through intra online networks and systems to ensure high levels of confidentiality of information and quicker responses. Figure 8.4 explains the main points of the specialised strategies.

8.3 The grounded theory: bringing all the categories together

Figure 8.5 illustrates how the core category of this study interacts with other main categories in one framework which explains the grounded theory. The emerged theory suggests that both the audit regulators and the regulated firms aim to regain public trust in the audit profession and have common objectives to achieve this aim. Four common objectives, for the two parties, are identified during the analysis: improve the audit quality, increase the auditors’ independence, enhance the transparency of the big audit networks, and mitigate the risk of litigation to avoid further audit or accounting collapse. However, two opposing goals, for the audit regulators and the audit firms, are also developed. Audit regulators are concerned about the increased concentration of the big four firms in the big audit markets in most countries, and aim to increase the number of audit firms which audit the largest listed companies in their capital markets; in contrast, the big four firms aim to increase their market shares and protect their leading reputations.

Further, the emerged theory explains how both the audit firms and the audit regulators establish a number of strategies to achieve their objectives. It suggests that the main themes of these strategies are that they are acting with more standardised and centralised strategies. The value of specialisation has been maximised for the highly complicated transactions which have been conducted by the international companies in special types of businesses and capital markets. Advanced software programs, systems and technologies have been used to provide faster communication and connections among different parties.

Moreover, the emerged theory sheds light on the important role of the increased number of global or multinational companies in encouraging the global audit networks to compete at the global level. In addition, the increased number of global professional bodies of auditing and accounting regulators and standards setters (such as IFAC, IOSCO, IFIAR, and Public Interest
Oversight Board (PIOB)) play an important role in the global audit market. Mutual influences have been identified among global audit networks, global professional bodies, and national audit regulators.

Figure 8.4: The main outlines of the specialised strategies
Figure 8.5: The core category and its relations with the main categories of this study
8.4 Towards a formal theory: globalisation theory

“One of the great social processes in the history of humanity is the globalization”
(Diaconu & Coman, 2006)

“Boundaries and physical distances are seen to matter less in determining the shapes of societies, organizations, and individuals than they did in the past” (Holm, 2003)

“Globalization is associated with the growing mobility of goods, services, commodities, information, people and communications across national frontiers. Its intensification is most visible in banking and finance where, with the aid of information technology, global stock markets, futures, debt, derivatives and interest rate swaps have accelerated the geographical mobility of capital, money and credit supply” (Arnold & Sikka, 2001)

The main idea of globalisation is removing boundaries and dealing with the whole world as one society, in particular, one market. The literature (see, for example, Holton, 2005; Martell, 2007; Szul, 2010; Robinson, 2011) has reviewed the history of globalisation theory and identified three waves of globalisation theory: globalists, sceptics, and transformationalists. While the first wave is more concerned with the economic effects of globalisation, the second wave is more focused on the culture effects of globalisation. The third and most recent wave of globalisation is concerned with its political effects on the national states. Further, Diaconu & Coman (2006) argue that cultures have a great impact on economic environments and this impact is one of the main challenges to providing one global economy.

“Despite of the efforts of the supporters to promote the global economy this cannot be realized on short term due to the major cultural and social discrepancies in the world” (Diaconu & Coman, 2006).

Robinson (2007) states that, according to Castells (1998), the development of information technology, especially in computers and the Internet, is one of the main reasons which has resulted in the rise of what is called “the network society”.

“This involves a new organizational logic based on the network structure in interaction with the new technological paradigm. The network form of social organization is
It seems as if during the first two waves, the national states, especially in the western part of the world, encourage the fast and strong movements of international companies towards providing global products (such as: Pepsi, Adidas, Wimpy and Dior) and services (such as: RCI, Thomas Cook and Hilton). These global movements have strong impacts when it comes to harmonising a set of common cultures in the different countries (such as: getting fast food meals, wearing jeans, and chatting on Internet websites such as Facebook or twitter). However, in the last decade, it is argued that for political reasons, the western countries would like to mitigate the risks of negative impacts of globalisation on their national economies (Martell, 2007). It is argued that social resistance is the main challenge to the globalisation idea.

8.4.1 Globalisation in accounting research

“Transnational accounting firms operate globally and rely increasingly on international standards in carrying out their activities” (Malsch & Gendron, 2011).

Humphrey et al. (2009) stress the importance of studying auditing at the global level to understand the main global institutions which interact in the global audit market. They argue that the recent financial crisis calls for global financial and audit regulatory bodies which can regulate the global practices that have been conducted by a small number of global institutions which dominate the audit profession.

“In particular, it is argued that audit researchers need to be aware of (a) the wide range of institutions (and individual key players within them) with whom the auditing profession interacts in the global sphere and (b) the ways in which such bodies and interactions increasingly set the boundaries for both audit practice and the ideas and thought processes that shape practice” (Humphrey et al., 2009).

During the last decade, some of the accounting and auditing literature (see, for example, Sikka, 2003; Cooper et al., 2003; Cooper & Robson, 2006; Humphrey & Loft, 2009) has studied the globalisation of the accounting profession. These studies can be classified into a number of groups according to their purposes, as follows.
Certain prior studies (see, for example, Loft et al., 2006; Arnold, 2005; Cameron & Neu, 2003) have investigated the role of certain international organisations (such as the World Trade Organization (WTO), International Mutual Fund (IMF), and the World Bank) in promoting globalisation in different countries and supporting the globalisation idea. This may reflect political effects on applying globalised accounting and auditing standards in different countries. For example, Loft et al. (2006) state that the world’s countries have been encouraged to adopt international accounting standards. World Bank loans to countries have been made conditional on their implementation of such standards (Schneider, 2002). Humphrey & Loft (2009) discuss the term “coordinated network governance” to explain the regulatory arrangements which interprets the greatest international regulators within the international profession in an ongoing project to monitor the global governance of the audit market. The previous findings reflect the role of political powers in encouraging (or forcing) developing countries to be part of the global accounting and auditing market. Further, this study provides another purpose, from the national governments’ viewpoints, for applying international accounting and auditing standards. National regulators of the capital markets, especially in developing countries, would like to send positive messages about the reliability of their capital markets, and encourage foreign direct investments to invest in their listed companies.

Another collection of literature (see, for example, Diaconu & Coman, 2006; Loft et al., 2006; Arnold, 2005) focuses on the establishment of a number of global professional bodies which represent different types of stakeholders. These include the IFAC for accountants and financial preparers, IFIAR for audit regulators, Forum of Firms (FOF) for audit firms’ networks, IOSCO for securities commissions, and PIOB for investors and public interests. For example, Loft et al. (2006) focus on the role of these professional organisations (such as: IFAC, IASB, EC) in providing unified standards for preparing financial statements which are globally accepted and applied in different countries. This type of accepted standard is more relevant for international companies which are listed in different capital markets and need to prepare their consolidated financial reports on a consistent basis. Diaconu & Coman (2006) emphasise that the international standards have been globally accepted as a result of most of countries having free markets and applying capitalism as an economic system. Problems will be expected when different countries with different cultures and other economic systems apply these global standards. Those countries will not accept changes in their cultures and social habits. However, the authors stress the
benefits of the globalisation and harmonisation of accounting standards as they will provide more transparent and comparable information for global investors.

Further, Loft et al. (2006) argue that the globalisation of financial activity is a huge task and will inevitably give rise to issues concerning the regulation of global finance. They stress that in the era of globalisation, the principle unit of auditing research should be the organisations which create the authorities to make and implement the audit rules and regulations. Moreover, Arnold (2005) analyses the ongoing efforts which have been conducted by certain institutions to create a global market of accounting and auditing services by using international trade agreements (such as the General Agreements on Trade in Services [GATS]) to eliminate the local regulations of different countries which avoid or prevent foreign professionals from acting in their countries. It is argued that such organisations set the current structure of the global audit market, and by extension affect the national audit markets in most of the world’s countries. They achieve this by setting a number of standards, principles, rules, and regulations which guide the national audit parties to establish similar structures in different audit environments. Currently, the audit profession is acting, competing, and is regulated globally. Few audit networks, audit regulators, and standards setters are supervising the global audit markets. This argument is consistent with the grounded theory of this study which suggests a number of values of the independent audit oversight system, a number of factors to establish an effective audit oversight authority, and a number of strategies which have emerged from the big four audit firms. It also provides a better understanding of how the main parties of the global audit market act. These findings can be applied in different countries regardless of their economic development.

