

THE UNIVERSITY OF SYDNEY

FACULTY OF ECONOMICS AND BUSINESS
THE DISCIPLINE OF ACCOUNTING

THE INTRODUCTION OF CLERP 9 AUDIT REGULATION AND ITS IMPACT ON THE AUDITING PROFESSION: THE NEW FORCE OF LAW AUSTRALIAN AUDITING STANDARDS



HONOURS THESIS

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2007

*SUBMITTED TO THE FACULTY OF ECONOMICS AND BUSINESS,
THE UNIVERSITY OF SYDNEY IN PARTIAL FULFILMENT OF THE REQUIREMENTS
FOR THE DEGREE OF BACHELOR OF ECONOMICS WITH HONOURS*

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CERTIFICATION OF ORIGINAL WORK

I hereby declare that this submission is my own work and to the best of my knowledge it contains no material previously published or written by another person, nor material which to a substantial extent has been accepted for the award of any other higher degree of a university or other institute of higher learning, except where acknowledgement is made in the text. Any contribution made to the research by others is explicitly acknowledged in this thesis and abides with the University of Sydney's policy on academic honesty.

.....

Angela Hecimovic

ACKNOWLEDGEMENTS

All honour and deep gratitude goes initially to my fantastic, enthusiastic supervisors Nonna Martinov-Bennie and Peter Roebuck, without whom this thesis would not be possible. Their audit expertise, support, patience and at times challenging perspectives are the reasons for my success in learning, research and the successful completion of this project. Nonna and Peter, you are my inspiration and what I have learnt from you both will be with me throughout this academic journey.

This project could not have been a success without the time, generosity and participation of all the respondents; thanks for all your views and perspectives; you know who you are. A deep gratitude goes to an angel called Judith that has assisted me in more ways that she will ever know.

To the friends that I have made in the Honours classes; thanks for sharing your knowledge. Thanks to all the honours academic staff for your advice and knowledge and for the constructive criticism throughout the course.

Last but not least a big thank you to my great family; Frank, Monika and Klaudia for their love and understanding of the many 'mum's in the dungeon' writing days and nights. Thanks Frank for being a great support, you allowed me to complete this study in peace and thanks for all the great dinners.

Thanks to the inner spirit inside me that kept telling me 'I can do this' at my age.

ABSTRACT

This study examines the introduction of legally enforceable Australian Auditing Standards (ASAs) and the impact on the audit profession after their first year of implementation. This study is informed by regulation theories and potential costs, benefits and other impacts of the new regulatory regime identified by the Australian government's April 2006 Regulation Impact Statement (RIS). This study collected relevant data through semi-structured in-depth interviews with the same key stakeholders as RIS (accounting firms, professional bodies and regulatory bodies). The results indicate significant differences to the government's pre-implementation RIS expectations, as well as differences between stakeholder groups. Overall the accounting profession does not consider that the extra burden of demonstrating compliance with the legally enforceable ASAs has changed the audit process or audit outcomes. The auditing profession does not consider the extra burden of the new regime justifiable as it has not increased audit quality or public confidence, which were the main aims of the government's regulatory intervention.

DEDICATION

I would like to dedicate this thesis to my daughters Monika and Klaudia in the hope that one day they too can believe that they can achieve anything they put their minds and heart to.

They are my inspiration and the reason for my positive approach to life.

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LIST OF ABBREVIATIONS

AARF	Australian Accounting Research Foundation
AASB	Australian Accounting Standards Board
APESB	Accounting Professional and Ethical Standards Board
APRA	Australian Prudential Regulation Authority
ASA	Australian Auditing Standards
ASIC	Australian Securities and Investment Commission
ASX	Australian Securities Exchange
AUASB	The Auditing and Assurance Standards Board
AUS	Auditing and Assurance Standard
ASRB	Accounting Standards Review Board
CLERP 9	Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004
CPA	CPA Australia
FRC	Financial Reporting Council
IAASB	International Auditing and Assurance Standards Board
ICAA	Institute of Chartered Accountants in Australia
IFRS	International Financial Reporting Standards
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IESBA	International Ethics Standards Board for Accountants
IIA	Institute of Internal Auditors
ISA	International Standard on Auditing
NIA	National Institute of Accountants
RIS	Regulation Impact Statement
SOX	Sarbanes-Oxley Act 2002

CHAPTER 1

INTRODUCTION, MOTIVATION, AIMS AND STRUCTURE OF THE RESEARCH

1.1 INTRODUCTION

The corporate failures such as HIH, One.Tel in Australia and Worldcom, Enron in the US, have once more focused attention on the auditing profession and the role of the regulators in protecting the investing public. The underlying theme behind the criticism of recent collapses is that financial reporting and auditing have ‘gone off the tracks’ (Rouse and Weirich, 2006, p. 25) and that higher quality auditing, education and best corporate practices are part of the objectives of the government’s intervention behind the introduction of regulatory compliance. Given the auditors’ vital role in the financial reporting process and an expectation that a properly conducted audit should enable users of the financial reports (including regulators, shareholders, policyholders, lenders and other creditors) to rely on these with a degree of confidence (HIH Royal Commission, 2003), it is commonplace for the regulators to react to corporate collapses with regulatory reform (Cooper and Deo, 2005).

Australian government’s justification of the specific regulatory reforms adopted in the wake of the corporate collapses was to argue that a stronger regulatory environment, (including the newly introduced statutory requirement for auditing standards to be legally enforced under the requirements of the Corporations Act 2001) will provide a clear public interest focus, and ensure that auditing processes and standards are of the highest quality (Regulation Impact Statement, April 2006).

Given the significant recent changes in the regulatory framework within which the auditing profession operates, reforms such as the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 (CLERP 9) in Australia and the Sarbanes-Oxley Act 2002 in the US, there is a need for timely research on the costs, benefits and other impacts of the reforms on audit practice. The focus of this research is specific to the Australian regulatory regime in terms of the introduction of the new legally enforceable Australian Auditing Standards (ASAs).

1.2 MOTIVATION AND AIM

This research is motivated by the government's intervention in the regulation of the Australian auditing profession by usurping the profession's traditional role in self regulation to one of control through government legislation. CLERP 9 changed the regulatory framework under which the Australian Auditing Standards (ASAs) are issued. As a result under section 336 of the Corporations Act 2001, the ASAs are legally enforceable for financial audits commencing 1 July 2006¹. This reorientation of the regulatory framework in Australia has potential implications for audit quality, audit practice, and the role of professional accounting bodies and the 'expectations gap' between users and those that undertake audits.

Implementing the Federal Government's decision to create legally enforceable Auditing Standards will enhance the credibility of audited financial reports in Australia and improve investor confidence in the capital markets.

(Merran Kelsall, AUASB Media Release, 31 August 2005)

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

The Australian Government's April 2006 'Regulation Impact Statement' addresses the pre-implementation effects of the legislation including perceived costs and benefits based on feedback from the affected stakeholders². In addition, the Auditing and Assurance Standards Board (AUASB) states that it will monitor implementation of CLERP 9, by liaising with the Australian Securities and Investment Commission (ASIC), Australian Prudential Regulation Authority (APRA), professional accounting bodies and engage in stakeholder enquiry³. However, what is unclear from the regulators is when and how a study will be conducted examining and assessing the actual consequences of its CLERP 9 and legally enforceable ASAs (Jubb and Houghton, 2007).

Given the silence on the assessment method and timing of the new legislation and in the absence of any other systematic evidence, this study will provide much needed feedback as to the initial post-implementation impact of the new Australian regulatory requirements of the legally enforceable ASAs on the auditing profession. The study provides insights from key professional stakeholders (accounting firms, professional bodies, regulatory bodies), into how the auditing profession has dealt with the new regulatory regime in its first year of implementation.

The divergence in views and perceptions of different stakeholders to the new regulatory regime is reflected in the Federal Government's claim "that the profession was no longer capable of setting its own standards to protect the

² All new Australian government regulation proposals undergo a preliminary assessment with the detailed analysis documented in a Regulation Impact Statement (RIS).

³ RIS, April 2006, p. 10 stipulates that will be a second phase of reviewing the Auditing Standards under a monitoring and review process, one of which regular consultative meeting with key stakeholders. Further details are not provided as to when and the exact format of the review.

public” (Jubb and Houghton, 2007, p. 19), whilst on the other hand Clarke and Dean (2007, p. 85) note that “recent reforms to auditing practices create the impression that problems lie with the audit profession”, as opposed to the defects in the accounting data that auditors audit. The data provided by this study of the varying perspectives of different stakeholders is critical given the complex issues and debates surrounding the effectiveness of government regulation of financial auditing especially in view of Australia and France being unique in applying force of law auditing standards. The study’s timeframe of one year post-implementation of the new legislation aims to provide critical insight into the profession’s initial perceptions of the main impacts, benefits, costs and actual outcomes of the new legislation for audit practice to date.

Research to date relating to current standard-setting is relatively scarce (Dick and Walton, 2007), descriptive in nature and confined to examining institutional arrangements for standard setting in Australia (Jones et al., 2004), regulatory relationships (Willman et al., 2003), external auditor and corporate governance (Holm and Laursen, 2007), structure of standard setting (Brown and Tarca, 2001), political process of standard setting (Walker, 1987) and a conceptual framework for accounting standards (Booth and Cocks, 1990). In contrast, this exploratory study investigates the various stakeholder views of the new regulatory regime and compliments the CPA Australia survey (2006)⁴ and the RIS (April 2006). The current study focuses on post-implementation impact qualitative data as presently there is “no accepted method to quantify the costs and benefits of auditing standard-setting” (RIS, April 2006, p. 4) given the relatively short post

⁴ CPA Australia 2006 Survey focused on the perceptions of members on the impact of CLERP 9 reform on auditing and public confidence pre-implementation of the legal ASAs.

implementation period and the complexity of the concurrent introduction of other regulations such as quality control of accounting firms (Accounting Professional and Ethical Standards (APES) 312), independence requirements (APES 110) and International Financial Reporting Standards (IFRS). This study is relevant in an Australian and international context for accounting firms, professional bodies, standard-setters and regulators in view of a number of other jurisdictions (e.g. South Africa) which are currently reviewing their financial reporting and auditing frameworks and exploring the possible introduction of a similar regulatory regime.

Therefore the aim of this research is to provide insights into the impact of the introduction of the CLERP 9 audit regulation, and in particular the new force of law ASAs under section 336 of the Corporations Act 2001 on the audit profession. Australian standard-setters argue that a stronger regulatory environment (including the newly introduced statutory requirement for ASAs to be legally enforced under the requirements of the Corporations Act 2001), will provide a clear public focus interest, and ensure that auditing processes and standards are of the highest quality. Hence this study builds upon and compliments the investigative pre-implementation RIS (April 2006) conducted by the Australian Government and examines the post-implementation impact on the audit profession after the first audit period under the new regulatory regime. This exploratory study is timely given lack of any other systematic post-implementation data. The data collected will make a significant contribution to the regulator's and audit profession's understanding of the effects on the key stakeholders and provide useful guidance in relation to actual costs, benefits and other operational impacts.

1.3 STRUCTURE OF THE RESEARCH

This study is structured as follows. Chapter 2 examines the relevant literature on regulation theory. Chapter 3 outlines the research questions stemming from the RIS (April 2006) and also analyses the initial stakeholder reactions to the proposed legislation. Chapter 4 provides the detail of the research methodology adopted. Chapter 5 presents the results, analysis and discussion. Chapter 6 concludes the thesis by identifying research limitations and potential future research.

CHAPTER 2

LITERATURE REVIEW

2.1 INTRODUCTION

This chapter examines the extant literature on regulation theory within the perspectives of ‘public interest’ theory, ‘capture or interest group’ theory and the ‘economic’ theory of regulation. Regulation theory informs the current research investigating the ‘impact of the new legally enforceable auditing standards on Australian audit practice’⁵ as it addresses the purpose of regulation, who benefits from regulation, what form the regulation will take place, and provides basis for analysis of other regulation issues such as interactions between regulatory parties.

The theories discussed in this chapter provide the framework for the broad based analysis on the economic, social and political influences involved in the regulation process (Godfrey et al., 2006) with a specific focus on the regulatory process of Australian audit standard setting and its implementation into practice. The questions of particular interest to this research are why and how has the regulation emerged and its impact on audit practice, what actions have audit firms taken to ensure compliance with the standards and has the new regime achieved the regulator’s objective of improved audit quality?

This review begins with the views on regulation definitions and concepts in section 2.2. Section 2.3 examines selected theories in order to gain an understanding into the behaviour and responses of parties engaged in the

⁵ On 1 July 2004 the Auditing and Assurance Standards Board (AUASB), was reconstituted as a Commonwealth body under the Corporate Law Economic Reform Program (CLERP 9) Act. Australia’s new legally enforceable Auditing Standards were issued by the AUASB and are operative for financial reporting periods commencing 1 July 2006.

regulatory process. ‘Public Interest’ theory is reviewed in section 2.3.1, ‘Capture or Interest Group’ theory is reviewed in section 2.3.2 and ‘Economic’ theory in section 2.3.3. These theories have been identified as critical to the understanding of why regulation takes on various approaches. The theories are extended in section 2.3.4 to facilitate understanding of the emergence of various other institutional approaches to regulation and section 2.4 summarises the literature in the context of standard setting within the Australian financial reporting and auditing framework. Concluding comments on regulation, research and theories are summarised in section 2.5.

2.2 DEFINITION OF REGULATION

Regulation generally suggests some form of action that restricts behaviour and prevents the occurrence of undesirable activities. The literature to date does not provide a concrete definition but presents many views and perspectives on regulation. The range of definitions is outlined below.

Mitnick (1982) asserts a simple definition of regulation as the ‘intentional restriction of a subject’s choice of activity by an entity not directly or partly involved in that activity’. He provides this view to present his perspective that regulation is a process of both the public and private entities, hence a co-regulatory process. This was the case in Australia pre-CLERP 9 with the accounting profession engaging in a ‘co-regulatory framework for audit standard setting’ (Jubb and Houghton, 2007).

