



UNIVERSITY OF STIRLING

IMAD KUTUM

Division of Accounting & Finance

Stirling Management School

THE APPLICATION OF BUSINESS RISK AUDIT METHODOLOGY WITHIN NON-BIG-4 FIRMS

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ABSTRACT

This research is motivated by interest in recent changes in the audit approaches of audit firms. The business risk audit approach has been adopted based on assertions about its benefits by administrators of large audit firms and academics linked with these firms and, more recently, has been legitimised by the issuance of international auditing standards that give recognition to this approach. Studies investigating the business risk audit approach have relied on the content of audit manuals of large audit firms and pointed to claimed benefits, such as providing consistency of worldwide audit practice, broadening auditors' awareness of risks, increasing audit effectiveness and efficiency, and creating more value for audit clients.

In investigating this recent change in audit approaches, this thesis is concerned with the application of the business risk audit approach within the non-Big-4 audit firms, with a focus on three countries: the United States, the United Kingdom and Canada. The research focuses on the motivation for adopting this approach for non-Big-4 audit firms in the three countries, and the advantages, disadvantages and aftermath of applying this method. These issues are addressed through research methods comprising semi-structured interviews and a questionnaire survey. These methods are deemed appropriate to provide consideration of the contextual factors affecting the non-Big-4 audit firms and audit practice in the three countries examined.

The findings show that non-Big-4 audit firms in the three countries adopted the business risk audit; their motivation was primarily to follow the standards in each country and to follow the general trend in the industry. The advantages were consistent with previous research; there was direct benefit to audit effectiveness and risk management. One major disadvantage of applying this method was the cost burden to both the audit firm and their clients. Some of the interviewees claimed that this method is better suited to large firms and large audits. Overall evidence from this research shows that this method helped auditors better understand their clients and assess the risk associated with the audit process. Auditors from non-Big-4 firms expressed their interest that the business risk audit should remain in use with some modification to fit small and medium audits. This study also contributes to the literature on the internationalisation of audit practice and the audit practice of small- and medium-sized audit firms, which is lacking in existing research related to this group.

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ABBREVIATIONS

AASB	Auditing and Assurance Standards Board
AICPA	American Institute of Certified Public Accountants
APR	Analytical Procedures Risk
AR	Audit Risk
ARM	Audit Risk Model
BRA	Business Risk Audit
CAS	Canadian Auditing Standard
CEO	Chief Executive Officer
CICA	Canadian Institute of Chartered Accountants
CR	Control Risk
EDI	Electronic Data Interchanges
IAASB	International Auditing and Assurance Standards Board
IFRS	International Financial Reporting Standards
IR	Inherent Risk
ISA	International Standards on Auditing
RMM	Risk of Material Misstatement
SAS	Statement of Auditing Standards
SEC	Securities and Exchange Commission
SSA	Strategic Systems Auditing
TDR	Test of Details Risk
UK	United Kingdom
USA	United States of America

Chapter One

Introduction

1.1 Introduction

For many, concern about how auditors conduct audits has become an important issue following the many accounting scandals of the 1990s. However, for auditors, concern over the methodologies that are used to conduct audits and identify risks for their clients has been an important issue for decades. Over the course of several decades, the popularity of different methodologies has changed as companies and concerns about auditors have evolved in terms of how audits are conducted and the information that is sought when conducting audits. The audit methodology that has received attention within the auditing industry over the past two decades is known as the Business Risk Auditing (BRA). This audit methodology has gained attention because it is believed to provide technical advantages in the way that auditors research and identify risk in the operations of companies (Bell et al., 1997; Brands, 1998; Lemon et al., 2000; Winograd et al., 2000; Knechel, 2001; Bell and Solomon, 2002)

The business risk audit method represents a major change in audit methodology. Developed in the 1990s in response to changes in the business environment and economic communities, it represents a new generation of audit approaches (Lemon et al., 2000). The BRA represents a shift in auditors' thinking about how to audit an entity; it broadens the concepts and procedures used in traditional auditing, and is based on a holistic view of the entity's business, while traditional approaches are based on financial statement view (Bell et al., 1997; Bell et al., 2002; Lemon et al., 2000). Most

research investigating the BRA approach relies on the formal content of large audit firms' audit manuals to allege the technical advantages of the new approach, or utilises artificial research settings to detect changes in audit procedures resulting from use of the BRA approach (Eilifsen et al., 2001; Wu et al., 2002).

1.2 The Research Topic

Over the course of the past 100 years auditors have used various methods to determine the risks that may be material to the operations of companies. Since the mid-1990s, KPMG introduced its new audit methodology (Bell et al., 1997). In order to fully investigate the business risk audit methodology, discussion and analysis of the auditing community's actions before the business risk audit methodology was introduced, as well as opinions about the future of audits following the changes implemented with the business risk audit methodology, is necessary. The business risk audit methodology has brought about changes both in the way auditors operate and the operations of auditing firms that may provide an important service to the financial community but that are also businesses in and of themselves. It is important to understand these changes in order to fully understand the impact of BRA, as well as to be able to determine whether these changes are truly as important as they may be perceived by some, at present and in future.

It is important to understand how the business risk audit methodology is used based on the country in which audits are conducted. Also, it is important to address cultural differences between countries and determine how this will affect the application of the methodology. To simply present information and opinions about the business risk audit

methodology without taking into account the country of origin is to potentially ignore much information about how auditors have implemented the methodology, as well as how they view the future of BRA use. This research will examine the business risk audit methodology and the view of auditors with regards to the use of BRA in the United Kingdom, the United States and Canada. Focusing on these three countries will make it possible to compare how auditors use BRA and how they feel about changes that may be needed to make BRA more appropriate and useful for their clients.

Finally, another issue seems often ignored in academic literature: the actions and operations of small and medium-sized auditing firms. Much of the auditing community's attention seems focused on the big-4 auditing firms. This research will focus on the business risk audit methodology from the standpoint of small and medium-sized audit firms, specifically in terms of how they have implemented BRA and how they view its future as an audit methodology. The Big-4 auditing firms referred to are: KPMG, Ernst & Young, Deloitte and Touche, and PricewaterhouseCoopers. This study will focus on auditing firms that are smaller than the Big-4 auditing firms.

1.3 Objective of the Study

This research is guided by three specific objectives:

Objective 1: The primary objective of this research is to examine the business risk audit methodology from the standpoint of small and medium-sized auditing firms in the United Kingdom, the United States and Canada. Within this primary objective there are several secondary objectives guiding the work. First, this research seeks to provide an

understanding of how the business risk audit methodology has been implemented by small and medium-sized firms in the United Kingdom, the United States and Canada, as well as how implementation is similar or different among the three countries.

These particular countries were chosen because they dominate the global auditing industry, and are considered the most influential in setting auditing rules and standards (Campbell, 2008). First, all three countries have specific governing bodies that have the responsibility and the task of research, identifying and ultimately implanting auditing rules that are used by all auditors. The presence of governing bodies such as the AICPA in the USA, the AASB in Canada, and IAASB in the UK, that establish auditing standards in all three countries as opposed to government bodies, or entities is important because it demonstrates that professional auditors in the United States, Canada, and the United Kingdom ultimately decide and implement auditing standards (Ball, 2006).

The United States, United Kingdom, and Canada are also very similar with regards to the establishment of auditing standards that are based on specific principals. The auditing standards that are in place in all three countries contain specific rules about the actions that auditors should take to review the financial documents of their clients. The rules that are in place also establish how auditors must create reports and provide those reports to their clients and to the general public (Benston, Bromwich & Wagenhofer, 2006).

Standard setting in all three countries is achieved with a focus on specific requirements that provide protection to the public from inaccurate and incomplete information (Lemon et al., 2000). According to Sherer & Turley (1997), the main aspects of audit that distinguishes various jurisdictions from each other include: audit assurance, audit reporting, audit independence and audit regulation and liability.

The US, UK and Canadian auditing jurisdictions have similar standards and regulatory frameworks for auditing and this includes giving assurance on the efficiency of management and the financial soundness of the company (Beck, 1973). Though the development of the regulations and standards were developed differently in the three nations, they all seek to meet the same ends.

These auditing system have been used in British Commonwealth nations albeit with some forms of modifications and changes especially after independence. The foundations of auditing in Canada developed based on the British influence which was first practiced in Crown Corporations and nationwide through colonial legislation (Cutt, 1998). Currently though, Canadian auditors have come under the critical scrutiny which the profession has experienced in the UK and USA.

In the United States, auditing and reporting are governed by the profession's Generally Accepted Auditing Standards (GAAS) (Abdol Mohammedi, 1998). These standards ensure that the audit assurance, audit reporting, audit independence and regulation/liability are safeguarded according to ideal standards.

Underlying International and US generally accepted auditing standards, used in both the UK and Canada, are a set of assumptions, principles, concepts, and conventions that are critical to auditing standard development, providing guidance and reference points (Kieso & Weygandt, 2001).

Even more, the auditing standards in the United States, United Kingdom, and Canada are based on a conceptual framework of providing the greatest protection possible to the public from inaccurate and incomplete financial information on the part of companies. In all three countries, auditors are given the task of ensuring that companies provide sufficient information and detail about their financial conditions to allow investors to make informed investment decisions. Auditors are expected to minimize exceptions to the auditing standards that are in place to the lowest level possible so that a high level of audit consistency between client firms occurs (Benston, Bromwich & Wagenhofer, 2006).

Finally, it is not uncommon for these three countries to actually base auditing standards on the successful practices that have been implemented in each other. For example, some of the auditing standards that are in place in Canada were enacted based on rules that were previously in place in the United States (Campbell, 2008). An on-going process is also occurring in which the United Kingdom, United Kingdom, and Canada will eventually adopt international auditing standards as a way to create greater

consistency in audit procedures for multinational firms that operate in these countries (Ball, 2006).

Since the three nations are pursuing the same end in auditing through similar standards and conventions, the Compliance Program of the International Standards on Auditing (ISA) issued by the International Auditing and Assurance Standards Board (IAASB) is gaining so much success in all three nations because it is being adopted by firms and businesses as an integrated framework that cuts across the three nations (IFAC website).

The focus of the auditing standards, as well as the way in which regulators and standard setters look to each other for advice and guidance demonstrate to similarities that exist between these three nations. This is basically because the US, UK and Canada are at the forefront of business, trade, commerce and auditing around the world. So there is no clear-cut difference between the three nations in terms of audit regulation and practice.

Overall, the similarities in auditing standards based on the presence of independent governing bodies that create auditing rules and standards, the basis of auditing standards on procedural rules, and conceptual frameworks that are based on the desire to protect the public by providing consistent information across all auditors demonstrates how auditing in the United States, United Kingdom, and Canada are similar and why these three countries were chosen for this research.

Objective 2: This research is being conducted in order to understand how auditors working for small and medium-sized auditing firms in the United Kingdom, the United States and Canada perceive how BRA has affected their own risks as auditors with regards to identifying material risks for companies. Specifically, auditors and auditing firms assume some risks when they identify, or fail to identify, material risks that may negatively impact a company's future. Auditors working for small and medium-sized auditing firms in the three countries of investigation will be asked about the application of the BRA and its effect on their audit work.

1.4 Motivation for and Contribution of the Study

The motivation for conducting this study is to understand how the increase in attention to and use of the business risk audit methodology has impacted small and medium-sized auditing firms. Much of the literature in both the academic community and the financial community seems to focus on the Big-4 auditing firms. The problem with this focus is that it ignores hundreds and even thousands of small and medium-sized auditing firms. Simply because small and medium-sized auditing firms do not attract the attention that the Big-4 firms receive does not mean that their actions and their impact on the auditing industry is any less important.

However, aside from the focus on small and medium-sized auditing firms, another motivation for this research is to look beyond a single country to examine the similarities and differences that exist between attitudes and actions of auditors across the United States, the United Kingdom and Canada. By taking an academic and scientific approach to comparing and understanding the similarities and differences that

exist with regards to attitudes and actions in relation to the business risk audit methodology, it will be possible to understand how cultural differences between the three countries may impact BRA and the way in which it is used.

While auditing laws and regulations certainly have an impact on auditors' actions, larger issues of tradition and culture, aside from those that impact a country's laws and regulations, should not be ignored, regardless of which country auditors operate in. One of the motivations of this study is to determine whether culture and tradition play a role in how the business risk audit methodology is viewed and used by small and medium-sized auditing firms in the United Kingdom, the United States and Canada. At the same time, the study seeks a better understanding of how culture and tradition may differ between the three countries in the way that the business risk audit methodology is implemented and used.

Based on the above motivations for carrying out this research, it is vital to note the contributions that this study will make to academic literature. First, this research will add to the available information about the practices and attitudes of small and medium-sized auditing firms in the United Kingdom, the United States and Canada towards the use of the business risk audit methodology. At the present time, very little attention has been focused on how BRA has impacted or been used by small and medium-sized auditing firms. The current research will provide defined information about their motivations for adopting the business risk audit methodology, or their motivations for perhaps only using certain parts of BRA. The impact on the existing literature will be a

much fuller understanding of differences between large and small and medium-sized firms.

On a larger scale, the contribution made by the information and analysis obtained in this study provides a means to encourage dialogue about the benefits and drawbacks of the business risk audit methodology for the auditing community. It is not overstating the importance of this research to explain that this study will allow for a better understanding of the problems and benefits that are believed to exist, at least by small and medium-sized auditing firms, with regards to the business risk audit methodology.

This research and the findings it provides can help turn discussion away from knee-jerk reactions to sensationalised stories. The discussion can move toward the actions of auditors and their clients, and how those actions and behaviours impact the material risks that are identified and the work that auditing firms undertake in the normal course of their business activities. The end result will be that any recommendations and changes that are made with regards to the business risk audit methodology, or any new methodology that is introduced in the auditing community, can be less about sensationalism and more about scientific research and analysis.

Finally, this research provides a snapshot of the views and opinions of auditors who currently work for small and medium-sized firms. This is important as future studies can be conducted to determine if the attitudes of auditors in the United Kingdom, the United States and Canada concerning the business risk audit methodology may change

significantly in the coming years. The current research provides a baseline of auditors' attitudes. This baseline can then be referenced and used to determine whether significant changes in ideas occur in the future. This research is also likely to suggest other ideas for research, not only with regards to the business risk audit methodology but also with regards to the work performed by auditors and the similarities and differences that exist between the United Kingdom, the United States and Canada.

1.5 Structure of the Thesis

The structure of the thesis is designed to provide thorough background information about risk, risk management, and how business risk is identified, as well as in-depth information about the business risk audit methodology and how its use has evolved, before actually beginning any discussion or analysis of the primary data collected for this investigation. Providing in-depth discussion and analysis of the background information related to business risk, audit risk, and the business risk audit methodology, enables a better understanding of the information collected in this investigation. It will also be possible to understand the results in terms of the larger issues and concerns facing the auditing community and its clients.

Chapter 2 of the thesis provides information about the concept of risk as it applies to both business risk and audit risk. The various types of risk are discussed. In addition, the concepts of business risk and audit risk are defined and discussed. Finally, the relationship and connections between business risk and audit risk are presented.

Chapters 3 and 4 provide an in-depth literature review relevant to the business risk audit methodology. The chapters are divided into three primary sections: The Pre-BRA Era, The BRA Methodology, and BRA Applications. These three sections provide a history

of audit methodology before introducing the business risk audit, the use of the business risk audit and current literature dealing with the BRA.

Chapter 5 compares business risk auditing standards in the United Kingdom, the United States and Canada. Information about the professional auditing organisations in each of the three countries is examined, as well as the role of auditors, including how they understand the entities that they are auditing and the tests and procedures used in the auditing process.

This leads into Chapter 6, which provides a full and thorough explanation of the methodology used for the primary data collection for this investigation. An explanation of the research methodology that guides the data collection survey is provided, as well as discussion of how the research participants were chosen and the questionnaires that were used to collect the information. Chapter 7 provides the results of the preliminary survey conducted and Chapter 8 provides detailed analysis of the main data collected through the interviews.

Chapter 9 provides a conclusion to the thesis, with a discussion of the results as well as suggestions and recommendations for improving the business risk audit methodology. In addition, recommendations are provided for future research concerning auditing and the business risk audit methodology.

Chapter Two

The Risk Concepts

2.1 Introduction

Risk has always existed since the creation of the world, but has become more complicated as life and humans have become increasingly sophisticated. Thousands of years ago life was simple and the risks associated with it were also simple. As scientists started to invent more sophisticated products and tools, risks increased. Today, the tools we use are complex and breakdowns can be catastrophic, with far-reaching consequences. The risk of a mistake at a nuclear power plant is much higher than the risk from a fireplace in a cave a thousand years ago. But we definitely need the nuclear power plant to cope with the increasing human consumption of energy.

Traditional risk management disciplines, such as insurance and finance, tend to focus on the quantitative elements of risk analysis; however, the qualitative aspect of risk should not be ignored (Lam, 2003). Risk management concept is becoming a focus and concern of shareholders as well as management teams in any organisation (Hoffman, 2002).

2.2 Definition and types of risks

Risk is the possibility of loss or reversal - or gain or advance - differing from what we expect from a decision or activity (Apgar, 2006). The word exploded into academic literature in the 1990s, coinciding with the translation into English of Ulrich Beck's

sociological best-seller *Risk Society, Towards a New Modernity* in 1992. Since then, the number of conferences, courses, centres and journals focusing on, or making use of, the word risk, have expanded rapidly.

Of interest to this research are the business risks that surround any enterprise, as shown in Table 2-1 (Apgar, 2006). This list was developed by David Apgar, the Managing Director of an organisation that researches and develops best practices for executives at over 2,500 companies around the world. In addition, David Apgar teaches at the Johns Hopkins School of Advanced International Studies. The list is comprehensive; it includes risks related to the acceptance or evaluation of what the enterprises provide, called the demand-side risks, and risks related to how they produce what they provide, or supply-side risks.

Table 2-1: Types of business risks

Production, or supply-side, risks	Marketing, or demand-side, risks
<ul style="list-style-type: none"> ▪ Operating risks such as: Control and compliance failures Partner coordination failures 	<ul style="list-style-type: none"> ▪ Security or political risks such as: Market-disrupting events Geopolitical volatility
<ul style="list-style-type: none"> ▪ Supply chain risks such as: Supplier failure or political rupture Key cost volatility 	<ul style="list-style-type: none"> ▪ End-market or customer risks such as: Brand or reputation erosion Customer consolidation
<ul style="list-style-type: none"> ▪ Technological risks such as: Infrastructure breakdown Information security breaches 	<ul style="list-style-type: none"> ▪ Competitive risks such as: Disruptive technologies New entrants to the market
<ul style="list-style-type: none"> ▪ Workforce risks such as: Capacity loss or disruption Key staff loss or defection 	<ul style="list-style-type: none"> ▪ Regulatory or legal risks such as: Legislation and litigation Official corruption
<ul style="list-style-type: none"> ▪ Assets risks such as: Fraud or theft Counterparty credit losses 	<ul style="list-style-type: none"> ▪ Financial or economic risks such as: Financial market volatility Recession

It is worth discussing at this point the difference between audit risk and business risk, before we get into more detail about these two types of risks. Audit risk is *‘the risk the auditor may...fail to...modify his opinion on financial statements that contain material misstatement’* (Sennetti, 1990)

According to the International Auditing and Assurance Standards Board (IAASB) Glossary

of Terms, audit risk is defined as follows:

‘The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of material misstatement and detection risk.’ (ISA 315)

International Standards on Auditing (ISA) 315 also defined business risk as follows:

'A risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity's ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.'

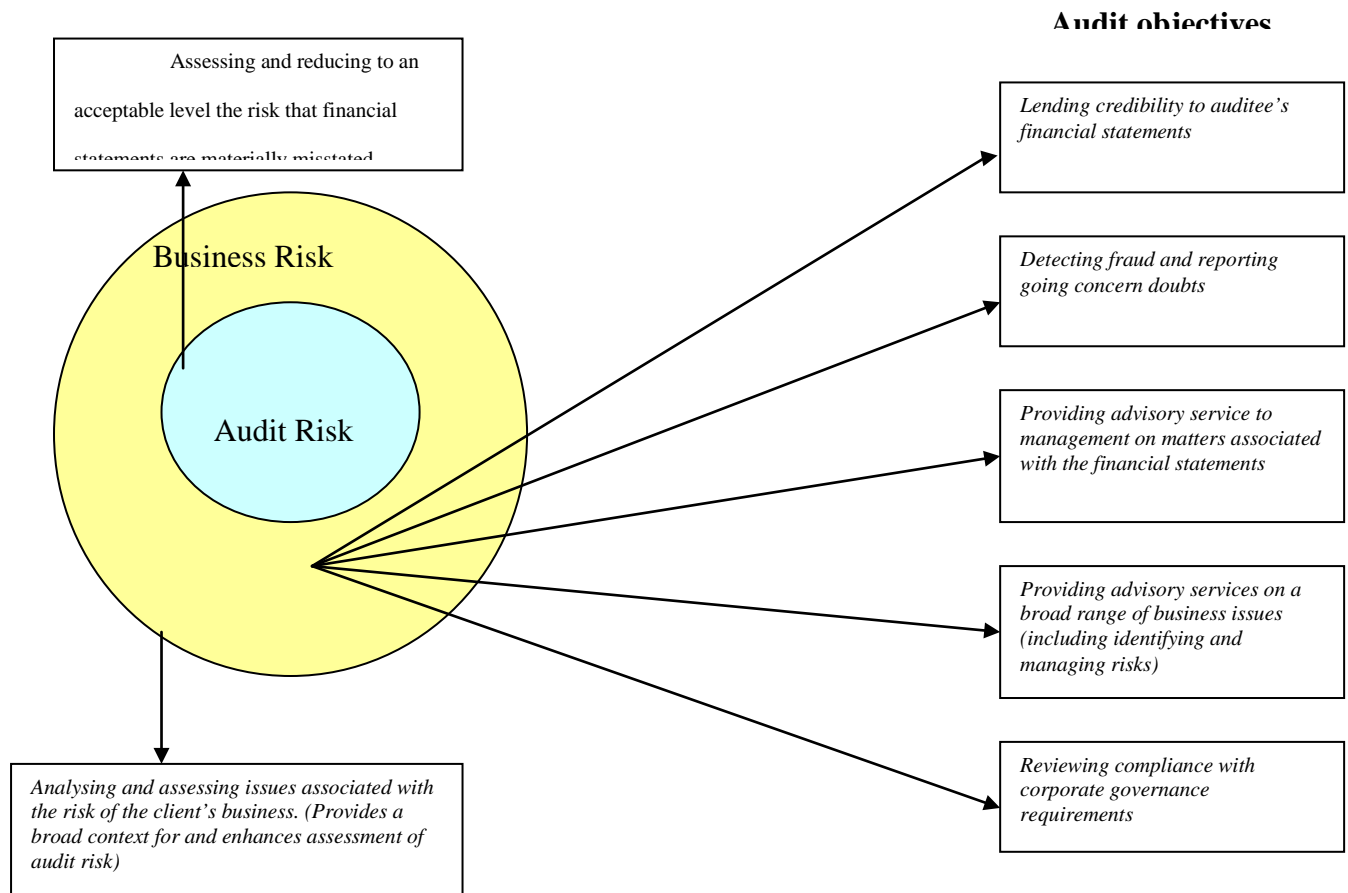
Therefore BRA is concerned with the audit risk consequences of this failure to meet objectives. This takes the form of material misstatements present within the financial statements. This is backed up by the application guidelines within the standards: ISA 315 states that "most business risks will eventually have financial consequences".

One viewpoint is to argue that BRA is simply a progression of the audit risk model in that it builds upon the knowledge required, particularly in the auditors' understanding of the entity. This is illustrated within ISA 315.

Business risk is broader than the risk of material misstatement of the financial statements, though it includes the latter.

Figure 2-1 presents the relationship between audit risk and business risk, from an audit objects prospects.

Figure 2-1 Audit Risk and Business Risk



Source: Porter, Simon and Hatherly, Principles of External Auditing, 2nd edition 2003

The figure shows that within the efforts to determine the business risks of an organisation is the threat of the audit risk of not finding material misstatements within an organisation’s financial statements. The goal is to reduce the audit risk to an acceptable level by determining the business risks that are associated with an organisation and its operations. The ability to find the business risks that are present is part of the larger objectives of conducting an audit, such as detecting fraud and reporting concerns that fraud may be present, as well as advising companies on the

types of information that should be included in their financial reports in order to alert stakeholders of business risks.

2.3 Risk Management

Risk management is the process of measuring or assessing risk and developing strategies to manage it. Strategies include transferring the risk to another party, avoiding the risk, reducing the negative effect of the risk, and accepting some or all of the consequences of a particular risk (Conrow, 2003). Traditional risk management focuses on risks stemming from physical or legal causes (e.g., natural disasters or fires, accidents, death, or lawsuits). Financial risk management, on the other hand, focuses on risks that can be managed using traded financial instruments (Schroeck, 2002).