A third group of the literature (see, for example, Covaleski et al., 2003; Cooper & Robson, 2006; Everett et al., 2007; Humphrey et al., 2009) investigates the interactions and mutual influences of regulators and regulated firms in the global audit market. Humphrey et al. (2009) stress that there are interlocking relationships between international audit regulators, international standards setters, and global networks of the big audit firms. Cooper & Robson (2006) argue that the relations between audit regulators and regulated firms have been changed. The global big four networks play a significant role in influencing the process of setting, regulating, and translating the global accounting, and auditing standards. They further stress that these may negatively affect the democratic and fair control of the profession. Sikka (2003: b) encourages the studying
of the governance of auditing firms. He argues that the global audit networks focus on making profits at the expense of their social obligations. Humphrey et al. (2009) emphasise that this significant influence of the global audit firms’ networks on the global regulatory audit bodies can re-emerge the self-regulated stage of the audit profession in a modified form of partnership between audit firms, professional bodies, and regulators at the global level.

Moreover, Sikka (2003) explains how globalisation is used to transfer the capital through competitive deregulation. He argues that accountants and lawyers play an important role in encouraging offshore financial centres which can be considered as an integral part of globalisation. Further, Graham & Neu (2003) suggest that the global trends of accounting often assume the market efficiency and provide certain solutions. However, Cooper et al. (2003) argue that these solutions are not relevant in different communities. Covaleski et al. (2003) analyse the relations between the main institutions which regulate the audit profession in the US and the big audit firms. They argue that the big firms are able to overcome governmental forces and defend their own interests. Everett et al. (2007) explain the global governmental efforts to face globally organised corruption. The grounded theory of this study contributes to the literature by adding another type of organisation which plays an important role in spreading a unified or semi-unified practice within the profession. The IFIAR is a good representative example of this new type of organisation which aims to share best practice among auditing and accounting regulators around the world. It is a new type of globalisation for the audit profession. The audit market is now more global than 10 years ago. This study identifies the new structure of the audit market which consists of global networks, and offers global opportunities for their people to provide unified audit approaches to better serve their global clients. Even this audit market can be considered as it is regulated at the global level by a set of international regulators who provide a set of certain recommendations to their national members.

Looking at the globalisation idea, it talks about removing borders between countries and geographical areas and considering the world as one village which consists of one society which has similar cultures, hobbies, and habits. This can create conflict or contradiction between the national interests of different nations or countries. Resistance to change and wanting to be leaders threatens the globalisation idea. Diaconu & Coman (2006) argue that the globalisation process is the biggest challenge of the current period. They believe that although there are
intensive efforts to support the globalisation idea, it cannot be successfully achieved in the short
term due to the cultures and social conflicts among different nations. In addition, from an
economic point of view, every country would like to enhance its own economy by providing its
local products and services to the largest number of other countries. Who will be the exporters
and who will be the importers? There are also political powers which must be recognised. Thus,
the main threats to globalisation are that nations will defend their own nationalities and will not
accept global solutions which can remove their national identities.

However, I argue that there is a new type of globalisation in the audit market. The global audit
market is now dependent on cooperation rather than conflict between the national regulators.
Sharing best practice is the main objective of globalising the audit regulatory framework. The
audit regulators from different countries oversee global networks of audit firms which are acting
and competing globally by applying unified or semi-unified strategies in most of the world’s
countries. Thus, the national audit regulators believe that they have to share their experiences and
cooperate with each other to better regulate the audit profession. This type of cooperation will
not impair their national identities. It does not remove the right of national regulators to set their
national rules and regulations which oversee their national audit markets. Instead, it provides
guides and ideas which can assist the national regulators to enhance the audit profession.
Consistently, the EC regulations cannot be considered as a good example of the new wave of
globalisation. The EC forces all its member states to apply its rules or regulations. These
mandatory rules are expected to be resisted by national cultures which are different even if all
members are within one geographical area. Jeppesen & Loft (2011) provide evidence that the EC
regulations are not relevant with the national practice of the audit market in Denmark, and
applying the European regulations gave rise to an intra-professional conflict over the statutory
audit jurisdiction.

Furthermore, to provide more generalised outcomes, this study provides a set of values which
reflect the importance of establishing an independent oversight system of the audit profession in
different countries. These values can be helpful for a number of audit stakeholders or
beneficiaries regardless of their nationalities or geographical areas. Further, it provides a number
of key factors to establish an effective audit oversight authority. Governments of different
countries can be guided by those factors when establishing a new independent audit oversight
authority or evaluating the performance of their current authorities. Globalising the audit practice and the audit regulatory framework can represent a new wave of globalisation theory which really could be expected to continue and survive. It is expected to face low levels of resistance as it does not force nations to accept external cultures, products, services or people.

8.5 Conclusion

This chapter explains the core category of the grounded theory of this study. It identifies and discusses four main themes of global strategies which have emerged by both audit regulators and regulated firms in the global audit market. This chapter suggests that both audit regulators and audit firms aim to achieve a set of common objectives. A number of global organisations have been established to organise cooperation between audit regulators and regulated firms to achieve such objectives. Continuing dialogues have been conducted between different parties of the audit market (including auditors, regulators, and investors) to promote public confidence in the capital markets and the audit profession. This type of global movement, which comes out of this study, suggests that globalisation theory should be discussed in the validation stage of the grounded theory methodology.

The grounded theory of this study suggests that these global efforts represent a different and new type of globalisation. This new trend of globalisation depends on sharing best practice among different audit parties from different cultures and geographical areas by providing a set of recommendations, guides, and principles without forcing those parties into mandatory implementation. Each national party has the right to apply suggestions which are relevant to their national circumstances. Even in the case of auditors, the national audit firms have the right not to apply certain audit programs or procedures if the national audit partners believe that they are not relevant to the clients’ circumstances and will negatively affect the truth and fairness of the audited financial reports. National partners, in this case, only have to provide a full explanation of any exceptions and obtain regional or global approval for such exemptions. This freedom and flexibility in applying global ideas and sharing global practice give highly competitive advantages to this new wave of globalisation. It is expected to be less resisted by national forces of different societies. Further research could be conducted to investigate the resistance towards this type of globalisation.
This chapter discusses the core category of this study, analyses its relationships with the developed main categories, and validates it with globalisation theory in accounting research. Chapter 9 provides the main conclusions of this study and explains the extent to which it is compatible with the Strauss & Corbin approach to grounded theory.
Chapter 9: Conclusion
(The last station, but not the least)

9.1 Introduction

At the last station, and before I leave the train, I need to take few minutes break and remember the greatest memories from my last trip. However, sometimes I do not have time to remember or to enjoy memories. I have to catch my next train and start my next trip. As a researcher, I always work surrounded by uncertainty, looking to the future, searching for the reality, working in a changeable environment (especially for social science researchers), and I am never sure of what the results will be.

In this chapter, the last chapter of the epic trip which has been my PhD thesis, I look back over all of the previous chapters, and ask myself the same questions which I used to ask every time I reached the last station: So what? What can I learn from this study? How can my findings and suggestions contribute to other studies? And what are my main suggestions? How can they make differences to others’ lives or knowledge? Did I conduct my research as I should have done? Indeed, there are many questions which I must ask myself before I start my next trip. Answers or conclusions regarding these questions may enhance my learning and improve my performance in the future.