Baldwin and Cave (1999) deal with regulation as a discrete mode of government activity. They identify regulation with a specific set of commands such as a binding set of rules, similar in nature to rules in the Corporations Act 2001 under specific sections dealing with auditor independence. Baldwin and

Cave (1999) extend their views on regulation to a ‘deliberate state influence’ designed to influence industrial and social behaviour. Puxty et al. (1987) theorise regulation as a combination of ‘market, state and community’. This broader view of regulation, encompassing all forms of social control and influence, has relevance to Australia’s current financial reporting regulation framework consisting of government regulatory bodies such as AUASB, ASIC, APRA, FRC⁶, in addition to the legislative requirements of the Corporation Act 2001.

The role of law as an instrument of social control within regulation, that is, shaping social behaviour (Morgan and Yeung, 2007) is relevant to the Australian regulators and their decision to provide legal backing for ASAs, thus making it easier to enforce the standards and also be seen to act in public interest by articulating the collective goals of the community, that is, increasing the quality of audit and reliability of financial information. Den Hertog (2000, p. 223) also defines regulation as the employment of “legal instruments for the implementation of social-economic policy objectives”. The behaviour can, in his view, only really be altered with legal sanctions. According to this legal perspective, regulation should not be viewed in negative terms as it is seen to facilitate and enable activities (Gaffikin, 2005) which for example may include a ban on handheld mobile phones whilst driving; a rule for safe driving. Under this perspective regulation is seen as the capacity for standard setting, information gathering and behaviour modification used by government in order to change the state of the system (Den Hertog, 2000; Gaffikin, 2005; Morgan and Yeung, 2007).

⁶ The Auditing and Assurance Standards Board (AUASB), Australian Securities Investment Commission (ASIC), Australian Prudential Regulation Authority (APRA), Financial Reporting Council (FRC). Abbreviations: see page x.

Social regulation (Gerboth, 1973; Joskow, 1976; Solomons, 1978; Joskow and Noll, 1981) views regulation as a political process with the success of the process reliant on public confidence. Social regulation is concerned with the environment, occupational health and safety, consumer protection and so forth supporting the positive view of regulation (Gaffikin, 2005). A number of authors (Noll, 1989; Joskow and Noll, 1981; Peltzman, 1979; Stigler, 1971) suggest that economic regulation such as regulation of prices, entry conditions into a market or industry is ineffective as it is subject to political constraints. The political economy of regulation adds not only to the views of economic regulation but more importantly highlights the consequences of regulation and attempts to find that optimal approach to regulation.

Bator's (1958), Selznick's (1973) and Breyer's (1982), notion of regulation as a sustained and focused control over activities that are valued by the community is closely linked to the Australian Government's intentions in introducing regulation. The Australian government's stated primary objective of any corporate regulation is to facilitate the achievement of a range of community objectives without creating unnecessary burdens on business or the community⁷. This also illustrates Gerboth's (1975) and Becker's (1983, 1986) stance that regulation is more than just a set of commands; influence plays a major part and only politically responsible institutions have the right to command others to obey rules. Regulation viewed from this political perspective raises questions such as; what was the reason for government regulation of the accounting and audit market, what purpose and whose interests are being served, what are the costs and benefits

⁷ Office of Best Practice Regulation definition <<http://www.obpr.gov.au/reform.html>>accessed October 2007.

of any new regulation and has the regulation fulfilled its collective goals (Gerboth, 1975; Mitnick, 1980; Mitnick 1982; Baldwin and Cave, 1999; Godfrey et al., 2006; Morgan and Yeung, 2007)?

The preceding notions of regulation highlight different reasons for justifying regulation, however according to Gaffikin (2005); it is a combination of these reasons that leads to regulation. Given the lack of a concrete definition of regulation in the literature to date, this study defines ‘regulation’ as “to regulate in essence is to control, guide according to authority that has the force of law” (Merriam Webster Dictionary, 2004).

The regulation theories analysed in the next section assist in the analysis of the social, political and economic influences in the regulatory process (Gaffikin, 2005; Godfrey et al., 2006). This is essential to the understanding the change regulation brings, which actors contribute to the change, why regulation emerges in its current form and whether and to what extent it has achieved its goals.

2.3 REGULATION THEORIES

The three main theories overlap (Majone, 1997; Majone, 1999; Den Hertog, 2000; Cooper and Deo, 2005; Gaffikin, 2005; Godfrey et al., 2006; Morgan and Yeung, 2007), in terms of providing reasons for government regulatory intervention and who will benefit from this intervention. In addition the regulation theories provide the framework for exploring the relationship between regulation (introduction of legally enforceable auditing standards in Australia), the various groups participating in, and affected by the new regulatory regime (that is, accounting firms, professional and regulatory bodies). The literature review on regulation theories encompasses numerous labels such as; ‘public interest theories’ (Becker, 1983), the ‘Chicago theory’ (Stigler, 1971; Peltzman, 1979;

Becker, 1983; Becker 1986), ‘public choice theory’ (Posner, 1974; Den Hertog, 2000), ‘regulatory capture’ (Walker, 1987; Laffont and Tirole, 1990; Laffont and Tirole, 1993; Laffont, 1999), ‘economic theory’ (Stigler, 1971; Posner, 1974; Becker, 1983; Peltzman et al.,1989), ‘political-economic’ theories (Joskow, 1976; Joskow and Noll, 1981; Laffont and Tirole, 1990; Puxty et al., 1987) and many more. Nevertheless, the various viewpoints have a common purpose, which is to explain the rationale and need for regulation and are further explored in sections 2.3.1 to 2.3.4.

Appendix A provides a comprehensive summary of the key perspectives and relevant research in the area of regulation.

2.3.1 PUBLIC INTEREST THEORY OF REGULATION

According to the proponents of this theory its purpose is to achieve publicly desired results which, ‘if left to the market, would not be attained’ (Bator, 1958; Gaffikin, 2005). This theory provides the reason for government intervention in regulation as regulation is pursued for public (that is, general public) as opposed to private interests. Arrow (1970) and Shubik (1970) state that government regulation is the instrument to overcome the disadvantages of imperfect competition and undesirable market results. In essence, public interest government intervention negates the tensions between private corporations and the general public as far as the inefficiencies in information disclosure, misleading accounting numbers, the monopoly of control over information by managers (Belkaoui and Jones, 1996) and other corporate shortfalls in reporting to the general investing public. The use of public interest theory has been popular in explaining regulation practices and origins given that “regulation in the past and

even today always followed some form of crisis or public dissent” (Uche, 2001, p. 68). The introduction and justification of government introduced CLERP reform to “modernise business regulation and foster a healthy and vibrant economy”⁸ after corporate collapses such as HIH and One.Tel can be legitimised by the public interest theory.

The concept of market failure (Bator, 1958; Posner, 1974; Mitnick, 1980; Ramsey, 1985; Godfrey et al., 2006) is often considered to be the reason for government to intervene as a response to the public’s demand for corrections to inefficient markets (Gaffikin, 2005). Hence there is the assumption that the market has imperfections (Bator, 1958; Posner, 1974; Mitnick, 1980; Breyer, 1982; Cooper and Keim, 1983) and failures such as unrestrained competition, lack of competition, imperfect information gaps, are not the best conditions for a competitive market and are not in consumers best interests (Godfrey et al., 2006). The underlying argument is that the government is ‘objective’ and that this type of democratic reform at the request of ‘public interest’ agents is necessary and beneficial to the public (Gaffikin, 2005; Godfrey et al., 2006). Further underlying assumptions of this theory is that markets are fragile, inefficient and if left alone, result in inequitable outcomes for the public (Breyer, 1982), and that government regulation is virtually costless (Mitnick, 1980). This is because government regulation is viewed as effective and can be implemented without great costs to society (Posner, 1974). Godfrey et al. (2006) further assert that the general public’s concerns are translated to legislative action, which in turn provides the notion that votes are seen as a form of currency. This leads to such questions as to

⁸ Treasurer Peter Costello in the second reading, Thursday 4 December 2003, House of Representatives debate. Accessed October 2007.

whether the intervening government regulators can act in an objective manner to serve the best interests of the public?

The critics of the public interest theory (Stigler, 1971; Walker, 1987; Watts and Zimmerman, 1978; Peltzman, 1979; and others) argue that regulators respond not only to ‘public interest’, but other influences such as economic, political and other private interest groups that determine the form of regulation. These alternative theories are outlined in sections 2.3.2 and 2.3.3. Section 2.4 brings public interest theory back under the microscope in the context of accounting and auditing standard setting.

2.3.2 CAPTURE OR INTEREST GROUP THEORY OF REGULATION

This theory extends and builds upon public interest theory, in that interest groups ‘battle’ for control of the government’s coercive powers to achieve their desired wealth gains (Gaffikin, 2005; Godfrey et al., 2006). The theory assumes that public interest underlies the start of the regulation and broadens (Posner, 1974; Walker, 1987; Den Hertog, 2000) it by exploring the relationships between various groups and the government, the extent of various groups’ capture of the regulation process. Posner (1974), Stigler (1971), Mitnick (1980) and Walker (1987) describe ‘interest groups’ and ‘capture theories’⁹ and suggest that regulators respond to the demands of special interest groups. Stigler (1971) has been instrumental in questioning the effectiveness and legitimisation of regulation under public interest theory and he suggests that “regulation is acquired by the industry and is designed and operated primarily for its benefit” (Stigler, 1971,

⁹ There are variations in the literature regarding the types of regulation theories and names used. In this study the theories of ‘interest group and capture’ are combined, as they are both describe the competing groups that shape the form of regulation.

p. 3). He challenges the ‘public interest’ origin for government intervention and argues that interest groups capturing the regulators are out to increase their own wealth and credibility. Stigler (1971) extends the capture theory analysis of regulation to include models and predictors of regulation under the economic theory of regulation outlined in section 2.3.3.

Mitnick (1980) states that ‘capture’ occurs if the regulated ‘interest’ controls the regulation and the regulatory agency; or if the regulated parties succeed in co-ordinating the regulatory body’s activities with their own activities so that their private interest is satisfied. This approach suggests that regulation is a competition for power, rather than just for public interest. Walker (1987, 1993) explores this suggesting that regulatory capture occurred in Australia when the Accounting Standards Review Board (ASRB) was ‘captured’ by the accounting profession, hence the regulatee (profession) dominated the regulator (ASRB). Posner (1974) also notes that the regulator’s original purpose of protecting public interest is somewhat diluted through the efforts of the interest group. The influences of interest groups as described by the capture/interest group theory are evident throughout the history of the accounting standard setting process and this includes regulators, who too act in self-interested ways (Brown and Tarca, 2001).

Makkai and Braithwaite (1995) describe the ‘revolving door phenomenon’ where regulators may become captives of industry because former industry employees take influential positions in the government agencies whose job it is to regulate that industry. This approach to capture suggests a multi-dimensional concept that is not a product of the regulation process but a contingent process that arises in certain situations. Nevertheless, “all over the world there is a concern that governments are captured by organised business interests” (Mitchell

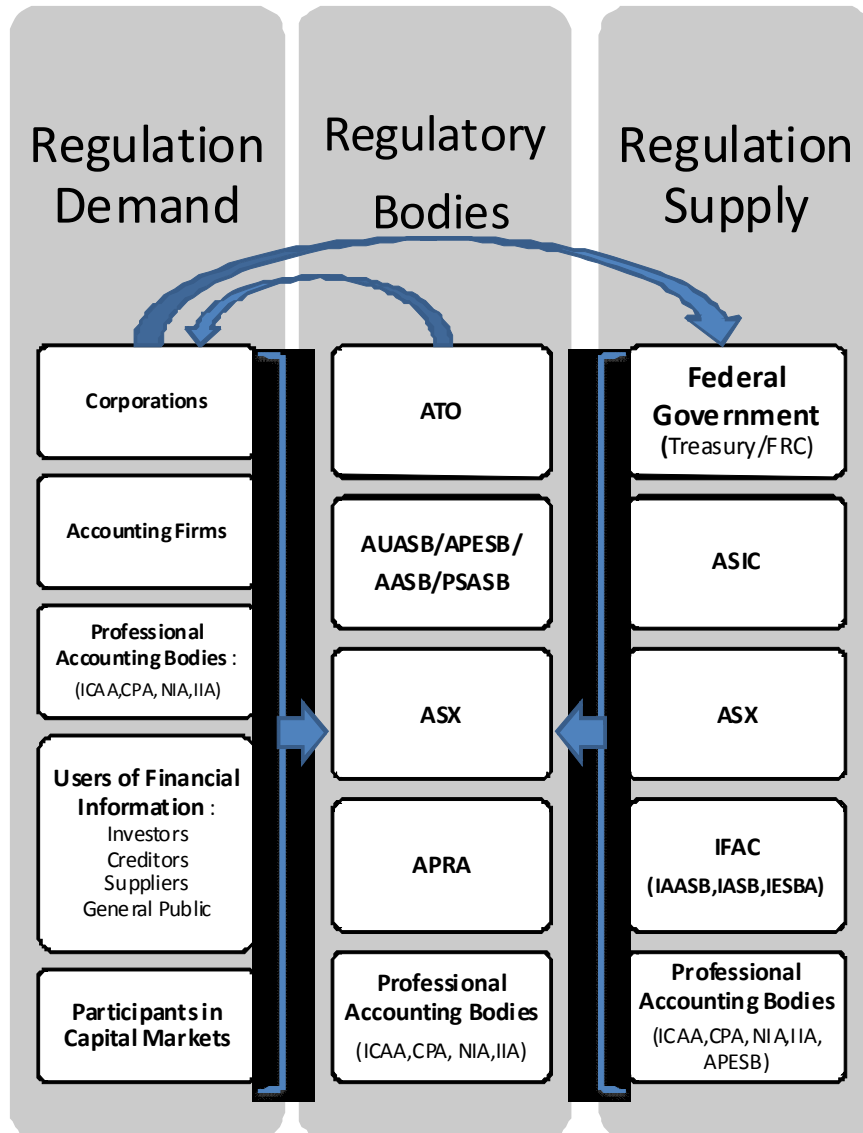
et al., 2001, p. 3). According to Posner (1974) and Stigler (1971) and the public interest and capture theory are incomplete theories of regulation, as ‘theories’ should be able to predict which industries should be regulated and as to which form it will take place; whether it be government or self regulation by the profession.