In ideal risk management, a prioritisation process is followed whereby the risks resulting in the greatest potential loss and having the greatest probability of occurring are handled first, and risks with a lower probability of occurrence and lower potential loss are handled later. In practice the process can be very difficult, and balancing between risks with a high probability of occurrence but lower loss versus risks with high loss but a lower probability of occurrence can often be mishandled (Damodaran, 2008).

Risk management also faces difficulties in allocating resources. This involves the concept of opportunity cost. Resources spent on risk management could be spent on more profitable activities. Again, ideal risk management minimises spending while maximising the reduction of the negative effects of risks (Doherty, 2000).

Boards are responsible for approving the overall strategic direction of their company. As part of the planning process, boards must clearly understand their company's current business strategy, its critical success factors and the related business risks. An effective board actively participates with its CEO and senior management in setting the overall strategic direction of their company and approving its strategic plan. They oversee the processes and controls that management has put in place to identify and manage business risks. They actively review the potential impact of these business risks on the achievement of their company's strategic objectives. And, after careful consideration of the opportunities and risks, the board determines the nature and extent of the business risks that are acceptable for the company to bear.

Risk management can be a complex process for businesses, but the basic concepts are very simple. There are four choices of risk management strategy (Canadian Institute of Chartered Accountants, 2006):

- **Avoiding risk** by choosing not to undertake certain types of activities. This includes not performing an activity that could be risky. An example would be not buying a property or business in order to not take on the liability that comes with it. Another would be not flying in order to not take the risk of the airplane being hijacked. Avoidance may seem to be the answer to all risks, but avoiding risks also means losing out on the potential gain that retaining the risk may have

allowed. Not entering a business to avoid the risk of loss also eliminates the possibility of earning profits.

- **Transferring risk** to third parties through insurance, hedging, outsourcing, etc. This causes another party to accept the risk, typically by contract or by hedging. Insurance is one type of risk transfer that uses contracts. Other times it may involve contract language that transfers a risk to another party without the payment of an insurance premium. Liability among construction companies or other contractors is often transferred this way, often referred to as sub-contracting. On the other hand, taking offsetting positions in derivatives is typically how firms use hedging to financially manage risk.
- **Mitigating risk** through preventive and detective control measures. This involves methods that reduce the severity of the loss. Examples include sprinklers that reduce the risk of loss by fire. This method may cause a greater loss through water damage and therefore may not be suitable. Halon fire suppression systems may mitigate this risk, but the cost may be prohibitive as a strategy.
- **Accepting risk**, recognizing that the benefits of doing so outweigh the cost of transference or mitigation. This involves accepting loss when it occurs. True self insurance falls under this category. Risk retention is a viable strategy for small risks where the cost of insuring against the risk would be greater over time than the total losses sustained. All risks that are not avoided or transferred are

retained by default. This includes risks that are so large or catastrophic that they either cannot be insured against, or the premiums would be infeasible. War is an example: most property and risks are not insured against war, so the loss attributed by war is retained by the insured. Any amount of potential loss over the amount insured is retained risk. This may also be acceptable if the chance of a very large loss is small or if the cost of insuring for greater coverage is so great that it would hinder the goals of the organisation too significantly.

2.4 Identifying Business Risk

In order to be able to actually manage risks, they must first be identified. It is necessary to discuss the ways in which the risks that impact companies can be identified. Today's finance executives are becoming the eyes of their corporations, looking for threats and opportunities inside and outside, and taking the lead in risk management and decision-making to ensure their companies' long-term survival. A possible starting point is the analysis of external change drivers (demographics, technology, globalisation, channels, competitors and regulations) to determine how they affect the specific organisation. Next, managers that seek long-term survival must take the following four steps (Axson, 2006):

1- Establish a Risk-Based Early-Warning System

To be effective in establishing a risk-based early-warning system, companies must get beyond the data in their enterprise in order to identify and fill gaps in the company's intelligence. The emerging picture should then be circulated throughout the company,

with orders to begin thinking about how to respond, and responses embedded in business plans.

The risk management team will identify and monitor trends, build and maintain the overall risk profile and, more critically, ensure risk is factored into all decision-making. They will also collate and disseminate information and educate the organisation. This process is vital to corporate survival, permitting companies to either stay in business and prepare for future trends, or prepare to exit the business when appropriate (Axson, 2006).

2- Radically Refocus Performance Reporting and Analysis

Stagnation and decline of businesses will likely accelerate if companies continue using current methods of measuring, reporting and analysing performance. The risk team must take the lead in radically refocusing performance reporting and analysis on relationships and linkages. Measures must be rebalanced in terms of leading and lagging internal and external information.

There is a defined universe of measures of importance based around finances, markets, customers, operations, employees, suppliers, competitors, infrastructure, risk, projects and compliance. These measures provide a comprehensive framework for defining the key relationships and ratios that allow managers to understand performance and rapidly respond to opportunities and threats (Axson, 2006).

3- End the Annual Planning Process

A front-line manager must always know where the organisation has been, where it is presently, what its destination is and how it will get there. Typically, planning is a painful, distracting, four-to-six-month march fraught with political battles. The result is a static tool, obsolete from its conception; the longer it takes, the more likely it is to be wrong.

It is time to start thinking of planning as a continual process that is refreshed every day, and is the actual embodiment of the work of a manager. To reach this state, the annual planning process must first be stopped. Annual planning becomes a method for setting performance targets, agreeing upon performance metrics and establishing shared commitment to performance. It is tactic-centric and embraces risk and uncertainty; it should be completed in about five days.

In this new planning, action is top-down rather than bottom-up. Performance management systems automatically generate a baseline business plan based upon past results, adjusted for predefined productivity and growth beliefs. Subsequent discussion about material events and trends on the horizon that will affect the baseline are established, along with appropriate performance targets (Axson, 2006).

4- Recapture Intuition in Decision-Making

Risk management managers must inspire the recapture of intuition as a factor in decision-making, fostering dialogue and discovery to create practical action plans and identify the first signs of flawed choices. They should guide the organisation towards ensuring that the right amount of time is allocated to innovation, improvement and execution, and understanding risk and how initiatives might fail. Financial analysis should be co-located with business partners. Analyst resources should be shifted away from spreadsheets and into dialogue and discovery. Half of the analyst's time should be allocated to direct interaction with peers' business partners.

The end result of following the four strategies above is a re-energised culture. The company no longer takes success and continuity for granted, nor is it blind to the effects of potentially adverse external trends. The acceptance of risk is greater, as failure is contemplated alongside success. Intuition and dialogue are promoted; changes and speed are rewarded.

Once risks have been identified, they must then be assessed as to their potential severity of loss and the probability of their occurrence. These quantities can be either simple to measure, in the case of the value of a lost building, or impossible to know for sure, as in the case of the probability of an unlikely event occurring. Therefore, during the assessment process it is critical to make the best educated guesses possible in order to properly prioritize the implementation of the risk management plan (Axson, 2006).

2.5 Audit Risk

The audit risk model began to be formally identified in the early to mid-1980s. As it came to be more widely identified, it affected the practice of auditing by providing auditors with a formal model to allow them to think about the information and details they needed to reduce the risk of overlooking or ignoring risks that were present with a company and its operations. The audit risk model is a risk-based approach to selecting the amount of detailed testing necessary for an audit to be effective. Because detailed testing is costly, audit efficiency can be increased by conducting such tests only to the extent necessary for an audit to be effective. The audit risk (AR) model lowers the auditor's risk of incorrectly concluding that no material misstatement exists in three major components: client inherent risk (IR), client control risk (CR) and auditor detection risk (analytical procedures risk (APR) and test of details risk (TDR)) (Dusenbury et al., 2000). These are defined as follows (Colbert, 1987):

- **Inherent risk:** the susceptibility of an account balance or class of transactions to error that could be material, when aggregated with error in other balances or classes, assuming there are no related internal accounting controls.
- **Control risk:** the risk that error that could occur in an account balance or class of transactions and that could be material, when aggregated with error in other balances or classes, and will not be prevented or detected on a timely basis by the system of internal accounting control. Before auditors can use a control risk of less than 100% they must do three things: obtain an understanding of the client's internal control, evaluate how well it should function based on this understanding and test the internal control for effectiveness. The first of these is

the understanding requirement that relates to all audits. The latter two are the assessment of control risk steps that are required when the auditor chooses to access control risk at a level below maximum.

- **Detection risk:** the risk that an auditor's procedure will lead him to conclude that error in an account balance or class of transactions that could be material, when aggregated with errors in other balances or classes, does not exist, when in fact such error does exist.

It is important to discuss the risk of auditors not identifying risks that are present in a business. In today's terminology, audit risk is explained as the risk that an auditor has provided an inaccurate assessment or opinion regarding the fairness of a company's financial reporting (O'Regan, 2004). Audit risk is defined as "*the risk the auditor may...fail to...modify his opinion on financial statements that contain material misstatement*" (Sennetti, 1990). It emphasises the risk of making a mistake on any assessment provided. However, in order to completely understand audit risk, it is necessary to understand how audit risk originated. While the concept of audit risk was first discussed in professional and academic literature around 1972, the term 'audit risk' is rarely used; rather, terms such as confidence, reliability and probability are employed (Bamber, 1983; Beck, Solomon & Tomassini, 1985; Basu, 2009).

In two papers dealing with statistical sampling, the AICPA discusses reliability and also employs the word 'confidence' (AICPA, 1962; AICPA, 1964). Stringer points out that many factors in statistical sampling require an auditor's judgment; one of these is the confidence level, the complement of sampling risk (Stringer, 1961).

In their work *Philosophy of Auditing*, Mautz and Sharaf (1961) frequently employ the word 'probability'. Although their focus is primarily on probability, they do briefly discuss risk. The client's history or the auditor's experience with the client may indicate that extra risk is associated with a particular type of transaction or asset, or a specific employee or department. In such a case, the auditor, as a reasonable or prudent practitioner, should exercise due audit care and focus extra attention on that portion of the audit. The risk that Mautz and Sharaf discuss is now termed 'inherent risk'.

Power (2000) explains that auditors would simply examine a sample of information to determine whether misstatements were present in financial reports and records. The problem, however, was that the actual science of selecting an appropriate statistical sample of financial information was not being used.

These early works laid the groundwork for the formal use of audit risk by the profession. Coming primarily from a statistical sampling viewpoint, this literature promulgates understanding of the concept of risk when performing an engagement. They also emphasize the importance of judgment in establishing appropriate risk levels.

The use of sampling as a means of obtaining enough information to make a judgment about risks in audits began to decline in the 1980s. Power (2000) notes that statistical sampling for an audit is typically only effective when there is a low risk of misstatement or when so-called typical errors are likely to be present. However, in

situations where there may be a possibility of high-risk errors being made in financial reports, statistical sampling would result in less of a chance of the high-risk errors being found. The use of statistical sampling in the audit procedure has become increasingly unpopular because auditors are not looking for low risk errors as closely. Instead, they are looking for high-risk errors that can greatly affect how the public interprets a company's financial information. These high-risk errors can lead to a company appearing to have increasing yearly revenues while actually having a great amount of risk that could result in its demise.

Statement on Auditing Standards 47 (SAS 47) was the first professional standard issued by the American Institute of Certified Public Accountants (AICPA) to deal with audit risk (AICPA, 1983). SAS 47 recognises two levels of audit risk: (1) audit risk at the financial statement level and (2) audit risk at the level of the individual account balance or class of transaction. It describes overall audit risk as “*the risk that the auditor may unknowingly fail to appropriately modify his opinion on financial statements that are materially misstated*” (SAS 47). The statement recommends that the auditor use overall audit risk both in planning the audit and evaluating the findings.

The importance of professional judgment and knowledge cannot be ignored or understated in the realm of audit risk. Much of the process of establishing audit risk and determining whether any mistakes in the assessment of financial records have taken place is based upon the knowledge that auditors use to guide their work. While there are certainly guidelines and models available, all of these things are open to some interpretation and understanding in terms of how to use them (Siegel & Shim, 2000).

In order to understand the inputs and how the audit risk model comes together, it is vital to understand the types of risk that are present when using the audit risk model. The first type of risk is known as Type I error risk. This is the risk of incorrectly accepting the hypothesis that there are no material misstatements in a company's financial reports. The other type of risk that is present is Type II risk. This is the risk of incorrectly rejecting the hypothesis that there are no misstatements in the financial reports. In other words, a Type II error would occur if an audit stated that material misstatements were present when they actually were not (Abdel-Khalik, 1998).

The audit risk model begins with the auditor creating a hypothesis about what is expected to be found from the data. The null hypothesis, or the hypothesis that the auditor would assume to be correct from the start, would be that there are no material misstatements. If the data were sufficient enough to show otherwise, however, the auditor would reject the null hypothesis and accept the alternative hypothesis that there are material misstatements in the financial records (Abdel-Khalik, 1998).

Simply having a model available that can provide a level of audit risk does not mean that the information obtained is foolproof. A researcher who has studied statistical analysis realizes that even the interpretation of statistics is just that: interpretation. This is why it is so important to provide a basic background of how audit risk came to be what it is today. The fact that audit risk was born out of concepts such as confidence, reliability, and probability brings the importance of interpretation into play.

In the world of business, the presentation of facts or statistics is often open to various interpretations by different groups of people. Simply creating a statistical output, such as a confidence level or a probability, does not mean that everyone will agree on what that number or figure means in a real-world setting. There may be basic arguments about how the number should be interpreted in theory versus reality. There may also be conflict about the inputs that went into the model that created the output in the first place (Bud-Frierman, 1994).

As the discussion of various aspects of the audit risk model proceeds, these ideas about interpretation should remain at the forefront. The discussion of the audit risk model will delve deeply into ideas of statistical inputs and the creation of output to interpret the risk of mistakes. However, as will be seen, the model has some critics who believe that too much interpretation is used. At the same time, some individuals argue that the audit risk model is actually robust enough to correct or at least tolerate various information inputs.

This is another area where professional judgment comes into play. The auditor might decide that he or she believes that a risk of material misstatements of 10% is acceptable. However, another auditor might believe that nothing less than a level of probability of 99% in regards to there being no material misstatements is acceptable. A 95% level of there being no material misstatements is merely considered standard. However, this is open to professional judgment and interpretation.

To plan work for a specific audit segment, the auditor decides what level of individual audit risk is appropriate. Judgments of inherent risk and control risk are then made. Finally, the appropriate level of detection risk is determined. The auditor may find it helpful to use a model to aid in understanding how the risks relate to each other and in setting detection risk. The model below is derived from the description of individual audit risk found in SAS 47 and follows from the model of audit risk SAS 39 “Audit Sampling”:

$$AR = (IR) \times (CR) \times (APR) \times (TDR)$$

In the model, the audit risk is equal to the control risk multiplied by the analytical procedure risk multiplied by the test of detail risk. The auditor uses this model to determine the nature, timing and extent of substantive work for an audit subject. Manipulating the model and solving for detection risk yields:

$$DR = \frac{AR}{IR \times CR}$$

In this form, the model shows that the assessed levels of inherent risk and control risk bear an inverse relationship to the planned level of detection risk. Intuitively, this makes sense: the riskier an audit subject is, the more attention it should be given. Increased work corresponds to limiting planned detection risk to a low level (the lower the planned detection risk, the more work must be done to restrict the risk to the low level).

Once the planned level of detection risk is known from the above model, the auditor selects the specific audit procedures in accordance with that level.

Auditors have often assessed the various types of risk in the model as being low, medium or high. The belief is that quantifying these different types of risk is so hard that it is easier to value them as low, medium or high. However, it is possible to quantify the types of risk that go into the model to determine an overall level of probability of audit risk (Abou-Seada & Abdel-Kader, 2003).

As Abou-Seada & Abdel-Kader (2003) point out, the fact that the theory of the audit risk model calls for quantification of the different types of risks, but that practicing auditors do not always quantify these variables illustrates the difference between theory and practice. This model was created to provide a systematic manner in which audit risk could be determined. However, the fact that professional judgment is present in the model means that some auditors have used the model more as a guide than an actual means of establishing a value of risk, and use that to determine whether material misstatements are present in financial reports.

Anderson (2006) explains that the audit risk model is a low risk model in terms of making mistakes. The reason for the low risk of making mistakes with the audit risk model is because the possibility of failure from the model is predictable. Table 2-2 shows the matrix of relationships between interactions and coupling for systems of risk developed by Anderson (2006).

Table 2-2

		Interaction	
		Linear	Complex
Coupling	Tight	<p>Possible failures are predictable and directly affect the system</p> <p>Although consequences of failure may be grave, linear interaction makes risk easily controllable by centrally-planned control. Risk is therefore medium in these systems.</p>	<p>Possible failures are unpredictable and directly affect the system.</p> <p>Inherent risk in the system is high and not easily controllable since the tight coupling requires a centralised control approach whereas the complexity requires a decentralised control approach.</p>
	Loose	<p>Possible failures are predictable and do not directly affect the system.</p> <p>These systems may be easily controlled centrally as well as decentrally and are therefore low-risk.</p>	<p>Possible failures are unpredictable and do not directly affect the system.</p> <p>Inherent risk in these systems is therefore medium and is best controlled by decentralised strategies.</p>

The centralised format of the model and the procedures that go into the model mean that the process of determining audit risk is highly controlled, at least in theory. In

addition, the author also explains that the audit risk model can be seen as a management control system because it states quite clearly, again, at least in theory, how to lay out various variables associated with risk in an organisation. If the model is used as proposed, auditors and the companies facing audit have a roadmap to follow that can help avoid material misstatements, or find material misstatements before they are actually released to the public.

Wallace (2005) notes that some assumptions are inherent in the audit risk model. First, it is assumed that the risk factors are independent of each other. This means that no variable has a causal relationship with another variable. For example, the client's inherent risk is unrelated to the details risk in the model. This lack of a causal relationship between the variables also means that errors in the variables should not lead to errors in the other variables in the model.

The second assumption is that the auditor can provide a subjective evaluation of control risk and analytical risk with a reasonable level of accuracy. The third assumption is that errors such as the auditor not choosing appropriate auditing procedures or tests are not statistically significant. It is assumed that the potential errors of choosing inappropriate auditing procedures are controlled in the model because of the planning and selection of audit procedures from the beginning (Wallace, 2005).

One concern expressed about the audit risk model is the way in which data is aggregated or brought together for the purpose of inputting it into the model. Lore and

Borodovsky (2000), for example, state that one financial institution might choose to put together data from various, connected sources. On the other hand, another institution might bring together completely different sources of information that have no connection at all. The problem with these two different procedures is that the different aggregation methods might result in vastly different results for the model. If this were to be the case, one model might show that material misstatements are present while another model might show no material misstatements. This introduces the idea of an auditor making a Type I or Type II error solely because of the way data is brought together.

The issue of how auditors assess variables in the audit risk model was the purpose of a study by Dusenbury, Reimers & Wheeler (2000). The researchers wanted to determine if experienced auditors brought previously obtained information about risks to the model or if the model inputs were truly independent of any previous information or data. The authors of the study expressed the same concern about how data are collected for the model. They stated that if data were collected and used independently, then the risk of not identifying material risks increases. However, if data for the model are collected interdependently or aggregated with other information, the chance of missing material risk decreases.

The researchers conducted the study with 67 senior auditors from one of the Big-6 auditing firms. The participants had an average age of 27 years and 3.3 years of professional experience. The study found that auditors do indeed input data into the

audit risk model on a conditional basis. This means that the study showed that the variables were interdependent on previous data and information.

The authors of the study concluded that the fact that their investigation showed interdependence in terms of the variables in the model actually improves the outcomes of the model as a means of determining audit risk. This is because the findings show that the auditors are using the model in such a way as to provide the highest level of information available to determine if material misstatements are present in financial reports. The risk of making a mistake with the audit risk model is reduced because of the interdependence of the variables and information used.

Even with this information, some concerns about the audit risk model exist. The possibility that the audit risk model may actually make the entire audit process simpler than it should be (Srivastava & Mock, 2002) has been expressed. The concern is that auditors may view the basic equation of the model as the primary focus of their work. As long as they can enter data into the various variables in the model and create a final answer, they may think that their work is done. Such simplified use of the model might lead to auditors missing material misstatements or other risks.

Another problem that has been expressed concerning the audit risk model is that the model is inflexible in terms of how it allows for the assessment of audit risk. Because the model is fairly straightforward, at least in theory, this may lead to auditors not incorporating other areas of risk that they might otherwise believe to be material in their

overall judgments as to whether material misstatements are present in financial reports. The model does not allow for other strategies or methods outside of what is expressed in the model. In essence, this actually limits the professional judgment that is so important in the audit process (Srivastava & Mock, 2002).

Finally, it is interesting to note another concern about the model: the way in which it is created does not take into consideration the way auditors actually think. Specifically, the way in which the model operates in a multiplicative manner to evaluate overall audit risk is not the way that auditors think. It is argued that the disconnect between the model and auditors' minds makes the audit risk model problematic (Srivastava & Mock, 2002).

What is interesting about the last argument is that there is no real discussion of how auditors think to justify the argument that the multiplicative nature of the audit risk model is incompatible with their thought processes. However, it is clear from these arguments that some people in the industry believe that, for one reason or another, the audit risk model is not good enough to provide an accurate assessment of whether material misstatements are present in financial records.

The actual ability of the audit risk model to determine the risk of inaccuracies or misstatements was the purpose of a study conducted by Houston, Peters and Pratt (1999). The researchers wanted to determine how the audit risk model allowed for determining whether errors and irregularities existed in financial records. The

participants in the study were 34 auditors from major auditing firms. They were given auditing scenarios to complete using the audit risk model.

The study found that the auditors were able to identify normal risks. However, the audit risk model was less successful at finding irregularities contained in financial reports. The authors conclude that the audit risk model is good when the risk of errors is high, but is less helpful when the risk of irregularities is high. However, the researchers go on to explain that the findings may not be completely due to the model. Instead, these findings may be an indication that auditors were not using the audit risk model in its full capacity:

“While our results suggest that professional standards should be reviewed, it is also possible that auditors are not fully utilizing the ARM. We show evidence, consistent with previous research, that audit firm policies may be constraining auditors from setting audit risk at a low enough level to adequately respond to irregularities. Recall in our experiment that acceptable audit risk judgments were insensitive to the discovery of both the error and the irregularity, and approximately half of the sample set audit risk at 5 percent. Such constraints could render the ARM less descriptive, a question that could be addressed by future research” (p. 296).

This issue of where to set the appropriate level of audit risk goes back to the issue of professional judgment and the probability statistic. If the model is unable to find errors and irregularities with a level of probability of 5%, then the acceptable level of risk for material misstatements may need to be lowered to 2.5% or even 1%. This does not

mean that the model is flawed, it simply suggests that perhaps it is necessary to establish a lower level of acceptance before auditors judge whether a misstatement is present. Rather than accepting a level of risk of misstatement of 5%, auditors may need to consider a level of risk of misstatement of no more than 1% acceptable.

In the end, the audit risk model does appear to be an appropriate determination of whether audit risks are present. However, simply inputting data into the model does not appear to be enough to reach a reliable conclusion. Instead, auditors who use the model must understand its particular nuances. Indeed, an understanding of some of the model's history and how it came to exist, especially related to statistical analysis and probability, would be very helpful.

The information discussed above indicates that simply setting a level of probability for all situations and having auditors input information is not enough to avoid making false judgments about the existence of material misstatements. Instead, auditors need enough information about the model and the circumstances that could result in either Type I or Type II errors. This is not to say that an auditor also needs to be a statistical expert. However, he or she needs to have a basic understanding of probability and how different levels of probability can affect the final decisions that they make from the outcomes of the audit risk model.

Finally, it should also be noted that the research available on the audit risk model and its complexities is far from providing conclusive answers about the model and how

outcomes from it can be affected. Use of the model is entirely due to the evolution of the auditing profession and how decisions are made about the presence or absence of material misstatements.

With this in mind, further research should be conducted on the audit risk model and the best ways for the model to be used. This type of research would allow for further exploration of the model and how to combine its variables in order to ensure even more accurate information about the possible presence of material misstatements. In addition, more information is needed about the way that individual auditors and auditing firms address the use of the audit risk model. If auditing firms tell all of their auditors to set the level of acceptable probability of the model to 5% in all situations, this may lead to some errors or irregularities going undetected. This removal of professional judgment based on information discovered during the audit process may be as important incorrect use by auditors.

2.6 Risk for the Auditor

Auditor risk refers to the range of possible consequences an auditing firm might suffer due to the way an auditor identifies concerns or material misstatements. These consequences may indeed be legal actions imposed by government organisations or sanctions imposed by professional governing bodies. However, risk for an auditor can also come from negative publicity towards an auditing firm from the public or the shareholders of a company (Abdel-Khalik, 1998).

On the surface, this appears to be a relatively straightforward concept. An auditing firm encounters a certain amount of business risk associated with the professional opinions that are made public regarding the financial records and statements of its clients. However, the risk for the auditor really involves an interaction between the business risk of a company and the risk that an auditing firm will not process enough information to fully determine whether material risks are present that should be made public (Andersen, 2006).