Thus, this chapter is divided into a certain number of sections to answer the previous questions as follows. Section 9.2 discusses the main contributions of the emerged theory and the extent to which they add value for a certain groups of beneficiaries. Section 9.3 interprets the main suggestions of the grounded theory with the research questions and objectives of this study. It shows the extent to which the main findings of this study address the research questions and achieve the main objectives. Section 9.4 evaluates the grounded theory from the perspective of Strauss & Corbin’s approach (1998, 2008). Following this, Section 9.5 explains the main limitations of the study, and suggests a number of further studies which may be required in the field of auditing regulations and audit firms’ strategies.

9.2 Summary of the emerged theory

In this section, I summarise the main idea of the entire thesis, whilst also explaining the main motivations for studying the research problem and how I have gone about studying it. I also outline the study’s aim and how the research questions are addressed before presenting the
emerged theory and outlining its main suggestions. I focus on the main areas in which the emerged theory contributes to the audit literature and explain the importance and the values of such contributions to the main audit parties (such as audit regulators, audit partners, and audit researchers).

One of the main reasons which has encouraged me to pursue this point of research is related to the great changes which have occurred in the global audit market after the major accounting collapses which happened at the beginning of the last decade. Transferring from the self-regulated stage to independent oversight system has had huge impacts on all parties of the global audit market. New independent audit oversight authorities have been established in many countries in different areas around the world (such as the PCAOB in the US, the AIU in the UK, the Auditing Oversight Board in Japan, the Australian Securities and Investments Commission, and the QCU in Egypt). Further, new international forums have been established in order to share the best practice among the national audit regulators and promote the audit oversight system in the remaining countries (such as the IFIAR at the global level, EGAOB, and EAIG at the European level).

Corporate governance has been a concern for the governments of many countries. Many corporate governance laws have been issued in the last decade so as to monitor and organise the relation between the management and their external auditors, particularly in listed and public interest companies (such as SOX Act in the US in 2002, companies Act in the UK in 2006, and Egypt code of corporate governance in 2008). The new rules and regulations assist the audit regulators in assuring the quality of auditors’ performance in order to regain the public’s trust.

Furthermore, the annual reports of the global networks of the big four audit firms have been significantly changed. Many new issues have arisen in their published reports. It is important to respect that the audit profession has a problem, and explain how they are working to assure the minimum acceptable level of audit quality and independence. New objectives have been set in order to protect their leading reputation, regain the public’s trust, and mitigate the risk of litigation by committing to the new audit regulations. The great number of multinational and global clients has led the big four audit networks to work globally. They understand that the quality assurance processes must be carried out globally. Many modified and emerged strategies must be applied through all of their national member firms. The big four networks need to send clear massages for all their current and potential clients so that they provide
similar and acceptable levels of quality through all their member firms. The provided audit quality in the US is similar to its peers in Europe, Africa, Asia, and everywhere.

The big four audit networks encounter a challenge regarding the additional requirements which they must fulfill in order to be committed to the national audit laws and regulations. They also have another challenge regarding the lower public trust in auditors which has been recently raised. Reviewing these great and global challenges of the audit profession motivates me to identify the views of the big four firms regarding the current performance of the independent audit oversight authorities, and to explore the main strategies which have emerged from the big four networks to achieve acceptable levels of audit quality and to regain the public’s trust.

Reviewing previous research reveals a gap of literature in this area of research. As stated in Chapter 2, the literature gap related to the views of the audit partners themselves toward the global challenges which are taking place in the audit market and exploring how they react to face such challenges. Studying the literature guides me to address two research questions through which I can achieve the study’s aim. The existence of a gap in the literature as well as my desire to explore the views of participants to build up a theory which explains what has been done in practice supports the use of grounded theory as a research methodology as stated in Chapter 3.

In grounded theory, a set of main categories interact together with an upper core category to tell the whole story and to build the theory (Strauss & Corbin, 1998). In this thesis, three main categories have emerged during the analysis process. The first main category analyses the role of independent audit regulators in monitoring the audit profession and the views of the audit firms toward the performance of such regulators. It suggests that the independent audit oversight adds value for different groups of audit related parties. It further proposes a number of key features for establishing an effective audit oversight authority.

The second main category differentiates among three groups of audit regulations – according to their purposes – by which regulators achieve their objectives. The first group of regulations improves the quality of the audit process. The second group increases the transparency level of the audit firms’ networks. The third group of regulations reduces the barriers of competing in the big audit market. The second main category explains the reasons and the ways by which the big four firms resist proposed audit regulations.
Furthermore, in the third and last main category, the main strategies of the big four firms which have emerged to tackle the new changes in the audit regulatory environment are analysed and explained. The third main category explains how and why each strategy has emerged and analyses how they are applied together to protect the leading reputation of the big four firms.

As stated in Chapter 8, the analysis explains how the above three main categories of the emerged theory interact together to build up the core category which represents the phenomenon of the globalisation of the audit market. Four main features, as followed by the main players of the global audit market (both audit firms and audit regulators) have been developed. The suggested features are: standardisation, centralisation, faster communications, and specialisation.

One of the main questions which should be asked after I summarise the main outputs of my thesis is “Did I achieve the study’s aim? Does the emerged theory – including its suggestions – achieve the research objectives and provide answers for the research questions?” These questions are addressed in the following section.

9.3 Revisiting the research questions and objectives

In this section, I interpret the main suggestions of the emerged theory with the research questions. This interpretation analyses the extent to which the grounded theory is linked with the main objectives of this study. The research questions of the study are addressed as follows.

RQ1: How do the big firms evaluate the current performance of the independent audit inspectors? What are the key factors of an effective inspection process? How the audit regulations protect the public interests and promote confidence in the audit profession?

The emerged theory concludes that the big four firms support the new external oversight system. The external inspectors enhance the quality of the audit process and add more credibility to the auditors’ performance. As stated in Chapter 5, a number of values and benefits of this system – not only for auditors, but also for other audit parties – are suggested. For example, the independent regulators aim to provide secured capital markets for current and potential investors. The existence of the audit oversight board increases the foreign direct investments which enter the capital markets which in turn enhance the whole economy.
Moreover, a set of key factors when it comes to establishing an effective audit oversight authority are proposed in Chapter 5. These factors are classified into three groups which are related to organisational factors, staff factors, and methodology factors. The analysis indicates that regulators are concerned with the independence of regulators as the main value which achieves their objectives. In addition, auditors believe that successful regulators should be experts and specialists in the business that they review in order to effectively evaluate the auditors’ judgments.

The regulators’ performance is criticised by the big four firms’ partners. Some areas of the inspectors’ approach might be changed in order to focus on the key risk issues in the reviewed companies. A lack of materiality in their findings is noted by the big four partners. It is suggested that regulators should consider the circumstances which at the time of the audit rather than the time of their inspection. The analysis suggests that higher attention should be paid to monitoring corporate governance in order to enhance the quality of financial reports.

The audit regulations by which the regulators achieve their objectives are analysed in Chapter 6. In addition, a discussion is put forth regarding the big four firms’ perceptions regarding these regulations and to what extent they improve the quality of the audit profession. A number of further and different procedures which can be taken by regulators in order to enhance the audit quality are suggested. For example, the audit liability limitation should be forced by the law in order to mitigate the risk of litigation. The mid-size firms should be encouraged to make higher investments in their global networks and to hire highly talented people in their firms.

Briefly, it is suggested that the audit profession is highly regulated and that more complicated regulations may have negative effects on the audit quality as auditors will be highly concerned with ticking the boxes rather than focusing on providing their technical judgments.

**RQ2: How do the big four firms react toward the new changes in the regulatory framework of the audit profession? What are the main strategies which have emerged to protect their leading reputations?**

The analysis in Chapter 7 identifies a number of strategies which have emerged from the big four audit firms to manage the current challenges of the global audit environment. Each strategy is analysed and explained to provide an in-depth understanding of the main
motivations, features, and effects of such a strategy on the audit market. The analysis develops six strategies of the big four firms which have been globally applied through all their member firms. The emerged strategies are: reviewing the audit methodologies, establishing faster communication among their member firms, stringent conservative strategy, global opportunities for their employees, increased audit fees, and competing in a highly competitive market.