Under this approach to regulation the Australian professional accounting bodies (Institute of Chartered Accountants in Australia (ICAA), CPA Australia (CPA), National Institute of Accountants (NIA), Institute of Internal Auditors (IIA)), and corporations, will aim to influence the setting of accounting and auditing standards governing their members (Godfrey et al., 2006). This may mean a formal approach, lobbying through the exposure draft process or representation on the relevant standard setting boards. Figure 1 builds upon Brown and Tarca’s (2001) work, in illustrating the influential groups in the regulation of financial reporting and auditing activity in Australia. The complexity of the relationships shows that certain interest groups take on various roles. For example ASX is seen as a regulator and supplier of regulation, as well as being subjected to regulation from ASIC; given it too is a corporation. The professional bodies are represented in all three categories of interest groups as although they no longer have responsibility for issuing accounting and auditing standards; they still regulate their members.

The capture theory has relevance for standard setting in Australia given that regulation of auditing financial statements has been taken away from the professional bodies by government and the International Auditing and Assurance Standards Board (IAASB) is emerging as a dominant supplier of regulation (see Figure 1). This is further discussed in section 2.4.2.

Figure 1: Relationships of Various Interest Groups in the Current Australian Financial Reporting and Auditing Regulatory Environment

Figure adapted from Brown and Tarca's (2001).



2.3.3 ECONOMIC THEORY OF REGULATION

The positive or economic theory of regulation¹⁰ has emerged from the Chicago¹¹ school of thought, with Stigler (1971) as its pioneer. He provides a theoretical foundation from which to challenge the views that regulation is for the benefit of the public at large or some large sub-class of the public. Unlike the public interest proponents, Stigler (1971) states that regulation is not directed to fix market failures, 'but at setting up income transfers in favour of the industries in exchange for political support' (Den Hertog, 2000).

The premise of Stigler's (1971) arguments and his followers (Posner, 1974; Peltzman, 1979; Becker, 1986) is that the government has the power to coerce, and regulation is a tool/commodity that is 'sold' by politicians and 'bought' by the most powerful interest groups. The behaviour of legislators is driven by their desire to remain in office. Peltzman (1979) models assume that politicians will choose their policy of regulation to maximise political support; the reason why this economic theory is also referred to in the literature as 'public choice' theory (Den Hertog, 2000; Gaffikin, 2005). Advocates of this perspective argue that agents are rational and self-interested. In contrast to public interest theory, regulation is supplied in response to those groups who are able to coordinate their powers for further wealth to themselves at the expense of others (Stigler, 1971; Peltzman, 1979; Joskow and Noll, 1981). To this effect regulation is viewed as a

¹⁰ Gaffikin (2005) asserts that this type of theory has many variations in name; private interest theory, public choice theory, captures theory and special interest theory. This research has elected to place capture theory in with interest group theory as both imply the government having a reactive role to regulation.

¹¹ Peltzman et al. (1989) also refers to the theory of economic regulation as 'The Chicago Theory of Regulation'.

means of redistributing wealth from those with “less political power to those with more” (Wilson, 1980, p. 373).

Stigler (1971) does not explain how much regulation has also benefited consumers (Peltzman, 1979), or address a notion of maximising political support by allocating benefits of regulation among various groups participating in the regulatory process. Peltzman (1979), Becker (1983), Joskow and Rose (1989), Noll (1989), Joskow and Noll (1981) have all extended the work of Stigler (1971) to suggest that regulation may be sought by an industry or it may be thrust upon it. All put forth models as approaches to predict which industries will be regulated, who will benefit, who will be burdened with the regulation, what form it will take and the effects of regulation upon resource allocation.

Becker’s (1986) approach focuses on the competition between interest groups, and develops a model that tests whether the role of the legislator is suppressed. Becker’s (1986) model provides some credibility to the assumption that regulation is used to increase the welfare of the most influential interest groups. Both Becker (1983) and Peltzman (1979), suggest that regulation is still most likely when there is the presence of market failure (Den Hertog, 2000; Gaffikin, 2005) and that regulation is efficient subject to political constraints.

The evidence as to the power of economic theory to explain regulatory developments and deregulation since the 1980s is mixed. The economic theory approach to regulation has encountered issues with respect to the efficiency of the models as interest groups cannot control the activities of the regulators as they are restricted with information access (Becker, 1983; Majone, 1997), regulation tends to dissipate wealth by generating inefficiencies (Peltzman et al., 1989), and regulation may result in government contributing to market failure (Den Hertog,

2000; Uche, 2000; Cooper and Deo, 2005). Nevertheless this approach to regulation is consistent with the assumption that all actors in the regulation process are maximisers of their own welfare. The regulation is seen to be the product of the interactions between regulators, the regulated parties and the wider community. However, analysing who benefits from the regulation economically and who carries the cost of regulation, may not explain the cause of regulation. Furthermore, in the models there is little attention placed on the following issues; motivation and behaviour of the various interest groups, and ways in which the legislators and regulators conform to the wishes of the interest groups (Joskow and Noll, 1981; Majone, 1999; Den Hertog, 2000; Gaffikin, 2005).

2.3.4 INSTITUTIONAL AND POLITICAL-ECONOMIC THEORIES OF REGULATION

A group of regulation theorists, who reject the previous economic rational actor model for regulation, argue that the institutional structure, arrangements, as well as the social processes shape regulation. These ‘Institutionalist’ writers analyse regulatory interactions not just at the individual actor level (Baldwin and Cave, 1990) but claim that there is much more than individuals’ preferences that motivate regulation and focus on the interactions between the legal systems, economic systems and the political systems (Tinker, 1984; Baldwin and Cave, 1996; Den Hertog, 2000; Cooper and Deo, 2005; Gaffikin, 2005; Morgan and Yeung, 2007).

Institutional theory from social-legal literature draws on agency theory and how information asymmetry needs to be taken into consideration when designing regulation procedures (Majone, 1999; McCubbins et al., 1989). In contrast researchers from a political science perspective, concentrate on the ways in which

political structures, institutions and decision-making processes shape political outcomes (Baldwin and Cave, 1996). There are other social factors that need to be included in the analysis of regulation and Tinker (1984) contends that there are many inequalities among social classes arising from access to markets and information, and hence there is a need for regulation to protect them and capital markets.

In contrast Puxty et al. (1987, p. 275) narrows the focus to accounting regulation amongst four countries and concludes that regulation is shaped according to the “contrasting histories, cultures and paths of development of different nation states”. The focus is on the market, state and community and that regulation goes beyond the economic approach (Peltzman et al., 1989; Peltzman 1979; Stigler, 1971) and should reflect a broad based approach to cultural and societal issues. Gaffikin (2005) and Den Hertog (2000) assert that this view has implications for standard setting; how the profession operates, nature of the regulatory framework, perceptions of social responsibilities and ethical behaviour.

2.4 THEORIES OF REGULATION IN CONTEXT OF AUSTRALIAN STANDARD SETTING

All the theories reviewed in section 2.3 attempt to explain the pattern of government regulation (Posner, 1974) and the effects on the different players in the market. This in turn raises the predominant issue with the accounting and audit standard setting process as to whether it should take the form of self regulation by the accounting profession or regulation by the public sector (Walker, 1987; Walker and Robinson, 1994; Gaffikin, 2005; Godfrey et al., 2006). ‘Self-Regulation Theory’ informs that success in this regulation approach will occur when the professional body can effectively oversee and enforce the activities of its

members. Jubb and Houghton (2007) claim that the Australian government by taking away audit standard setting from the profession has in fact implied that the profession has failed in enforcement of credibility in standard setting. This view has been enhanced by the involvement of accountants in corporate collapses, business fraud and lack of auditor independence (Gaffikin, 2005).

2.4.1 PUBLIC INTEREST THEORY

Given that public interest theory has the underlying assumption of market failure and the need for government intervention to correct the market inefficiencies (Peltzman et al., 1979; Baldwin and Cave, 1999; Croley, 2000), the Australian government's arrangement of the ASRB (in 1984) and the reconstitution of the AUASB (2004) as statutory bodies to provide legally enforceable accounting and auditing standards respectively, is seen as justified. The market failure and inefficiency is evidenced on a number of fronts; namely failure in the market for accounting information (Godfrey et al., 2006), failure in corporate disclosure of financial performance (Clarke and Dean, 2007), and failure in the accounting profession to self regulate (Jubb and Houghton, 2007). According to Godfrey et al. (2006), the public interest theory provides the reason for the origin of Australian government intervention into regulating the standard setting process, given its purpose was to serve the general public interest, which in turn will be evidenced by the return of investor confidence in the capital markets. This view alludes to protection of the general public and is supported by the AUASB Strategic Corporate Plan:

AUASB should develop Australian Auditing Standards that have a clear public interest focus and are of the highest quality, to maintain investor confidence in the Australian economy (including its capital markets)

(AUASB Corporate Plan, 1 July 2006 to 30 June 2009)

This approach to standard setting assumes that government regulation is effective and can be implemented without great cost (Posner, 1974; Den Hertog, 2000), that it seeks the protection and benefit of the public at large (Hantke-Domas, 2003) from the negative impacts of harmful business behaviour. Baker (2005) also states that public interest protects investors and creditors in capital markets. Gaffikin (2005), Godfrey et al. (2006) and Clarke and Dean (2007) also provide the alternative to more government regulation by stating that accounting and disclosure by corporations needs to be strengthened before the costs of government intervention are executed.

2.4.2 CAPTURE OR INTEREST GROUP THEORY

According to the capture theory the accounting profession and its standard setting regime was also devised to protect public interest under the Accounting Standards Review Board (ASRB). The Peirson Report (1990) recommended that the government relinquish substantial control of the standard setting process and that the profession continues to be self-regulated. However Jones et al. (2004) and Walker (1987), argue that this regulatory body was captured by the accounting profession it was supposed to regulate. Walker (1987, 1993) portrayed the accounting profession as not accountable to the public, but orchestrating control of the standard setting process for its own gain. This was achieved in a number of ways; the accounting profession needed to legitimise accounting standards and compliance, and it did so by retaining an interest in the process through the Australian Accounting Research Foundation (AARF). Currently, as a result of

CLERP 9, audit standard setting is now a government-controlled process. However, the adoption of International Financial Reporting Standards (IFRS), and the role of the IASB, has highlighted the possibility that the IASB has now captured the standard setting process and its influences are seen in the diminishing role of Australian standard setters in the ‘international standard setting arena’ (Simnett, 2007; Brown and Tarca, 2001). Similarly, the adoption of International Auditing Standards (ISAs) promulgated by IASB can also be seen as diminishing the role of the AUASB to merely ‘rubber stamping’ the IASs as ASAs with some minor changes to ensure compliance with specific Australian legislative requirements.

2.4.3 ECONOMIC THEORY

Rahman (1988) extends on the capture of the ASRB by the accounting profession as exposed by Walker (1987), by suggesting that the influence on standard setting has come from a number of groups, namely political, such as the Ministerial Council, ASIC, company executives on the ASRB, and that it was in essence the corporate sector that was the regulated industry. From this view, Rahman (1988) debates that the accounting profession did not capture the standard setting process (Godfrey et al., 2006). Furthermore, international harmonisation has changed the ability of various parties to influence, control or capture the standard setting process.

2.5 CONCLUDING COMMENTS

This chapter has outlined the various theories and definitions of regulation in order to explain the reasons behind government intervention. The three key theories outlined in this chapter focus attention on various groups of actors to try to explain the purpose, the need for and the various approaches to regulation. Gaffikin (2005, p. 9) states that “there is not only market failure but theory failure” as none of the theories can really explain whether the market for financial information, corporate disclosure, and performance in the capital markets has improved as a result of government intervention in regulation. Nevertheless, Clarke and Dean (2007) and Gaffikin (2005) make the point that no amount of theory or government regulation will prevent some people in engaging in unethical behaviour. The major cases of business fraud and spectacular corporate collapses will no doubt continue to ensure the demand from the public for accounting regulation (Gaffikin, 2005).

CHAPTER 3

RESEARCH QUESTIONS DEVELOPMENT

3.1 INTRODUCTION

The purpose of this chapter is to develop the research questions based on the various theories of regulation reviewed in Chapter 2. The CLERP 9 legislation (CLERP, 2003; CLERP, 2004), the RIS (April 2006), and public reports also relevant to the development of research questions are outlined below in sections 3.2 to 3.4.

3.2 CLERP 9 LEGISLATION

CLERP 9 changed the framework under which ASAs are issued. CLERP 9 continued the government's reform agenda under Corporate Law Economic Reform Program Act 1999 to modernise business regulation, "progressing the principles of market freedom, investor protection and quality disclosure of relevant information to the market" (Treasurer Peter Costello¹²).

The AUASB was reconstituted under the CLERP Act and is now charged with the responsibility of issuing ASAs, which became legally enforceable (under section 336, Corporations Act 2001) for audits for financial reporting periods commencing 1 July 2006. The move from a self-regulatory regime to a government-controlled standard setting process was the result of much debate along with the Australian government's perception that the accounting profession was no longer capable of setting its own standards and thus they needed to step in and protect the public (Jubb and Houghton, 2007). This view is supported by

¹² House of Representatives, Official Hansard, Thursday, 4 December 2003, first reading of the proposed CLERP bill, p. 23761.

others (Gaffikin, 2005; Gaffikin, 2006; Clarke and Dean, 2007) that question the appropriateness of self-regulation by the profession at a time when the profession was criticised in respect of independence, conflicts of interests and their member's roles in various corporate collapses.

The Australian approach to standard setting pre-CLERP 9, in contrast to the US rules-based approach to corporate regulation was predominantly based on principles of a self-regulation regime with minimal and piecemeal legislative requirements. Given that principles are open to interpretation and hence very difficult to enforce (Jeffrey Lucy, ASIC, 2007), the problem of enforcement was evident (Gaffikin, 2006; Treasurer Peter Costello¹³). Thus the government's regulatory intervention was not surprising, as one of the government's main objectives in passing CLERP 9 was to promote the enforceability of auditing standards to allow for better enforcement of financial reporting and auditing requirements.