In the past, auditors have actually tried to deflect audit risk away from themselves by educating the public about the variables involved in the audit process, in order to show that auditing is not a complete science (Basu, 2009). There is variability in the professional opinions stated regarding clients because of the available information from clients, and a client's willingness to be upfront and honest about its financial and business risks. However, in recent years, and especially in light of recent accounting scandals, this method of deflecting blame away from auditors has not been effective. Instead, auditors have felt more pressure to truly understand a company and its processes. Companies have also felt more pressure to be truthful and honest about their business practices (Andersen, 2006).

Because of this change in how the public and companies view the role of auditors, it is necessary for auditors to have a much more complex understanding of their clients and of business risk. Audit risk must be understood as much more than just the risk of making professional judgments that are seen as ineffective by stockholders and the public. Instead, auditors must also understand the business risk for companies and the

consequences that can be faced from governmental bodies, stockholders, and the public (Andersen, 2006).

It is also important to understand that business risk is often greatest among companies that are cyclical industries, or companies that are in relatively new industries (Scott, 2003). This information is important; an auditor should immediately feel a heightened sense of urgency and investigation when approaching companies that fit into either of these categories.

2.7 Relationship Between Audit Risk and Business Risk

Audit risk primarily addresses the risks associated with issuing unqualified audit opinions on client financial statements that contain material misstatements. Business risk is present even when auditors comply with generally accepted auditing standards (GAAS) and render appropriate audit opinions. Business risk encompasses more than the risk associated with issuing unqualified opinions on a materially misstated financial statement. For example, a client with a weak internal control system experiencing financial difficulty introduces two kinds of risks: the risk of material misstatement and the risk of financial failure. Audit risk reflects only one risk; business risk encompasses both (Houston, 1999).

If a client is forced to file for bankruptcy or suffers a significant loss after completion of the audit, there is a greater chance of the auditor being required to defend the quality of

the audit than if the client were under no strain. The loss could be due to fraud, loss of a major customer, or a computer disaster that crippled the company for a period of time. There is a natural tendency for those who lose money in bankruptcy or because of a stock price reversal to file suit against the auditor.

In situations where the auditor believes the chance of financial failure or loss is high, and there is a corresponding increase in business risk for the auditor, the level of audit risk should be reduced. The desired audit risk affects the amount of evidence to be gathered; as audit risk decreases, the level of assurance required increases and more evidence must be gathered, making the audit more costly. If a subsequent challenge does occur, the auditor will then be in a better position to successfully defend the audit results. The idea is that the business risk approach to auditing a company is more thorough because it focuses on all of the areas from which risk may be derived for a company. For the auditor, this can also mean reducing their own business risk because of the greater likelihood of identifying potential business risks for clients and making those risks known to the public.

Part of this move toward a greater concern with BRA on the part of auditors is seen as a move to assure company stakeholders that material risks are not present, or at least that a company has been informed that it is taking on material risks through various actions (Koletar, 2003). This is not hard to imagine in light of the recent accounting scandals that have affected major companies around the world. Shareholders want some assurance that they are being made aware of whether a company is taking on actions that might result in future financial trouble.

Fraser and Henry (2004) actually attempt to bring together the issues of business risk and audit risk with regards to the work performed by auditors. They explain that it is likely impossible to fully reconcile business risk and audit risk. In other words, auditors cannot identify all of the business risks that are present for a company, which means that there is no way to fully eliminate audit risk. The reason for this is that factors such as the auditors' level of expertise and the amount of time available for contact with client firms impact auditors' ability to identify all existing business risks.

Furthermore, Fraser and Henry (2004) explain that the business risk audit methodology may actually result in auditors overlooking business risks related to the health and safety of employees and health and safety issues related to the products or services being produced. This is because the business risk audit methodology places a focus on business risks that are perceived to directly impact an audit, so issues of health and safety are generally viewed as secondary issues and are overlooked. Once again, the result is that it is not possible to completely identify all of the business risks that exist, so some audit risk always remains.

Overall, the relationship between business risk and audit risk might best be viewed as two forces moving in relation to each other. As an auditor is able to identify as many business risks as possible, he or she is reducing the level of existing audit risk.

However, as variables related to time, resources and expertise influence the audit process, the level of audit risk increases, because it is not possible to identify all existing business risks.

Falollahi (2002) explains that the BRA approach to the auditing process is taking precedence among auditors because it considers the financial, technical and managerial aspects of a business as being interconnected. Rather than being concerned only with accounting functions or how transactions are reported, the BRA approach is concerned with future risks and companies' risky behaviour. In addition, this form of auditing must seek to determine if internal and external controls are present. A company may have successfully handled risk from an internal level, but may have left themselves open to external risks, such as risky investments, economic downturns, or litigation. The BRA approach, if done properly, should discover that these external risks are present and not being carefully controlled.

More specifically, business risk for a company or firm that is the client of an auditor can be divided into two categories: organisational or management risks, and financial risks. Organisational or management risks are often the kinds of risks that lead to material misstatements in financial reports. These kinds of risks can be relatively innocent, such as system errors or mistakes in tracking accountings and internal accounting practices. Management or organisational risks that lead to material misstatements could also be more sinister, such as employees who willingly destroy information. This could also include managers who are simply trying to mislead the public in some way (Bowden, Lane & Martin, 2002).

Within the auditing industry, and even among the public and stockholders, it is typically assumed that it is a manager's job to try and minimise risk. Senior-level managers within a company are assumed to understand that they must ensure material mistakes are not being made. This means having systems in place to check accounting procedures, procedures in place to double-check employee actions, and not giving any individual employee or manager enough authority that misstatements could go unnoticed (Coyle, 2001).

At the same time, business risk on the part of companies can come from decisions made by management about how to proceed with various business decisions. A company might choose to take on risky product ideas that are not likely to result in increased future revenue and profit. A company might also choose to acquire other organisations that have significant debt or are involved in potentially expensive litigation. Again, these are risks that might appear higher than normal to shareholders or other members of the public (Coyle, 2001).

In addition to business risk and audit risk, there is a third type of risk that can impact both the business risk of an organisation and the audit risk for an auditing firm. The third type of risk is known as financial risk. This type of risk is somewhat more complicated because it can involve several things. Financial risk can be a result of the external economy not being as strong as expected, as has been the case in previous years. Financial risk can also come from the cost of borrowing money. If a company takes on loans with a changing interest rate, a change in the interest rate might cause a

company to spend money repaying existing debt instead of on other company activities (Coyle, 2001).

Financial risk can also be related to a company's ability to obtain cash to finance operations. If a company's credit rating declines, their ability to borrow enough money for new projects might decrease. Similarly, if the value of a company's investments declines, this would expose the company to greater financial risk (Coyle, 2001).

Explaining the various types of financial risk is important in showing just how difficult it can be to identify all of the potential sources of financial risk for a company.

Financial risk is about much more than just what is stated on a company's balance sheets. An auditor must be able to identify how a company has invested its money and whether those investments might be at risk of losing value. Also, there are many external financial factors related to consumer spending, interest rates and economic conditions that can be very difficult to pinpoint.

However, an auditor must begin any audit with an understanding of all of these factors and the related sources of risk that contribute to the larger concept of business risk. It is quite clear that auditors must consider many factors. It is not enough to merely examine how a company operates or the internal processes that are in place. From the above examples we can easily see how the risk of making mistakes could increase if a company is involved in potentially risky operations, a new industry, or an industry with a high chance of possible economic downturn.

This leads to the professional standards that are in place for the business risk auditors face due to professional judgment and opinions regarding the risks to their clients. The professional standards that are in place, which are discussed in greater detail in Chapter 5, call for auditors to identify the existing extreme risks. This is done in financial reports by having auditors provide a warning known as a “going concern” paragraph. In this paragraph, auditors can state their concerns about impending problems due to client companies’ business risks (Lorsch, Berlowitz & Zelleke, 2002).

It should be noted that auditors have been criticized in recent years because of major accounting scandals. Auditors and auditing firms have been criticized for not having done enough to identify when managers have used standard accounting practices in ways that led to greater business risk. Auditors have also been criticized for not bringing to the attention of investors the possibility that certain business activities on the part of clients might result in lower than expected returns due to declines in the business or economic market (Lorsch, Berlowitz & Zelleke, 2002).

This might indicate that auditors are reluctant to publicly discuss clients’ risks that are based more on perceptions than on what can be immediately found on balance sheets. It is interesting that many of these recent complaints against auditors and how they notify the public of risk are related to financial risks. These are the types of business risk that are less straightforward because they involve personal decisions and inferences about the future of a company’s business operations and the larger economy.

An auditor must obtain as much information as possible about the company being audited. One of the first things they must obtain is a complete understanding of the company's objectives and visions. The auditor should examine the level of understanding that a company's personnel have about risk and being able to manage risk (Pickett, 2004).

The auditor should also make a preliminary assessment of the risks that are present. These should be risks such as compliance with legal and professional standards. Once these risks have been identified, the auditor can then begin to identify which of the risks are most significant for the future of the company as they relate to material information that should be made available to the public (Pickett, 2004).

Beyond identifying the material risks that are present, the auditor has to determine the controls that the client has put in place to lessen the severity of the material risks. Specifically, he or she needs to determine if the controls in place are designed and implemented to actually control the risk they are intended to control. This leads to the identification of any problems with the control mechanisms that might lead to material risks (Pickett, 2004).

Finally, even for those controls that do appear to be effective in reducing risk, the auditor should do further work to find any flaws that might exist which would not fully reduce the present risks. The auditor should ensure that the company is doing its own

internal work to monitor the controls on a regular basis and make adjustments as necessary. This can be a sign that a company is remaining on top of business risk and working to reduce these risks as much as possible (Pickett, 1999).

These steps show the real work that has to be done for an auditor to reduce his or her own audit risk by thoroughly examining the business risk that is present for a client. If an auditor does not go through all of these steps and almost try to become part of the company being audited, the business risk for the auditor increases. It has even been suggested that part of the business risk process of the audit should become a normal part of the internal audit process for companies (Friedman, 2003). If external auditors subscribe to this idea, they might look at whether an internal business risk audit is in place for their clients. If this is not in place, it might lead to material risks that should be made known to the public, and should be discussed as such.

McCarthy and Flynn (2004) have put together an agenda of the processes that auditors might examine within a company as part of the business risk process. This agenda includes an examination of a strategic analysis of the company, a business process analysis, risk identification and assessment, business measurement, continuous improvement, and a business risk profile. Table 2-3 provides an explanation of this agenda (McCarthy & Flynn, 2004):

Table 2-3

Strategic Analysis

Identify critical elements of the business environment that may impact financial reporting and the audit strategy—elements that include competition, technology, economic conditions, legislation and industry issues. How are business strategy, products and services, customers, industry issues and critical drivers of success defined?

Business Process Analysis

Acquire an in-depth understanding of the business processes supporting the strategy in order to obtain a more detailed understanding of how the business operates and determine what criteria or measurements are used to gauge company performance against objectives. Consider the key business activities and associated controls.

Risk Identification and Assessment

Once critical strategies and supporting processes are understood and mapped, the auditor should interact with members of management to elucidate the primary risks that could threaten attainment of the business goals. The auditor will consider how management is addressing and controlling risks in developing their audit strategy and plan.

Business Management

Focus on the process and variables that have the greatest impact on the financial results. These processes could consist of products, customer service, credit delivery, or others. These measurements may be compared to financial risks, benchmark data, or other appropriate measures to see what gaps are revealed.

Substantive Audit Procedures

Perform substantive audit procedures to obtain audit evidence as to whether the assertions in the financial statements that relate to certain identified risks are free of material misstatement. As part of performing these procedures, the auditor may obtain direct or indirect evidence about management's responses to identified risks.

Continuous Improvement

The best audits are continuous processes, with the above steps taken in an integrated, as opposed to a sequential, order.

Business Risk Profile

The auditor may consider preparing a detailed business risk profile to clarify conditions or activities that relate to the company's business plans and to document the external and internal forces that might affect both those plans as well as the financial statements.

One of the things that could be added to this agenda of auditors' assessments and actions as related to the business risk of a company, and could possibly reduce their own business risk of missing material information, is to look outside of a company to other experts. However, it must be remembered that for auditors to determine whether certain financial business risks exist, they must have some information about the state of the economy or the state of the industry in which a company operates. This means that soliciting information from economists or other experts in the particular industry in which a company operates can provide valuable information as to whether the behaviour of a company is risky, based on potential changes (Tandon, 2007).

Another source of outside professional information might be lawyers and other legal experts involved in corporate litigation (Tandon, 2007). Auditors might refer to these experts as they can provide information as to whether certain business decisions or certain types of products might invite legal action from consumers or other companies. This type of information would certainly be valuable if a company is taking on products that could make it vulnerable to years of costly legal action. This would be a material action that investors would certainly want to know when making investment decisions.

Saudagaran (2005) notes that some countries are creating new professional auditing standards that are more focused on the business risk of companies. This is leading to revisions of existing auditing standards that require auditors to focus more on business risk. Based on this, one might assume that the desire for greater knowledge of business risk and auditors' desire to control their own business risk and not leave themselves open to litigation or public backlash will result in even more attention to business risk among auditors and auditing standards.

This section has demonstrated that the risk between business risk and audit risk is largely based on the way in which auditors conduct their activities in relation to the larger organisational and financial issues that impact a company. While this discussion may have seemed somewhat complicated, it demonstrates the complexity between identifying business risks and the larger impact on audit risk. Auditors that attempt to examine a variety of variables and issues in detail may be reducing audit risk by

identifying more of the business risk that is present. In contrast, trying to ignore some of the variables and issues that have been discussed in relation to determining business risk may result in an increased audit risk.

2.8 Summary

This chapter discussed audit risk and business risk, and how both risks relate to audited companies. Also, the relationships between business risk and audit risk were discussed. The issues and concerns related to both business risks and audit risks provide a foundation for examining the larger literature that is available on the business risk audit methodology. The next chapter focuses on the literature that exists about BRA. Chapter 3 presents two eras in auditing history: the history of auditing before the BRA, and the BRA era.

Chapter Three

Literature Review

3.1 Introduction

While the previous chapter examined the issue of risk as it relates to audits for both companies and auditing firms, this chapter and the next provide an overall review of the literature dealing with audit history in general and the business risk audit methodology in more specific. The literature review is divided into three sections: the first section, Pre-BRA Era, will review literature on auditing before the introduction of BRA. It will briefly discuss the development history of the audit methodology.

The second section will examine the BRA methodology. It will review academic and professional literature that discusses the BRA methodology itself, in particular KPMG's "Auditing Organisation through a Strategic-Systems Lens", which was the first publication to initiate the BRA concept. This section will also review literature that discusses the KPMG publication. The reason for focusing so much attention on this publication is that professional auditors often reference it, making it an important source of information. However, other sources of literature will also be referenced in this discussion in order to add greater validity to the information presented by KPMG and to further demonstrate its relevance.

The next section will examine the third section of the BRA methodology, the application of BRA. It will review literature that deals with the application of BRA in

practice. It will also discuss the main methodologies used in the review and the latest available literature in the BRA field.

3.2 THE PRE-BRA ERA

The Pre-BRA era will be divided into three phases:

- Detailed audit inspection era
- Audit sampling era
- Audit risk era

3.2.1 Detailed audit inspection era

The first pre-BRA audit period to be discussed is the detailed audit inspection era. The reason that the period before 1900 is called the detailed audit inspection era within the auditing industry has to do with the nature of the audit process. Before 1900, audits consisted of evaluation of all the financial records of a company. The nature of how businesses operated before 1900 allowed for a complete and detailed inspection of records.

Evidence discovered in the form of markings on tables and buildings proves that ancient civilizations such as the Egyptians, Greeks and Romans used a checking system 2,000 years ago to account for the public funds officials were entrusted with. Those responsible for public funds were required to orally present their accounts before a government official. This practice continued during medieval times in England, where

Crown representatives visited various manors and estates to check the accounts and assess the amounts due to the Crown (Porter et al., 2003). Prior to the Industrial Revolution in the late eighteenth century, auditing had limited application beyond checking on trusted funds. Industry was primarily based on cottages and small mills located where water power was available. These industries were run by individual owners who did not need reports on the management of their businesses.

During the eighteenth century overseas trading became increasingly popular; this created a commercial relationship between the captains of ships and businessmen. The captains of the ships engaged in these commercial ventures were required to account for the funds and cargo entrusted to their care; therefore, an audit was necessary to ensure the accuracy of the cargo (Porter et al., 2003).

Most scholars agree that auditing literature began to appear in the nineteenth century. Maltby (1999) presents the factors contributing to the rise and growth of the auditor's role in Great Britain; the 1844 Joint Stock Companies Act, which required companies to provide a "full and fair" balance sheet that was to be audited and presented at every general meeting of the shareholders and also filed with the Registrar of Companies. The second factor was the shareholders' influence; between 1856 and 1900 company law in Britain provided a minimal framework for corporate governance. The nature of shareholder interests in the limited liability companies of the nineteenth century was significantly different from what it later became. Many companies were closely held, mainly family-controlled, with few outsiders. Therefore, financial statements were less important than continued personal contact between shareholders and directors. As the

structure of shareholders started to change, small shareholders were a new phenomenon, reflecting a slow but steady change in the conduct of investments in the UK. As a result, the press in the UK started to publish financial reports to meet the needs of the new class of investors. Vissink (1985) lists six major financial periodicals that began publication between 1878 and 1884, and mentions more than twenty others that started up between 1880 and 1900. These publications were meeting the information needs of the “outsiders” who relied on press coverage and financial reports because they did not have social or business contact with the directors of their companies.

The third factor Maltby presents was the “the rule of the courts”. A series of court cases in the second half of the nineteenth century dealt with issues of determining the amount of profit that might legitimately be distributed as a dividend, often with the objective of deciding whether directors had acted fraudulently in the payments which they sanctioned. Reid (1986) and Yamey (1978) agree that the Victorian litigation court cases did not have a coherent view of the profit measurement, whereas Bryer (1998) demonstrates that judicial decisions did demonstrate consistency; they were made in the interest of “social capital”, to the extent that they were intended to promote the survival of the company.

Because of the political, cultural and financial relationship between the UK and the United States in the period leading up to the American Revolution, the understanding of US auditing history has also been influenced by the British Companies Act of the nineteenth century, which opened the door for the rise of outside expert auditors as

professionals. They began assisting in audits by shareholders who were “amateurs” in conducting audits of corporations (Flesher et al., 2005).

The first auditing book appeared in 1881 from Pixley in Britain, entitled *Auditors: Their Duties and Responsibilities*; it was followed by Dicksee’s *Auditing: A Practical Manual for Auditors* (1892). These were technical books that showed the auditor how to conduct an audit. These two British books were influential in early US auditing practice. In 1905 the first US auditing book was published by Robert H. Montgomery as an authorised American edition of Dicksee’s *Auditing*. Moyer (1951, p. 3) accepted the view that US auditing originated from these British roots, saying that US audits were

“patterned after the British general audit. In fact, much of the auditing work was done by visiting British auditors, retained by British investors in American corporations. It is generally recognised that auditing in Great Britain had been instituted to a great extent by specific statutory requirements. The principal function of an audit was considered to be examination of the report of stewardship of corporation directors, and the most important duty of the auditors was to detect fraud. The search for defalcations resulted in a minute, painstaking check of the bookkeeping work done by the employees of the client. Almost all of the time of the auditor’s staff was devoted to checking footings and postings in detail, in looking for bookkeeping errors, and in comparing the balances in the ledger with the trial balance and with the statements.”

In 1827 some Baltimore merchants, from both the city of Baltimore and the State of Maryland, capitalized the Baltimore and Ohio (B&O) Railroad. The B&O's 1827 corporate charter granted by the State of Maryland required an annual statement of affairs from management. Further, the corporate minute book details that the by-laws of the corporation, from its inception, established that an audit by the members of the board was to be conducted. The use of the board audit was thus an early and important tool of corporate governance and accountability.

Figure 3-1 is the first known written US corporate audit report and was issued by B&O in October 1827.

Figure 3-1

October 1827 Baltimore and Ohio Railroad Audit Committee Report

Meeting of the Board

1st Oct 1827

Report of the Committee

Appointed to examine the Treasurer's a/c

1827 Oct. 1 We have examined the foregoing a/c & find the same to be correct exhibiting the amount rec'd by the treasurer of the Railroad & the several disbursements authorized by the board which it will appear there remains a balance of \$17,835.9/100 at the credit of the company as per book balances on the 29th of September (with) satisfactory vouchers being produced to show the correct refs of the afore said disbursement.

Signed

John B. Morris

William Stewart

Source: Baltimore and Ohio Rail Road Company Board of Directors, Minute Book A, 24 April 1827 to 26 August 1830, Hays T. Watkins Library, B&O Museum, Baltimore, PP.31-2

It should be noted from Figure 3-1 that vouchers were being used to support disbursements, all of which had been authorised by the board of directors. These internal controls, along with the audit committee's examination, were techniques to ensure that assets were safeguarded.

As financial reporting developed, so did audit techniques. In its report to the board of directors for the period ending June 31, 1828, the Audit Committee Report of B&O rendered a "two paragraph" report, resembling a scope of examination and an opinion paragraph, which is similar to a modern "two paragraph" audit opinion.

More description and details of the work performed by the audit started to appear in financial reports. Figure 3-2 from the Mobile and Ohio Rail Road Company, dated 1854, details the work performed by the auditors.

Figure 3-2

March 1854 Mobile and Ohio Rail Road Audit Committee Report

The undersigned, Committee appointment to a resolution of the 4th January, paused by the Board of Directors, to examine the books of the Mobile & Ohio Rail Road Company, beg leave to report: That they have carefully and thoroughly examined each entry in said books, posted to their proper accounts, commencing of the first of May, 1853, the date of the last examination, and ending on the 1st of February, 1854- that date is correct and exhibits the true state of the affairs of the Mobile & Ohio Rail Road Company. They have also examined auxiliary books and vouchers for money paid and received, and find them all correct.

T.J. FETTYPLACE

JESSE CARTER

C. GASCOIGNE

Mobile, March 6th 1854.

Source: Mobile and Ohio Rail Road Company, proceedings of Sixth Annual Meeting of Stockholders, 1854, pp 21-2.

Boockholdt (1983) credits the railroads with developing the “modern internal audit function” as a way to discover and prevent errors and fraud by railway agents. He points to the B&O establishing a position of Chief Clerk to Audit Railroad Receipts as being a significant internal audit control event in corporate American history.

Boockholdt (1983) found that “external auditing” developed with railroads. He cites the 1845 example of angry shareholders and creditors of the Reading Railroad appointing an audit committee of one member from the board of directors and three shareholders to examine the railroad’s accounting practices. The auditors were to look at the budget and compare it to actual receipts and expenditures, to project cash flows and liability balances, and to assess management’s overall ability and performance. Boockholdt considered these audit specifics to be sophisticated for their time.

Financial institutions such as banks and insurance companies began to appear in growing numbers at the turn of the nineteenth century. In 1791, when the First Bank of the United States was chartered, there were only three banks in the entire country; by 1816 that number had increased to nearly 250 (Shapiro, 1995).

Banks were not the only vehicles of financial intermediation and investment capital. Insurance companies, such as the Union Marine and Fire Insurance Company of Massachusetts, formed in 1807, served as allocation mechanisms. Early corporate financial institutions were then, as now, not immune to the risk of embezzlement. Such an early alleged fraud became the basis for the Report of the Auditors appointed by the Justice of the Supreme Court to examine the accounts of the Union Marine and Fire Insurance Company. The court-appointed auditors provided a twelve-page document which laid out the lack of controls between the company's accounting for cash, checks drawn and deposits made, and dividends paid through its accounts at the Hallowell and Augusta Bank. However, no mention was found in the report that routine or annual auditing, as a procedure, was required or employed as part of the insurance or banking arrangements in question.

Insurance companies in the United Kingdom were learning that auditing might be a way not only to ensure trust in their operations but also to shield their operations from the threat of shady financial dealings. In 1845 London had 47 different insurance companies providing insurance to companies and individuals, but all of these

companies were out of business by 1887. This was partially due to the lack of financial control and auditing with which these companies oversaw their financial dealings (Hickman, 2004).

Until 1900, the Canadian audit market was no different from that in the UK and the US. Canada, as a UK colony, adapted its auditing profession from the UK's, driven by the flow of capital from the UK into North America during the 1800s. Auditing was linked to the early creation of the intercontinental railway, which was an explicit condition of the Act of Union which created Canada as a country in 1867. The railway was largely financed by bonds sold in the London, UK market. Not surprisingly, the financial statements issued by the railways were audited by UK audit firms, and continued to be audited by UK auditors until 1919 (Richardson, 2001).

During this period of time the audit function was comprised of detailed testing of transactions; it was simply the inspection and verification of all vouchers for cash payments. At this early stage the emphasis of auditing was on asset stewardship, meaning verification of the existence and proper handling of assets. Profitability was not a significant concern. The audit focus was concerned only with the balance sheet; some scholars call it "balance sheet audit" (Matthews, 2006; Porter et al., 2003; Flesher et al., 2005).