The analysis is extended in Chapter 8 to explain the common features of the global audit market. The grounded theory suggests that both audit firms and audit regulators have common objectives and follow strategies which have similar characteristics. Four themes have been identified to represent the main features of such strategies. Chapter 8 presents how the main players in the global audit market interact to enhance the quality of audit services which have been globally provided, and to promote public trust in the audit profession. However, while the big audit firms aim to increase their market shares in the global audit market, the audit regulators aim to decrease the domination of the big four in auditing the largest listed companies in different capital markets and encouraging the mid-size firms to enter the big market.

9.4 Evaluating the emerged theory

“Quality in qualitative research is something that we recognize when we see it; however, explaining what it is or how to achieve it is much more difficult” (Corbin & Strauss, 2008, p.297).

One of the main objectives of this study is to evaluate the effectiveness of the new independent audit oversight system from the auditors’ perceptions; I feel – at the end of the study – that it is also important to evaluate the effectiveness of the emerged theory. I think this gives my results more reliability and objectivity. Further, it is argued that the evaluation process is necessary – especially for qualitative research – to improve the quality of further research (Corbin & Strauss, 2008). They provide a list of criteria – drawn from the literature – which can be used to evaluate the quality of qualitative studies which use the grounded theory as a research methodology (especially the Strauss & Corbin approach). However, Corbin & Strauss (2008) stress that these criteria must not be generalised and cannot be valid for all studies which use their approach. There are some factors which depend on the researchers themselves, their purposes, and the nature of the research problems.
In this section, I discuss the extent to which the list of quality measures provided by Corbin & Strauss (2008) can be valid for the emerged theory. In other words, I aim to evaluate to what extent the emerged theory achieves the criteria of quality as suggested by Corbin & Strauss (2008). This can be shown as follows.

9.4.1 Fit

“Do the findings resonate with the experience of both the professionals for whom the research was intended and the participants who took part in the study? Can participants see themselves in the story even if not every detail applies to them?” (Corbin & Strauss, 2008, p.305).

This is how Corbin & Strauss (2008) explain what the fit criteria means. For this study, the answer is yes. At the validation stage of the analysis process, I assure that the emerged theory represents the participants’ perceptions and they agree with its suggestions. All the participants’ comments are considered whilst the grounded theory is modified and changed several times before it reaches its final version.

Moreover, some of the other professionals and regulators who do not participate in the study agree with the outcomes of the emerged theory and feel that it represents their opinions. This is confirmed during my attendance to a number of conferences in which I met some audit partners and regulators. Of course some of the professionals make certain comments regarding the emerged theory, although these comments are considered during the analysis process and the final results include all of this feedback. For example, the main values of the independent audit oversight system (which are suggested in Chapter 5) have been modified many times during the analysis as a result of in-depth discussion with the study’s participants. Further, the key success factors of establishing an effective audit oversight authority have been modified many times as a part of the analysis process.

9.4.2 Applicability

“Do the findings offer new explanations or insights? Can they used to develop policy, change practice, and add to the knowledge base of a profession?” (Corbin & Strauss, 2008, p.305).

By reviewing the main suggestions of the grounded theory, I argue that the emerged theory contributes to the auditing literature by providing a number of applicable findings which
could be applied in different countries. For example, understanding the main values of the audit oversight system can encourage different governments to commence an independent supervision of the audit profession. Further, the key factors of establishing an effective audit oversight authority can be used by governments to enhance the audit profession in their capital markets. Countries which already have independent audit oversight authorities can use the suggested factors to evaluate the performance of their current audit regulators. Other countries which do not have such oversight systems can use the proposed factors to establish new systems. Audit researchers can use such factors to criticise the regulators’ performance or conduct comparative studies among different oversight boards of different countries.

9.4.3 Concepts

“What is important is that findings have substance, or that they must be something more than a mass of non-interpreted data that leave the reader trying to figure out what to make of it” (Corbin & Strauss, 2008, p.305).

The suggested theory has emerged from data gathered from the field and been coded, grouped, analysed, and developed into a number of meaningful categories which represent the research phenomenon. The emerged theory provides a greater understanding of the regulatory challenges in the global audit market. It explains how the main players of the audit market (in particular, the audit firms and the audit regulators) are interacting together to enhance the quality of the audit profession.

The emerged theory studies the three main components of the audit regulatory framework: the regulators (in Chapter 5), the regulations (in Chapter 6), and the regulated audit firms (in Chapter 7). Chapter 8 provides a framework which interprets all of these main categories with the core category of the emerged theory which is the globalisation of the audit market. Chapter 8 suggests a number of common themes of the global audit market which have been applied by all its players. Thus, the suggested theory provides interpreted substance which is valuable for different groups of audit parties rather than a set of non-linked data. The emerged theory provides a better understanding of the big four views regarding the independent regulators. This can be useful for the regulators themselves to modify their performance and to cooperate with auditors. Mid-size firms can get a better understanding of how the big four firms act to increase their market shares and protect their leading reputations. The emerged theory suggests a number of further studies which can be conducted by audit researchers.
9.4.4 Contextualisation of concepts

“Findings devoid of context are like jelly donuts devoid of jelly .... Without context, the reader of research cannot fully understand why events occurred, why certain meanings and not others are ascribed to events, or why experiences were one way and not another” (Corbin & Strauss, 2008, p.306).

It is argued that qualitative data must be understood within context, and researchers should first provide some background information (Collis & Hussey, 2009). Although this study investigates the phenomenon of the regulatory challenges of the audit market at the global level, which is referred to by much of the audit literature, the data are gathered from two certain case studies which represent the main context of this research. As explained in Chapter 2, for the practicality of collecting data and asking participants about specific regulations and audit authorities, it is important to choose specific cases for investigation. I argue that analysing data from two different audit markets can provide valuable information which could be valid to understand the challenges of the global audit market.

The emerged theory is developed using data gathered from two different audit markets: the UK audit market as a developed market, and the Egyptian audit market as a developing market. My notes are made while the big four strategies are consistently applied in both the UK and Egypt (as they emerge from the global networks). Indeed, differences do exist between the regulatory audit environments in both countries. Egypt is a member of the IFIAR and shares its practice of the audit oversight system with the UK and all other IFIAR’s members. However, the legal framework in Egypt restricts many of audit regulations from being applied in the Egyptian environment. For example, the Egyptian audit law prevents audit firms from auditing companies; individual auditors only have the right to practice the audit profession. This restricts many of the audit regulations from being applied in Egypt as they are mainly applied through firms rather than individuals (such as the mandatory annual transparency reports that should be applied by the audit firms or the audit firms’ governance code).

9.4.5 Logic

“Is there a logical flow of ideas? Do the findings “make sense”? Or are there gaps or missing links in the logic that leave the reader confused and with a sense that something is not quite right? Are methodological decisions made clear so that the
reader can judge their appropriateness for gathering data and doing analysis?” (Corbin and Strauss, 2008, p.306).

The ideas flow during the main stages of conducting this research as follows. I initially begin by thinking about the audit market which has been regulated – for the first time – by independent regulators after the collapse of Enron and the failure of Arthur Anderson. Since 2002, many changes and challenges have taken place in the audit profession which has been intensively regulated. It seems that it is not only an American phenomenon; many countries follow the US in applying the same audit oversight system.

The new audit regulators believe that they enhance the quality of the audit profession and promote the public’s trust in both auditors and capital markets. Thus, a research study is required to study how auditors evaluate the new regulators’ performance (as stated in Chapter 5). A research is also required to examine the extent to which the audit profession needs this external oversight (which is examined in Chapter 5). Further research is required to investigate the effectiveness of the new audit regulations in improving the audit quality (which is investigated in Chapter 6). The analysis is “logically” extended to discuss the main strategies which have emerged from the audit firms to manage these regulatory challenges of the audit profession (as discussed in Chapter 7). Finally, as these challenges have been in existence in most countries, thus, the core category of the grounded theory discusses the main themes of the global audit market (as stated in Chapter 8). This is how I conduct my research and how the ideas flow in a logical way. I argue that I have tried my best to reach the highest degree of fairness, objectivity, and logical thinking.