The government justified its intervention of both forming and enforcing regulation of financial reporting under CLERP 9 by reflecting both its policy initiatives and public expectations (Godfrey et al., 2006) as a response to corporate collapses, recommendations in the Ramsey Report 2001, HIH Royal Commission (2003) and investor demand for more transparent accounting. The specific stated intent of introducing CLERP 9 reforms and legally enforceable ASAs was to:

- provide a clear public focus
- demonstrate a high quality in standard setting, and

¹³ House of Representatives, Official Hansard, Thursday, 4 December 2003, first reading of the proposed CLERP bill, p. 23761.

- to conform with International Standards of Auditing.

CLERP 9 also expanded the role of the Financial Reporting Council (FRC) to include: oversight of the auditing standard setting arrangements; advising, monitoring and reporting on auditor independence issues; promoting and advising on the adequacy of the teaching of professional and business ethics; and monitoring and assessing the adequacy of the disciplinary procedures of the professional accounting bodies (FRC media release, 2003). As a result of this new direction in standard setting, the AUASB's strategic direction comes from the FRC whose membership consists of key stakeholders from the business and investing communities, the professional accounting bodies, governments, and regulatory agencies.

Given the FRC's strategic direction issued to the AUASB on 6 April 2005 (RIS, April 2006) to develop ASAs that 'have a clear public interest focus', it is clear that 'public interest theory' appears to be the dominant theory behind the government's justification of regulatory intervention which was considered necessary to nurture public interest and public confidence after the market failures of corporate collapses.

3.3 ASIC AND CORPORATIONS LAW

The Australian government's motivation in introducing the force of law auditing standards was to significantly enhance the rigour of the standards applying to the auditing profession and to improve ASIC's enforcement capabilities. ASIC is an independent government body set up to enforce and administer the Australian Corporations Act 2001, under the Australian Securities and Investment Commission Act 2001 (ASIC Act). ASIC's core responsibility is market confidence and a commitment to better regulation of corporate financial

information (ASIC, 2002) and public confidence in the auditing process is considered to be vital to the efficient functioning of Australia's capital markets. ASIC Chairman, Jeffrey Lucy, states that a high quality and independent audit process is crucial to the operation of a fair and efficient market, where we have confident and informed investors (ASIC, 2006). Consequently, the role of ASIC extends to reviews of the audit firms and quality of audits, monitoring adherence to the particular rules and standards in the Corporations Act. The introduction of force of law ASAs capable of enforcement, thus enhance ASIC's role and its responsibility in ensuring high quality audits.

In addition to the ASIC reviews, the Audit Quality Review Board (AQRB)¹⁴ review is designed to gain a reasonable level of assurance that the firm has in place, in relation to its audits of listed companies, systems and processes that are effective in ensuring compliance with applicable professional standards and legal obligations regarding independence and audit quality. Unlike the ASIC review and outcomes that are made public, the AQRB reviews are reported back to firms and the professional bodies. Given ASIC's enhanced role with CLERP 9 and the ASAs as legal instruments, there is some concern within the audit profession about ASIC's role, the implications of the reviews and potential duplication of reviews by bodies such as AQRB.

¹⁴ AQRB was set up in February 2006 to complement other existing review processes undertaken by the professional bodies – the Institute of Chartered Accountants in Australia, the National Institute of Accountants and CPA Australia – and the surveillance activities of ASIC. AQRB is focused on the quality of audit and independence processes of the participating firms' audits of listed entities. Its work reviews the effectiveness of firm wide systems that assist the firm and its auditors to comply with all the relevant codes and rules. The AQRB work aims to enhance overall effectiveness of firm processes and encourage the continual improvement of auditing practice (AQRB website, accessed October 2007).

3.4 ANALYSIS OF REGULATION IMPACT STATEMENT APRIL 2006

Prior to any new regulation being implemented, the government releases a RIS detailing whether the impact of the new regulation on business is warranted and efficient. The RIS addressing the introduction of the new legally enforceable ASAs was released in April 2006, providing feedback from the affected stakeholders including representations from the audit profession, regulators, business and standard setters which are summarised in Figure 2. The public comments are summarised in Table 1 (AUASB Exposure Draft Comments, Groups 1 to 5, 2005).

Figure 2: RIS (April 2006) Respondents and the Key Stakeholder Groups

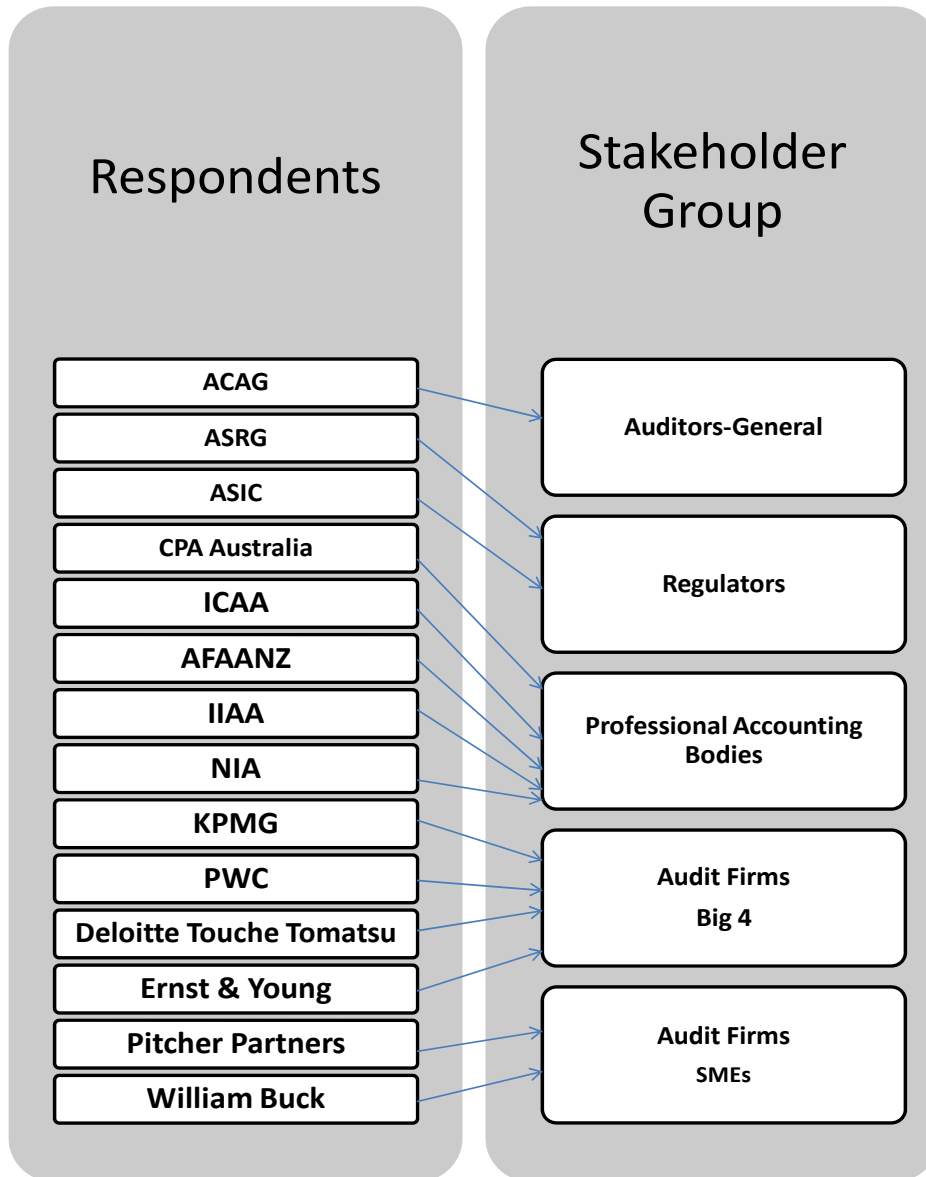


Table 1: Summary of Stakeholder Pre-implementation Comments on the Impact of Legally Enforceable ASAs

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

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

Costs:

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

Benefits:

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

3.5 RESEARCH QUESTIONS AND ANTICIPATED RESULTS

The public interest theory of regulation holds that government regulation is supplied in response to public demand for the correction of inefficient market practices and perceived market failure (Posner, 1974; Peltzman et al., 1989). Therefore according to the public interest theory the Australian government's intervention in the standard setting process and in making ASAs legally enforceable was justified, as it "considered the public interest first and foremost" (RIS, April 2006, p. 4) by rectifying the perceived failures in the market for accounting information. It is consequently proposed that,

Research Question 1: The government's perceived motivation for regulatory intervention and making Australian Auditing Standards legally enforceable is public interest.

The Government's intervention and the resulting move away from the previous co-regulatory regime framework for audit standard-setting significantly reduced the power and influence of the accounting profession (Jubb and

Houghton, 2007). The FRC and AUASB are now the key players, with the government appointing key stakeholders from the business and investing communities, the professional accounting bodies, governments, and regulatory agencies to participate in standard setting (Gaffikin, 2005; Jubb and Houghton, 2007). According to ‘Self-Regulation’ theory and consistent with ‘Public Interest’ theory, the lack of success of self-regulation by the professional bodies is mainly due to lack of enforcement powers against non-complying members and that their jurisdiction does not cover all firms within the industry (Walker, 1993; Graham, 1994; Walker and Robinson, 1994;). Given the shifts in regulation power as a result of self-regulation being replaced by statutory regulation, it is proposed that from the perspectives of the professional bodies and the accounting firms,

Research Question 2: Reaction to the new audit regime by the professional bodies and accounting firms will be negative.

The literature (Gaffikin, 2005; Godfrey et al., 2006) implies that governments intervene to correct market inefficiencies and that the optimal approach to regulation will be evident in increased audit quality. Public confidence in the information produced by corporations, and in particular the audit process has been undermined by recent corporate failures. CLERP 9 and the legally enforced ASAs were introduced to restore public confidence by enhancing the integrity of the audit function. The FRC’s strategic direction proposes that the AUASB should develop ASAs that are of the highest quality, conform to ISAs and follow international best practice (RIS, April 2006). “CLERP 9 reforms have by and large raised the bar for the auditing profession and will help regain investors’ confidence” (CPA Australia, 2006, p. 10). Accordingly it is proposed that,

Research Question 3: The benefit of the new audit regime is an increase in audit quality and public confidence.

The literature (Mitnick, 1980; Gaffikin, 2005; Godfrey et al., 2006) poses that government regulation is costless when it is pursued for public interest as a result of market failure. In addition, the RIS (April 2006) asserts that there would be little, if any, compliance costs to the audit firms. Hence it is proposed,

Research Question 4: The costs of the new audit regulation will be minimal.

CHAPTER 4

RESEARCH METHOD

4.1 INTRODUCTION

This chapter outlines the research method employed to investigate Research Questions 1 to 4 posed in Chapter 3. Section 4.2 outlines the research method and section 4.3 describes the participants. The approach to data collection and analysis of the data are outlined in section 4.4.

4.2 RESEARCH METHOD

The research method utilised in this study involved semi-structured in-depth interviews with the key stakeholders affected by the new legislative framework. This is an exploratory-orientated method and allows the researcher to elicit the respondent's views, feelings and perspectives on the impacts of the new legislative framework after the initial year of audits. The form of semi-structured in-depth interview encourages participants to share as much information as possible in an unconstrained environment, where the interviewer uses a minimum of prompts and guiding questions (Cooper and Schindler, 2003) and thus is well suited for describing outcomes from the perspective of the key stakeholders.

4.3 THE PARTICIPANTS

The stakeholders interviewed represent the key groups affected by the new regime of legally backed auditing standards namely; accounting/audit firms, professional bodies and regulatory bodies. These are the same stakeholders that were consulted in the government's pre-implementation and consultative phase. Senior stakeholder representatives of the target organisations are deemed to be

appropriate participants as they are in a position to have an overall understanding of the new regulation and its impact.

Participants were recruited indirectly through a formal approach to the participating key stakeholders' organisations, i.e. the professional and regulatory bodies and accounting firms. Contact was made initially through a formal approach at the organisation level and each organisation subsequently nominated an appropriate representative and facilitated contact between the researcher and their representative. Participation was totally voluntary and no incentives were offered.

Audit firms include the Big 4 plus the NSW Audit Office. The NSW Audit Office is included as an accounting firm given its responsibility for audits of over 400 NSW government entities under the Public Finance and Audit Act 1983 and the Corporations Act 2001. Audit office staff are members of either CPA Australia or ICAA. Three of the accounting firm participants consisted of two partners at each interview, with one a specialist in compliance at the technical level, whilst the other a practicing partner familiar with audit engagements. The remaining two Big 4 partners interviewed play a key role in the assurance/advisory work area and are involved primarily in technical compliance issues. Professional bodies' participants were representatives from CPA Australia, ICAA, and IIA. All are in technical advisory roles responsible for their respective bodies' policies, responses to audit regulation and engaging with members and government in liaising on these issues. IIA was included as a professional body given their involvement with the external auditor and exposure to the ASAs in practice. Regulatory bodies' participants include a recent member of the IAASB and an AUASB member, as well as an ASIC representative. The RIS (April 2006)

also acquired pre-implementation comments from SMEs. This study does not include SMEs as they are still finalising their first year audits under the new regime and hence are not in a position to provide fully informed responses until January 2008.

Due to the sensitivity of information, the nature of audit research and the small number of stakeholders in the audit environment, the need for anonymity was considered of vital importance and assurances were given to those interviewed. Table 2 summarises interviewees by applicable code to protect their identity, hence preventing the link between the interviewee and the relevant organisation within the stakeholder group¹⁵. This table also indicates the number of interviews conducted within each stakeholder group.

Table 2: Coding of Each Individual Response Under the Stakeholder Category

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

Prior to the agreed interviews, informed consent procedures were either emailed or mailed to all respondents. The components included a ‘Participation Information Statement’ (Appendix E), ‘Background Information Sheet’ (Appendix F), ‘List of Target Issues’ (Appendix G), and a ‘Participation Consent Form’ (Appendix H).