Matthews (2006) and Moyer (1951) describe this period as "Bookkeeping Audit". It began with a review of the client's bookkeeping system. The auditor would then close

the account books, reconcile the cash book and bank statements, check the posting of figures from one account book or ledger to another, vouching transactions with documentary evidence such as invoices, and then total the books to ensure arithmetic accuracy. The auditor's main function was to make up the books for their clients; their audit work had to focus on transactions. Where possible they had to guarantee arithmetic accuracy of the figures and ensure the books were balanced.

The accountancy profession itself began to develop during the third quarter of the nineteenth century. The first accountancy society in the world was formed in Scotland in 1853. Other societies in the UK were formed in 1870 and after. The Institute of Chartered Accountants in England and Wales was formed in 1880, the Institute of Chartered Accountants in Ireland was formed in 1888 and the London Association of Accountants was formed in 1904 (Matthews et al., 1997).

Moyer (1951) describes the auditing profession at this time as still in an immature stage. Yet growth and change were taking place. Conditions at the time facilitated new development in auditors' procedures, most of which reflected the desire for and necessity of reducing the audit time spent on the engagement, and the possibilities of audit services relating to the growing separation of management and owners.

The period up to 1900 was really the beginning of an understanding that businesses needed to know not only how money was spent but also that it was being spent properly so that companies could actually remain in business. This need was largely brought

about by the vast changes that took place in business ownership, the move from family-owned companies to companies owned by shareholders who wanted to ensure that they were receiving a fair share of the profits of the company in which they were invested.

This period up to 1900 also saw the courts becoming involved in the financial matters of companies so that some form of business auditing would take place for the benefit of shareholders and even for the companies themselves. Court involvement in the auditing of financial accounts for stock companies was something new, and something that was not as involved as might be expected, as there were fewer rules and guidelines apart from the fact that some type of auditing had to take place for certain companies. Part of this lack of real standards was due to the fact that many companies did not have a large number of financial transactions, meaning that strict auditing requirements were not particularly important, even in terms of the auditing knowledge existing at the time.

Perhaps most important at this time was the fact that the entire profession of accounting was beginning to organise, as there was clearly a need for people who could work through a company's transactions over various time periods and report as to whether all of the accounts added up correctly (Kaplan, 1984). Until this point accounting and auditing were really nothing more than adding and subtracting transactions from one account to another in order to show that they has all been accounted for and that a company could show its shareholders that money was being spent in a meaningful way, with nothing hidden or detracting from profits (Rahman, Peresa & Ganesh, 2002).

This may seem minor, but it was these individual factors - the beginning of an organised accounting profession, court involvement in auditing, and the start of shareholders wanting access to evidence that a company was accurately maintaining its financial transactions - that would move auditing into its next era of existence, where more formalities would become the norm (Rahman, Peresa & Ganesh, 2002).

3.2.2 Audit sampling era

The second era of auditing is known as the audit sampling era. The nature of how audits were conducted changed in the early 1900s (Brown, 1962). The move from being able to audit an entire company's records to only auditing a sample of the records came about as the nature of business changed. This led to a change in the entire notion of what it meant to conduct an audit (King & Case, 2003).

By the early 1900s companies began to outgrow the capital base that could be controlled within a family or close-knit group of individuals. Equity markets were developing and large corporations were beginning to sell equity interests to outsiders and small investors (Knechel, 2001). The pre-1900 creation of large factories by the Industrial Revolution led to the demand for large amounts of capital. New middle class investors emerged with small surplus funds available for investment. As a result, small amounts of capital were contributed by many people. *“Unlike shareholders of earlier years, who were few in numbers but closely bound to the companies they partially owned, the new breed of investors were little interested in management performance and concerned with the return on their investment”* (Porter et al., 2003 pp. 25-26).

Because outside investors were more concerned with future profitability than stewardship of specific assets, the role of both accounting and auditing began to change.

The idea of sampling started to emerge in practice by the mid-1930s (Power, 1992).

Audit sampling is defined as “*the application of an audit procedure to less than 100% of the items within an account balance or class of transactions for the purpose of evaluating some characteristic of the balance or class*” (SAS 39).

Two types of sampling were used by auditors during that period. Sampling risk is defined as “the risk that auditor may fail to detect material error present in financial statement because not all the available evidence is examined” (Porter, Simon and Hatherly, 2003). Non-sampling risk is defined as “factors that cause auditor to reach an erroneous conclusion for any reason not related to the size of the sample” (Bell et al., 2005).

During this period the centre of economic and auditing development shifted from the UK to the US. The trend in the new economic changes, followed by the 1929 Wall Street Crash, increased the demand for accountability of company directors. The 1938 *McKesson & Robbins* case changed audit methodology (Baxter, 1999). New emphasis was placed on the physical observation of assets such as stock, and the use of external evidence such as confirmation of debtors. These procedures came to be recognised as equally important to auditors’ traditional tasks of examining records and documents.

As a result of the *McKesson & Robbins* case the SEC commissioners' report pointed to the failure of the auditors:

“PW’s audit procedures conformed to what was generally considered mandatory, but their failure...is attributed to the manner in which the audit work was done... they failed to employ the degree of vigilance, inquisitiveness, and analysis of the evidence available that is necessary.... the time had long passed when an audit was restricted to the books and records; the facts should be confirmed by physical inspection or independent confirmation.” (Baxter, 1999 p. 172)

As return on investment became a prime factor for investors, companies started to focus their attention towards providing their shareholders with information about their performance. Financial statement users shifted their focus away from balance sheets and stewardship, and towards profit and loss statements.

As companies grew in size, so did the volume of transactions; this became a challenge for some auditors. Jeppesen (1998) details the development of audit methodologies in the 1900s. Audit sampling began to be used at this time due to the large volume of similar transactions occurring repeatedly; therefore, audit conclusions were based on samples rather than an examination of the total population. Statistical sampling appeared from the mid-1930s, beginning in the US since clients there were larger, on average, than British clients. Because of their size, US companies were professionally managed and had sophisticated accounting systems. Power (1992) distinguishes

between early uses of sampling and what is known as expertise sampling: early uses lacked the representativeness concept. Power refers to early uses of sampling as audit procedures tests, since early auditors undertook random tests as representations of the whole. Any mistakes found during the sample testing indicated weakness and required further investigation.

By the mid-1960s, the second generation of audit approaches in the big US and UK firms began: the systems approach of analytical auditing. The change from statistical sampling to analytical auditing occurred because a decrease in trust in internal controls occurred. Auditors wanted to rely less on a simple trust that the internal controls of a company were sufficient, which meant that only the transactions needed to be examined. Now auditing was no longer based on the inspection and verification of vouchers but rather chiefly on the examination and evaluation of internal control systems (Matthews, 2006).

Analytical auditing procedures are techniques based on the concept that there are relationships among transactions recorded in financial statements. The auditor's expectations of these relationships among the transactions are relatively stable. When deviations from the expected relationships are identified by investigations as having material errors, irregularities, or misrepresentations, more attentions will allocated to the risky areas (Guantt et al., 1997).

Auditing techniques developed during that period and shifted from “Bookkeeping Audit” to what Matthews (2006) called “Pure Audit”. This was a result of companies starting to hire professional accountants to perform bookkeeping jobs, leaving auditors to only do audits. This development provided both a challenge and opportunity for auditors. It was a problem in that when the audit had also involved making up the accounts, clients could see they were getting something for their money. As this unofficial accounting role of the auditor disappeared, clients were increasingly likely to view the audit as an extra cost, which accounts for auditors making themselves more useful to their clients (Matthews & Piriie, 2000; Gandossy & Sonnenfeld, 2004).

This period also witnessed developments in working papers documentation; more evidence was required to support the audit decision and assertions about the financial statement, and increased emphasis was placed on external audit evidence, particularly on physical observation of assets such as cash and stock. Confirmation of debtors began to be required in any audit performed; this was a direct result of the case mentioned earlier (*McKesson & Robbins*).

Analytical Review developed during the early 1950s; it appeared in a list of audit methods recommended by the American Institute of Accountants (now AICPA). The list also mentioned risk and materiality (Myers, 1985).

Porter et al. (2003) state that the single greatest change that took place during that time period was the change in audit objectives. The focus of auditing shifted away from

preventing and detecting fraud and errors, towards assessing the truth and fairness of the information presented in the financial statements.

The Canadian audit market started to take its institutional form after the 1907 Ontario Companies Act and the Canada Companies Act of 1917, which introduced statutory audits for public companies (Richardson, 2001). The presence of international auditing firms dominated the market, and these applied the same methods used in the US and the UK.

From the 1940s to the mid-1960s accounting, auditing and the accounting profession in the United States and the UK reached the height of their standing and reputation (Zeff, 2003a; Matthews et al., 1997). Throughout this period “generally accepted accounting principles” (GAAP) were established, as were the auditing procedures that auditing firms were to adopt in their engagements.

The period from 1900 to 1960 saw real changes to the role of the auditor and the business audit process because of important changes in the way companies did business, especially as they continued to grow in size. As with the detailed audit period, the changes that took place between 1900 and 1960 were brought about by changing concerns on the part of individuals investing in large companies. The stock market crash of 1929 in the United States showed many that being concerned with the financial conditions of a company was very much related to how companies were accounting for

their financial resources, and whether there was accuracy in the way in which companies maintained those financial resources.

At the same time, the role of accountants and auditors continued to change. Auditors found themselves shifting into a corporate role all their own, a role that was at first difficult to justify based on the old standards and practices of auditing that had developed in the detailed audit period. The changes in the role of the auditor meant that the auditing profession had to continue to evolve and create standards for auditors.

This rapid development of standards, practices, and even justification for the need for auditors and their ability to maintain the honesty, truthfulness, and accuracy of corporate accounting shows how and why auditors and auditing firms became respected and trusted. These were the people who were in many respects working not just for the companies they were auditing but also for the investors of these companies, whose investments depended largely on the ability of large companies to accurately account for how funds were spent. This demonstrates how auditors and auditing firms become so respected and trusted in the financial world.

3.2.3 Audit risk era

As with the changes that took place between the pre-1900s era and into the 1900s, the time around the 1960s saw major changes for companies, which caused major changes in the way audits were conducted. Auditing was no longer about simply examining the financial records of a company. Instead, the 1960s marked the beginning of an era

where companies were concerned about managing risk and auditors wanted to ensure that they were not overlooking material information that could damage their reputations.

Socio-economic developments continued to accelerate, necessitating changes to the auditing application. With the help of technological advances, companies continued to grow in size and, particularly in the case of national and multinational companies, became extremely powerful and influential forces in society.

Auditing techniques developed to meet the challenges of this period. Auditors increased their emphasis on relying on and examining audit evidence derived from a wide variety of sources, both internal and external (Porter et al., 2003). There was a significant increase in the use of audit programs and manuals, audit sampling, flowcharts and in-depth compliance testing, and a growing reliance on internal control questionnaires (Matthews, 2006).

The other factor affecting audit changes was the emergence and increasing significance of computers, both as an audit tool and as an element in clients' business to be included in the examination, causing auditors to change their audit techniques. Other technological devices, such as fax machines, compact disk data storage, cellular telephones and cable TV, affected lifestyles and standards of living, which caused changes to the knowledge sharing and communication industry (Previts et al., 1998). The main debate within the profession was whether to audit "through" or "around" the

computer. The latter approach relies on verifying input and output and reconciling the two, without investigating too closely the actual computer process. Auditing through the computer urges the use of test packs, putting trial data through the system and running the auditor's own program in the client's computer. Matthews (2006) suggests that "audit through" did not triumph completely, as most auditors consider a perfectly satisfactory audit can be carried out around the computer.

The development of risk-based auditing was another factor contributing to the change in audit techniques. In the first half of the 1980s, analytical auditing was supplemented by the risk approach in the big audit firms, and with the worldwide mega-mergers in 1989-1990 the audit risk model spread rapidly throughout the world. This "audit risk" approach, as explained in more detail in Chapter Two, was in essence concerned with assessing the likelihood of material misstatements occurring in the financial statements and focusing audit efforts on those areas identified as most likely to contain errors (Porter et al., 2003; Matthews, 2006). While still being based on the evaluation of internal control systems and thereby on a certain degree of examination of vouchers, the audit risk model focuses the audit according to materiality and risk judgments, thus drastically reducing or omitting areas where the inherent risk of material errors is considered low and where the control risk is low.

Robert Elliott, who previously chaired The AICPA Special Committee on Assurance Services, the "Elliott Committee", published several articles dealing with the future of audits (Elliott, 1994). Elliott believes that information technology in the 1990s created great changes. Information technology provides alternative information sources to those

who have traditionally relied on financial statements, and dramatically changes all aspects of preparing, auditing and using financial statements. Although these changes pose a serious threat to the economic viability of auditing, they also offer auditors extraordinary opportunities to strengthen the audit function.

Elliott identifies three threats to the auditor as a result of information technology. The first threat relates to the relative importance of financial statements to investors. Historically, investors and creditors depended on financial statements to make their decisions; these days, investors and creditors can get up-to-the-minute data about companies through public and proprietary databases without waiting for quarterly or annual reports. Information technology has created new ways for businesses to become more competitive, for example in terms of quality improvement, cost reduction, and enhanced vendor and customer relations, the effects of which are not reflected in financial statements.

The second threat comes from the fact that financial statements are such a highly compressed version of what happened to an enterprise during the year. Analysts using financial statements as an information source are forced to look at a company through a keyhole that permits only a small part of available information to be seen.

The third threat Elliot presents, which is in a way related to the first threat, is the fact that annual printed financial statements may be outdated by the time they became public, as information technology offers far more frequent and timely reports.

Moreover, the capacity to link suppliers to company databases is at hand. The concept of electronic data interchanges (EDI) between suppliers and customers has become a reality. Once suppliers have real-time access to an enterprise's databases, they will have little interest in annual financial statements – and, by extension, auditors' opinion on them - issued well after the entity's fiscal year end. What they might be far more interested in is real-time assurance from the auditor that either the information in the enterprise's database is reliable or that the system itself is highly likely to produce reliable data.

The role of information technology, fortunately, is two-edged. It presents threats to traditional audits and auditors but it also creates opportunities. Information technology has been used by many businesses to get closer to their customers and provide cheaper, better and faster products and services. The same applies to auditors; if the information they provide is deficient, unreliable, irrelevant or out-of-date, decisions based on it may not be optimal. High quality information is reliable, relevant, credible and timely.

The traditional audit function focuses on reliability. Along with the auditor's independence and competence, it provides credibility. But customers could also benefit from relevance and timeliness, which represent additional dimensions of service that auditors, empowered by information technology, might provide.

Elliott raises several questions to be addressed relating to the auditor's role, and extending that role to cover areas that auditors normally do not look at in a traditional

audit. He stresses that auditors have to think about the economic space in which they operate, to see where opportunities may exist. Elliott believes that the profession should broaden the current attest function to take advantage of the opportunities and avoid the threats.

The period from the 1960s to the present has in many respects been another period of beginnings for professional auditors. The use of technology along with the ability for investors to receive up-to-minute financial information has meant that auditors have to re-think how they do their jobs and even how they remain relevant in a changing world.

It is also clear that the widespread use of computer systems in the audit process required auditors to change their entire focus of what it meant to audit an organisation and its financial transactions. This has led to a growing focus on the actual systems that a company uses, including working to ensure these systems provide reliable and accurate financial information and do not include a way for companies to hide financial transactions. In reality, this has meant that auditors have had to once again shift from just focusing on being able to reconcile financial transactions to having some knowledge about the computerized accounting systems that are in place, and making that another part of the larger auditing process.

3.3 THE BRA METHODOLOGY

The first generation of audit methodologies featured detailed inspection of the books, which gradually moved to the second generation of sampling-based audit during the

1960s and 1970s. The third generation, the audit risk base, was widely used in the early 1980s. Since then, the fourth generation of audit methodology, BRA, began to be used by auditing firms between 1995 to early 2000.

All Big-4 firms adapted the BRA methodology under different names. KPMG was the first to introduce the “Business Measurement Process”, Ernst & Young introduced the “Audit Innovation Project”, PricewaterhouseCoopers introduced the “Management Eyes” approach, and Arthur Andersen introduced the “Business Audit” (Winograd et al., 2000; Curtis & Turley, 2007).

The actual methodology used by all the firms had a similar basis. All of the firms used the three steps of understanding the organisation being audited, identifying the business processes of the organisation and collecting audit material. It has been stated that the audit procedure used by Arthur Andersen, while similar to that used by the other Big-4 firms, was somewhat more complex in terms of actual procedures used by the auditors than the other firms (Andersen, 2006).

3.3.1 BRA demand or supply

Since the introduction of the BRA approach, scholars have been divided over whether its actual formation was an innovation by auditors that came as a natural answer to the development of auditing and the question of how to better serve the demands of clients (Lemon et al., 2000; Humphrey et al., 2003; Jeppesen, 1998), or was merely a reaction

to the declining image of auditors and a way to sell more services to clients (Hatherly, 1999; Power, 2000).

During the early 1990s large corporations continued to grow in size and became more sophisticated in conducting business and therefore in recording transactions. This period also witnessed an era where CEOs who received earnings-based bonuses were pressured to report favourable revenues and performance results (Zeff, 2003b).

It has been reported that the top five CEOs of each of the 1,500 largest US companies take about 30% of all options issued each year. From 1992 to the peak of the market in 2000, these corporate elite saw a 1,000% increase in the paper value of their unexercised options, to a collective total of \$80 billion (Bernstein, 2002). This shows the kind of complications and type of transactions auditors had to consider when reporting on the fairness of these corporations' financial statements.

During the 1980s the big auditing firms sustained heavy price competition phenomenon, which forced them to start looking for alternatives to the costly process of traditional audits (Davis, 1995; Jeppesen, 1998). Fischer (1996) researched that particular area and stressed that there must be a better way of conducting more cost-efficient audits without sacrificing effectiveness. He suggested that a new approach to adapting new technological tools should reduce or eliminate the costly substantive audit procedures.

It should be remembered that during the 1980s much of the audit process was still about analysing records that were maintained on paper. Computers were still not widely used or even available for business purposes. Even more, technology did not exist as it does today. That meant that combining cost effectiveness with material effectiveness had to be examined to ensure that audit firms could do the job demanded of auditors while also keeping their own companies afloat.

Up to the mid-1990s the audit risk approach dominated the audit methodology framework. This approach serves auditors in reducing the audit risk to an acceptable level – the audit risk being the risk of material misstatement in financial statements. As explained in Chapter Two, the audit risk is a combination of three risks: inherent risk, control risk and detection risk.

Regardless of whether the new methodology was a result of demand or supply, change was needed, at least from the perspective of auditors. Jeppesen (1998) wrote

“...apparently auditing in itself is not considered to be of value to the auditee. Something extra has to be delivered, and this extra comes in the form of spin-off advisory services. This, however, is not possible without changing the audit approach, the auditors, and the organisation of the professional services firms.”

Lemon et al. (2000) present eight reasons for adopting a business risk approach. **Audit effectiveness:** to have an effective audit requires an understanding of the business risks. In some cases, audit failures, when not a result of audit procedure deficiency, rather

result from a failure to recognise a business context, like going concern problems or identification of fraud. **Technological change:** advancement in technology caused data recording to be inherently less erroneous, giving the auditor more time to look into higher level assessments. **Client service:** audit firms strongly believed that a business risk approach would “add value” to the audit work by providing insights and information which are valued by the entity’s management. The other reasons were: audit effectiveness, corporate governance, internationalization, product differentiation and engagement risk.

3.3.2 KPMG “Business Measurement Process”

In this section the BRA concept will be explained as presented by Bell et al. (1997), who considered the foundation of the establishment of the BRA concept. KPMG introduced the Business Measurement Process (BMP) framework to explain their audit methodology. Theoretically, BMP is used to analyse risks associated with the client’s strategy, key business processes and performance measurement procedures. It allows the auditor to determine if their clients are adequately monitoring and managing the risks that threaten their businesses.

This research focuses on KPMG’s risk model, even though other big auditing firms have similar risk models, because KPMG was the first to introduce this concept and publish it in a book available to the public. It is the first comprehensive publication about audit methodology used by a public audit firm.

KPMG claimed that its new risk-based strategic-systems audit approach was an innovative and powerful means of meeting auditor goals and organisational objectives (Bell et al., 1997). In this approach the auditor still uses some traditional techniques; he still allocates audit efforts on the basis of risk assessment, performs conventional procedures for the most part, and formulates an opinion on the financial statements. What makes the risk-based approach innovative is its broader knowledge base in the fields of auditing, system theory and business strategy.

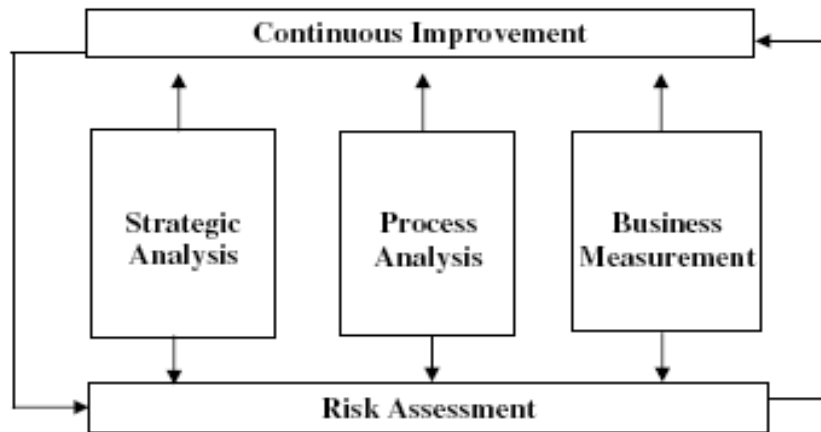
Taking this idea one step further, KPMG (Bell et al., 1997) explains that auditors must see a company as a complex system that is more than simply their financial positions or their operations. Instead, auditors must look at the organisation's total picture,

“whose productivity, profitability, adaptability, and ultimate survival are dependent on the strength of its intra- and interconnections—structural couples and symbiotic alliances among the business processes comprising the organisation itself, and between the organisation and external economic agents” (Bell et al., 1997, p. 15).

The BMP framework consists of five procedures that guide the auditor in evaluating the client's business activities: 1- strategic analysis; 2- business process analysis; 3- risk assessment; 4- business measurement; and 5- continuous improvement. Each of these principles then goes into a more detailed examination, as shown in Figure 3-3.

Figure 3-3

KPMG Business Measurement Process



Source: Bell (1997)

During the detailed examination of each of the models the auditor will identify significant risks and come to understand how they are being controlled by the client, then make a judgment about the client’s current practice and assess the business risk implications both for the client’s business and the audit approach.

The BMP auditor uses a “client business model”, which is like a folder in which related data about the client’s business and industry is collected. This folder consists of eight sections:

- **External Forces:** outside threats, e.g. political, economic, social and technological
- **Markets:** the domain in which the client operates, its facilities and design

- **Strategic Management Process:** missions, objectives and business risk management
- **Core Business Process:** production, marketing and distribution
- **Resource Management Process:** resource acquisition, allocation and development
- **Alliances:** relationships established to attain and expand business
- **Core Products and Services:** commodities details
- **Customers:** customer details

The following is a summary of the five principles of the BMP framework, which are very important for the BMP auditor to understand when conducting an audit.

BMP Strategic Analysis

In this section the auditor obtains a better understanding of the environment in which the client's organisation operates. This includes internal operational strategies, goals, organisational history and competitive edge, as well as the industry and global surroundings of the client's organisation. The auditor then assesses how this information relating to the client's strategic risks will impact additional audit work at the business process or transactions levels.

BMP Business Process Analysis

This provides the auditor with an in-depth understanding of the key core business processes that create value. The auditor uses eight dimensions in collecting and

integrating the information: process objectives, inputs, activities, outputs, systems, classes of transactions, risks that threaten objectives, and other symptoms of poor performance. This detailed analysis provides the auditor with a basis for developing an expectation about the operating results and financial conditions.

BMP Risk Assessment

This is a continuous process performed throughout the audit. During the first two steps, strategic analysis and business process analysis, the auditor reviews the client's procedures to identify and manage the risk associated with the strategic and business process activities. The auditor will then judge whether management has considered all significant business risks, decide upon the extent to which strategic and process risks remain uncontrolled, and determine the level of residual risk. The auditor will classify the risks and cross-match them with the related financial statement assertions, and then use the business risk profile to assist in his final review of the adjusted financial statement.

BMP Business Measurement

This procedure is performed on an ongoing basis similar to BMP risk assessment. Here the auditor measures the variables in the client's business process that appear to have the greatest impact on the organisation. The auditor assesses the revenue recognition practices, the quality of the client's reported earnings and their impact on the related financial statement assertions. The auditor uses the completed model as a basis for his final review of the adjusted financial statements and his assessment of the entity's

ability to continue as a going concern. This model also provides an assurance of the entity's achieved level of performance in terms of operation, financial reporting, and compliance.