9.4.6 Depth

“It is the descriptive details that add richness and variation and lift the findings out of the realm of the ordinary. It is depth of substance that makes the difference between thin, uninteresting findings and findings that have the potential to make a difference in policy and practice” (Corbin & Strauss, 2008, p.306).

The main contributions of the study are that it provides interesting findings which might not have been previously discussed in the audit literature. Further, it provides an in-depth understanding of the main strategies which have emerged from the main players in the global audit market and the main themes of such strategies. It also explains the importance of the independent audit oversight system and to what extent it adds great value to the whole audit
market. These findings support the valuable and interesting suggestions which have been provided by the study to all audit parties (auditors, regulators, and audit researchers).

9.4.7 Variation

“Has variation been built into the findings, meaning are there examples of cases that do not fit the pattern or that show differences along certain dimensions or properties? By including variation, the researcher is demonstrating the complexity of human life” (Corbin & Strauss, 2008, p. 306).

The study’s interviews reflect both the auditors and regulators’ perceptions toward certain issues which are related to the regulatory framework of the audit market. Different views have been raised between the two audit parties. However, this difference maximises the value of the analysis and provides opportunities to understand many issues which have not yet been debated in prior studies. For example, an intensive analysis is conducted in order to gauge the views of audit regulators and the big four partners toward the regulators’ performance and how they can enhance the audit quality. The analysis suggests that more cooperation is required between both of the audit parties. Both partners and regulators participate in setting a number of factors which should exist in the audit oversight authority.

9.4.8 Other factors

“Are the findings presented in a creative and innovative manner? Does the research say something new, or put old ideas together in new ways? It is not that the topic needs to be new, but the new understandings of that topic are brought forth” (Corbin and Strauss, 2008, p. 306).

Creativity is one of the quality measures which should exist in the study. The emerged theory contributes to the audit literature by providing interesting and new findings. It also contributes in a creative way as there is a lack of qualitative studies in the audit literature. The main contributions of the emerged theory are summarised in Section 9.5.

“Did the analysis drive the research or was the research driven by some preconceived ideas or assumptions that were imposed on the data? The latter may or may not be okay, depending upon how careful the researcher was to put aside bias and honestly seek to find contradictions in the data to his or her assumptions” (Corbin and Strauss, 2008, p. 306).
Another factor is the sensitivity and avoiding bias as one of the main criteria for the effective qualitative research. The researcher does his best to avoid human bias during the conduct of the main stages of collecting and analysing gathered data. For example, the interviews cover different views of audit partners from all of the big four firms and do not reflect only one specific firm. Moreover, when auditors comment about the regulators’ performance, the researcher argues that it is fair enough to conduct interviews with those regulators to discuss these comments with them and explain to what extent they agree with the auditors’ views. This debate adds great value to the study as it provides a better understanding of both the auditors and regulators’ perceptions of the inspection process in the audit profession.

“Memos should grow in depth and degree of abstraction as the research moves along. Thus, there should be some evidence or discussion of memos in the final report” (Corbin & Strauss, 2008, p. 307).

In qualitative research, memos may be taken to remind the interviewee regarding his feelings or observations during the interview. Memos about the main dimensions and properties of the developed codes, concepts, and categories are taken during the research. They are considered during the analysis process as they provide clearer images about the relations and the interactions among developed categories. This assists me in providing interpreted findings which enhance the values of the emerged theory.

The following section summarises the main contributions of the emerged theory to the audit literature.

9.5 The main contributions of this study

The emerged theory contributes to the literature in different ways. The achieved contributions are classified into three groups according to their nature. The first group includes contributions to the research methodologies which are followed by many prior studies in auditing. The second group includes theoretical contributions to the audit literature. The third group consists of practical contributions which are related to actual practical cases in certain audit markets. The third group is explained as follows.

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1 Memos refer to any notes or observations the researcher may take during the interviews and affect the analysis.
9.5.1 Methodological contributions

This study contributes to the auditing literature by providing one more qualitative research which can be added to the few qualitative studies in the auditing literature\(^2\). The data is gathered from 31 semi-structure interviews with audit partners and regulators. Each interview provides from 1.5 to 3 hours of recorded data. Communicating with auditing professionals and regulators is very difficult as they are too busy all the time. However, building personal networks through attending conferences and convincing them of the importance of the research problem and the extent to which their perceptions will add valuable information is one of the keys to building a good network of professionals. The snowball method is another effective method, as professionals usually trust in their peers.

Further, qualitative studies provide an opportunity for the researcher to analyse live data through looking for a number of actual words and statements which represent actual feelings and arguments rather than dealing with blind figures or statistics. The importance of the quantitative analysis cannot be ignored. However, according to the research problem, sometimes it is felt that qualitative analysis is required in order to provide live information about certain unknown areas. The grounded theory adds this type of vital information by building up a meaningful framework which explains the interactions among the main players of the global audit market including audit regulators, regulations, and regulated audit firms. Both auditors and regulators’ point views are considered, debated, analysed, and criticised during different stages of the analysis process. The grounded theory methodology in the accounting research is used by many of prior studies (see for example, Parker & Roffey, 1997; Gurd, 2006; Elharidy et al., 2008). For example, Parker & Roffey (1997) review the grounded theory in accounting research and argue that more grounded theory studies are required in the accounting literature. Further, Elharidy et al. (2008) stresses the increased number of studies which use the grounded theory as a research methodology in the accounting literature since the call of Parker & Roffey (1997). Thus, this study fills the lack of accounting literature – especially in auditing – which uses the grounded theory as a research methodology.

\(^2\) Auditing: A journal of practice and theory calls for qualitative research in auditing: "The purpose of this Forum is to encourage research that delves into the black box of auditing and to develop a richer understanding of the audit process and the nature of auditor work in either the public or private sector. We encourage submission of qualitative analyses grounded in a variety of established approaches” available at: http://www.earn.eu/fileadmin/earn/News/Call_for_Papers_AJPT_Research_Forums_9-2011.pdf.
Furthermore, there are three types of coding processes put forth by Strauss & Corbin (1998) for grounded theory methodology (open, axial, and selective coding); the grounded theory develops a number of categories which provide a better understanding and a clearer image of how the new independent audit regulators currently act in the audit market and how to improve their performance. Further understanding is provided of the role and the effectiveness of the current audit standards and regulations in achieving the regulators’ objectives. Moreover, the analysis is extended to explore the perceptions of the audit firms toward the new stage of external oversight of the audit profession and explain their interactions toward the new challenges of the audit profession. A number of strategies have been explored, analysed, and developed through the analysis processes to provide a greater understanding of the strategies which have emerged from the big four audit firms to manage the changeable environment of the global audit market.

9.5.2 Theoretical contributions

The emerged theory contributes to the audit literature by discovering and analysing a number of unknown areas in the field of audit regulations and audit firms’ strategies. The emerged theory contributes to the literature by providing a better understanding of a certain number of issues which have not been discussed before in the audit research. Further, it suggests a number of conclusions which contribute to the current audit literature. These theoretical contributions are provided as follows.

9.5.2.1 Suggested added value of the independent audit oversight system

As stated in Chapter 2, reviewing the literature identifies a number of areas in the field of audit regulations which may require further research to discover the suggested unknown areas. This study contributes to the auditing literature by justifying both auditors and regulators’ perceptions toward what happens in the global audit environment. Data is gathered from the field, and is then discussed, analysed, and criticised to provide a number of suggestions which, to the best of my knowledge, are provided in the literature of audit regulations for the first time.