¹⁵ Interviewees under the University of Sydney Ethics requirements, for this study, necessitated that interviews cannot be linked directly to the individual or the organisations therefore the research was conducted to ensure confidentiality. The nature of the audit environment and the stakeholders involved also supports the need for anonymity. Interviewees will be referenced as their coding applies and their individual responses can be located in Appendix D.

This allowed respondents the opportunity to examine the scope and procedures of the project prior to the interview.

4.4 DATA COLLECTION

The data collection consisted of semi-structured interviews. In order to gather and analyse relevant information systematically a series of issues to guide the interview process were identified. The target issues utilised are based on the government's RIS (April 2006), the researcher's knowledge of the new audit regime, discussions with academic colleagues and practicing auditors. The target issues (Appendix G) were reviewed for completeness and clarity by two academic colleagues with practical and research backgrounds in auditing and an audit technical advisor from one of the professional bodies. Where appropriate, their suggestions were incorporated.

The main themes surrounding the perspectives of stakeholders on the impact of the new auditing regime are:

- government's motivation for legal standards
- the main costs of the audit regime
- the main benefits of the audit regime
- the main impacts on audit methodology
- the main operational impacts; staff training, compliance
- audit quality
- justification of the new audit regime

The list of target issues (Appendix G) was made available to the respondents prior to the interview and was explored in the interview to elicit their understanding and perceptions of the costs, benefits and direct impacts of legally

enforceable auditing standards. Given the semi-structured nature of the interviews, the interviewees were able to express themselves without specific boundaries or restrictions (Farneti and Guthrie, 2007). They were allowed to speak freely. The interviewers steered the interviews to make sure that all target issues were covered. Use of issues and non-directional style of questioning mitigated any potential interviewer bias. The interview guides were designed to be open-ended as possible to allow the interviewee to express their opinions and ideas and to further pursue relevant areas of interest. Once the list of target issues was covered, interviewers asked if the interviewees had anything further to add that might be relevant to the study. All interviews were approximately an hour in duration and were recorded on a digital device¹⁶ (Table 3).

The responses of each interview were accordingly summarised under the relevant issues and themes as individual stakeholder summaries under the heading of Accounting Firms, Professional Bodies and Regulatory Bodies (Appendix C).

All interviews were conducted over September and October 2007. All the interviews but one were carried out in the Sydney CBD at the respective stakeholder's premises. The only exception was a phone interview with a stakeholder located in the Melbourne CBD. Table 3 provides a summary of the interviews conducted.

¹⁶ Request to tape interviews were made on the interview day, and there were no objections.

Table 3: Summary of Interviews

Interview Summary	
Total numbers of interviewees (respondents)	11
Total number of stakeholder groups represented	3
Total interview duration	502 mins
Average interview duration	45 mins
Summary of interviewees by stakeholder group	
Accounting firms (Big 4 and NSW Audit Office)	5
Professional bodies (CPA Australia, ICAA, IIA)	3
Regulatory bodies (IASB, ASIC, AUASB)	3

4.4.1 DATA ANALYSIS

An interview protocol was established to guide and record the interviews. Each interview was attended by at least two researchers, simultaneously taking notes. Immediately after each interview, both researchers would collaborate and agree on the responses made by the interviewee. These agreed combined interpretations were recorded onto handwritten Issues Sheets¹⁷, which were used to recheck consistency and accuracy of transcripts by each researcher in order to circumvent the main disadvantage of in-depth interviews, in that free responses are viewed as difficult to analyse (O'Dwyer, 2004).

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

¹⁷ Handwritten individual researcher notes, A3 combined notes, and digital interview recordings for all interviews can be obtained from the principle researcher upon request.

details relevant to the study to ensure no relevant omissions or misinterpretations by the researchers. To address the issue of anonymity each participant also verified that their name was not linked back to an identifiable organisation. These individual interviewee interpretations are located in Appendix D.

The individual interviewee key relevant data was summarised by one of the researchers into ‘Stakeholder Summary’ tables found in Appendix C. The summaries were validated by the other researcher and any differences were referred onto the third independent academic researcher. This protocol was followed for all stakeholder summaries with the final ‘Summary by Stakeholder Group’ detailed in Appendix B.

The key points identified in this chapter frame the process by which the current study is guided and data analysed. The following chapter 5 provides the results and discussion of the research questions posed in Chapter 3.

CHAPTER 5

RESULTS AND CONCLUSION

5.1 INTRODUCTION

This chapter presents the data collected for addressing the relevant issues underlying each of the Research Questions 1 to 4 outlined in Chapter 3. The summarised responses across stakeholder groups, supplemented by individual stakeholders' responses where appropriate, are discussed and analysed within the context of the relevant regulatory theory and the pertinent pre-implementation stakeholder conclusions drawn from the RIS (April 2006). Data summary by key issues for each individual interview are presented in Appendix D. Each of the stakeholder group summary data is located in Appendix C and Appendix B summarises the data across the three stakeholder groups (accounting firm, professional and regulatory bodies).

5.2 RESULTS

Research Question 1 (RQ1) proposed that the government's motivation in introducing legally enforceable ASAs was public interest. As discussed in Chapter 2, 'public interest' theory assumes that the government intervenes to regulate in order to protect public interest (as opposed to private interest) from inefficient market behaviour and perceived market failure (Posner, 1974; Baker, 2005; Gaffikin, 2005). Also, according to the RIS (April 2006) "*the main objective was to ensure that the new redrafted Auditing Standards consider the public interest first and foremost and to produce high quality standards based on ISAs*".

The review of the stakeholder responses suggests general agreement that the government’s motivation was primarily driven by corporate collapses and the need to increase public confidence in Australian financial markets. The government’s reaction of removing standard setting away from the profession into government regulated legislative and monitoring framework was a means of ensuring higher audit quality as a critical ingredient of increase in the level of confidence in capital market. The stakeholder responses support RQ1, the ‘public interest’ theory explanation for the government intervention and are in alignment with the RIS (April 2006). The summarised responses are presented in Table 4.

**Table 4: Australian Government’s Motivation for Making ASAs Legally Enforceable
Summary by Stakeholder Groups**

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

Although respondents refer to ‘public confidence’ rather than ‘public interest’, the overall consensus that the government acted in articulating the collective goals of the Australian community post corporate collapses by responding with regulation is evident in Table 4. However, individual responses (Appendix D) show varying emphasis placed by each of the stakeholder groups on different aspects of public confidence as being more important in the Australian government’s motivation.

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

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

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

Furthermore, despite an overall consensus by the stakeholders as to the motivation for the government's regulatory intervention, the responses as to whether the government's approach of introducing legally enforceable ASAs is justifiable are mixed (refer Table 5).

**Table 5: Justifiability of the Legally Enforceable Standards
Summary by Stakeholder Groups**

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

For example, AF4 “believes that government needed to do something that would expand audit scope and audit quality, however legally enforceable standards are unlikely to achieve this; more in line with satisfying political objective”. This comment is representative of the overall view of accounting firms and AF5 strongly affirms this stance, “the government overreacted and not sure whether the path of legal ASAs is warranted”. This is also reflective of the Big 4 in their responses to the RIS (April 2006) and their ‘concern with unintended consequences’ of the introduction of legally enforceable ASAs.

In contrast to the accounting firms, the regulatory bodies’ responses affirm the government’s justification of legally enforceable ASAs and are aligned with their initial stance outlined in the RIS (April 2006): “the approach will increase audit quality, increase capital market confidence and will position Australia globally”. This is illustrated by RB3’s claim that “Audit quality is the holy grail” as justification of the new regime.

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

In conclusion, there appears to be an overall support and consensus for RQ1, that is, that the government's motivation for introducing CLERP 9 and the legally enforceable ASAs was one of public interest. However the stakeholder groups differ in their views whether the government's response in making ASAs legally enforceable is justifiable as the appropriate regulation choice.

Research Question 2 (RQ2) proposed that the professional bodies' and accounting firms' reaction to the new audit regime will be negative. The negative reaction was expected as the government intervention in taking the control of standard setting away from the profession shifted the balance of power and implied that self-regulation was not effective as the profession was no longer seen as capable of setting its own standards to protect the public (AUASB, 2005). This sentiment was echoed by RB3: "*In Australia, traditionally we had two bodies (ICAA/CPA Australia with NIA emerging) which promulgated standards and regulated themselves. After the corporate collapses, the government took steps to increase audit quality and to regulate the audit profession.*"

The data from the stakeholder summary (refer Table 6) illustrates the overall negative nature of the firms' responses and supports RQ2. The audit firms consider the legal enforceability of ASAs to be an overreaction and a lack of

understanding of the nature of the audit process by the government. According to AF4: “Auditing is an art rather than a science” and “is about making judgements not about prescriptive legal rules”.

**Table 6: Reaction to the New Regulation
Summary by Stakeholder Groups**

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

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

The support for RQ2 is in contrast to the RIS (April 2006), where the 14 respondents were noted as ‘broadly supportive’ of the legislative proposal and legally enforceable standards. Given that the regulatory capture or interest group theory suggests that the Australian professional bodies will seek as much control as possible over the setting of standards in order to influence legislation, it was inevitable that the accounting profession did not want to relinquish the standard setting process to the government (Posner, 1974; Walker and Robinson, 1994; Walker, 1997; Gaffikin, 2005; Godfrey et al., 2006).

Research Question 3 (RQ3) proposed that the benefit of the new audit regime is to increase audit quality and public confidence. This aim is implicit in the RIS (April 2006) and CPA Australia survey (August 2005) in which four out of five respondents thought that the new ASAs would improve audit quality even though the underlying basis (of auditing) has not changed. However the CPA Australia study also highlights that the general public are “*unlikely to benefit because the reforms do not address the public’s lack of understanding of audit*”.

The stakeholder responses in this study provide limited support for increased audit quality, namely by the regulators. Although audit firms admit some benefits (refer Table 7), they do not believe that there are any real changes to audit outcomes (refer Table 8) and highlight potential risk of increased focus on process rather than substance under legally enforceable ASAs. AF2 asserts that “*it is questionable if there has been any real increase in audit quality. There is no change in audit outcomes; mainly the change is in additional rules in relation to the process.*” AF4 agrees that the “*underlying audit process/audit quality remains fundamentally the same; however a greater portion of the time is spent on documentation which does not necessarily increase audit quality. The increase in focus on documentation to ensure legal compliance with form runs a risk of process taking over from substance and not identifying significant issues/risks requiring judgement.*”

However, there is an agreement that the legally enforceable ASAs have forced the profession to refocus and increase consistency and execution of the process. According to PB3 there has been some benefit of “*greater consistency and transferability of skills across auditors and consequently less costs/impacts for clients when changing auditors*”. PB1 also comments that a benefit of the new

regime is that “auditing is seen as an advanced technical specialist skill” and “if you are going to audit you need to be serious about it”. Although the stakeholder responses provide limited support for increased audit quality, there is no support for increased public confidence (refer Table 9 to 11).

Table 7: Summary of Benefits by Stakeholders

Issue Addressing RQ3	Accounting Firms	Professional Bodies	Regulatory Bodies
<ul style="list-style-type: none"> The main benefits of the new audit regime 	<ul style="list-style-type: none"> Discipline, refocus on profession Increase in documentation provides consistency in process, audit execution Global compatibility 	<ul style="list-style-type: none"> “In time we will benefit, but not yet” Internationally there has been recognition that audit is an advanced technical specialist skill Restored confidence in capital markets More conscientious audit process leading to an increase in audit quality in general Clearer linkage between non-compliance and consequences Independence of standard setting from professional bodies is positive in terms of perceptions Transferability of skills across auditors 	<ul style="list-style-type: none"> Increase in audit quality Promote confidence in capital markets

**Table 8: Main Impact on Audit Practice
Summary by Accounting Firm Respondents**

AF1	AF2	AF3	AF4	AF5
<ul style="list-style-type: none"> Increased documentation given fear of ASIC review 	<ul style="list-style-type: none"> No change in audit outcomes/ quality rather additional rules in terms of process 	<ul style="list-style-type: none"> No change of scope of audit work under ISAs/ASAs Demonstrate compliance with ASAs Increased cost of documentation, personnel involvement in ASIC review 	<ul style="list-style-type: none"> Mechanistic process to ensure compliance Focus on form and documentation compliance rather than increasing audit quality 	<ul style="list-style-type: none"> Tension between using audit judgement and compliance with black letter requirements Less flexibility/need to comply even when risk is negligible

The summary of all individual interviewee responses in Tables 9 to 11 illustrate a consensus that there has been ‘no impact’ on public perception and that the government’s prime goal of increasing public and investor confidence has not been achieved. In fact, some respondents suggest that it has been detrimental as it potentially increased the expectations gap even further.

**Table 9: Impact on Public Perceptions
Summary by Accounting Firm Respondents**

AF1	AF2	AF3	AF4	AF5
<ul style="list-style-type: none"> No difference in public perception Expectations gap potentially wider as public expectation of higher quality audit 	<ul style="list-style-type: none"> Small investors no impact Sophisticated investor maybe more aware 	<ul style="list-style-type: none"> Even sophisticated investor has trouble with ‘true & fair’, and assurance Potential for expectation gap to widen further 	<ul style="list-style-type: none"> No real impact on broad public Expectations gap unlikely to be reduced 	<ul style="list-style-type: none"> No real impact on broad public as they generally do not understand audit objective or process Capital markets may have different view

**Table 10: Impact on Public Perceptions
Summary by Professional Bodies Respondents**

PB1	PB2	PB3
<ul style="list-style-type: none"> Public is not interested There is evidence that the expectation gap is still alive and well 	<ul style="list-style-type: none"> The public's level of understanding is questionable 	<ul style="list-style-type: none"> General public and small investors 'would not know any different' Professional investor (e.g. large superannuation funds) might have an overall awareness of CLERP reforms as a package rather than legally enforceable ASAs specifically

**Table 11: Impact on Public Perceptions
Summary by Regulatory Bodies Respondents**

	RB1	RB2	RB3
Impact on public perceptions of quality of audits/ financial information	<ul style="list-style-type: none"> "I do not think that the public care nor understand what we do" 	<ul style="list-style-type: none"> Improvement in the quality of an audit, accountability of those charged with corporate governance 	<ul style="list-style-type: none"> The general public does not distinguish between large and small audit firms. Issues and criticisms, regardless of the size of the firm, will have significant repercussion on the overall confidence in the profession

In conclusion, overall the stakeholder responses fail to support RQ3. This result is in line with the 'political economy of regulation' theory (Joskow and Noll, 1981) according to which 'public interest' and regulation acceptance depends on public confidence, hence there needs to be an educated effort on behalf of the regulator in acquiring acceptance (Gerboth, 1973; Solomons, 1978).