BMP Continuous Improvement

Entities control and improve performance through a process of measuring and reporting their activities. This process is usually done internally, which makes it significantly biased. The bias can arise unintentionally, due to the close relationship between people and units of the organisation. The auditor's role is to provide external and independent feedback to the client about 1- entity-level performance; 2- structural strengths and weaknesses; 3- business process strengths and weaknesses; and 4- its current strategic positioning and possible vulnerabilities related to emerging trends.

KPMG claimed the risk-based strategic-systems audit approach to be an innovative and powerful means of meeting audit goals (Bell et al., 1997). The risk-based strategic-systems auditor still performs conventional audit procedures, allocates audit effort based on risk assessment and formulates an opinion on the financial statements. The difference in the new approach is that it is based on combined knowledge from different fields of auditing, systems theory and business strategy; the auditor must blend them to comprehend the client's whole business environment and its effect on financial transactions.

3.3.3 The Relationship between Audit Risk and Business Risk Audit

It is worthwhile to understand the relationship between audit risk and business audit risk. As discussed in Chapter Two, the Audit Risk Model (ARM) is presented by the Audit Risk (AR), which is a component of the following formula:

$$AR = \text{Inherent Risk (IR)} \times \text{Control Risk (CR)} \times \text{Detection Risk (DR)}$$

IR and CR can be combined into a single term, Risk of Material Misstatement (RMM), defined as the risk that the financial statements are materially misstated prior to the audit (Peecher et al., 2007).

DR is often broken down into Analytical Procedures (AP) and Test of Details (TD). TD is further broken down into sampling and non-sampling risk. DR is assessed and managed by the auditor. This process can be reduced to a negligible level through adequate planning and supervision.

To further explain the relationship: AR is jointly determined by whether the financial statements are materially misstated prior to the external audit, and the likelihood that the auditor will not detect material misstatements during the audit, should they exist. The auditor then assesses the risk of the existence of material misstatements by identifying and assessing factors outside of the audit which increase the risk of material

misstatement or expose the existence of actual material misstatements. Peecher et al. (2007) claim that the risk of material misstatement exists independently of the audit and is assessed by the auditor through the exercise of professional judgment.

It is important to point out that that KPMG talks about the importance of professional judgment as part of the larger business risk audit. Bell et al. (2005, p. 19) explain that

“Professional judgment refers to judgments of persons with experience, extensive education, and/or specialized training within a profession. Professional judgments typically are difficult, and often the most expert of professionals encounter especially challenging problems when forming judgments. It is no wonder that persons, especially nonprofessionals, sometimes disagree with professional judges’ conclusions.”

This definition of professional judgment makes clear that the auditor’s professional experience and actions can cause problems for those who are affected by these actions but who have no professional knowledge in a particular area. This means that for companies affected by the decisions of professional auditors, which usually arise when an auditor thinks that a company make her/him attempting to misstate financial information, or at least be deceptive in some way, and that deeper auditing procedures are necessary.

Judgment errors in assessing RMM cause the auditor to further miss-assess and mismanage DR. AR will likely be higher than planned. This is another part of the

business risk audit, where professional auditors must ensure they are not deceived by managers who have publicly misstated material financial information, or who have even been what might be called materially optimistic about financial information in regards to a company's operating performance (Bell et al., 2005).

Maintaining a neutral level of scepticism, where judgments are not made with a mentality of expecting something is going to be out of place, is important. Otherwise, increased pressure is placed upon auditors not only by the public but also by the companies that employ professional auditors. From the auditor's point of view, they must perform their job with neutrality in order to prevent judgment errors that may be too lenient, and avoid appearing easily swayed by corporate leaders who wish to materially misstate financial information or by a public that is demanding more intensive audits when they are not always needed (Bell et al., 2005).

This concept of neutral professional scepticism is an issue that must be faced in light of recent accounting scandals, especially considering that these recent events may cause some auditors to move more toward outright doubt rather than neutrality in their scepticism. It is explained (Bell et al., 2005) that auditors are held to a higher standard by both the financial industry and the general public. It is not enough for an auditor to believe that a company's financial statements are correct, or even that there is some form of material misstatement taking place.

However, it is worth considering how neutral an auditor can be when he or she is attempting to conduct a business risk audit of a client while also reducing the audit risk of his or her own firm. Auditors will certainly be aware that there is a risk that their firms might face civil or criminal penalties for not making potential risks known to the public. To think that an auditor can be completely neutral and enter a business risk audit without some scepticism may be slightly naïve.

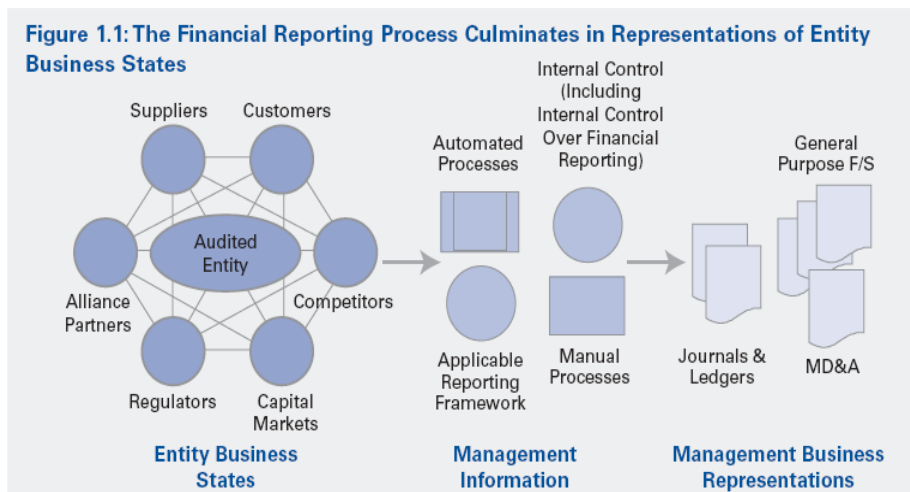
Bell et al. (1997) also explain that financial statements in the modern audit process are actually not enough to fully understand and make judgments about the validity of a company's stated financial position. Instead, an auditor who comes into a company from outside of its operations needs to understand the internal as well as external relationships, and it is this entire realm of relationships and dealings that are being audited.

The larger view of the company being audited involves a variety of relationships, both internal and external, as well as similar services offered by competitors and even the regulations that govern the industry in which a particular company operates. Bell et al. (1997, p. 19) list the interrelationships that an auditor should be aware of in order to accurately understand a company and its operations. They explain that auditors must understand capital markets, regulators, strategic partners, competitors, complements, customers, suppliers and their facilities, suppliers and the inventory that they provide, suppliers and labour, and suppliers and capital.

Again, it must be stated that auditors will protect themselves in the audit process. If an auditor is afraid of facing penalties because of anything that might seem out of place in a company, he or she is going to focus on that particular area and make the information public. In addition, whether or not an auditor understands the specifics about a company, he or she certainly understands how most businesses operate in regards to relationships and financial obligations. Auditors were not expected to be experts on all businesses in the past. It would seem that auditors today do not have to be experts on the businesses they audit in order to determine whether risk is present that should be made public.

Figure 3-4

The Financial Reporting Process



Source: Bell et al. (2005)

As illustrated in Figure 3-4, management establishes and maintains a link between Entity Business States (EBS) and their financial statements representatives. This link is the Management Information Intermediaries (MII), which include internal controls, risk management frameworks, computer networks and information systems, human information processing and financial reporting. Auditors using SSA will be assured of whether management's financial statement representations are fairly represented; this will not be possible unless the auditor maintains a thorough understanding of the entity's business states.

It is important to step back for a moment and realize what is truly being stated here in terms of what the auditor must know about a company in order to actually perform an audit that is based on all available knowledge. It is not enough for an auditor to look for problems in a company's accounting system, or even to merely look for ways in which a company leader may have misstated material facts about financial performance. Instead, the auditor must understand the company's strategies, goals and operations before the actual audit even begins.

If the auditor does not approach an audit with an understanding of the client's risks, advantages, competencies, ability to create value and overall business model, there is a risk of making errors in professional judgment. In fact, it would seem that if the auditor lacks an understanding about any of these areas as they pertain to a client, it would be almost impossible to use SSA to make any type of well-informed professional judgment regarding the information being reported in a client's financial statements.

Auditors must be cautious that MII could accidentally or intentionally ignore or alter selected EBS transactions, resulting in unfair representation of EBS in management's financial statements. Bell et al. (2005, p. 49) list several areas where auditors can examine the entity's business state transactions in terms of MII:

- Sales growth
- Changes in:
 - Other key account balances
 - Composition of the balance sheet and income statement (i.e., comparative common-size financial statements)
 - Operating margins
 - Asset turnover measures (e.g., receivables, inventory, fixed assets)
 - Ratio of operating cash flow to operating income
 - Proportion of bad debt expense to sales revenue
 - Levels of discretionary accounting accruals
- Comparable measures at the segment, divisional, or other levels

There are other areas where auditors can seek to examine if there have been any misstatements of financial information that are simply out of place with EBS. These areas include examining a company's stated level of inventory turnover for a particular quarter and determining if the stated level of turnover is possible based on the time of year and even the company's level of operations (Bell et al., 2005).

What is really being called for here, as explained by Bell et al. (2005), is known as reasonableness in the EBS. The auditor, with an understanding of the company and its various financial positions and statements, can seek to determine if the material facts that are presented to the public, as well as to the auditor, can be reasonably true from the standpoint of the company and its operations. If a company that has been in the news for having many customer complaints is reporting margins that seem high even for a company with high levels of customer satisfaction, then the stated margins are not reasonable. Based on the professional judgment of the auditor, this result would warrant closer inspection.

3.3.4 The BRA Focus

All big audit firms quickly rushed to implement the new concept, and each claimed to introduce its new method in response to their clients' needs and as a means of adding value to the service they provided. Elliot (1996), a leading KPMG partner, suggested that auditing was "reborn". KPMG also promised a new era for audit clients requesting an audit that did more than just look at the numbers.

KPMG also used the actual development of auditing procedures, going back to business failures in the early 1900s brought about by a lack of auditing, to explain the value of the business risk audit model. They explained:

"our overview of the evolution of the risk-assessment orientation during the 20th century highlights several important systemic issues and trends. For example, at several key junctures throughout the century, corporate business

failures accompanied by fraudulent financial reporting prompted the profession to develop more effective techniques for assessing RMM due to fraud” (Bell et al., 2005, pp. 12-13).

Deloitte & Touche claimed to be “reengineering” their audit approach: “*we have radically reengineered our audit approach to enhance our effectiveness and efficiency and to increase our focus on client service. Our audit approach emphasizes adding value to our clients by enhancing quality and productivity*”. Arthur Andersen stated in their literature, “*we are in the midst of redefining the way we deliver financial audit assurance services across the board... thereby creating an opportunity to deliver ideas to improve the future performance of the auditee as a part of the audit*”. Similarly, Ernst & Young came out with its new “audit innovation” approach, which they claimed would significantly increase the value of services provided to their auditee by focusing more closely on their business (Jeppesen, 1998).

The business risk audit approach to the work that auditors perform has, like so much of the auditing methodology and tools developed over the past 100 years, been shaped by the continued changes in the different ways in which companies operate, as well as the ways in which financial information is provided to the general public. The change in the amount of information and the way in which information can be obtained complicates how auditors can be relevant and how they can perform their duties in changing business climates.

For example, it is stated (Abdel-Khalik, 1998) that firms in the United States typically use the audit risk model explained earlier. However, firms in Canada and parts of Europe focus on a model of business risk audits relying more on subjective probability. What is meant by the idea of subjective probability is that auditors examine the history of actions taken by company leaders, as well as the past record of material misstatements. This information is then used to make determinations about the level of threat that is present regarding material misstatements in the future.

In other words, it would appear that firms in the United States may simply use the audit risk model by inputting numbers and multiplying through the formula to come up with an answer. However, auditing firms in other nations take the audit risk model and add their own subjective opinions and feelings based on the previous actions of their clients. The real difference may be that in countries outside of the United States the professional judgment of the auditor is weighted more heavily in the audit risk model.

3.4 Summary

The information that has been reviewed in this chapter has shown not only the evolution of audit methodologies within the auditing industry over the course of the past century, but also further demonstrated the connection between business risk and audit risk. The key point to take away from all of this information is that the business risk audit methodology is meant to provide a way for auditors to undertake a more complete examination of audit clients. Rather than only examining financial statements or examining a small sample of internal activities and transactions, the business risk audit methodology is supposed to provide a framework for examining the practices of an

organisation and how those practices may relate to business risks that cannot be easily identified on a financial statement. However, the business risk audit methodology requires that an auditor take the time and be willing to examine a large number of issues and variables in order to determine the business risk that is present.

The professional judgment of auditors is not removed from the work that is performed with the business risk audit methodology. Auditors still have to exercise their professional judgments and use their knowledge and expertise in the work that they carry out. In fact, auditors must recognise that the business risk audit methodology is no different than previous audit methodologies in terms of professional actions and judgments. While the basis for how to conduct audits may be different in terms of methodology, auditors still assume risk in the actions that they take, the particular variables they choose to examine, and the final determinations that they make about the business risk that is present with a client.

Chapter Four

BRA Applications

4.1 Introduction

This section will expand upon the literature presented in the previous chapter by examining literature that discusses the application of BRA. Since its introduction, audit literature agreed that BRA was widely accepted by auditors and implemented right away. An early paper on the application of BRA presented by Eilifsen et al. (2001) examining the 1997 audit of the Czech bank Ceskoslovenska Obchodni Banka (CSOB) will be discussed, since it represents a good example of BRA application, soon after it was introduced by KPMG. It should be noted that while other literature will certainly be examined, the first part of this chapter presents the work of Eilifesen et al. (2001) because this research is based directly on KPMG's audit approach, which was extensively examined in the previous chapter. It seems only necessary to discuss the findings of the research conducted on KPMG's own efforts because of the level of attention that has been given to the firm and its information.

4.2 BRA Application

Eilifsen et al. (2001) based their research on KPMG's BMP audit approach. Emphasis on understanding the client's business and related risks is gaining acceptance among auditors, who are moving away from traditional audit methods focusing on financial reporting, and towards more strategic risks, business processes and controls. The research was expected to observe differences in the conduct of a business-risk based audit in the following areas: 1- risk assessment, 2- audit evidence, 3- audit

administration, 4- audit team structure, 5- value added assurance, and 6- expanded service opportunities.

Eilifsen and his team selected the 1997 audit of Ceskoslovenska Obchodni Banka, a state-owned bank based in Prague, Czech Republic, as their subject of research. The researchers had full and unrestricted access to the audit team and working papers. Prior to the 1997 change, the audit team followed traditional audit approaches, which focused on the financial statement assertions, including valuation of loans, investments, revenue recognition, regulatory compliance and off-balance sheet items. Most audit evidence was obtained through substantive testing for most of the account balances, and analytical procedures were used for revenue recognition and evaluation of uncollectible loans. Confirmations were used for loans, collateral, deposits and investments. Minimal input was obtained from specialists. In summary, the previous audits were typical traditional audits that relied mostly on substantive testing with little reliance on controls. The audit team consisted mainly of junior staff and senior auditors.

In the 1997 audit engagement, the audit team adopted KPMG's BMP audit methodology for the entire audit. This practice necessitated significant changes in the planning and performing of the audit. The audit team completed training in the new audit techniques. Eilifsen and his research team had 85 hours of direct contact with the audit team and visited them six times during the eight-week audit period.

Risk Assessment was the area where major changes took place, as the researchers had expected. Due to the changes in the auditor's focus on risks, some risks were considered less significant while others received greater attention. Prior to the 1997 audit, the bank concentrated on managing financial risks: interest rate risk, market risk, credit risk and exchange rate risk. These risks are related to loan management, investment management and regulatory compliance. In the 1997 audit, the time devoted to evaluating and testing these risks was reduced by 30%, giving the auditor more time to evaluate and test more important and precise risks.

With better understanding of the conditions and environment in which the bank operated, auditors found that specific loan management risks were less significant, whereas new, more significant risks were identified. In the past, emphasis was on the policy of loan approval/rejection process by senior management, and on transactions causing errors in customer accounts and financial records. In contrast, economic risks impacting loans, such as inflation, unemployment and exchange rates, could have overwhelming impact on the economy and the bank's loan customers. Other economic risks that the auditors took into consideration were: default credit risk conditions of borrowers, collateral risks due to vagueness and unenforceability, and loss of customers due to tight money supply.

Political risks marked another area where auditor focus changed in comparison to previous audits. This included ongoing dispute at that time between the Czech and Slovak governments concerning the division of banking assets when the countries separated in 1993; concern that the dispute with the Slovak government was

discouraging Slovak businesses from dealing with the bank; and political implications of the Czech Parliament's final authority over the disposition of the government's interest in the bank and its assets.

The auditors identified two other new areas of risk assessment: social risk and technology risk. Social risks related to the country's change from communism to a free market economy. This included potential threats to mid- and lower-level employees implemented by management trying to make the bank more competitive. Many customers distrusted banks from their past experiences under communist rule, and uncertainty surrounded the collection of loans. The bank's technology was generally less developed than Western banks. It was weak in customer service and management reporting but considered highly reliable in processing transactions, due to the education and training of low-level employees.

The second area tested was **Audit Evidence**. The researchers found that the audit team had significantly shifted from substantive test evidence to evidence concerning risks, controls and performance measures. An important issue identified as the primary source of evidence was the audit team's documentation of strategic risk, processes and performance indicators. The team relied less on evidence from the documentation of individual transactions than in the past.

The new model allowed the audit team to expand their knowledge acquisition and risk assessment skills, which provided them with far more evidence about risks and

potential financial statement misstatements. The researchers' overall conclusion in this regard was that the team performed a more effective audit using the new approach to collective audit evidence.

The **Audit Administration** was the third area tested. This is related to the allocated engagement time. Overall, the audit team decreased the time spent on the CSOB engagement by 9.5%. The audit managers were more involved at the planning stage, which helped senior and junior staff concentrate on the risky areas, thereby reducing or eliminating substantive testing in low residual risk areas. More work was completed at an early stage, six or eight months before year-end, and updated during the year. There was also heavy reliance on specialists, particularly in the fields of information risk management and taxes.

In the fourth area tested, **Audit Team Structure**, the observed changes were not as significant as the researchers expected. In 1996, 41.9% of the engagement hours were charged by staff auditors, compared to 39.9% in 1997, when more experienced staff were involved with the audit. Meanwhile, the hours charged by specialists increased from 4.2% of the total engagement hours in 1996 to 6.3% in 1997.

The fifth and sixth areas tested were **Value-Added Assurance** and **Expanded Client Service Opportunities**. These areas are considered a by-product of the audit service and, as the researchers expected, the audit team changed in their approach to these areas. In 1997, 14.5% of the total engagement hours were spent on activities not

directly related to the verification of financial statements, compared to 7.3% in 1996. It was also noted that the standard management letter was expanded significantly, from a small report to a 20-page report, which resulted in positive feedback from the bank's management. As a result of the audit team's communication with CSOB, management requested two proposals relating to strategic planning for the bank.

4.3 Emphasis and Alignment of Ideas

Information about the relationship between business risk audit and audit risk has presented some potential conflicts between an auditor's responsibility and their job to protect the public. Because the possibility of misalignment of ideas between the two concepts may be present, it is important to understand how auditing firms and their leaders have worked to align the sometimes conflicting concepts of audit risk and business audit risk.

Lemon et al. (2000) have noted in their research that the emphasis of the application of the BRA audit is different from the traditional audit form that only sought to examine financial statements for material misstatements. They explain that the application of the business risk audit model moves toward an area where auditors are determining if the actual objectives of the financial statements as laid down by a company's management are being met.

Lemon et al. (2000) go on to explain that in actual application, companies may not fully understand this link between risk assessment and material misstatement of financial results. Companies may not understand why auditors are even trying to examine risk and, furthermore, why they are trying to explain various aspects of risk assessment in their reports and dealings with company leadership. This may be an area in practice where issues arise as to the actual role that auditors play, and may be an area where explanation is required from the auditor to company leadership if the business risk audit approach to auditing is to be carried out successfully. Once this explanation takes place, Lemon et al. (2000, p. 16) explain that the very nature of how company leaders view the audit may actually change:

“in some cases, the firms are explicit in suggesting that once purpose of the business risk approach is that it assists the auditor to form a view of the entity that is consistent with that of management. As stated by one firm, the new approach is useful for aligning our audit process more closely with management’s needs to improve business performance and manage business risks.”

In fact, this idea that auditors and auditing firms need to explain and be more open with company leadership is, as Lemon et al. (2000) explain, part of the change in emphasis in the BRA audit model. They explain that BRA is really a top-down approach to performing an audit, beginning with the actual business, then moving to its operations and finally examining the business’s financial statements.

Application of the BRA audit has, in fact, run into issues with companies that are concerned as to the reasons why auditors would require information that lies outside of the standard information needed to evaluate and audit financial statements. The BRA approach to auditing certainly requires evaluating information that may have little to no direct link to the information contained in a financial statement. Asking for information about company objectives, suppliers, partners, or even competitors may cause raised eyebrows among company leadership. Specifically, clients were worried about the reasons why information not entirely related to financial statements was even necessary and how it would be used (Knechel, 2007).

Curtis & Turley (2007) explain that the BRA model calls for more than just company leaders to change their focus of what they believe about the emphasis and importance of the audit. This change in emphasis, however, has been difficult for some auditors who were trained with the notion that an audit is about examining financial statements and looking for material misstatements. This change in emphasis is especially difficult for senior partners in auditing firms who have been in the auditing business for years or even decades. These senior partners have found the lack of clear distinctions between the importance of business risk and the evaluation of outside information as compared to the importance that financial statements play in the audit process to be a difficult adjustment (Robson et al., 2007).

Furthermore, in their research regarding senior members of auditing firms and partners in relation to the BRA approach, Curtis & Turley (2007) found that there were problems in how these auditors actually used business risk audits with information

contained in financial statements. Interviews with senior auditors and partners of auditing firms found that there were disagreements about where in the larger auditing process to examine business risks and where to assess only the information contained in the financial statements. Some senior auditors and partners were concerned that assessing business risks too early in the audit process distracted auditors from the process of examining financial records for material misstatements.

It is clear from this research that the changing nature of the audit to a BRA approach has not been easy for some members of the auditing profession. Those who have been in the business for a long period of time may have a hard time adjusting to an application of auditing which steps completely outside the lines of information contained in financial statements. They may also be unsure of at what point to introduce information not contained in financial statements.

Lemon et al. (2000) provide an approach to the delivery of the BRA in the audit process. They explain that the movement from audit risk to business risk can be thought of graphically along one axis moving from right to left, with financial statement attention and valued added client services on another axis moving from bottom to top. In this regard, audit risk is more aligned with attention to financial statements, and business risks are more connected to the value added services provided to clients.

Robson et al. (2007) further explain that the BRA requires other changes in thinking about the audit process, one of which is the very notion of when risk assessment should

take place. They state that in the older paradigm of auditing, risk assessment took place periodically, but the new way of viewing BRA requires thinking of risk assessment as a continuous process rather than something that occurs, for example, once a year.

Furthermore, the issue of control over business risk is no longer centered solely on the financial risks that are present. The BRA model requires that control for a company be centered on trying to avoid unacceptable levels of risk, as well as the management and control of another types of business risks which cannot be completely avoided in a business environment (Robson et al., 2007).

For the current research, these issues and concerns raise questions about how auditing firms have implemented the business risk audit methodology, as well as how the people working for these firms view the BRA methodology. For example, auditors working for firms that have implemented the business risk audit methodology might view it as simply part of the larger evolution in standards and practices that have occurred in the profession over the past century. However, they might also view it as little more than a way to focus more on selling services to clients as opposed to focusing solely on risks and identifying them.

This leads to a final very important change in emphasis brought about by BRA, which is where risks are created within a company in the first place. In previous decades, it was believed that having ineffective people in an organisation was the source of business risk. The new model of BRA moves the emphasis of the source of business

risk away from people and toward the processes that are in place within an organisation that actually monitor and handle identified risks (Robson et al., 2007).

Thinking about the audit process from the actual application of business process assessments has meant that both auditors and company leaders have had to adjust how they view the environment in which they operate, and the sources of risk that are present. No one in a company may be making material misstatements or even taking actions that would appear to be illegal or unethical. However, it is the auditor's job to find risks that may be present, which the company has failed to notice.

BRA calls for an understanding of the processes that are in place and an examination of how those processes may be leading to unnecessary exposure to avoidable business risks, or how they need improvement in order to help handle the unavoidable business risks present in any company. This also means that auditors must be able to gather diverse information from a variety of sources about a variety of processes, some of which may seem completely unrelated to actual financial reporting and what is listed on a company's balance sheets.

As has already been mentioned, the idea that auditors would need information that would appear completely unrelated to financial reporting or what is listed on a balance sheet might concern some companies. They might not fully understand or even appreciate having information about their interactions with suppliers and customers, or their plans for future growth, being examined in detail. This also returns to the idea of

the motivation for implementing the business risk audit methodology. The question arises as to whether the BRA methodology is simply part of the evolution in auditing standards and practices that have occurred over the past century, or whether the motivation for adopting BRA is more about changing the role of auditing firms and how they are able to attract clients.