For example, this study considers the auditors’ perceptions regarding the importance of the independent audit regulators’ role in enhancing the quality of the audit profession and regaining the public trust in auditors and capital markets. In Chapter 5, the analysis suggests a number of added values for certain beneficiaries from different audit parties (such as auditors,
regulators, investors, and governments) as a result of the existence of the audit oversight system. Understanding these values explains to what extent the audit profession and different groups of audit parties still need this independent oversight system in different countries. The emerged theory suggests that governments should continue in supervising the audit profession by fully independent regulators, ending up at the stage of self-regulated profession. This suggestion can also be provided for any government which has not yet established the independent audit oversight, regardless of its national cultures, behaviours, or economic system. Independence maximises the value of trust for different nations.

9.5.2.2 Suggested key factors of establishing an effective audit oversight authority

As explained in Chapter 5, the findings assist governments in establishing an independent audit oversight system by suggesting a number of key factors that could be essential for applying an effective audit supervision system. The analysis combines both regulators and auditors’ perceptions to explain how a sufficient audit oversight authority can be established (such factors are grouped in authorities’ factors, staff’s factors, and methodology’s factors). Even governments or researchers of countries which already have audit oversight systems can use these factors to evaluate the organisational performances of their audit oversight authorities.

9.5.2.3 Analysing auditor’s criticisms of regulators’ performance

One of the main problems which auditors have when they communicate with regulators is that they cannot criticise the regulators’ performance\(^3\). It is not usual in the auditing literature to discuss the feelings and impressions of auditors regarding their regulators. However, the emerged theory suggests a number of auditors’ comments and criticism toward the audit regulators and inspectors’ performance. This contributes to the literature by exploring the auditors’ feelings and feedback regarding their regulators. The study gives the opportunity for auditors to talk freely without any pressure about their comments and criticism toward the audit regulators and inspectors. Auditors trust that their arguments are very confidential and are used only for research purposes without announcing any personal names or even positions, not more than “Audit partner, Company X”. These free criticisms are discussed, analysed, criticised, and provided in Chapter 5 of this study. A debate is analysed between

\(^3\) “We cannot criticize our regulators” Said by one of the big four firms’ partners in his speech in the Auditing and Assurance Conference (AAC) that was held in London on the 17\(^{th}\) and 18\(^{th}\) of May 2012, organised by the special group of Auditing, British Accounting and Finance Association (BAFA).
auditors’ criticisms and regulators’ defences toward such criticism. Fairness and objectivity push me to discuss and analyse both of the two perceptions to achieve a greater understanding of the reality.

9.5.2.4 Analysing the audit regulations

Regulators are not the only dimension of the regulatory framework. Any regulatory framework consists of regulators, regulations, and regulatees (further dimensions could be added such as audit clients and other public beneficiaries). Regulations are the tools by which regulators can achieve their targets. The emerged theory contributes to the literature by analysing the common audit regulations in the audit market. It provides an understanding of how the audit regulators achieve their objectives. As discussed in Chapter 6, the audit regulations are classified into a number of groups according to their purposes and what type of objectives they try to achieve. Moreover, the analysis is extended in order to explore the auditors’ perceptions toward such regulations and to what extent auditors feel that the current regulations enhance the quality of the audit profession. Understanding these arguments provides valuable information for different audit parties (regardless of their nationalities) which can assist them in evaluating the current audit regulations that govern the audit markets and decide which of those regulations are valid and which of them must be changed or at least modified.

9.5.2.5 Explaining the audit firms’ strategies

As argued in Chapter 2, many prior research studies discuss the effects of the new independent oversight system on the audit profession (such as audit quality, audit independence, or audit risks) or the audit market (such as audit competition, audit fees, and choice of auditors). However, very few studies investigate the effects of the new oversight system on the audit firms per se. Even these few studies examine the effects of the new system on the relations between the audit firms and other regulators of the audit profession or the capital markets. The role of the audit firms, especially the global networks of the big four firms, in influencing the regulation and standards’ setting processes of the audit profession has been discussed in a number of prior research in the auditing literature. The literature review provides evidence that there is a lack of literature when it comes to studying the audit firms’ strategies toward the global challenges of the audit market’s regulatory environment.
The grounded theory contributes to the literature by suggesting a number of strategies which have emerged from the audit firms – in particular, the big four audit firms – to face the global challenges of the audit market. The grounded theory sheds light on the big four audit firms and provides great understanding about their performance and how they interact with their clients, competitors, regulators, global networks, member firms, and even their employees to achieve their objectives and provide a better audit service. This represents a contribution to the audit literature as there have been many calls for more transparency and published information regarding the big four firms from many authorities.

Chapter 7 discusses how the big four firms react toward the global challenges of the global audit market. The grounded theory suggests and analyses six strategies which have been followed by the big four firms to manage the current challenges of the global audit market. Understanding such strategies is valuable in understanding the current structure of the global audit market and the relations among its main players.

Further, the grounded theory explains how and why certain phenomena have appeared in the audit market. For example, it analyses the main causes, advantages, disadvantages, and the effects of the recent mergers which have been conducted between a number of regional audit firms which are members of the same global networks. The new mergers of the audit firms, to the best of my knowledge, have not been discussed before in the auditing literature. The grounded theory also discusses the main motivations and features of providing global opportunities by the global networks for their audit staff at different levels. The global opportunities’ strategy has been intensively applied during recent years by the global audit networks and, to the best of my knowledge, has not been discussed before in the audit literature.

Moreover, it suggests a number of factors which cause the increased fees of auditors after the establishment of the independent oversight system of the audit profession. Further, it provides a number of reasons for the higher concentration level of big audit firms in auditing the largest companies which are listed in most of the capital markets. It also provides a better understanding of the main drivers of competition in the global audit market.

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4 Basel committee on banking supervision (2008) argue that the audit firms need to be more transparency about their structures and the relationships between the global networks and their member firms by making dialogues with related parties as regulators, investors and all the society. Furthermore, the FRC (2007) force the big audit firms to publish annual transparency reports about their performance including their objectives, structures, and financial positions.
9.5.2.6 Suggested characteristics of the global audit market

The grounded theory extends the analysis of the audit firms’ strategies to better understand the whole audit market at the global level. The global theory interprets the strategies which have emerged from both the audit regulators and regulated firms together to suggest a number of common features of the global audit market. These features are applied to both audit firms and audit regulators as both of them have such characteristics. The grounded theory suggests that the global audit market and its main players become more standardised, centralised, closed and faster communicating, whilst they are also specialists in their decisions, regulations, and future plans. Both audit firms and regulators interact globally to mind their steps toward other players in the same global market. Mutual influences have been raised among the main players of the audit market through a number of global dialogues, meetings, and discussions which aim to enhance the audit profession and regain the trust in the capital markets. Understanding these characteristics, their motivations, and their objectives provides valuable information for different audit parties (such as regulators, auditors, investors, governments, and investors) and contributes to the auditing literature by providing further analysis and understanding for the current debate of research which discusses the global audit market.

9.5.3 Practical contributions

This study investigates two case studies from different environments to provide a better and in-depth understanding of the current players of global audit market. The two cases that have been investigated are the audit environment in the UK as one of the developed countries and Egypt as one of the developing countries. The grounded theory achieves practical contributions by providing a better and in-depth understanding of the actual and current performance of the FRC as the unified audit regulator in the UK. This includes an analysis of the current performance of the AIU and how it affects the quality of the audit profession. It also includes a criticism of the FRC’s performance and an examination of the extent to which the key factors of establishing an effective audit oversight authority can be applied to the FRC’s performance.

A similar understanding has been provided for the Egyptian audit environment by analysing the QCU’s performance and to what extent the suggested factors of establishing an effective audit oversight authority can be implemented. The grounded theory further explains the Egyptian auditors’ perceptions toward what type of regulations can be applied to enhance the
quality of the audit profession in Egypt. This detailed analysis provides great understanding of the audit practices in two different audit environments. Practically, this study provides a better understanding of the audit practices in both the UK and Egypt, including the relations between different audit parties (such as audit firms and audit regulators).