Self-regulation theory (Kinney, 2006) and Institutional theory (Bealing and Baker, 2006) suggest that for the shift in regulation from ‘self-regulation’ to ‘mandated’ regulation to be accepted, there needs to be a full understanding of the objectives of the change in regulation approach. This view is also supported by the CPA Australia (2006, p. 6) survey that “the impact on confidence will depend on how the new standards are communicated to the public, the capital markets and investors”. This is echoed by AF3’s comment that: “external review of profession and legally enforceable ASAs should create more confidence in financial reporting framework. However, for this to be achieved a balance media reporting regarding impact of the process is necessary”.

PB1 similarly suggests that: “Professional bodies need to do more to increase the awareness of the value of an audit ‘a really valuable service that is largely unseen’”. PB2’s statement that “regulators/standard setters need to improve communication of the benefits of the new regime to the public”, further supports this sentiment.

Research Question (RQ4) proposed that the costs of the new audit regulation will be minimal. The RIS (April 2006) did provide initial pre-implementation predictions that audit firms may have to revise programs but this would not be more significant than a normal update and consequently costs of compliance will be minimal. Similarly according to ‘public interest’ theory the government is assumed to intervene with minimal costs and burden to business (Brown and Tarca, 2001; Uche, 2001; Hantke-Domas, 2003).

The responses in this study suggest difference of opinion between the stakeholder groups. According to the regulators after the initial year of audit the costs of compliance are still minimal. In contrast the professional bodies and

accounting firms note that there are substantial up front costs of training, mapping of methodology to black letter requirements in ASAs as well as continuing increased costs of documentation, technical support staff, retention of staff and increased costs of compliance in respect to the external ASIC inspection process (refer Table 12).

Table 12: Costs of New Regime

Summary by Stakeholder Groups	Accounting Firms	Professional Bodies	Regulatory Bodies
The main costs of the new audit regime	<ul style="list-style-type: none"> • Once off implementation costs of reviewing methodology/ training and ongoing costs of documentation • Significant increase in technical resources • Costs of ASIC inspection reviews 	<ul style="list-style-type: none"> • Extra caution in terms of increased documentation under new ASIC regime • Concern that force of law is a deterrent to young auditors progressing to partner level • More likelihood of class actions 	<ul style="list-style-type: none"> • No significant increase in costs if complied with ASAs prior to legalisation • Firms using legal ASAs as an opportunity to make audits recoverable for costs that should have been already factored in under pre-legalised ASAs • Some initial costs of mapping methodology to ASAs • Increase in documentation costs is not attributable to legal standards
Training requirements for audit staff	<ul style="list-style-type: none"> • Increased training in terms of documentation and black letter compliance not the actual audit 	<ul style="list-style-type: none"> • Significant investment by professional bodies to ensure that members are aware and well prepared • Increased training and support material 	<ul style="list-style-type: none"> • Not an applicable issue to this stakeholder
Impact/changes on other administrative, insurance, cultural considerations	<ul style="list-style-type: none"> • Focus on compliance made audit less desirable as a profession; attraction and 	<ul style="list-style-type: none"> • Not an applicable issue to this stakeholder 	<ul style="list-style-type: none"> • Not an applicable issue to this stakeholder

	retention of personnel an issue		
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5.2.1 ADDITIONAL ANALYSIS

The accounting firms (refer Table 13) also suggest that one of the impacts of the increased audit cost has been some tension in auditor/client relationship; *“clients have been grappling with IFRS compliance/costs and any increase in audit fees based on the change of scope under new ASAs is difficult to explain”* (AF3). The increases of 10-30% in audit costs suggested by a number of firms have in fact not been recouped on many engagements.

However, regulators and professional bodies suggest that the firms are blaming increase in fees on legally enforceable standards while in fact these are costs of the new ASAs and should have been built into audits some time ago. RB1 does not *“think there is a lot of cost in new regime; the increase in costs is not attributable to legal standards, these costs in risk and internal control documentation should have been already factored in under the revised pre-legalised ASAs”*. Similarly, PB1 states *“practitioners are looking to blame audit fee increases on force of law audit standards, when in reality should have been raising fees when audit risk standard came out, now under the new regime you have to comply, people overreacted to make sure they document everything”*.

**Table 13: Impact on Audit/Client Relations
Summary by Individual Accounting Firms**

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

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

Other cost increases specific to the new regime (refer RQ4 results discussion) relate to the loss of flexibility and judgement and mandatory performance of procedures that would have been considered unnecessary or of limited value. AF5 implies that there is “*tension between using audit judgement and complying with black letter requirements (process vs. objective). Less flexibility to changes in circumstances as need to comply with mandatory requirements even when risk is negligible.*” Research by Buffini (2006) predicts that audit fees will rise as a consequence of CLERP 9 reform and Andrews (2006) hypothesised that small

firms will opt out of the audit market support firm’s comments on the additional costs of the new regime.

Another significant issue of the new regime relates to ASIC’s monitoring of compliance with legally enforceable standards and the penalties for non-compliance. The summary of accounting firms’ views of penalties in Table 14 illustrates the level of uncertainty as to the likely consequences of non-compliance in terms of penalties. However, overall perception appears to be that this aspect of the new regulatory framework is very significant. PB3 concludes, “*yet to see whether this legislation has ‘any teeth’ before it has a reputation*”. However all firms appear to be taking this seriously by implementing controls to ensure compliance in order to manage firm and individual (partner) risk exposures.

**Table 14: Penalties and Compliance
Summary of Accounting Firm Responses**

	AF1	AF2	AF3	AF4	AF5
The process of enforcing/ monitoring compliance with the auditing standards	<ul style="list-style-type: none"> • Global methodology supplemented by Australian compliance checklist • ASIC review in process 	<ul style="list-style-type: none"> • Some uncertainty; clarification in time with ASIC inspections 	<ul style="list-style-type: none"> • Threat of ASIC inspection and shaming for non-compliance made a difference 	<ul style="list-style-type: none"> • Firm has extensive compliance regime, no real change in controls 	<ul style="list-style-type: none"> • Internal and external reviews
Penalties for non-compliance	<ul style="list-style-type: none"> • To be dealt with as and when necessary • Penalties taken seriously before and perception that maybe outcome no different 	<ul style="list-style-type: none"> • Different interpretations in terms of jailable offence or fines 	<ul style="list-style-type: none"> • Uncertain as to how ASIC will deal with non-compliance 	<ul style="list-style-type: none"> • Significant consequence of non-compliance in negative press coverage and reputation loss 	<ul style="list-style-type: none"> • Fines and disciplinary action involved • Unclear as to how courts will interpret the ASAs and non-compliance

5.3 CONCLUSION

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

In summary, the findings indicate a number of significant differences between perceived pre-implementation costs, benefits of the new regime to what the respondents have portrayed as their experience after the first year of audit. The data also illustrates that the impact and perspectives of different stakeholder groups are not uniform. For example, the stakeholder groups support the public interest notion as the motivation behind the government's introduction of the legally enforceable standards, however the emphasis as to what this means varies between the groups. Accounting firms and professional bodies place more emphasis on separation of the standard setting from the profession as a response to corporate collapses whilst regulatory bodies place more emphasis on increasing confidence in capital markets. Furthermore, in contrast to the regulatory bodies, the profession does not consider that the extra burden of the legally enforceable ASAs has increased audit quality or public confidence. According to the firms, the additional significant costs of increased documentation, training, monitoring and reviews have not met the government's desired objectives of 'upholding public interest, conformity with ISAs and high quality ASAs' (RIS, April 2006, p1).

In conclusion, the data collected in this study does not provide strong support for the Australian government's introduction of the legally enforceable standards as an appropriate response to achieve an increase in the quality of audits. However, the findings in this study need to be appropriately placed and understood within the context of the new regime's relatively short term implementation time frame. The long term impacts may change and this cannot be ascertained until some time into the future after several years of audits undertaken under the current regime.

CHAPTER 6

CONTRIBUTIONS, LIMITATIONS AND DIRECTIONS FOR FUTURE RESEARCH

6.1 INTRODUCTION

This chapter outlines the contributions and limitations of this study, as well as presenting a number of suggestions for future research. Section 6.2 restates the main findings of the research and its contributions. Section 6.3 outlines the main limitations and section 6.4 provides some directions for future research.

6.2 CONTRIBUTIONS

This study examined the initial stages of the implementation of legally enforceable ASAs and provides valuable insights into the impacts of the first year of compliance across key stakeholders. The results of this study will be of interest to accounting firms as they address the challenges of compliance and associated costs. Professional bodies will benefit from this feedback in terms of future directions in supporting their members with training and updates on standards. The results will also be of interest to standard setters as this study provides useful insights to inform the second phase of reviewing ASAs impacts to “consider any potential improvements” (RIS, April 2006, p. 10). The importance and value of this study has been visible throughout the data collection, where accounting firm respondents and the professional bodies in particular, were keen to see how the new regime collaborative post-implementation impact was reflected across the firms.

6.3 LIMITATIONS

The study's results must be considered in light of a number of limitations. Firstly, the use of an semi-structured interview research method reduces the external validity of the study, that is, generalisation to different settings, such as firms other than the Big 4. However, given the limited quantitative data at this early stage of the implementation of the new audit regime, qualitative data from semi-structured in-depth interviews with the key stakeholders affected by the new legislative framework was the most appropriate method to capture these initial insights which provide a useful snapshot of practice and the impacts.

Secondly, there is the potential of interviewer bias as there are many factors that may influence interviews, such as influence on the answers, interviewer not probing properly, intentional subversion by the interviewer (Neumann, 1995) and there are possible errors that may occur in the recording process (Cooper and Schindler, 1991). The potential interviewer bias was addressed by maintaining a disciplined and systematic protocol (Lillis, 2002) encouraging data around the themed key issues relevant to the identified research questions (refer section 4.4.1). Each interview was attended by at least two researchers, simultaneously taking notes and both researchers would collaborate and agree on the responses made by the interviewee. This interview protocol was further extended by emailing the agreed interview interpretations to the interviewee for review and approval increasing the validity of the process. This allowed each interviewee not only to validate the interpretation of the interview, but also provided them with an opportunity to refine, clarify, delete or add any further details relevant to the study to ensure no relevant omissions or misinterpretations by the researchers.

Finally, findings of the this study are limited to Big 4 accounting firms and may not be representative of the impact on smaller and mid tier firms (that is, SMEs). The audits of SMEs will not be finalised for another two months and therefore the full impact is not evident yet.

6.4 FUTURE RESEARCH

The current study has identified a number of views as to the impact of the new regime of legally enforceable ASAs. The diversity in perspectives leads to a number of important considerations for future research. Future studies could address the differential impacts of the new regime between the Big 4, middle tier and smaller firms. The current study focused on initial implementation impacts which may change with time, hence future studies need to consider longer term impacts after several audit periods. Jubb and Houghton (2007) suggest that future research into CLERP 9 implementation impacts and the efficacy of reforms should utilise existing financial reporting models based on earnings management levels, earnings response coefficients and modified audit opinions.

Another important consideration in terms of practice and standard setting is how much of the initial costs of compliance are due to legal enforceability of ASAs and how much can be attributed to changes in ASAs. This may provide insights into the likely burden of future changes to ISAs/ASAs and the 'Clarity Project' for the profession. Future long term studies could also address and measure audit quality in terms of audit opinions, outcomes of ASIC inspections and the number of prosecutions to provide the profession and standard setters with significant insights as to whether this type of regulatory intervention is justified and effective in terms of its objective.

APPENDICES

Appendix A: Summary of the Relevant Regulation Theory Literature

Year	Author	Focus of Research	Research Perspective	Insights and Contributions
1958	Bator	The anatomy of market failure	Market efficiency	Provides insight into the market failure concept. Relevant to public regulation theory in assisting to explain the reason for government intervention.
1971	Stigler	Theory of economic regulation	Economic theory 'Chicago School of Positivists'	Develops the economic theory of regulation integrating politics and economy. Extends the rational economists behaviour to regulation. Challenges the public interest theory and adds a slightly different twist to Capture Theory from an economist's view; in that regulation results from the demands of interest groups. However fails to examine the effects of these demands on the consumers and other groups within the regulatory process.
1973	Gerboth	Politics in accounting inquiry	Political economics	Politicization of accounting rule making is inevitable and depends on public confidence for it to be perceived as successful in achieving objectives.
1974	Posner	Economic theory of regulation	Economic theory and public choice theory	Highlights practical and relevant issues to economic regulation theory looking at taxation regulation in particular. Asserts that the central reason for government regulation is market failure. Dismisses Public Interest theory in its current form and provides an economist's view of an adequate positive theory of regulation.
1976	Cobb, Ross & Ross	Political process and the public interest	Agenda building	Develop and use an agenda building model to produce a framework from which to examine policy making processes. Jones et al (2004) use this model to explain the tensions among various groups within society that compete to place issues on the agenda of political policy making.