4.4 The Role of the Auditing Firm

The changes in the work performed by auditors and auditing firms, as well as the changes in expectations from companies taking on the services of auditors, has meant that business changes have occurred at all levels of auditing firms. First, the role that senior level auditors and partners of auditing firms play has actually increased in terms of number of hours worked for individual audits. Curtis & Turley (2007) found that the percentage of hours billed to clients from 1996 to 2000 for the work of auditing firm partners actually grew from 14% to 20%, and the percentage billed for senior auditors grew slightly from 35% in 1996 to 38% in 2000. What is interesting is that the actual percentage of hours worked by junior staff actually decreased as a percentage of the entire auditing process, from 48% in 1996 to 31% in 2000.

What is clear from this information is that the move to the BRA approach to auditing has meant that senior members of auditing firms and even partners in the firms have had to take on extra roles and duties. They can no longer simply supervise junior staff members and make sure that things run smoothly. Now, they must be more involved in

making decisions, and gathering and analysing information for the companies that have hired these firms to perform their audits.

It is also important to understand that the use of BRA has merely shifted the work that auditing firms charge for. Auditing firms have not necessarily gained more work. Instead, the nature of the work has shifted from auditing work to consulting work. Robson et al. (2007) show that in 1975, the big eight auditing firms in the United States generated 71% of their total revenue from audit work, and another 12% from consulting work. By 1990, these figures had changed so that the big eight auditing firms in the United States were receiving only 49% of their total revenues from audit work but 26% from consulting work. In 1999, the difference was even more drastic, with the big eight auditing firms only receiving 30% of their total revenues from audit work and 49% from consulting work.

The use of the BRA audit has blurred the lines between auditing firms performing genuine audits of a company to ensure that material misstatements of financial information have not taken place, and auditing firms performing consulting work to identify and help keep business risks under control for their clients. Knechel (2007) explains that one of the new challenges for auditing firms is to separate auditing from consulting work and avoid any appearance of the two duties being the same.

Knechel (2006, p. 396) explains that this is an important issue because it raises the concern that a company's management might not be fully aware of where consulting

ends and auditing begins, and this might raise concerns over the true nature of an audit performed by an auditing firm:

“To the extent that management interpreted ‘value-added’ as meaning value to themselves, the risk increased that the auditor would be perceived as being on management’s ‘side’. This perception could undermine the already sensitive nature of independence in appearance. Furthermore, the need to disabuse this impression raised the risk that the relationship between management and the auditor would be conflicted in a way that affected the quality of the fundamental audit, e.g., by making the auditor less willing to disagree with a client’s position on sensitive accounting issues.”

Auditors’ independence in the face of the changing nature of the audit process, and the role that auditors play for their clients, are very important issues that have arisen with the application of the BRA. With auditors moving to a greater role in helping advise companies about their risks and how to avoid them, the concern becomes one where auditing firms may be getting too close to their clients in a way that would cause problems if misstatements of financial information or risks in financial reports were discovered. However, this relationship may change in the future if the auditing industry and companies move away from the business risk audit approach in favour of different audit methodologies as professional standards and legal requirements change.

4.5 The Expertise of the Auditors

Researchers (Curtis & Turley, 2007; Lemon et al., 2000; Knechel, 2007) have noted that use of the BRA model requires that individual auditors have a greater level of knowledge and additional skills to perform a successful audit. In the traditional approach to the audit, auditors really only needed the ability to examine financial data and look for areas in financial transactions or in accounting systems where mistakes or misstatements could occur. This is certainly not to devalue the knowledge that was needed, but the focus was very limited and, as such, the focus of the necessary knowledge was limited to specific information about financial statements and accounting processes.

With the increased use of the BRA approach to auditing, the auditor must be able to examine information from a wide variety of sources that concerns a variety of facts and figures. It should not be a major surprise, as Knechel (2007) states, that the information gathered in BRA can sometimes be conflicting in nature and in terms of what it says about a company and its financial reporting risks. This means that auditors must have or develop the skills to make judgments based on evidence and information that may appear uncertain. Auditors must also know when the uncertainties are truly too large, and be able to make decisions regarding where more information and data are needed, or if enough investigation has occurred to make a decision.

Lemon et al. (2000, p. 22) explain that conducting audits through the BRA methodology requires knowledge of strategic management literature, and auditors without this background and knowledge need to obtain this information in order to perform their duties effectively. He also explains that from a practical standpoint of the actual application of auditing duties,

“the formal qualifications recognized as appropriate for auditors, for the structure of educational courses accredited in the process of qualification and for the recruitment and training of audit staff by the public auditing firms.”

Knechel (2006) also raises the issue that the use of the BRA in actual application means that auditors must do more than simply examine documents; they must also examine the people who put into place the processes a company uses. This may be difficult for auditors who much prefer analysing numbers to interviewing people and analysing the information they provide. However, to effectively implement and apply the strategies of the BRA, auditors must become aware of how to judge information obtained from personal interactions and formal interviews.

It should be noted that other auditing practices have required auditors to do more than simply look at financial records. The business risk audit approach is not the first audit methodology to involve auditors in examining many aspects of a company, as well as the leadership style of the organisation. While business risk audit is the current preferred method among many companies, this does not mean that all of the methodologies are new or even different.

One of the reasons why so much of the actual application of BRA can be difficult for auditors is that it deals with some levels of ambiguity in the data to be analysed. In the traditional model of the audit, professional auditors examined financial reports using mathematical formulas and accepted accounting principles. The BRA model, however, creates certain types of ambiguity in the information collected and even in the ways in which information is collected. Auditors typically do not like uncertainty, especially when attempting to make professional judgments about the materiality of a company and its financial reports to the public. However, the use of the BRA requires that auditors be aware that some ambiguity exists, and develop strategies to deal with the ambiguities so that professional judgments can be made with some degree of confidence and certainty (Knechel, 2006).

Robson et al. (2007) explain that the ability of auditing firms to successfully navigate and implement the BRA is important in terms of their legitimacy in the financial world, especially among firms that pay large fees to hire auditing firms. Curtis & Turley (2007) go so far as to state that the development and implementation of business risk audit in actual application must be brought about by the concern many auditing firms have that companies do not want to pay increasing fees charged by firm partners without getting some added value in return.

However, Curtis & Turley (2007) explain that during the initial stages of the move toward the BRA, proper attention may not have been paid by firm partners to the actual

role that auditing firms and even senior partners would need to play in these changes.

The researchers (Curtis & Turley, 2007, p. 21) stated,

“Since practitioners retain ultimate control over the nature and extent of audit procedures performed, this resulted in difficulties in achieving a lasting move to a controls based audit. It also seems that, in trying to reengineer the business model, administrators gave inadequate consideration to the organizational structure of the firms and the manner in which this structure supports the production of legitimacy.”

In terms of actual application of BRA, auditing firms and individual auditors must approach a company that has retained its services with the knowledge and preparation needed for the job. Auditors must be aware that their roles have changed and shifted because of the adoption of the BRA model in regards to the actual application of audit procedures and client interactions. Knechel (2006) has noted that auditing firms must put into place rules and procedures for what each member of an audit team will do.

This can be difficult for auditors who have understood their roles in previous audit procedures and remain unaware of their place within the larger BRA. This is also true because of the fact that the goal of the traditional audit was delivering a client’s audit on time and under budget. However, with the blurring between consulting and auditing in the business risk audit, the goals for the auditing firm may not be as clear. Knechel (2006, p. 398) explains,

“auditors who had many years experience but were not yet partners often felt threatened by the changes since they were the ones expected to deliver an engagement on time and within (or under) budget. Due the radical changes in the audit process, they did not now know how to do what they had known how to do in the past. However, obtaining buy-in by the individuals tasked to implement the new methodology was critical to enabling the benefits that might be obtained from the new approach.”

It becomes clear that the role of the auditor in the actual application of the BRA can take on many forms. At times, the auditor plays the role of a financial advisor. At other times, the auditor must be able to effectively interview company personnel. Finally, the auditor may also have to play the role of a consultant to the client being audited. What is important for the auditor and the auditing firm during this process is possessing the required knowledge and taking care of the planning before arriving to perform an actual BRA audit, so that the customer sees the auditing firm as being in control and prepared to do what has been paid for.

Finally, with regard to the role of the auditor within the actual application of the BRA, Robson et al. (2007) state that the use of BRA as the prevailing model of financial audits is really a merging of the prevailing attitudes in the current business climate and the prevailing technology at the present time. The explanation provided by the authors is that auditors are trying to bring together the role of adviser with the role of a financial auditor into one larger role. The purpose of this has been to keep the role of the auditor, and the professional status of the job and the auditing firm, at a higher level, even as the

need for auditors has shifted and as businesses want more out of auditors and auditing firms.

Robson et al. (2007) also believe that the emergence of the business risk audit among auditing firms has not been fully studied to determine its outcome. They state that additional study of how audit firms have changed or shifted their actions because of business risk audit would allow for a more thorough analysis of the benefits and downfalls, as well as any conflicts, to be better understood within the industry.

From this information, the question that has arisen, and one that is important for this research, is what is the motivation of auditing firms in adopting the business risk audit methodology? The information that has been reviewed suggests that the motivation for adopting BRA might be little more than going along with a continuing evolution in auditing practices. However, some suggest that auditing firms might be motivated to adopt the business risk audit methodology for reasons related to their ability to sell other services and attract more clients.

4.6 BRA Applications with the Perceptions of the Public

It seems appropriate to examine the business risk audit methodology and its use in relation to the function that auditing firms have to protect the public from material misstatements and other risks related to the business operations of companies. It may seem out of place to discuss public perceptions in a discussion about the application of

the BRA, but it is important to realize that public perceptions about the role of the auditor and the information they provide has a direct influence on BRA application. Knechel (2006) has noted in his research about the transition to the BRA approach to financial auditing that the public was somewhat sceptical as it became known that auditing firms were changing their approach to financial auditing. This means that the general public was not completely convinced that the changing nature of the role auditing firms play was really in their best interest.

The reason for this scepticism was partially based on the fact that the beginnings of this transition occurred at the same time that many auditing firms were increasing the consulting services they offered to clients. This caused the general public to wonder about the real motives of auditing firms in changing the very foundations of their work. BRA provides auditors with a means of looking beyond what is solely reported on financial statements and actually looking around a company to determine if its management might be under so much stress that material misstatements may be more likely because of the current business environment.

Auditors are no longer tied to only looking at specific numbers or statements provided by a company or even by a company's financial partners. Instead, auditors can now take stress, both internal and external, into account when deciding where to look and how to audit for business risk. From the public's point of view, they must remember the demand from shareholders for larger dividends and yearly increases in revenue and profit. These demands can be enough for an auditor to design tests and controls that can

determine whether the stresses have been sufficient for material misstatements to take place.

What is perhaps most important regarding how business risk audits are implemented in light of demands and stress, both internal and external, is that this approach to the financial audit allows for tests and controls to be created based on each client's circumstances. This approach is not a one-size-fits-all approach to auditing. This means that companies with greater stresses, such as concerns about not having enough available capital to meet debt payments, may need one set of tests and controls, while a company with less serious stresses, such as being able to meet debt payments but wanting to take out loans for future growth, may need different tests so that auditors can focus on other areas.

Lemon et al. (2000, p. 21) discuss the implications for this freedom of test design in the BRA as a favourable method for audits to occur in the business community because of the

“judgment in the design evidential procedures applied on an individual audit. The need for audit procedures to be varied and tailored to the individual engagement rather than standardized programmes has been accepted for many years, but this emphasis on judgment and matching procedures to the circumstances of the client is given added weight through the rationale of a business risk audit approach.”

In the end, the information that has been examined suggests that the business risk audit methodology may be adopted because it serves to improve, or at least help to improve, the public perception of auditing firms. What is meant by this is that the business risk audit methodology may allow auditors to exercise greater professional judgement in order to demonstrate that they can look beyond a financial statement and actually make determinations about how the internal operations of a firm may create business risks that need to be identified and made public.

4.7 BRA Aftermath

It is important to examine the impact and aftermath of the implementation of the business risk audit methodology for auditing firms. Any plan of action put into place must have an understanding of the possible outcomes of the actual application of those actions; the possible results of the BRA are no different. Curtis & Turley (2007) point out that their research has shown that the application of BRA does not necessarily result in any type of payoff for the client company. However, it could easily be questioned whether an audit should ever result in any payoff for the client of auditing firm. It could be argued, perhaps correctly, that audits are intended to assist investors rather than companies. If investors are helped by having a complete picture of the risks associated with the companies in which they have invested, that is the desired payoff (Flint, Fraser & Hatherly, 2008).

For audit firms, this is especially important as they try to maximize their influence and importance in the financial world, and show their customers that they can provide valuable services. However, the results of Curtis & Turley's (2007) study show that auditing firms will not always see increased value from the BRA. Instead, there may be plenty of clients for whom a BRA results in nothing more than finding that the company has not materially misstated anything in their financial reports and are operating truthfully and within the constraints imposed by both avoided and unavoidable risks.

Again, this information requires returning to the original idea of the point of an audit. Audits are supposed to give investors and the public a complete financial picture of a company. Audits are meant, or at least used to be meant, for the benefit of the public. Over the past few years and even decades, some have tried to change the focus of the benefit of the audit from the public to the companies that are audited and even the audit firms themselves.

There may be times when this is the result, and it must be remembered that in the old paradigm of the financial audit, the result was either that everything was acceptable or that problems existed in the financial reports and accounting practices of a company. The BRA methodology has its objectives as well. However, it is only with the BRA methodology that auditing firms, and even many clients, have come to expect something more out of the application of the BRA. In fact, there was a time when an acknowledgement that all accounting practices and financial statements were in order was considered a successful audit.

Curtis & Turley (2007, p. 22) explain that the BRA process is still one in which auditing firms are trying to maintain and even gain legitimacy by providing something more for their clients, and even as a way of gaining client business for related consulting services. The issue, however, is that

“while the BRA sought to promote legitimacy through a rationale based on the application of experience and expertise to assess business risks in order to draw inferences about the financial statements and to enhance value with clients, this did not meet practitioners’ need for a culturally legitimate, defensible evidence process.”

Knechel (2007) provides his own analysis of the actual application of the BRA as merely a means for auditing firms to gain related consulting and non-auditing business from existing clients. However, he goes on to explain that the implementation of the BRA, even though it was likely done for less than truly pure reasons by the auditing industry, has provided auditors with tools that they can use to bring together many of the internal and external factors that can work together to create the financial reports created by companies.

In fact, as Knechel (2006) states, the increased concern with business risks and various types of reporting strategies is a positive result of the BRA application. Auditing firms may seek to increase consulting fees by showing companies that they have the skills and knowledge to find and help alleviate business risks, looking for these risks can also

point out areas of concern with tests and controls needed to prevent material misstatements on financial reports.

Robson et al. (2007, p. 25) seem to concur with this notion that the BRA methodology was not created with the simple intention of being able to conduct a more thorough or accurate audit. Instead, the use of the methodology has allowed for a better understanding of the nature of clients' operations and the various opportunities that arise for materially misstated financial information. They explain,

“indeed, with the various attempts to shift from audit to business advice, it may be that the success or failure of the BRA methodology will prove critical both to the future strength/viability of the market for auditing services and the social significance of the auditing function. It could be argued that the auditing profession is at a crossroads – but it is not the typical one portrayed in the media, centered on the need for auditors to become more active in detecting fraud, closing expectations gaps and preventing corporate collapses.”

Finally, Lemon et al. (2000) also explain that the basis for the move to the BRA model to find a way to gain more consulting services through a means of providing additional value added services and results to clients. However, Lemon et al. (2000, p. 23) also state that, out of somewhat selfish motivations, the implementation of the business risk audit methodology may have improved functions for auditing firms to find potential material misstatements and other problems in companies' financial reports. They explain,

“it is perhaps self evident that the firms that have introduced a business risk audit approach have done so on the basis that it will assist and enhance audit effectiveness, in other words that it will help meet expectations. Second, it is apparent that adoption of a business risk framework involves the auditor in a somewhat broader set of considerations than under the audit risk model and this could in time lead to additional expectations from management and others. Third, the use of the terminology of business risk auditing could in itself have an impact on the way in which the beneficiaries of audit services form perceptions about the manner in which auditors execute their responsibilities.”

The actual application of the BRA is something that can create conflicting demands for auditing firms and their clients. On one side of the equation, auditing firms are using the BRA as a way to show clients that auditing firms are relevant in the modern era and that they have something more to offer companies in a time of increasingly expensive audits. However, companies are on the other side of the equation and they want to feel as though the money they spend on these large auditing firms is well spent. This has changed from previous decades when audits were merely an independent check of financial reports and accounting procedures to verify that a company was not hiding anything from its investors or regulators.

This desire on the part of both auditing firms and companies to get something more out of the entire auditing process can create conflict within auditing firms. The expense of the business process audit provides nothing more to a company than the actual audit itself. Research has shown that the BRA methodology is not necessarily something that

can deliver improved financial performance for companies or auditing firms. This is something that auditing firms need to prepare their clients for, and even leaders of auditing firms need to take it into account when they adopt and apply the BRA approach (Curtis & Turley, 2007).

Overall, it is easy to see where the BRA approach would require added expense in its actual application because of the increase in knowledge, senior-level personnel and time required to perform the BRA appropriately. This type of audit requires more hours than the traditional audit because there are more records and information, and more people to be interviewed.

At the same time, it must be remembered that the actual application of the BRA requires more time when it is first implemented with a client because of the amount of explanation that is needed. Clients who are new to the BRA have shown that they typically have concerns and even some scepticism over the role of the auditors in this methodology and how the information gathered will be used. The explanation that must accompany the BRA is not something that can be ignored by auditing firms, regardless of the amount of time or explanation that may be needed (Rittenberg, Johnstone & Gramling, 2009).

Auditing firms that take on the BRA methodology must prepare even before an audit begins by training auditing personnel and creating a plan for implementing the actual application of the audit. This type of audit requires that everyone on the audit team

know their individual roles and how to carry out those roles. Research has shown that this can actually be harder for senior-level auditors in a firm because this approach is not what they learned when they trained as auditors (Rittenberg, Johnstone & Gramling, 2009). Overcoming the changes involved in the application of this new methodology is not something that only clients or the general public must do. Auditing firms must also prepare for and adjust to these changes, even though they are the catalysts.

Overall, the literature on the BRA has provided much important information about the use of such a methodology, as well as reasons why the methodology emerged when it did. It is clear that the accounting scandals of Enron and other major companies that greatly affected the auditing industry, including the demise of Arthur Andersen, brought about some necessity for the changes that have occurred.

The public was becoming more and more sceptical of the auditing industry and whether auditing firms could do the job that they had been entrusted to do - protect investors and other stakeholders of large companies. In addition, regulators and lawmakers wanted to know what auditors were doing, and in some cases not doing, that was causing large scandals to take place at all. The result was really a change in how auditors saw the information that they were examining to make decisions about the accuracy of the material presented in financial reports (Flint, Fraser & Hatherly, 2008).

The BRA approach provides the means for auditors to understand the larger picture and the entire environment in which their clients operate, and how those external forces may

create stress and reasons for material misstatements to be made in the first place. It is often the case that financial transactions and accounting procedures alone do not allow an auditor to see the stressors that cause auditing scandals to occur. The business risk model is really the first approach used in more than 100 years of financial auditing where the entire territory of a company and its operations become part of the audit and the realm of the auditing team. It is likely that the next few years will see continued improvements and advances in the business risk model.

Much time and space has been used to discuss past and present notions of auditing, especially the business risk audit methodology. However, the past has brought about changes in the approaches that the audit community use to conduct their business. The future also seems to hold changes for the methodologies used by the auditing community. Robson et al. (2007) take a very critical approach to past and even current use of the business risk audit. They explain that the BRA approach did not really come about because of economic need to keep auditing firms afloat. Instead, they argue that the business risk audit approach became popular because auditors simply wanted to maintain their own level of perceived importance and necessity in the business community. Auditors feared their prestige was declining and so changed their business from one of auditing to one that is more about consulting and business assistance.

Khalifa et al. (2007) are perhaps even more direct in their view of the future of the business risk audit approach when they say

“the re-intervention of audit pursued through the BRA may well have offered a useful source of internal legitimacy to the audit services for several of the Big Four firms. However, a developing body of evidence suggested that BRA methodologies have struggled in practice to displace reliance on prior audit approaches or have proved less popular in particular geographical regions, notably in Europe (p. 846).

Khalifa et al. (2007) also note that regulatory agencies in the United States and the United Kingdom are focusing more on the quality of audit information in new standards. Furthermore, they point out that the debate over audit quality involves the independence of auditing firms, the transparency of audit practices, the documentation and evidence of audit procedures, and increased competition in the auditing market.

Conducting appropriate tests of financial systems and accounting methodologies in companies has been present in the field of auditing for centuries. Interviewing company leaders to examine their motives and the potential for material misstatements is not new. These concepts seemed new under the business risk audit methodology; in reality, however, they were not new at all.

4.8 Summary

This chapter and the previous one reviewed the literature review related to the audit in general, and the BRA in particular. From the information and literature examined, questions have emerged that can form the basis for the research questions that will

guide the investigation performed within this study. It has been noted that the issue of the motivation for auditing firms to adopt the business risk audit methodology has certainly been questioned. However, on a larger level, the issue of whether the business risk audit methodology provides any benefits in terms of how audits are conducted for clients has also been raised. There is also the issue of how the audit process has been improved in general in the aftermath of implementing the business risk audit methodology.

Chapter Five

Business Risk Auditing: Standards Comparison

5.1 Introduction

The purpose of this chapter is to examine the similarities and differences between auditing standards in the United States, Canada and the United Kingdom that specifically deal with the business risk audit approach; international standards are also considered. The move toward global standards of auditing and accounting makes an examination like this one extremely important.

In terms of the research on the business risk audit methodology, an examination of the similarities and differences between the United States, Canada and the United Kingdom also provides an opportunity to determine whether culture and regulatory differences between these three countries result in different ways of implementing the business risk audit methodology. Examining these countries will also provide information about whether cultural and regulatory differences have resulted in auditing firms viewing the business risk audit methodology differently in terms of the impact on client companies and the profession in general.

The regulatory organisations that maintain auditing practices in each of these countries have issued standards on risk audits and the role that auditors must play. What is vital to understand, however, is that the standards issued in the United States, Canada and the United Kingdom feature differences that have led to variations on how auditing firms in

each country approach the business risk audit methodology (Abdel-Khalik, 1998, p. 44).

At the same time, the move toward international standards that will guide the work performed by auditors in the United States, Canada and the United Kingdom continues. This means that while auditors in each of these three countries are working under the guidelines of the professional organisations in their respective countries, international standards are being created and put into place. The end result is that there are similarities and differences that exist not only between auditing practices in each of the three countries but also between each of the three countries and international standards (McCahery, 2002, p. 182).

This chapter will first examine the auditing standards in place for each country concerning the issue of the business risk audit. For each country and the international organisation, the standards that are in place will be discussed in detail with regards to the role of the audit and what information is expected to be provided to those who use the financial reports examined by auditing firms. This separate examination of the standards and practices for each country and the international organisation individually is necessary to provide a basis from which to compare and contrast the practices and standards that are in place across the three countries.

After the separate analysis and examination of auditing standards related to the business risk audit approach, an in-depth comparison of each of the three sets of standards will

occur. This comparison will look at the similarities and differences that exist, and what those differences mean for auditors and the general public. What should become clear by the end of this chapter is that there are basic standards and practices in place to guide the business risk audit approach. At the same time, this analysis will also show how the move toward international standards is being taken seriously in the United States, Canada and the United Kingdom in order to streamline the auditing approach and provide a more level playing field in terms of the information provided to companies and their investors.

5.2 Cultural Differences

The issue of culture deserves attention in this research because the cultures of the United States, Canada and the United Kingdom are different. It has been noted that previous research has shown that differences in accounting and financial practices are present around the world in relation to differences in cultural attitudes (Gray, 1988). Culture impacts the accounting standards that exist within a country because of the way people view individualism and power. Research has demonstrated that countries in which individualism is viewed as being important, particularly within the financial industry, have a greater reliance and place greater importance on numerical statements, but are also more likely to have greater errors in such statements as opposed to countries that are less individualistic in nature and value power sharing (Chan, Lin & Mo, 2003).

This information suggests that auditors in countries in which individualism is a source of pride, such as the United States, may have a less positive attitude toward the business risk audit methodology because they may feel that they are being forced to take certain actions and given up some of their ability to exercise professional judgment. However, because companies in cultures in which individualism is valued may allow employees to make decisions on their own, auditors need to consider that the chance of material misstatements of information increases (Chan, Lin & Mo, 2003). Interestingly, research has found that accounting professionals in the United States tend to be more conservative in how they apply financial reporting rules (Tsakumis, 2007). This means that accountants in the United States actually tend to provide more information when creating financial reports for fear of leaving out something that might later be considered a material misstatement of information.