9.6 Limitations and areas of further research

Communicating with audit partners and regulators is one of my main challenges during this research. The number of interviews which can be considered as sufficient to support a meaningful analysis is debatable. For example, Strauss & Corbin (1998) argue that the number of interviews to build a grounded theory depends on the nature of the research problem and gathered data, whilst it is limited to relevant costs and time. In this study, the interviewees are conducted with top management partners and heads of audit, assurance, and risk management departments in the big audit firms and top management level of audit regulators in both the UK and Egypt.

Getting access to these participants is limited to their availabilities and time. Further, within grounded theory the number of interviews is decided based on the saturation level – the point at which there is no significant addition to the findings. In this context, I argue that the 31 interviews help me to reach the saturation level. I do my best to contact audit partners and regulators as much as I can. However, depending on the availability of their times, and the fact that the number of interviews are not equal for each firm of the big four firms, it is also not equal among audit partners and audit regulators. A table which shows the time, date, and the participant of each interview is inserted in the research methodology chapter (Chapter 3).

Furthermore, some of the research interviews (seven interviews) are not recorded as desired by the main participants. The participants are not happy with recording what they say and argue that their participation will be more valuable and free if the interviews are not recorded. According to the ethical consideration, I am committed to adhere to their desires and take intensive notes during their answers. Indeed, they are patient enough to talk slowly until I finish writing. Moreover, following the conclusion of each interview, I directly record all my notes, memos, and observations during the interview. This helps me to not lose any important data during the analysis.

Further research is suggested to contribute more qualitative research to the auditing literature. The emerged theory suggests that audit regulators fail to increase the number of the big audit
firms and to enhance the choice of auditors, especially in the big audit markets. A number of suggested solutions are provided during the study. However, such solutions represent the views of the big four partners and audit regulators. Understanding the main factors which limit the mid-size firms competing in the big audit market is an additional area for further research. The views of the mid-size firms and the management and audit committees for the audited companies should be considered. Furthermore, this study suggests a number of success factors to establish an effective audit oversight authority. These factors can be applied in different audit environments. Further research is needed to test the extent to which these factors are valid in different countries. This can achieve the development of a general theory regarding the phenomenon of establishing a number of audit oversight authorities. Comparative studies can be useful for this type of research.

Moreover, there is a lack of literature regarding the effects of offering global opportunities for the audit staff on the quality of the audit process. In this study, the views of the audit partners are considered. However, the views of auditors, at lower levels, who are offered such opportunities, should be analysed in further research. Understanding the extent to which they evaluate such opportunities is quite important to suggest a number of factors which can enhance the outcomes of such a strategy. In addition, further research is needed to analyse the views of the audit clients regarding foreign auditors and to what extent this affects the relations among the audit firms and their clients. Comparative studies can be conducted among different cultures in different countries.

Finally, the emerged theory suggests that the big four firms are establishing a new trend of closer structures by commencing a number of regional and global mergers among their member firms. This is one of many strategies which is followed by the global audit networks to become more standardised, centralised, and faster communicated with their member firms. The effects of these new mergers on the financial and non-financial measurements of the audit firms’ performance require further investigation.
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Appendix

Appendix 1: Final recommendations of the MPG’s report “choice in the audit market”

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<th>Recommendation</th>
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<tr>
<td>1</td>
<td>The FRC should promote wider understanding of the possible effects on audit choice of changes to audit firm ownership rules, subject to there being sufficient safeguards to protect auditor independence and audit quality.</td>
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<td>2</td>
<td>Audit firms should disclose the financial results of their work on statutory audits and directly related services on a comparable basis.</td>
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<td>3</td>
<td>In developing and implementing policy in auditor liability arrangements, regulators and legislators should seek to promote audit choice, subject to the overriding need to protect audit quality.</td>
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<td>4</td>
<td>Regulatory organisations should encourage participation on standard setting bodies and committees by appropriate individuals from different sizes of audit firms.</td>
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<td>5</td>
<td>The FRC should continue in its efforts to promote understanding of audit quality and should promote greater transparency by the firms and the FRC of the capabilities of individual audit firms.</td>
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<td>6</td>
<td>The auditing profession should establish mechanisms to improve access by the incoming auditor to information relevant to the audit held by the outgoing auditor.</td>
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<td>7</td>
<td>The FRC should provide independent Guidance to Audit Committees and other market participants on considerations relevant to use of firms from more than one audit network.</td>
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<td>8</td>
<td>The FRC should amend the section of the FRC Guidance to Audit Committees dealing with communications with shareholders to include a requirement for the provision of information relevant to the auditor re-selection process.</td>
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<td>9</td>
<td>When explaining auditor selection decision, Boards should disclose any contractual obligations to appoint certain types of auditing firms.</td>
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<td>10</td>
<td>Investor groups, corporate representatives, firms and the FRC should promote good practices for shareholder engagement on auditor appointment and reappointments.</td>
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<td>11</td>
<td>Authorities with responsibility for ethical standards for auditors should consider whether any rules could have a disproportionately adverse impact on auditor choice when compared to the benefits to auditor objectivity and independence.</td>
</tr>
<tr>
<td>12</td>
<td>The FRC should review the Independence section of the FRC Guidance on Audit Committees to ensure that it is consistent with the relevant ethical standards for auditors.</td>
</tr>
<tr>
<td>13</td>
<td>Regulators should develop protocols for a more consistent response to audit firm issues based on their seriousness.</td>
</tr>
<tr>
<td>14</td>
<td>Every firm that audits public interest entities should comply with the provisions of a Combined Code-style corporate governance guide or give a considered explanation.</td>
</tr>
<tr>
<td>15</td>
<td>Major public interest entities (PIEs) should consider the need to include the risk of the withdrawal of their auditor from the market in their risk evaluation and planning.</td>
</tr>
</tbody>
</table>
### Appendix 2: the main threats of non-audit services and possible safeguards

<table>
<thead>
<tr>
<th>Non-Audit services</th>
<th>Threats</th>
<th>Safeguards</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal Audit services</td>
<td>Self-review threat, Management threat</td>
<td>Internal audit partner and staff should not involve in external audit processes.</td>
</tr>
<tr>
<td>Information technology services</td>
<td>Self-review threat, Management threat</td>
<td>Information technology partner and staff should not involve in external audit processes.</td>
</tr>
<tr>
<td>Valuation services</td>
<td>Self-review threat, Management threat</td>
<td>NA</td>
</tr>
<tr>
<td>Actuarial valuation services</td>
<td>Self-review threat</td>
<td>NA</td>
</tr>
<tr>
<td>Tax services</td>
<td>Self-interests threat, management threat, advocacy threat, and self-review threat</td>
<td>Tax partner and staff should not involve in external audit processes. Tax services are reviewed by independent tax partner.</td>
</tr>
<tr>
<td>Litigation support services</td>
<td>Self-review threats, advocacy threats, and management threats</td>
<td>NA</td>
</tr>
<tr>
<td>Legal services</td>
<td>Advocacy threats, self-review threats, and management threats</td>
<td>NA</td>
</tr>
<tr>
<td>Recruitment and remuneration services</td>
<td>Management threats, familiarity threats</td>
<td>Advices being provided by partners and staff who have not involvement in the external audit processes.</td>
</tr>
<tr>
<td>Corporate finance services</td>
<td>Self-review, management threats, advocacy threats, and self-interests threats</td>
<td>Advices being provided by partners and staff who have not involvement in the external audit processes. Advices being reviewed by independent corporate finance partner.</td>
</tr>
<tr>
<td>Transaction related services</td>
<td>Management threats, self-review threats</td>
<td>Advices being provided by partners and staff who have not involvement in the external audit processes. Advices being reviewed by independent partner.</td>
</tr>
<tr>
<td>Accounting services</td>
<td>Self-review threats, management threats</td>
<td>Any staff involved in the accounting services has no involvement in the audit of the financial statements. Accounting services being reviewed by independent partner. The engagement would not lead to any audit firm’s staff or partners to take decisions or make judgments which are properly the responsibilities of management.</td>
</tr>
</tbody>
</table>
### Appendix 3: Examples of risks, impacts, and mitigations that set by the big four firms.