Year	Author	Focus of Research	Research Perspective	Insights and Contributions
1976	Joskow	Government regulation	Political economy of regulation	Examines the regulatory activities of government agencies to explain the political tensions between the government agencies.
1978	Solomons	Impact of politics on accounting standards	Political motivations in standard setting	Insight into why standard setting is a social and political decision. The process for standard setting is political as there is an educational effort involved in acquiring acceptance for a new standard.
1978	Watts & Zimmerman	Accounting theories	Positive approach	Adopted an interest group approach to regulation in the context of examining the demand and supply for accounting theories and the market for making excuses.
1979	Peltzman	Theory of economic regulation	Economic theory 'Chicago School of Positivists'	Toward a more general theory of regulation examines the interest in the effects of government regulation and voting and the interaction between wealth distribution and efficiency.
1980	Mitnick	Political economy of regulation	Economic welfare	Regulation can be understood in terms of an agency relations, political relations, framework developed for government intervention.
1981	Joskow & Noll	Regulation theory in practice	Political economy of regulation	Provide insight into political economy of regulation in line with their support of the public interest theory of regulation. The research into public regulation of the utilities organisations reveal that economic disruptions change the distribution of political power, and as a result have the view that economic theory of regulation should be integrated with other theories such as public interest.
1982	Breyer	Regulation and its reform	Government intervention	Develops a framework for government intervention; reform-efficiency and consumer equity are main areas of concern. There are certain conditions for government intervention, mainly when unrestrained competition does not work well.
1982	Mitnick	Regulation and agency theory	Agency theory	Regulation can be understood in terms of an agency relation and regulating accounting standards is a solution to the agency problem. Further develops the research from 1980 on agency theory.

Year	Author	Focus of Research	Research Perspective	Insights and Contributions
1983	Cooper & Keim	Corporate financial disclosure regulation	Financial disclosure	Examine failure in financial reporting and disclosure as the need for regulation. Insight into market failures highlighting the issues of public goods that are free for some.
1983 & 1986	Becker	Regulation, pressure groups and public interest theory of regulation	Public choice, political influences	Furthering works by Posner (1974), Stigler (1971), Peltzman (1979), using the economic approach to explain political choices, influences and regulation. Model testing the competition between interests based on economic theory and public interest theory; concludes that regulation is used to increase the welfare of the most influential interest group.
1984	Tinker	Theories of the state	Neoclassical state theory	There are many social factors that need to be considered in any analysis of theory of regulation. Existence of social inequalities is required to be balanced by government regulation.
1984	Laughlin & Willmott	Accounting regulation	Critical perspective	Analysis of self interest and world views within accounting regulation. Recognises the structure of social relations with both the users and setters of accounting standards.
1984	Keeler	Theories of regulation	Economic or specialist interest	Adapts Peltzman's (1979) model to explain regulatory policies and changes and asserts that a rational regulator could easily behave in the public interest. Examines adapted model in industries that have been deregulated.
1987	Walker	ASRB case study	Political activity and regulatory capture	This case study review provides evidence of the Australian standard setting process; suggests that ASRB was captured by interest groups it was to regulate. This research adds to the 'Capture Theory' literature.
1987	Puxty, Willmott, Cooper & Lowe	Modes of regulation in advanced capitalism	Critical and with a social context	The authors focus on the roles of accounting in regulating economic and social activities in society by examining four countries UK, Sweden, USA and West Germany. Research provides a framework for examining regulation issues within a broader view of the theory of regulation.

Year	Author	Focus of Research	Research Perspective	Insights and Contributions
1989	Peltzman, Levine & Noll	Theory of economic regulation	Economic theory 'Chicago School of Positivists'	Further extends the work of Stigler (1971) and looks into the economic theory in light of deregulated airline and railroad industries. Looks towards a more general theory of regulation.
1990	Booth & Cocks	Accounting standard setting	Critical approach to standard setting	Examines the issues in standard setting and reflects on the lobbying groups that affect the process.
1990	Laffont & Tirole	Theory of regulatory capture	Agency theoretical approach	The authors contribute to the literature on interest group politics in regulation and develop an agency theoretical approach to understanding government decision making.
1992	Makkai & Braithwaite	Modes of regulation	Capture theory of regulation	Their examination of Australian nursing homes reveals that inspectors with prior senior management experience in the industry tend to be lax in regulation enforcement.
1993	Laffont & Tirole	Government and regulation	Incentive theory	Examines the economic reasons behind the government's role in regulation.
1993	Shavell	Regulation and enforcement	Legal perspective	Examines the optimal structure of law enforcement; to balance the social costs arising from imperfect enforcement to the administrative costs of enforcement.
1993	Walker	Accounting and auditing regulation	Critical	Examines the processes used to administer compliance with accounting and auditing rules, highlighting the regulation and the profession and their relationships. This paper highlighted that the Australian government back in the 1980s withdrew from the regulation of accounting and placed reliance on the accounting profession to self-regulate-these arrangements are looked at as failures in regulation.
1994	Ogus	Effective self regulation	Legal perspective	The public interest and the private interest theory approach to regulation are useful together in focusing attention on how the different institutions of regulatory decision-making can be used either to advance the ostensible goals of regulation or else to subvert those goals to private ends. Argues that economic analysis plays a role in regulation approach.

Year	Author	Focus of Research	Research Perspective	Insights and Contributions
1994	Walker & Robinson	Development of financial disclosure rules	Regulation of accounting	Case study reviewing the participation of public-sector and private-sector agencies in financial accounting standard setting. Explores that the relations between public and private agencies are at times pursuing self-interests, creating turbulence. During 1985-1992, the accounting profession viewed the government intrusion into standard setting as unwelcome.
1995	Zeff	History of standard setting	Regulation of accounting	Provides a comparative history of accounting between US, UK and Australia.
1997	Majone	Regulation	Institutional public choice theory	Examines the causes and consequences of change in governance and regulation in the democratic political institution.
1998	Zeff	Views on standard setting	Regulation of accounting, in particular auditing	Provides some useful views on CLERP 9 in Australia, comparing it to the US experience of the PCAOB and SOX.
1999	Baldwin & Cave	Understanding regulation theory	Fundamentals of regulation	Highlights practical and relevant issues of regulation theory examining questions such as; why regulate, what strategies work best, self-regulation, and concludes that understanding regulation calls for a multidisciplinary approach.
1999	Laffont	Regulation theory	Economic perspective	Examines theory of government regulation and how it is translated into practice. Claims that regulators need to understand the principles of regulation to explain their decisions, develop solutions and to communicate the benefits to the regulatee.
1999	Majone	Regulation	Institutional public choice theory	Examines the regulatory state and its legitimacy issues. Regulation as a mode of policy making; examines the Europeanization of British policy-making. The issues of credibility, public control underpin the government's success in regulation; democratic public parties have short term periods and regulation is often needed for the long term to be effective.
2000	Den Hertog	General theories of regulation	Economic perspective	Makes the distinction between public interest theories, the Chicago theory of regulation and public choice theories - adds to the labeling and evaluation of the theories , analysing their merits and limitations.

Year	Author	Focus of Research	Research Perspective	Insights and Contributions
2000	Croley	Public interest regulation	Banking and finance	Examines the issues around regulatory agencies being in a better position to provide broad based interests with beneficial regulation.
2000	Ravlic	Standard setting and auditor independence	Political overview	Highlights issues with the monitoring of compliance regulation, in respect of the independence audit reforms.
2001	Brown & Tarca	Politics, process and the future of accounting standards	Public interest and private interest	Examine the future of Australian accounting standard setting, concluding that the regulation of accounting standards has been captured by the interests of the IAASB. Adopt perspective of public interest and interest group theories to argue that government intervention in accounting and auditing regulation is seen as a low cost solution to increase capital market confidence.
2001	Collett, Godfrey & Hrasky	International harmonisation	Political	Provide insights into the political drivers of regulation which conflict with the fundamental reasons for the reform currently facing accounting standard setters.
2001	Mitnick	Uses of regulation and deregulation	Benefits of regulation	Provides insight into regulatory benefits for firms in managing those regulatory transitions.
2001	Ramsey	Auditor independence	Regulation reform	Review of current Australian independence of auditors and requirements and proposed reform to auditor independence and monitoring of compliance.
2001	Uche	Theory of regulation	Banking and finance	Provides a review of the public interest and capture theories of regulation within a banking industry context. Contributes to the notion that regulation serves different purposes for different interest groups on different occasions. Concludes that there is a change in the concept of public good and that the theories are all intertwined.
2003	Clarke & Dean	Conceptual framework	Critical approach	Attention needs to be given to accounting and its fundamentals rather than the unfruitful efforts to create the optimal conceptual framework.

Year	Author	Focus of Research	Research Perspective	Insights and Contributions
2003	Hantke-Domas	Regulation theory and welfare economics	Public interest	Examines the interpretation of public interest theory and concludes that it has merits along the lines of economic welfare and that regulation seeks the protection and benefit of public at large.
2003	Jones & Wolnizer	Harmonisation and conceptual framework	Critical approach	Examine both harmonisation and conceptual framework and the issues around globally acceptable accounting standards.
2004	Jones, Rahman & Wolnizer	Accounting reform in Australia	Political agenda building	Using political agenda building framework by Cobb et al (1976) conclude that the government's CLERP 9 proposals were superior to the accounting profession's attempts to bring changes to standard setting.
2005	Cooper & Deo	Australian corporate reforms	Foucauldian and capture theory of regulation	Use of Foucauldian theoretical framework to examine how past events have shaped the future of Australian corporate regulation. Concludes that flaws are not with the regulation legislation but with a system that allows interested parties to control the regulatory process.
2005	Baker	Ideology of the US public accounting profession	Public interest theory of regulation	Emphasises the importance of regulation of capital markets through auditing and financial accounting standards setting and reveals the inability of the accounting profession and researchers in determining what the meaning of public interest is.
2005	Gaffikin	Theory of regulation	Public interest	Reviews the various theories and approaches to regulation within the Australian context and provides insights into the various perspectives used to explain the interplay of political, economic and social forces, that all influence the regulation on accounting practice.
2005	Godfrey & Langfield-Smith	Globalisation of accounting standards	Capture theory	Examine globalisation of accounting standards, adoption of IFRS, and conclude that the political and regulatory influences are explained by regulatory capture theory.
2005	Grajzl & Murrell	Government regulation	Legal and economic	Examines the implications of self regulation versus government regulation, in the context of history of law practice.

Year	Author	Focus of Research	Research Perspective	Insights and Contributions
2005	Kinney	Trends in regulation of audit in the US context	Self-regulation to mandated regulation	Explores trends in audit regulation in the US from 1981-2005; non-mandated value-adding assurance services of the 1990s to statutory adoption of independent regulation and government sanctioned corporate governance role for auditors in 2005. Provides implications of the last 25 years for the future researcher, student and concludes that there is a shift from self-regulation theory to understanding of external regulation.
2006	Andrews	Commentary on audit regulation	Regulation impacts	Examines issues that the new force of law auditing standards are predicted to force up audit fees.
2006	Bealing & Baker	SOX and its real impact	Institutionalist theory	Examines the role of the accounting profession and SEC in protecting the investing public after corporate collapses. They examine the changes of regulation in the US and challenges the need to bring together a more effective legal and regulatory regime.
2006	Buffini	Commentary on audit regulation	Reform	Examines the issues around documentation given ASIC role in monitoring of compliance with ASAs (media commentary).
2006	Gaffikin	Standardised accounting practice	Public interest	Provides insights into the current Australian accounting regulation.
2007	Clarke & Dean	Misleading financial disclosures of corporations	Effective reform	Propose that accounting reforms are still not addressing the fundamental problems of 'indecent disclosure'; debate on reform effectiveness, principle-based versus rules-based regulation, true and fair views, accounting standards compliance, etc.
2007	Dick & Walton	IASB Agenda for audit and accounting standards	Reform	Examine the agenda of the IASB and note that the academic community is not contributing much to assist with the IASB research projects such as revenue recognition, conceptual framework, financial statement presentation and other research issues related to current standard setting.

Year	Author	Focus of Research	Research Perspective	Insights and Contributions
2007	Jubb & Houghton	Auditing regulation	Regulation efficacy	Review the current post-CLERP 9 standard setting reforms in the Australian environment. Examine the relationships between the regulatory stakeholders and provides an insight into the current role and activities of the AUASB and FRC, as well as an update on the IAASB Clarity Project.
2007	Morgan & Yeung	Law and regulation	Legal	These researchers draw upon their legal and social backgrounds to provide useful insights into regulation and the law. They explore the role of public and private actors in the enforcement of regulation, adding to the regulation debate that its sole purpose is to influence human and institutional behaviour.
2007	Simnett	IAASB developments	Critical review	Examines the role of the IAASB and its impact on Australian legally enforceable auditing standards in Australia including concerns with IAASB's Clarity Project.