Furthermore, Ding, Jeanjean & Stolowy (2005) found that culture was actually a more important variable in the determination of the actual accounting standards that are implemented than existing laws. The researchers explain that the cultural attitudes toward rules and standards of practice are often the most important variable in the standards that are put into place. They state that from the standpoint of attempting to achieve a single accounting and auditing standard around the world, cultural issues are likely to make this very difficult. It is less the concerns about technical issues of accounting standards and how they will impact the financial community in a country and more about cultural motivations and attitudes toward accounting standards.

In the United States, the cultural attitude that exists is that government oversight of the accounting industry is required because the private sector cannot regulate itself.

However, many in the accounting and auditing industry in the United Kingdom have actually called for greater private-sector efforts to regulate the accounting industry and ensure that shareholders and the public are protected (Zeff, 2007). This shows the drastic difference in cultural attitudes. The general attitude in the United States is that personnel working in accounting cannot be trusted on their own without oversight from the government. In the United Kingdom, however, there is an attitude that the accounting industry can regulate itself and trust auditors and accountants to act in such a way as to generate the best outcomes for shareholders and the public.

Based upon this information, it might be concluded that auditors in the United States may not like the business risk audit methodology because of feeling that their ability to make their own judgments is being taken away from a set of specific standards and practices. In contrast, auditors in the United Kingdom may have a more positive attitude about BRA because of the benefits that it can provide to audit clients. While this is only speculation at this point, the importance of understanding the impact that culture can have on the accounting industry is to be prepared to examine how differences in attitudes between auditors in the United States, Canada and the United Kingdom that are found in this investigation may not be based on differences in legal standards but instead on cultural differences.

Overall, the literature suggests that cultural differences between countries with regards to the auditing industry are not something that can be ignored. Instead, cultural

differences can be important in terms of how auditing standards are carried out, as well as how auditors in different countries perceive their roles and responsibilities.

5.3 Professional Auditing Organisations

5.3.1 United States

In the United States, the American Institute for Certified Public Accountants (AICPA) is the organisation responsible for issuing Statements on Auditing Standards (SAS). At present, there are three specific statements, SAS 107, 108 and 109, that concern three important issues that auditors in the United States should take into account when performing business risk audits. These three areas concern the role of the auditor, an understanding of the entity being audited, and the tests and procedures needed to determine the risk that is present (Fragniere & Sullivan, 2006, p. 104).

5.3.2 Canada

In Canada, the organisation responsible for creating professional standards for auditors is the Auditing and Assurance Standards Board (AASB). This organisation has created standards and practices for the business risk audit approach dealing with the role of the auditor, the procedures that are to take place, and understanding the entity (Keenan, 2005 p. 43). It is worth going through the Canadian standards, as some differ from those in the United States.

Canadian public companies will start reporting their financial statements in accordance with the IFRS standards in 2011 (Canadian Institute of Chartered Accountants, 2009). As a result of the IFRS adaptation, Canada is currently working on a proposed new set of auditing standards similar to international standards. They are called Canadian Auditing Standards (CAS). The numbers of the new CASs are similar to the numbers of the ISAs.

5.3.3 United Kingdom

The United Kingdom has adopted standards issued by the International Auditing and Assurance Standards Board for use in all UK audits. The International Auditing and Assurance Standards Board (IAASB) is the organisation that has taken on the task of putting together the framework for international standards of auditing. The documents created by this organisation are known as International Standards on Auditing (ISAs). These standards have important implications for auditors involved in the business risk audit methodology. As with the US and Canadian standards that have been discussed, these standards can be broken down into the following three areas: the role of the auditor, understanding the entity, and procedures and tests (International Auditing Standards May Get Clearer, 2007).

In 2004 the Auditing Practices Board (APB), which oversees auditing standards for the United Kingdom and Ireland, began moving toward the use of the international standards. The idea behind the move was that it would help unify auditing standards and update auditing practices based on the financial scandals that took place in the United States and Europe during the late 1990s and in the early part of this decade (Auditing Practices Board, 2004).

In their decision to move toward the use of the International Standards of Auditing, the Auditing Practices Board listed benefits of making the change:

- It will help maintain the stature of UK and Irish standards internationally. In the aftermath of accounting and auditing failures in the US and Continental Europe, securities regulators and governments have recognised the value of harmonised auditing standards. In particular, the European Commission is in the process of introducing an amended directive on the statutory audit that will, in all probability, require the adoption of ISAs by all member states.
- It will allow the APB to efficiently benefit from future improvements to ISAs. APB members are involved in working parties to revise the ISAs on materiality and accounting estimates and, in so doing, focus on the issue of management bias - a common element in aggressive earnings management. The UK is also involved in IAASB projects to revise ISAs on audit reports, group audits and related parties (Auditing Practices Board, 2004).

The real benefit, at least from the standpoint of auditors using the business risk audit method, is that by using international standards in the United Kingdom and Ireland, they also know that they are following the standards for those countries as well. This makes the job of following standards and communicating information much easier because everyone is aware of which standard is being used, and those standards are the same for everyone. At the same time, there is no doubt about which standard to use since UK standards and international standards are one and the same. From now on in this chapter, international standards will be used to conduct auditors, since it is the standard used in the UK.

5.4 The Role of the Auditor

This section will discuss the standards listed below. These standards are discussed in detail because they are related to risk-based standards and impact the way in which the business risk audit methodology is carried out in practice. By examining these standards, it will be possible to gain an understanding of how these standards impact the way in which auditors in the United States, Canada and the United Kingdom approach the business risk audit methodology.

- SAS No. 108, Planning and Supervision
- CICA Handbook Section 5150, Planning (new proposed CAS 300 Planning an Audit of Financial Statements)
- ISA 300, Planning an Audit of Financial Statements

5.4.1 United States

First and foremost, the auditing standards explain that the auditor must help create an understanding with the client about the purpose of the audit, as well as the responsibilities of the auditor and the client themselves (Zimbelman, 1997). At the same time, the auditing standards in the United States explain that the objective of an audit is for the auditor to express an opinion about the financial statements presented to the public (SAS No. 108, p. 1593).

In addition, guidelines for auditors developed by the AICPA actually make it the auditor's responsibility to prove that, among other things, he or she is independent from the entity being audited (Zimbelman, 1997). It is also the job of the auditor to ensure that he or she has the resources necessary, including the necessary documents and access to necessary documents and personnel, to conduct a business risk audit. Finally, the auditor is responsible for managing the resources needed to conduct a full audit of a company (SAS No. 108, pp. 1595-1596).

Finally, in terms of the actual role of the auditor in the larger sense of conducting a business risk audit, it is the job of the auditor to actually create and oversee the audit plan. The audit plan should include the nature of the audit, the timing of the audit and the extent to which the business risk audit approach is to be carried out (SAS No. 108, p. 1597). In some respects this may seem like common sense, but the standards laid out in the United States for auditing carried out in that country make it clear that the auditor is solely responsible for planning and executing the business risk audit. In addition, all of these guidelines lay the foundation for the responsibilities of the auditor over the entire business risk audit approach.

In many respects, it is quite clear from these guidelines that auditors in the United States are expected to take charge when they enter into an agreement with a client to conduct a business risk audit. While the entity that has hired the auditor is a customer, the auditor must step out of the role of trying to treat the entity like a client and instead

treat the entity and its information in a manner that ensures all risk is identified and unnecessary risk is avoided for the sake of that entity and its own investors.

5.4.2 Canada

Canadian procedures, as outlined in CICA Handbook Section 5150, call for auditors involved in the business risk audit approach to not only have an understanding with the entity being audited about what is take place, but to have that agreement in writing (Viger et al., 2004). It is explained that the Auditing Assurance Standards Board in Canada believes that the understanding between the auditor and the entity will be stronger and clearer if the agreement is in writing rather than simply a discussion of what is to take place. Furthermore, the Canadian guidelines establish what the written agreement document between the auditor and the entity should entail. The guidelines call for several things:

- the objectives, scope and limitations of the engagement
- the responsibilities of the auditor, including the requirement to perform the audit in accordance with GAAS (a list of specific responsibilities that must be addressed to the letter is provided)
- management's responsibilities (a list of specific responsibilities that must be addressed to the letter is provided)
- other matters relevant and important to the engagement (Comparison of International Standards, 2006, p. 3).

In fact, the Canadian standards for business risk audits seem to emphasize the importance of expressly stating that documentation at all levels of the audit by the auditor is key. The Canadian guidelines do not just imply but expressly state that auditors are to document all aspects of the audit, from the procedures that are used, to the findings, to the actual actions taken to address the issues and risks found in the audit. All of these steps must be documented in the auditor's final report, which is made available to the public (Comparison of International Standards, 2006, p. 5).

In addition, the Canadian guidelines state elsewhere that the auditor must make it his or her task to communicate matters and issues surrounding the audit with the management of the entity being audited. Even more, rather than being vague about simply communicating important matters, the standards actually lay out what types of information should be communicated. This information includes the auditor's independence in the audit, any fraud or errors that are found, acts that are either illegal or could be illegal, weaknesses in the entity's internal control system, and any supporting information that has allowed the auditor to make these judgments (Comparison of International Standards, 2006, pp. 7-8).

As with other areas of Canadian practices that discuss the actual role of the auditor, the guidelines do not leave a great deal open to professional judgment. Instead, much of what is to be communicated is expressly stated and listed. In some respects, it appears that these guidelines are actually intended to set the foundation of the business risk audit between the auditor and the entity so that there is no confusion about what is to take place or how it will take place (Johnstone, 2000).

One of the other tasks involved in the auditor's role under Canadian standards is ensuring that all members of the audit team follow the standards and practices that have been created for audits. This goes so far as to give the auditor the task of resolving any disputes or conflicts of professional judgment that might exist within the audit team. In fact, it is expressly stated that the auditor is not to release any reports to the public or even to the entity being audited until all disagreements or disputes among the audit team have been resolved (Comparison of International Standards, 2006, p. 4).

5.4.3 International Standards

The International Audit Standards describe the role that the auditor is to play in conducting the business risk audit of an entity. Before any audit or even plans for an audit begin, the standard ISA 300 states clearly that the auditor must be sure that he or she has the proper degree of independence from the entity being audited (International Standards on Auditing, 2005). In addition, it is the auditor's job to ensure there are no conflicts between the auditor's own view of the entity's management and the management's integrity that might cause conflict between the two parties as the audit proceeds. Finally, there must be an understanding between the auditor and the entity about what is to take place (ISA 300, 2005, p. 4).

What should be noted from the initial tasks given to the auditor by the international auditing standards is that there must be no conflict in how the auditor feels about the integrity of an entity's management. In many respects, what is being stated here is that

an auditor should not take an auditing assignment or job if he or she begins the job with the idea that an entity's management lacks the proper integrity to avoid any material risks, or at least clearly explain them in financial documents. If the auditor takes on an assignment, he or she must be willing to continue regardless of the actions or perceived notions of the level of integrity of an entity's management.

The next role of the auditor is to establish the actual audit strategy. The international standards use such terms as scope, timing and direction to describe the basis upon which the auditor must plan the audit strategy. However, the standards list three very distinct areas that must be part of the planning process of the larger audit strategy:

- Determining the characteristics of the engagement that define its scope, such as the financial reporting framework used, industry-specific reporting requirements and the locations of the components of the entity.
- Ascertaining the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required, such as deadlines for interim and final reporting, and key dates for expected communications with management and those charged with governance.
- Considering the important factors that will determine the focus of the engagement team's efforts, such as determination of appropriate materiality levels, preliminary identification of areas where there may be higher risks of material misstatements, preliminary identification of material components and account balances, evaluation of whether the auditor may plan to obtain evidence regarding the effectiveness of internal control, and identification of recent significant entity-specific,

industry, financial reporting or other relevant developments (ISA 300, 2005, p. 5).

Aside from planning the actual process that will be used to conduct the business risk audit, international standards also state that the auditor's role is to lead and supervise the entire audit team. It is the auditor's role not only to supervise the work being performed but also to review the work completed by the audit team. Finally, the auditor is responsible for determining what individual and specific tasks will be carried out by which team members, based on their individual levels of knowledge and ability (ISA 300, 2005, pp. 8-9).

Finally, it is the role of the auditor to actually document and communicate the work being performed with the management of the entity being audited. However, the international standards do warn that the auditor should take care to determine whether discussing specific information about the audit before it is carried out might compromise the larger audit effort. Too much discussion about the procedures that will be used in the audit might make those procedures and tests predictable for the entity and prevent the discovery of risks and errors (ISA 300, 2005, p. 10).

What can be seen from these international standards is that the auditor is given a great deal of advice, along with some standards, for beginning the audit process. The auditor is definitely advised on how to approach the management of the entity being audited, as well as when and how to communicate information with them about the audit process.

The auditor must constantly take into account the potential risk to the integrity of the audit when communicating with an entity's management before the audit has been completed.

After reviewing the various standards and what they say about the role of the auditor, it is easy to see that the auditor is given a great deal of authority and responsibility. The auditor is not only responsible for all aspects of the audit process but must also act as negotiator, fact finder, and even a bridge between the audit team and the executive managers of companies being audited. On the one hand, this seems like a great deal of responsibility to give to one person. The auditor not only assumes all these responsibilities but also faces problems when these conditions are not met. However, the other side of the argument is that senior auditors lead audit teams and must be prepared to take on these roles not only to conduct proper audits but also to train junior members of audit teams on their roles and responsibilities.

This information is important in relation to the business risk audit methodology because it notes the actions that are expected of auditors in Canada with regards to the data that they examine and the interactions that they have with their clients. These standards act as a foundation for the way in which auditors perform their duties. The standards that have been examined with regards to the role of the auditor in the United States, Canada and the United Kingdom indicate that auditors must be impartial in how they conduct themselves. However, professional judgement is also something that is discussed. In terms of the business risk audit methodology, this would suggest that auditors have a

great deal of freedom to determine for themselves the type of information and internal systems they need to examine in order to complete a business risk audit.

5.5 Understanding the Entity

In this section the following standards will be discussed:

- SAS No. 109, Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement
- CICA Handbook Section 5141, Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement (new proposed CAS 315 Identifying and Assessing the Risks of Material Misstatement, Through Understanding the Entity and its Environment)
- ISA 315, Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement

5.5.1 United States

The next set of guidelines for auditors using the business risk audit approach in the United States involves understanding the entity for which an audit is being conducted. The guidelines for auditors go far beyond simply talking about doing a textbook-type evaluation of an entity and its business environment. Instead, the audit procedures actually make clear who in an entity might be useful for gaining important information to determine the level of risk that is present. For example, the audit procedures state that making inquiries to a company's leadership, internal audit personnel, and even front-line employees can all provide useful information for the business risk audit approach (SAS No. 109, p. 1615).

More specifically, audit standards in the United States actually spell out what types of employees might be useful for inquiry in the business risk audit approach, and the type of information they might provide. First, the procedures explain that approaching employees involved in handling large or unusual transactions or orders might be a source of information in terms of how appropriate an entity's accounting procedures are in relation to the type of transactions being handled. Another example is talking to marketing personnel within an entity to help determine whether a company is going through a major change in marketing or sales strategies that could pose a risk to the entity and its investors (SAS No. 109, p. 1615).

Business risk audit standards in the United States list areas in which actual observations can be conducted to help auditors obtain important information about the environment in which an entity is operating. On the surface, most people would expect that areas such as document archives and business plans would be important areas of observation. However, the standards also make note of observations of an entity's manufacturing or business operations areas. They even mention making actual visual observation of how transactions move from the point where they enter a company's computer systems to where an internal department handles recording those transactions.

- Observation of entity activities and operations
- Inspection of documents (such as business plans and strategies), records and internal control manuals
- Reading reports prepared by management (such as quarterly management reports and interim financial statements), those charged with governance (such as minutes of board of directors' meetings), and internal audit

- Visits to the entity's premises and plant facilities
- Tracing transactions through the information system relevant to financial reporting, which may be performed as part of a walk-through (SAS No. 109, pp. 1615-1616).

US auditing standards go on to explain that in order for an auditor to understand the total business environment in which an entity operates, other areas must be examined. These include understanding the industry in which the organisation operates, as well as the regulatory aspects of that industry. In addition, an auditor should understand the strategies of the entity being audited and the potential risks associated with those strategies and objectives. Of course, the auditor should also have financial statements from the entity to determine where potential risks may exist in terms of what is stated by the company and what actually appears on their financial records (SAS No. 109, p. 1618).

The procedures for the business risk approach to conducting audits in the United States include being able to examine an entity's internal control systems to prevent and handle risk. It is worth mentioning this because the procedures for evaluating the internal control system of an entity go beyond simply making sure that there are steps in place to prevent and handle risk, such as ensuring that transactions are handled in specific ways or that those steps are taken to ensure financial resources are handled properly. These standards go beyond that to instructing auditors to look at how ethical issues are communicated within an organisation.

In addition, auditors are instructed to examine the degree to which an entity's management considers the competence of key employees. The auditor should also be aware of the entity's organisational structure and the assignment of authority and responsibility within that structure. Finally, the procedures call for an understanding of the human resource policies of the entity being audited, as well as how the entity handles such issues as recruitment and retention, orientation of new employees, training and even compensation (SAS No. 109, pp. 1629-1630).

Overall, guidelines in the United States call for auditors to do more than simply take a surface-level approach to understanding an entity. They call for an examination of how entities interact with their employees and how those interactions may lead to important risks for the future of a company and its investors. Even more, the procedures for business risk audits call for the auditor to move away from information that can be gained on paper and examine an entity and its operations and structure firsthand. The idea is that this can help an auditor determine if what is being stated on paper and what is actually taking place within an entity may lead to risks that should be made public.

In terms of the business risk audit methodology, the standards that are present in the United States with regards to understanding the entity require that auditors fully understand more than just what is located on a balance sheet. Just as the business risk audit methodology requires that auditors examine the larger operations of a company and other companies with which relationships exist, the standards present in the United States also require this of auditors.

5.5.2 Canada

The Canadian standards discuss the important issue of understanding the entity and the larger business environment in which it operates. What is interesting, however, is that some of these guidelines are actually more to the point and succinct than the guidelines regarding the actual role of the auditor. For example, in understanding the entity, the Canadian guidelines state that other auditors' previous reports should be used as a basis for understanding the entity's current situation and the potential for risk or misstated information (Comparison of International Standards, 2006, p. 4).

It is also interesting that understanding the entity itself appears to be left mostly to the auditor's professional judgment. The guidelines that talk about understanding the entity appear to focus more on having an understanding with the management of the entity that exists in writing, and being able to communicate with management in a timely and efficient manner. In many respects, at least on the surface, it seems that the Canadian guidelines are heavily focused on having a direct understanding of an entity's management structure and the individuals that lead the organisation.

In relation to the business risk audit methodology, the standards used in Canada would certainly seem to guide auditors to carry out the functions and procedures that are called for as part of concepts related to the business risk audit methodology. These standards call for auditors to understand the management structure and operations of their clients. The idea behind having an understanding of the management of a company is to allow

auditors to better understand decisions that they might make that might result in added risk. This is information that auditors need in order to perform their roles under the business risk audit methodology, which means that the standards used in Canada in terms of understanding an entity once again seem to have much in common with BRA.

5.5.3 International Standards

The international standards state that the auditor should obtain as much information about the entity being audited as possible. This information does not just include what can be learned from internal documents regarding transactions and business plans. The auditor should obtain information by asking questions of various types of employees and management members within the company. At the same time, the auditor should examine the actual working facilities of the entity and follow the path that transactions and other financial reporting takes from its beginning in the company to its final reportage (ISA 315, 2005, pp. 6-8).

Furthermore, the international standards list five specific areas that the auditor should understand about the entity and its industry in order to be able to make judgments about risks and potential material misstatements of financial information:

- Industry, regulatory, and other external factors, including the applicable financial reporting framework
- Nature of the entity, including the entity's selection and application of accounting policies

- Objectives and strategies and the related business risks that may result in a material misstatement of the financial elements
- Measurement and review of the entity's financial performance
- Internal control (ISA 315, 2005, p. 11).

The international standards state very clearly that auditors must understand the entity's objectives and the risks related to those objectives. The standards explain that such information can be obtained from looking at the entity's stated objectives, as well as business plans and other strategies for the entity's future. The standards explain that examining all of these things is important because strategies and objectives have risks associated with them. It is the auditor's job to understand the risks that are present merely based on the plans and strategies that an entity's management has for its future (ISA 315, 2005, p. 14).

The internal control system is another area where guidelines are listed for evaluation of potential risks or other material information that should be made available in an entity's financial statements. The international standards list the various aspects of an entity's internal control system. These are listed as:

- The control environment
- The entity's risk measurement process
- The information system, including related processes, relevant to financial reporting and communication
- Control activities
- Monitoring of controls (ISA 315, 2005, p. 17).

In addition, the international standards provide guidance for the auditor in the examination of the internal automation and technology systems that are in place to track and record transactions for financial reporting purposes. What is important about this in terms of the business risk audit approach is that risks are listed in the guidelines that auditors should be aware of. For example, the guidelines explain that IT systems can pose risks in terms of users who are not authorised to have access to systems being able to destroy or manipulate data. In addition, IT systems can present risks when data is not updated as it should be, or when data is lost because of inappropriate steps taken to back up and protect information. This is presented not necessarily to establish any hard and fast rules but rather to be part of the larger examination of the control systems in place in a company. The auditor should examine the level to which a company monitors its IT infrastructure to ensure that the data being processed and reported is as accurate and error-free as possible (ISA 315, 2005, pp. 22-24).

Beyond the actual guidelines and suggestions for how to understand the entity being audited, it is interesting to note the amount of information contained in the guidelines about understanding an entity. These guidelines are over 100 pages long. This is the longest of the documents that are central to conducting the business risk audit. The document providing standards and guidelines about understanding the entity is actually longer than the standards for the audit procedures. This may say something about the importance of actually understanding the entity being audited in terms of being able to conduct an audit into business risks.

It would seem that the most important aspect of an audit is understanding the entity being audited. This part of the audit process can potentially reveal more about a company than anything contained in financial records. This part of the audit process can allow an auditor to determine if the management of the company appears to be hiding material information, or may have the desire to hide material information. While this might seem like wasted work for auditors, or more like friendly meetings, important information can be obtained from these meetings. These are definitely tasks that should not be taken lightly. In fact, these so-called friendly meetings could provide essential information for investors and other stakeholders.

Overall, the standards that are in place in the United States, Canada and the United Kingdom do have slight differences in terms of the specific focus that auditors are asked or required to place on the entity, such as either focusing more on the actions of company management or more broadly on the entity in general and its relationship and actions with suppliers and others. From a critical standpoint, these slight differences might not seem very important. However, it is possible that these slight differences in how auditors are guided with regards to where their focus should be during an audit could mean that the business risk audit methodology is carried out differently between the United States, Canada and the United Kingdom.

5.6 Tests and Procedures

In this section the following standards will be discussed:

- SAS No. 110, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained
- CICA Handbook Section 5143, The Auditor's Procedures in Response to Assessed Risks (new proposed CAS 330 The Auditor's Responses to Assessed Risks)
- ISA 330, The Auditor's Procedures in Response to Assessed Risks

5.6.1 United States

In terms of the actual tests and procedures that an auditor should use during the business risk audit approach, standards and practices in the United States leave this up to the auditor's professional judgment. What the standards do explain, however, is a basis for which tests and procedures should be used. For example, the procedures state that the auditor should take into account the significance of the risk that is present, as well as the likelihood of there being mistakes or misstatements in the financial reports of the company being audited. In addition, the standards call for tests and procedures to be chosen based on the type of internal controls and procedures that are in place within the entity being audited (SAS No. 110, p. 1673).

The standards in the United States list several guidelines by which auditors should determine the extent to which they are going to test for risk controls in an entity. These guidelines are centered around not only the controls used by the entity but also other factors based on the controls in place, such as operating effectiveness and even how much data the auditor obtains from other sources.

- The frequency of the performance of the control by the entity during the period.

- The length of time during the audit period that the auditor relies on the operating effectiveness of the control.
- The relevance and reliability of the audit evidence to be obtained in supporting that the control prevents, or detects and corrects, material misstatements at the relevant assertion level.
- The extent to which audit evidence is obtained from tests of other controls related to the relevant assertion.
- The extent to which the auditor plans to rely on the operating effectiveness of the control in the assessment of risk (thereby reducing substantive procedures based on the reliance of such control).
- The expected deviation from the control (SAS No. 110, p. 1681).

In some respects, the actual tests and audit procedures for business risk audits in the United States are left to the professional judgment of the auditors, as well as to the specific situations of the entities being audited. Auditors are expected to use their knowledge, as well as the knowledge they have gained from studying the entity and its business environment, to determine which tests and audit procedures are necessary for a full evaluation of the risks that are present. In many respects, this makes a great deal of sense. Establishing specific tests and audit procedures for use in all business risk audits would be very difficult. Even worse, it would limit or hinder auditors when those tests and procedures needed to be changed. In this regard, auditors in the United States have a certain level of freedom to find risk and evaluate its importance in terms of the entire picture of the entity being examined.