<table>
<thead>
<tr>
<th>Risk description</th>
<th>Potential impacts</th>
<th>Mitigation</th>
</tr>
</thead>
</table>
| **Appropriateness of clients and services:** Acceptance of clients those are inappropriate to our brand and/or delivery of services which are either illegal, unethical, contravene professional standards, or are otherwise perceived by investors, regulators or other stakeholders as inappropriate. | Reputation in the marketplace impacted by working for the wrong clients or delivering the wrong service.  
Regular sanctions including temporary loss of licence.  
Loss of major clients. | Our internal quality control system including:  
Our client and engagement acceptance procedures.  
Our proprietary system which checks for conflicts of interest.  
Detailed policies and procedures around auditor independence.  
Strict new products and services approval processes.  
Our routine compliance programs.  
Our Code of Conduct and Values. |
| **Regulatory relationships:** Failure to maintain good relationships with audit regulators or deal with any adverse findings from regulatory inspections to the regulators satisfaction. | Loss of major audit clients  
The inability to attract new talent into our ELLP firms | Nominated individuals responsible for interaction with regulatory authorities on a country by country basis and a clear framework for understanding local regulatory matters.  
Majority of ELLP Board are “Qualified Individuals” with appropriate audit training and background. |
| **Audit failure:** Major or multiple audit failures (as a consequence of signing an incorrect audit opinion and/or poor quality auditing) resulting in litigation and/or regulatory action. | The loss of a number of audit clients due to reputational damage.  
The inability to attract new talent.  
Regulatory fines and/or temporary or permanent loss of audit licence. | Our audit quality controls include:  
A tone at the top which emphasises quality, ethics and integrity.  
Our client and engagement acceptance procedures.  
Clear standards and robust audit methodology and tools.  
Controls over recruitment, development and assignment of our professionals.  
Commitment to technical excellence.  
Controls to deliver an effective and efficient audit.  
Commitment to continuous improvement through monitoring. |
| **Major litigation:** Major litigation, particularly cross-border litigation, arising where we have either delivered services directly in another jurisdiction or are working as part of an engagement with other firms within the KPMG network and that engagement results in litigation. | Significant defense costs and/or settlement costs incurred  
Reputational damage and resulting regulatory scrutiny  
Excessive use of leadership time in resolving issues | Default position of engagement contracts being prepared under local law and jurisdiction  
Rigorous and robust inter-firm contracting protocols when working with other KPMG member firms  
Detailed policy, guidance and approvals for delivering services in overseas jurisdictions |
| **Pricing:** Tough economic conditions mean clients are seeking more innovative pricing models and becoming more value conscious in their purchasing. | Losing out to competitors on price – impacting ability to retain market share  
Increased incentive for our professionals to cut corners – impacting on quality  
Existing resources will need to work harder – with consequences for morale and talent management | Engagement recovery considered as part of acceptance process  
Specific pricing panels in operation in parts of our group  
Compliance programmes monitor engagement quality  
Increasing use of resource in lower cost territories to support delivery |
| **Regulatory change:** Major changes in regulation impacting on our business model including regulatory action proposed by the European Commission including: Audit only firms  
Mandatory tendering and audit firm rotation  
Prohibiting, or severely restricting, auditors from providing non-audit services to their clients | Fundamental impact on our business model  
Making it more difficult to achieve audit quality  
Undermines our ability to deliver multi-disciplinary solutions to our clients  
Reduction in audit quality | Processes and procedures established to mitigate the risk include:  
An established plan within KPMG Europe LLP for regulatory liaison  
Specific planning for potential medium-to-long-term outcomes arising from regulatory change  
Contingency planning for key potential changes arising from the recent EU proposals on Audit Policy and the impact of other foreseeable regulatory change |
<table>
<thead>
<tr>
<th>Risk description</th>
<th>Potential impacts</th>
<th>Mitigation</th>
</tr>
</thead>
</table>
| **Data loss:** Failure to protect client confidential or personal data. | Reputational damage  
Loss of clients  
Potential litigation                                                                 | Robust IT security policies and processes  
ISO 27001 accreditation in our largest firms  
Ongoing training                                                                 |
| **Reacting to new trends:** Inability to quickly and effectively match key skills to growth areas due to organisational barriers; skills shortages; slowness in identifying/recruiting appropriate skills; or a lack of staff mobility and/or flexibility. | Failure to quickly and fully exploit growth opportunities resulting in loss of revenue  
Failure to match resource to demand could result in an excessive cost base in areas of reducing demand  
Failure to develop future leaders with the right experience and international mindset  
Quality implications of having the wrong people deliver services | Monitoring of resource levels and functional hot spots  
Partner career paths and development  
Partner succession planning  
Global mobility program in place |
| **People engagement:** Reduced morale potentially caused by high workloads impacting work life balance; poor internal communications; uncertainty around career development; and reward packages being perceived as uncompetitive. | Demotivated staff leading to service delivery issues and a reduction in quality  
Lower productivity  
Loss of key talent  
Loss of reputation in marketplace as an ‘employer of choice’ | An embedded group of People Management Leaders  
Sophisticated appraisal and reward processes  
Ongoing review of global performance management  
Ongoing initiatives to address feedback from people surveys |
| **Talent management:** Inability to recruit and retain sufficiently qualified, motivated and experienced people. | Loss of talent leading to service delivery issues and a reduction in quality  
Loss of reputation in marketplace with clients  
Succession planning fails | Special training programme in place focusing on leaders of the future  
Annual promotion process and pay review  
Defined partner career paths and development  
Partner succession planning |

Appendix 4: The developed categories for Chapter 6 and the main themes for each category

<table>
<thead>
<tr>
<th>Projects</th>
<th>Benefits</th>
<th>Auditors’ perceptions</th>
<th>Suggestions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improving quality</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reviewing the audit firms’ performance</td>
<td>Improving audit firms’ performance</td>
<td>The quality of the audit reports has been increased</td>
<td>Reviews should avoid press pressure</td>
</tr>
<tr>
<td>Preventing the provision of non-audit service to audit clients</td>
<td>Adding creditability</td>
<td>Increased documentary system</td>
<td>No more complicated regulations are required</td>
</tr>
<tr>
<td>Professional scepticism</td>
<td>Mitigating risks</td>
<td>Increased quality of the audit process</td>
<td>Regulations’ setters (not only inspectors) should be fully independent</td>
</tr>
<tr>
<td></td>
<td>Identifying measures of audit quality</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Improving the quality of the audit report</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Increasing the auditors’ independence</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increasing transparency</td>
<td>Annual transparency reports</td>
<td>Reducing the expectations gap among auditors and investors</td>
<td>Highly transparent information has been available for public regarding the audit firms’ objectives, strategies, structures, and financial positions. More time is required to evaluate such projects</td>
</tr>
<tr>
<td>Reviewing the audit proposals for listed companies</td>
<td>Get better understanding of the audit market</td>
<td></td>
<td>Regulations’ setters (not only inspectors) should be fully independent</td>
</tr>
<tr>
<td>Audit firms’ governance code</td>
<td>Enhancing the choice in the audit market</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Used by auditors as a competitive and advertising tools.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Used by investors as a comparable tools (balance scorecards)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reducing barriers</td>
<td>Audit liability limitation agreements</td>
<td>Enhancing the choice of the audit market</td>
<td>Threatens the rules of auditors independence Further safeguards should be granted</td>
</tr>
<tr>
<td>Changing ownership rules for the audit firms</td>
<td>Mitigate the risks of further accounting collapse</td>
<td>Threatens the quality of the profession</td>
<td>Different ideas should be discussed to increase the number of big audit firms</td>
</tr>
<tr>
<td>Modifying ES 3</td>
<td>Limiting auditors’ liabilities</td>
<td></td>
<td>Auditors’ independence should be carefully considered.</td>
</tr>
<tr>
<td></td>
<td>Adding more financial resources for auditors</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Reducing the risk of litigations</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>