Appendix B: Issue Summary by Stakeholder Group

Issues	Accounting Firms	Professional Bodies	Regulatory Bodies
Australian Government’s motivation/reasons in making Auditing Standards legally enforceable	<ul style="list-style-type: none"> • Government under pressure to respond to corporate collapses • Separate standard setting from the profession • Increase confidence in audit quality • Access to US markets 	<ul style="list-style-type: none"> • Government reaction after corporate collapses was to take standard setting away from profession • The new regime was introduced to regulate rather than disable the profession • Increase confidence in the financial market 	<ul style="list-style-type: none"> • Government response to corporate collapses was to regulate the profession to increase audit quality • Ensure global positioning in terms of regulatory framework and reporting
Main impact(s) of the legally enforceable standards for your audit practice	<ul style="list-style-type: none"> • No change in audit outcomes/ quality • Mechanistic process/focus on form and documentation compliance rather than increasing audit quality 	<ul style="list-style-type: none"> • Highlighted awareness of auditing as “advanced technical specialist skill” • Professional bodies play role in monitoring and ensuring compliance • Increase documentation requirements • Struck fear into small practitioners given new penalty regime 	<ul style="list-style-type: none"> • No change to ASAs other than replacing ‘should’ with ‘shall’ • Scrutiny of methodology to ensure compliance with standards
Reaction to the new regulation	<ul style="list-style-type: none"> • Overreaction by government • Another change • Partners opting out of profession/questioning continuing as auditors • Auditing is about making judgements not about prescriptive legal rules 	<ul style="list-style-type: none"> • PB: Additional costs of increasing awareness of legal ASAs; additional training and resources • Firms: grudging acceptance and a ‘lot of moaning’ • Overreaction blaming legal ASAs for increased costs that were really part of revised risk standards 	<ul style="list-style-type: none"> • Audit firms approach has been negative • Concern with increase in documentation costs • Big 4 comfortable with compliance but small firms lobbying against changes

Issues	Accounting Firms	Professional Bodies	Regulatory Bodies
Impact of the legally enforceable standards on firm's audit methodology	<ul style="list-style-type: none"> No change in methodology Global audit methodology supplemented by Australia's compliance checklist meets all requirements 	<ul style="list-style-type: none"> No much change in standards, e.g. 'should' replaced by 'shall' Review methodology/programs to ensure compliance with ASAs 	<ul style="list-style-type: none"> Ensures that firms revisit their audit methodology and comply with the ASAs in order to drive a better audit
Training requirements for audit staff	<ul style="list-style-type: none"> Increased training in terms of documentation and black letter compliance not the actual audit 	<ul style="list-style-type: none"> Significant investment by professional bodies to ensure that members are aware and well prepared Increased training and support material 	
Impact/changes to audit planning process	<ul style="list-style-type: none"> No real change other than focus on form filling and documentation of rationale of judgements 	<ul style="list-style-type: none"> More resources spent on planning considerations , risk assessment and addressing the risk in the audit Legalisation of ASAs did not change the audit process, audit changes are caused by aligning ASAs to ISAs More overt documentation of risks and controls 	
Impact/changes in the focus/importance placed on the assessment of the client's internal controls	<ul style="list-style-type: none"> No real change, just increase in mandatory documentation 	<ul style="list-style-type: none"> Internal control assessment must be done prior to determining audit approach 	
Impact on audit/client relations	<ul style="list-style-type: none"> No material impact Increase in audit fees difficult to justify as client sees no change in audit outcome 		

Issues	Accounting Firms	Professional Bodies	Regulatory Bodies
Impact/change in the firm's approach/criteria to identify areas requiring more/less audit effort	<ul style="list-style-type: none"> • Underlying audit process the same • More time spent on documentation 	<ul style="list-style-type: none"> • Audit effort has increased mainly in terms of documentation • Some additional requirements, e.g. revenue recognition 	
Impact of new regime on level of audit effort generally and/or in specific areas	<ul style="list-style-type: none"> • Underlying audit process the same • Need to manage risk of checklist mentality approach 	<ul style="list-style-type: none"> • More time spent on audit overall as a result of increased documentation 	
Impact/changes on other administrative, insurance, cultural considerations	<ul style="list-style-type: none"> • Focus on compliance made audit less desirable as a profession; attraction and retention of personnel an issue 		
The main costs of the new audit regime	<ul style="list-style-type: none"> • going costs of documentation • Significant increase in technical resources • Costs of ASIC inspection reviews 	<ul style="list-style-type: none"> • Extra caution in terms of increased documentation under new ASIC regime • Concern that force of law is a deterrent to young auditors progressing to partner level • More likelihood of class actions 	<ul style="list-style-type: none"> • No significant increase in costs if complied with ASAs prior to legalization • Firms using legal ASAs as an opportunity to make audits recoverable for costs that should have been already factored in under pre-legalised ASAs • Some initial costs of mapping methodology to ASAs • Increase in documentation costs is not attributable to legal standards

Issues	Accounting Firms	Professional Bodies	Regulatory Bodies
The main benefits of the new audit regime	<ul style="list-style-type: none"> • Discipline, refocus on profession • Increase in documentation provides consistency in process, audit execution • Global compatibility 	<ul style="list-style-type: none"> • “In time we will benefit, but not yet” • Internationally there has been recognition that audit is an advanced technical specialist skill • Restored confidence in capital markets • More conscientious audit process leading to an increase in audit quality in general • Clearer linkage between non-compliance and consequences Independence of standard setting from professional bodies is positive in terms of perceptions • Transferability of skills across auditors 	<ul style="list-style-type: none"> • Increase in audit quality • Promote confidence in capital markets
Impact on different size firms (i.e. Big 4 vs. SMEs)	<ul style="list-style-type: none"> • Difficult to contemplate how SMEs will cope given their limited resources • Some smaller firms may opt out of audit profession due to costs of compliance 	<ul style="list-style-type: none"> • Minimal impact on Big 4 as have resources and international methodology already in compliance with ISAs • Mid tier audit firms; significant impact on quality control and independence compliance systems • Small firms are still in the process of adjusting to change and ensuring compliance of methodology with ASAs 	<ul style="list-style-type: none"> • Big 4 part of global network and have the resources, thus only marginal impact • SMEs do not have the resources for training and updates on methodology and more work to ensure compliance is to be expected

Issues	Accounting Firms	Professional Bodies	Regulatory Bodies
The process of enforcing/monitoring compliance with the auditing standards	<ul style="list-style-type: none"> Firm has compliance regime ASIC reviews in process Threat of non-compliance 	<ul style="list-style-type: none"> Each breach is 50 penalty points where each point equates to \$110 under the Crimes Act Introduction of new ASIC inspection program has added to the already existing monitoring costs 	<ul style="list-style-type: none"> Big 4 have compliance checklists in place
Penalties for non-compliance	<ul style="list-style-type: none"> Consequence of non-compliance and reputation loss significant Not clear as to how the courts will interpret ASA non-compliance 	<ul style="list-style-type: none"> Many not aware of correct penalty-no jail time just fines, it is ‘victimless crime’ Not clear how the courts will interpret the ASAs and the repercussions from criminal actions Yet to see whether this legislation has “any teeth” 	<ul style="list-style-type: none"> Consequence of non-compliance and reputation biggest deterrent No clear on ASIC penalties
Impact on public perceptions of quality of audits/ financial information	<ul style="list-style-type: none"> No real impact on broad public or even sophisticated investor as they generally do not understand audit objective or process Expectations gap unlikely to be reduced but may widen further 	<ul style="list-style-type: none"> Public is not interested There is evidence that the expectation gap is still alive and well The public’s level of understanding is questionable 	<ul style="list-style-type: none"> No real impact on general public as they do not understand audit process or objectives Improved audit quality
Clarity of Auditing Standards	<ul style="list-style-type: none"> Clarity Project should improve clarity No great confidence or perceived impact yet 	<ul style="list-style-type: none"> IASB adding further black letter requirements are likely to increase the burden of compliance Practitioners need to have a period of time without changes to be able to cope with demands of the new regime before Clarity Project effect 	<ul style="list-style-type: none"> Questionable whether the quality of audit standards will be improved More black letter requirements and duplication

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

Appendix E: Participation Information Statement



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NSW 2006 AUSTRALIA

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PARTICIPANT INFORMATION STATEMENT

Research Project Title: The introduction of legally enforceable Auditing Standards and its impact on the profession.

(1) What is the study about?

The study aims to gain insights into the impact of the new legally enforceable auditing standards on audit practice after their first year of implementation.

(2) Who is carrying out the study?

The study is being conducted by Angela Hecimovic (Associate Lecturer, Discipline of Accounting, University of Sydney) and will form the basis for the degree of Bachelor of Economics Honours at The University of Sydney under the supervision of Dr Nonna Martinov-Bennie (Senior Lecturer, Discipline of Accounting, University of Sydney).

(3) What does the study involve?

This study involves the completion of semi structured interviews with representatives of key professional stakeholder organisations. Interviews are based on a set of target questions designed to elicit information as to the impact of completing the first year of audit under the new regulatory framework. The interview will be audio digitally recorded only if you provide your consent.

(4) How much time will the study take?

Each interview should take 30 to 60 minutes.

(5) Can I withdraw from the study?

Participation in this study is entirely voluntary: you are not obliged to participate. If you consent to participate you can withdraw at any time without prejudice and without affecting your relationship with the researchers and the University of Sydney.

(6) Will anyone else know the results?

All aspects of the study, including results, will be strictly confidential and only the researchers will have access to information from individual participants. A report of the study may be submitted for publication, but individual participants or firms will not be identifiable in such a report.

(7) Will the study benefit me?

The results will provide valuable post implementation feedback to accounting firms, professional bodies, regulators and standard-setters as to the costs and benefits of the new audit regulatory regime.



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(8) Can I tell other people about the study?

Yes, although no confidential data should be discussed.

(9) What if I require further information?

When you have read this information, Dr Nonna Martinov-Bennie or Angela Hecimovic will discuss it with you further and answer any questions you may have. If you would like to know more at any stage, please feel free to contact either Nonna or Angela:

Dr Nonna Martinov-Bennie P:(02) 9036 6593 E: n.martinovbennie@econ.usyd.edu.au
Angela Hecimovic P:(02) 9351 8614 E: a.hecimovic@econ.usyd.edu.au

(10) What if I have a complaint or concerns?

Any person with concerns or complaints about the conduct of a research study can contact the Senior Ethics Officer, Ethics Administration, University of Sydney on (02) 9351 4811 (Telephone); (02) 9351 6706 (Facsimile) or gbriody@usyd.edu.au (Email).

Regards

Dr Nonna Martinov-Bennie

Appendix F: Background Information Statement



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BACKGROUND PARTICIPATION INFORMATION SHEET

This information sheet is for you to keep

Research Project Title: The introduction of legally enforceable Auditing Standards and its impact on the profession.

The Australian Government's Corporate Law Economic Reform Program Act 2004 (CLERP 9) changed the framework under which Australian Auditing Standards (ASAs) are issued. The Auditing and Assurance Board (AUASB) was reconstituted and is now charged with the responsibility of issuing ASAs, which are now legally enforceable on audits for financial reporting periods commencing 1 July 2006 under section 336 of the Corporations Act 2001.

These new legislative requirement making ASAs legally enforceable were implemented by the government in order to:

- Provide a clear public focus
- Demonstrate a high quality in standard setting and
- To conform with International Standards of Auditing

Prior to any new regulation being implemented, the government releases a Regulation Impact Statement (RIS) detailing whether the impact of the new regulation on business is warranted and efficient. The RIS addressing the introduction of the new legally enforceable ASAs was released in April 2006, providing feedback from the affected stakeholders including representations from the audit profession, regulators, business and standard setters.

The April 2006 RIS argued that the auditing profession is used to regular changes to the standards and that the new legislative changes would be no different to normal updates. The RIS also concluded that there would be little, if any, compliance costs to the audit firms.

This study aims to shed useful insight into the government's legislative objectives and the costs and benefits from the profession's perspective, post implementation. The results from this study will precede any post-implementation government review on the impact of the CLERP 9 legislation on audit practice.

Your interview responses are critical to providing useful feedback direct from the key stakeholders affected by the newly introduced legally enforceable ASAs.

If you have any questions you are most welcome to contact me at any time.

Regards

Dr Nonna Martinov-Bennie

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Appendix G: List of Target Issues for the Interview Process



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LIST OF TARGET ISSUES TO BE DISCUSSED IN SEMI-STRUCTURED INTERVIEWS

Research Project Title: The introduction of legally enforceable Auditing Standards and its impact on the profession.

Demographic information of Interviewee

Name.....
Organisation.....
Current Position.....
Brief Description of duties/professional association and/or involvement

The Australian government's 'Regulation Impact Statement' (April 2006) analysis of the perceived pre-implementation costs and benefits of the legally enforced auditing standards has been utilised to identify issues to examine the post-implementation impacts of the new regulatory regime on the profession.

The following issues by stakeholder group are indicative of the areas that will be explored during the interviews with individual participants:

Accounting Firms

- Australian Government's motivation/reasons in making Auditing Standards legally enforceable
- Main impact (s) of the legally enforceable standards for your audit practice
- Your firm's/audit partners' reaction to the new regulation
- Impact of the legally enforceable standards on firm's audit methodology
- Training requirements for audit staff
- Impact/changes to audit planning process
- Impact/changes in the focus/importance placed on the assessment of the client's internal controls
- Impact on audit/client relations
- Impact/change in the firm's approach/criteria to identify areas requiring more/less audit effort
- Impact of new regime on level of audit effort generally and/or in specific areas
- Impact/changes on other administrative, insurance, cultural considerations
- The main costs of the new audit regime
- The main benefits of the new audit regime
- Penalties for non-compliance
- Impact on different size firms (ie Big 4 Vs Small ,Medium and Large audit firms)
- The process of enforcing/monitoring compliance with the auditing standards
- Impact on public perceptions of quality of audits/financial information
- Clarity of Auditing Standards
- Justifiability of the legally enforceable standards

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Professional Bodies

- Australian Government's motivation/reasons in making Auditing Standards legally enforceable
- Impact of the legally enforceable standards on firm's audit methodology
- Training requirements for audit staff
- Impact/changes on other administrative, insurance, cultural considerations
- The main costs of the new audit regime
- The main benefits of the new audit regime
- Penalties for non-compliance
- Impact on different size firms (ie Big 4 Vs Small ,Medium and Large audit firms)
- The process of enforcing/monitoring compliance with the auditing standards
- Impact on public perceptions of quality of audits/financial information
- Clarity of Auditing Standards
- Justifiability of the legally enforceable standards

Regulatory Bodies

- Australian Government's motivation/reasons in making Auditing Standards legally enforceable
- Impact of the legally enforceable standards on firm's audit methodology
- Impact/changes on other administrative, insurance, cultural considerations
- The main costs of the new audit regime
- The main benefits of the new audit regime
- Penalties for non-compliance
- Impact on different size firms (ie Big 4 Vs Small ,Medium and Large audit firms)
- The process of enforcing/monitoring compliance with the auditing standards
- Impact on public perceptions of quality of audits/financial information
- Clarity of Auditing Standards
- Justifiability of the legally enforceable standards

Appendix H: Participant Consent Form



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PARTICIPANT CONSENT FORM

Research Project Title: The introduction of legally enforceable Auditing Standards and its impact on the profession.

I,, give consent to my participation in the
above named research project.
Name (please print)

In giving my consent I acknowledge that:

1. The procedures required for the project and the time involved have been explained to me, and any questions I have about the project have been answered to my satisfaction.
2. I have read the Participant Information Statement and have been given the opportunity to discuss the information and my involvement in the project with the researcher/s.
3. I understand that I can withdraw from the study at any time, without affecting my relationship with the researcher(s) now or in the future.
4. I understand that my involvement is strictly confidential and no information about me will be used in any way that reveals my identity.

Signed:

Name:

Date:

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