5.6.2 Canada

The actual tests and procedures carried out by the auditor to determine if material risk or even misstatements are present are not entirely left to professional judgment. While professional judgment is certainly part of the business risk audit approach, there are guidelines in place that make it very clear what auditors are to look for to determine the level of risk present within an entity. For example, auditors in Canada are required to examine the internal control systems of the entity being audited and determine if the internal control systems are in place and actually working. At the same time, auditors are required to have an understanding of the internal controls even when these controls may not be relied upon to determine risks or misstatements in the final audit plan (Keenan, 2005, p. 44).

This emphasis in the Canadian standards for examining internal controls is related to another important area of the guidelines known as significant risk. Under Canadian standards, auditors are required to examine significant risks based on the following criteria:

- Auditors must evaluate the design of controls over significant risks and determine the implementation of controls that address significant risks.
- When a significant risk is identified and reliance is planned on the operating effectiveness of controls intended to mitigate the risk, audit evidence must be obtained about the operating effectiveness of relevant controls in every period audited.

- When the approach to significant risks consists only of substantive procedures, audit procedures must include tests of details (Keenan, 2005, p. 44).

Finally, auditors rely on professional judgment to determine exactly how they will test for errors or misstatements involving risks that deal with the control mechanisms or inherent risks associated with an entity. They are allowed to make judgments as to whether their tests and procedures should combine the control risks and inherent risks, or if these areas should be tested separately. However, the Canadian guidelines do state that tests and procedures implemented by the auditor should be linked to potential risks of the entity in terms of the nature of the risks, the timing and the extent of those potential risks (Keenan, 2005, p. 44).

5.6.3 International Standards

The international standards for business risk audit procedures begin with standards for determining the procedures that are needed based on the entity being audited. The issues stated as a basis for determining audit procedures are:

- The significance of the risk
- The likelihood that a material misstatement will occur
- The characteristics of the class of transactions, account balance, or disclosure involved
- The nature of the specific controls used by the entity, particularly whether they are manual or automated

- Whether the auditor expects to obtain audit evidence to determine if the entity's controls are effective in preventing or detecting and correcting material misstatements (ISA 330, 2005, pp. 4-5).

International standards also call for auditors to use professional judgment when considering which tests are appropriate based on the nature of the entity being audited, as well as the timing of financial information that is available, and the extent of controls. The standards state that the tests and procedures that are separate from the final audit processes should be suitable based on what is known about the company. In addition, the guidelines state that the auditor should take into account the reliability of the data being used to determine audit procedures. Finally, the auditor should take into account the potential risks that are present in order to determine the most appropriate audit procedures to use for a specific entity (ISA 330, 2005, pp. 19-20).

One concern about the tests and procedures created by auditors for the audit process is that the standards leave a great deal up to the auditors' professional judgment. While this is certainly understandable because all audits are different, it can also lead to some confusion and even laziness on the part of auditors. If auditors think that a company has nothing to hide, they may be tempted to create tests that are easy to carry out. This could result in material information being missed. While it is certainly understandable that professional organisations do not want to limit the judgment that auditors can use, more guidance in this area might be warranted.

5.7 Conclusion about Auditing Standards

The discussion of auditing standards in the United States, Canada, the United Kingdom, and international standards have allowed for an examination of specific rules and areas of interest in each country. This in-depth discussion was necessary in order to compare the auditing standards and discuss the similarities and differences that exist between the different countries. In fact, this discussion brought to the forefront many differences that became apparent simply by examining each country's auditing standards.

The remainder of this chapter is devoted to discussing the similarities and differences in the auditing standards that have been found. This discussion will not only focus on the stated differences in how audits should be carried out but also in what is implied by the differences and similarities in the standards for the countries that have been presented.

5.7.1 Similarities among Business Risk Audit Standards

One of the first similarities existing among all of the auditing standards is the need for auditors to be independent of the entity they are auditing. The standards for all the countries examined make clear that the auditor's first task in a business risk audit is to ensure that he or she has the proper independence from the entity and its management structure to perform audit duties without any conflict. Perhaps the only difference between standards lies in the fact that the international standards actually go one step beyond simply stating that auditors must ensure their independence of the entity being audited. The international standards explain that the auditor must also ensure that he or

she has no issues with the integrity of an entity's management that would cause a problem with the completion of the audit process.

Another commonality among all of the standards that were examined, and one that is not surprising, is the fact that they all state that the auditor is the leader and supervisor of the entire audit process. It is the auditor's job to assemble a team and ensure that team has the necessary skills and instructions to carry out the audit and other functions that have been discussed by the entity and the auditor. In fact, all of the standards seem to make clear that the auditor is not merely someone to rubber stamp ideas and actions taken by others on his or her team. Instead, the auditor must be involved throughout the process. It is the auditor who is ultimately responsible for all the decisions made about the business risk audit, and he or she is ultimately responsible for the audit report that goes to an entity's management and to the public.

In many respects, this relates to the notion that across all of the standards the auditor is more than just someone allocating tasks to others. All the standards make clear that the auditor is expected to study the internal control mechanisms that are in place, as well as the internal structure that is used to process and handle transactions. In fact, this is directly related to the task of understanding the information technology systems that are in place in the entity being audited. All of the standards make a point of explaining that an examination of an entity's IT systems is important when conducting a business risk audit.

All the standards explain that IT systems can pose risks for an entity that would certainly not show up on paper in the form of financial statements or future goals or objectives. IT systems present the opportunity for data to be mishandled or for individuals without permission to access them for their own benefit. This relates to another similarity among the standards: they all explain that the auditor needs to examine the IT systems to determine how access to these systems and the information they contain is controlled. Even more, auditors need to ask questions and become educated within each entity being audited as to the policies of handling attacks on IT systems and ensuring data protection.

This leads to another similarity: all the standards make the point that business risk audits need to look for risks that may not even be directly related only to financial figures and transactions. The business risk audit methodology is about considering everything about an entity, from its management structure to the way that it handles customers to its long-term goals and objectives, and determining where material risks may exist. All of the standards reviewed advise auditors that everything about an entity needs to be known. All of the standards explain that auditors need to interview various types of employees, including front-line employees in sales and marketing, to gain a better understanding of how an entity functions.

Auditors are also advised in all of the standards to actually look at the production facilities and examine the workspace of the entity in order to better understand the company. This is part of gaining information about an entity's industry, various laws and regulations that govern how companies in that industry operate, and even how

management has responded to rules and regulations in the past. The underlying idea is that all of these things can work together, or even individually, to create material risk. The standards in the United States, Canada, the United Kingdom and international standards, are quick to realize this aspect of the business risk audit.

All of the auditing standards reviewed are similar in the way that they approach the basis for the way in which audits are carried out. The specific tests and procedures conducted for any specific audit are left up to the auditor's professional judgment. While all of the standards lay out specifics about what areas are advisable to be examined and investigated, the final audit plan is left up to the auditor and what he or she feels is necessary after thoroughly examining an entity. None of the standards expressly state types of tests or audit plans for all situations. However, the importance of professional judgment based on a thorough examination of an entity is expressed across all of the auditing standards. In fact, the term professional judgment is frequently used in all of the standards.

Similar among all of the auditing standards in the United States, Canada, the United Kingdom and the international standards is the importance placed on the auditors' professional judgment and integrity. They are given guidance for ensuring that they have all of the information they need to identify all of the areas in which risk can be present. On a larger scale, auditors in all of the countries discussed are expected to lead their auditing teams and truly know what is going on. In many respects, they are not expected to simply be an auditing firm partner that directs others. Instead, they are expected to be an active part of the auditing team. Under the business risk audit

methodology, and considering everything that is required to understand an entity and be able to pinpoint risks, this is actually not surprising.

5.7.2 Differences among Business Risk Audit Standards

While there are many general similarities between the various auditing standards that have been discussed, there are also some important differences. One of the first differences that becomes apparent between the standards has to do with the importance of the entity in the Canadian standards. All of the standards explain the importance of understanding the entity being audited but the Canadian auditing standards touch on specific points of the entity. For example, much of the discussion about understanding the entity in the Canadian standards seems to be specific to actually understanding the management of the entity rather than the entity as a whole.

Much of the Canadian standards focus the attention of the auditor on the management of the company being audited. The auditor is actually informed to ensure that he or she has no conflict with the company's management that would cause him or her to desire to drop out of the audit process before its completion. None of the other standards discussed in this chapter present something so specific. The other standards only discuss the necessity that auditors be independent from the management of the entity being audited.

Furthermore, the US, UK and international standards, talk about the need for the auditor to have an understanding about the entity being audited and the purpose of the audit in

terms of discovering potential business risks. The Canadian standards, however, specifically state that these topics should not only be discussed between the auditor and an entity's management but should be stated in writing. The written agreement should include details about the nature of the audit, as well as other details about the engagement of the auditor with the entity.

In fact, many of the auditing standards in Canada require agreements and even discussions to exist in writing. This is very different from the standards in the other countries, which allow some of the discussions between an auditor and an entity's management, especially in the early planning stages, to exist purely in the form of conversation. Canadian standards, however, state that getting agreements and information in writing prevents misunderstandings and disagreements later in the auditing process.

The stringent standards about reaching an understanding between an auditor and an entity also allude to the actual procedures and tests that determine whether risk is present in a company. While the auditing standards of the other countries point out the importance of finding risk and determining whether it is material in nature, Canadian standards actually have a special category known as significant risk. This section defines how auditors are required to examine whether significant risk is present in an entity. These types of strict auditing standards for specific risk are not found in the auditing standards of the other nations. Other standards simply talk about the need to look for risk and use appropriate tests and procedures to test for risk based on personal

judgment. The Canadian standards, however, treat significant risk as a separate issue with its own rules.

Another important difference between Canadian auditing standards and the standards of the other nations involves the actual process of testing for risks. The standards of the other nations explain that examining internal control systems is one way of finding material risks that should be reported on financial statements. The Canadian standards, however, go one step further by explaining that testing internal controls is not only required but that the actual process used to test the internal controls must be part of the final report submitted by the auditor to an entity's management.

Canadian auditing standards expect auditors to have a thorough understanding of the internal control systems. This is true regardless of whether the internal control systems actually show any risk that needs to be discussed in the final audit report. Unlike in the other countries discussed, this is also an area of the actual testing and auditing process where auditors do not have sole power to make professional judgments about what needs to be done in order to successfully conduct the business risk audit. Canadian auditing standards set down certain rules that must be followed for all audits.

This is, in fact, one of the biggest differences between the Canadian auditing standards and those in the United States, the United Kingdom, or the international standards. The Canadian standards leave a great deal of the audit process up to the auditor's professional judgment, as do the standards of the other countries. However, the

Canadian auditing standards also contain many more areas where auditors are directed to specific standards of practice that do not leave room for professional judgment. In these sections, such as a full examination of internal controls or following criteria to discover so-called significant risk that may be present in an entity, less room is left for professional judgment. Instead, auditors are expected to follow the criteria for each business risk audit, whether it may be useful or not.

At this point it seems necessary to talk about Canadian standards in relation to international standards, considering that there is a move in many countries to adopt true international standards. The fact of the matter is that the accounting standards in Canada state quite clearly that some of the Canadian accounting standards have requirements that go beyond what is required in the international standards (Canadian Institute of Chartered Accountants, 2006, p. 2). In some regards, this might be an understatement. Many of the various aspects of conducting business risk audits that have been discussed in this paper have rules and requirements with many more details and procedures to observe in the Canadian standards than in the international standards.

Because of the vast number of differences that exist between Canadian standards and international standards, there is actually a list of differences Canadian auditors can use as a guide (Canadian Institute of Chartered Accountants, 2006, p. 1). Looking through this document quickly shows that Canada takes the auditor's role very seriously and in most cases has more stringent guidelines and requirements for auditors to follow than the international standards. What also becomes clear is that many of the guidelines set out in the Canadian standards have specific elements that must be understood and

followed. As has been stated in this report, auditors are given a great deal of room to make personal judgments. However, there are areas of the Canadian standards where even the freedom auditors have to make professional judgments is specifically stated (Adopting International Standards on Auditing, 2006, p. 1).

It should also be noted that the vast differences that exist between Canadian and international auditing standards do not mean that Canada is not working toward a more uniform set of accounting standards. In fact, current guidelines state that the CASs comes into effect for audits of financial statements for the period ending on or after December 14, 2010 (Canadian Institute of Chartered Accountants, 2009A).

In fact, the present rules call for Canada to have a set of auditing standards that work with international standards. One way that this will take place is that each international standard will have a corresponding Canadian standard with the same title, to make reference between them easier. In addition, it is expected that there will only be a Canadian standard for each auditing rule for which an international standard exists. In other words, all standards used in Canada will truly mirror international standards, down to their number and title (Adopting International Standards on Auditing, 2006, p. 4).

At the same time, Canadian standards will take into account differences that exist between Canadian law and the laws of the country's various provinces. When this occurs, Canadian laws and regulations will certainly take precedence over international

standards. This makes it seem unlikely that Canada will ever fully adopt the international standards without exerting some control over them (Adopting International Accounting Standards on Auditing, 2006, p. 10).

Moving away from the Canadian audit standards, the only other major difference has to do with the requirement in the international standards that an auditor ensure that the integrity of a company's management will not interfere with the auditor finishing their task. The auditing standards for the United States, Canada and the United Kingdom certainly make clear that an auditor should be prepared to finish the task that he has taken on. However, international standards make clear that the auditor must ensure that no issues will arise during in the audit process that will prevent the auditor from completing the engagement.

In some respects, the international standards actually put more pressure on the auditor to perform a thorough check of an entity and its management before even accepting an engagement. Once an auditor accepts an engagement, he or she is essentially obligated to complete the task. This remains the case even if the auditor becomes disgruntled over feeling that the management of a company may not be taking the audit seriously and is not working toward dealing with any risks found. Instead, the auditor is expected to complete the business risk audit and report on the risks that have been found.

From another angle, this requirement really seems to say that an auditor cannot simply walk away from a business risk audit if dealing with a company's management

becomes difficult. Instead, the requirement for an auditor to actually work with a company's management and find ways to communicate in a timely manner about the risks that have been identified becomes more important. In some ways, this requirement in the international standards makes it difficult for an auditor to simply leave because he or she finds an entity's management unfriendly or uncooperative. This may be the information that an auditor needs to bring to the forefront because it presents risks for the future of the company and its investors. In the end, this may actually be a very good requirement in terms of the business risk audit methodology.

5.7.3 Conclusion about the Similarities and Differences of Auditing Standards

On the surface, the auditing standards that are in place in the United States, Canada, the United Kingdom and international standards appear to essentially be very similar. The fact of the matter is that all of them are very similar in nature. They all share a goal of guiding auditors so that potential business risks can be discovered and brought to the attention of a company's management and its investors in business risk audits

As work continues to try and standardise auditing requirements across each of these nations with international standards, it is not surprising that there are many more similarities than differences. This is also true as more and more companies operate on a global scale and countries do their best to ensure that financial reporting makes sense regardless of the country in which auditing takes place. Investors and the public benefit from having audits that are conducted in a similar nature across nations so that the information presented can be trusted regardless of which standard is used.

However, based on reading and examining each of the auditing standards, it seems that Canada actually has stricter guidelines, especially for auditors involved in the business risk audit approach. These guidelines leave much less up to the auditors' professional judgment and provide more room for interpretation of what types of actions need to be taken throughout the audit process. At the same time, there are clearer definitions for what is meant by certain types of risks and how those risks need to be investigated in all circumstances.

In some respects, the standards put forth in the United States and in the international standards leave much more room for auditors to make their own decisions about what steps need to be taken in order to perform a business risk audit. The only exception might be in some of the specifics that are provided in terms of how auditors should actually learn about the entity being audited. The standards in the United States and the international standards discuss at length various aspects of how to examine an entity in its actual business environment. The standards also explain why specific types of employees can be valuable to interview and question about how the company and its internal systems function.

However, even with these specifics, the standards for the United States and the international standards do not make it mandatory to interview anyone specifically, with the exception of an entity's management. Everything else is left up to the auditor's professional judgment in terms of the risks or potential risks that are identified, and

what additional tests or examinations are needed. Beyond requiring that information be reported and that the auditor must be independent of the entity, the standards in the United States and the international standards seem to avoid stating any requirements that must be followed for each and every audit.

The last difference appeared once again in the Canadian standards. In Canada, the standards appear to call for more of an understanding and even relationship between the auditor and the entity being audited. Much of the discussion in the standards about understanding an entity was really focused on understanding the management. It could be speculated that some of this is in light of the recent accounting scandals involving US companies such as Enron and WorldCom.

It could be that understanding a company's management is a way of understanding any hidden risks that might be present in terms of how a company is run. Having an in-depth understanding of a company's management can reveal knowledge about risks that would certainly not show up on paper until the risk was so great that a company might be in serious trouble. Furthermore, based on the information gained from knowing the management, the auditor can establish appropriate tests for other risks and prepare a much more accurate and in-depth business risk audit.

5.8 Summary

This chapter discussed different audit standards that deal with the business risk audit. The similarities and differences between the different countries were discussed. For the present research, the information reviewed in this chapter indicates that there are many similarities in the auditing standards used in the United States, Canada and the United Kingdom. This may be an indication that the auditors in these countries will have similar opinions about the business risk audit methodology. However, some important contrasts between the auditing standards used in these three countries were also found. For example, the Canadian audit standards appear more stringent in terms of the specific actions that must be taken by auditors as compared to the standards used in the United States and the United Kingdom. This might suggest that Canadian auditors will have different opinions about the business risk audit methodology as compared to their counterparts in the United States and the United Kingdom. Overall, the differences that have been identified in this chapter with regards to the specific elements of the auditing standards used in the three countries investigated in this research provide a basis from which to expect differences in the data obtained from auditors in these three countries.

Chapter Six

Research Methodology

6.1 Introduction

The purpose of this chapter is to provide the research questions and an in-depth explanation of the research methods used in the selection of research participants and the analysis of the collected data. This chapter will begin by providing a discussion of the qualitative and quantitative research methods used to acquire data from the participants. In addition, this chapter will examine the research paradigm that will be the basis for the way in which the investigation will be conducted

This chapter will end with a discussion of how the actual data collection will be carried out and the reasons for the sample of participants used in this study. The limitations of the research methods will also be discussed as a way of understanding the ways in which future studies might improve upon the methods used here. At the same time, a presentation of the limitations allows for an understanding of the boundaries in which the researcher is operating and how those boundaries translate into limitations for the investigation.

6.2 Research Questions

Based on the information and literature reviewed, several research questions have come to the forefront to guide the remainder of this investigation. Because of the issues raised by the evolution of the auditing industry, as well as the concerns about the business risk

audit approach and the standards that oversee how auditors do their jobs, the following research questions have been formulated:

- What were the motivations for adopting the business risk audit methodology?
- What were the benefits and disadvantages of adopting the business risk audit methodology in terms of audit process and risk concepts?
- Regarding the aftermath of adopting the business risk audit method, did this new method improve the audit process? Is there a downside to the BRA method from the perspective of the auditing?

These questions will provide a means for understanding the nature of the industry as it now exists in relation to small and medium-sized firms, as well as providing an understanding of any current evolution that may be taking place. One of the concerns within the financial community is that the motivation for adopting the business risk audit methodology was purely for increased revenue and profit for major auditing firms. By asking auditors about their motivations and their firms' motivations for adopting this methodology, it will be possible to understand actual working auditors' thoughts about the methodology and why it has gained so much popularity within the industry.

6.3 Research Paradigm

The research paradigm that will guide the way in which this investigation will be conducted, as well as the way in which the collected data will be analysed, is known as

grounded theory. Grounded theory is a method of conducting research so that theory can be derived from the collected data (Glaser & Strauss, 1967). Its main focus is generating theories and hypotheses from the data as opposed to testing previously specified theories. As these new theories arise from, and are supported by, the data, they are said to be grounded (Gibbs, 2007). Grounded theory was originally developed as a research paradigm in the early 1900s by sociologists as a way to explain social events that took place among the larger population, based on research of individuals and groups. However, the paradigm is now used by more than just sociologists as a basis for research methodology. Today it is used in many disciplines, from business and management to nursing. Within the world of business and management, grounded theory is a useful paradigm for explaining organisational behaviour (Locket, 2001).

Gibbs (2007) mentions many specific ideas and techniques for achieving grounded analysis, such as open coding, constant comparison and waving the red flag. The basic idea is to be able to analyse the data, highlight the relevant ideas and draw conclusions to form a theory. This research will use the computerized coding software NVivo 8 to facilitate the data analysis. A description of the software will be presented in a later section of this chapter.

The current research attempts to better explain how auditors and auditing firms operate within the context of the business risk audit methodology, as well as within the standards that have been established to guide the work performed by auditors. Furthermore, this research is concerned with explaining the primary motivations for the widespread adoption of the business risk audit approach. This makes use of grounded

theory appropriate because the data obtained from the current research will be used to explain the behaviour of the wider auditing community.

6.3.1 Differentiating Research from Paradigm

Before moving forward, it is appropriate to explain the difference between the types of research that will be performed, which for this study is largely of a qualitative nature, and the actual research paradigm that will be used, which is grounded theory. Many people confuse the idea of qualitative research as a paradigm by itself. A research paradigm is a set of principles that guide the way in which data collection is performed. By stating that a study will use a qualitative method, only one part of the research method has been selected. This is not a specific set of principles that will guide the work to be performed. A specific research paradigm is a mode of working that can help move the research in a direction that will allow for the research questions to be answered (Maxwell, 2005). While this study will largely use a qualitative research design, there are many ways in which data for a qualitative research study can be collected. By adopting the grounded theory approach to data collection, it is possible to understand that the data collection should allow for a theory to be developed. The current study wishes to explain the motivations of auditors and auditing firms for using the business research audit methodology in their work with clients.

It should also be noted that the research paradigm should not be confused with the concepts of ontology or epistemology. Research ontology is the way in which knowledge is gained, as well as what is believed to be reality. For most research,

knowledge is gained through repeated observations or repeated data collections (Sulaiman, 2007). The current research seeks to obtain knowledge through multiple interviews and data collection from auditors. On a more specific level, it is assumed that most auditors are using the business risk audit methodology in some way. It may be that conducting this study and interviewing the auditors reveals that auditors are moving away from the business risk audit approach. If this is indeed the case, then the research will be able to explain how this assumption is wrong and what the data shows about the methodology that the auditors in the sample are using.

Research epistemology, on the other hand, is concerned with the way in which people shape their knowledge and reality about the world around them. One of the ways in which this is done in research is by having a theory from which to work (Sulaiman, 2007). In the current study, the idea is to work from a theory where there is no pre-conceived notion. Instead, the use of grounded theory means that based on the information collected, it will be possible to put forth theories about the auditors being studied and their motivations for using the business risk audit methodology. The use of grounded theory will also allow for the formulation of theories about how the auditors in the sample view themselves and their work within the guidelines set by the standards agency in their country of operation.

6.3.2 Grounded Theory and Research

While grounded theory is most often used with qualitative research, because of the desire to explain how the larger world works, it can be used in quantitative research and

especially in research that blends qualitative and quantitative methods (Swanson & Holton, 2005). The current study uses quantitative methods as a complement to the qualitative interviews performed. This allows for the use of surveys to help to provide further information that can be obtained more efficiently about the sample of participants and their backgrounds. Using grounded theory alongside quantitative methods of this nature is appropriate and can be beneficial for formulating theory from data more fully (Sprenkle & Piercy, 2005).

The reason for taking the time to make the distinction between the use of grounded theory in qualitative research as compared to its use in a study that blends qualitative and quantitative research is to avoid the argument that grounded theory is not an appropriate paradigm for this study. It has been noted that grounded theory was developed by sociologists conducting qualitative research. This might lead some to believe that trying to use grounded theory in any way in a study where some qualitative data will be collected is inappropriate. In reality, the use of grounded theory and the appropriateness of its use are based on the research methodology being used. It is not only available for studies that are strictly qualitative in nature. However, the larger focus of the study should be qualitative, which is the basis for the current investigation.

It should also be understood that the use of grounded theory within the mixed method approach of this investigation is useful when the issue being studied is based on time and context (Belk, 2007). This method can allow for an understanding of why something may be taking place within a specific context in a specific time. This is

certainly important for the current investigation because the goal is to understand what auditors' motivations were for adopting the business risk audit methodology.

The objective in the use of grounded theory is to draw conclusions based on the data that are collected. Research that is conducted from this perspective is conducted without any preconceived theory or theoretical bias; it is research conducted with the goal of being able to create theories and conclusions from data generated (Bryant & Charmaz, 2010). In this investigation, preliminary survey data has been collected for a sample of auditors for the purpose of gaining an initial insight into the perceptions of auditors in a general sense in the United States, United Kingdom, and Canada about the business risk audit methodology, its application and effectiveness. Based on the data collected from these surveys, the primary research interviews were then created. In compliance with the grounded theory method, initial information or existing theories were not used as a basis for conducting research into perception of BRA methodology or to make conclusions about its acceptance or possible application. Instead, the research was conducted with the goal of moving from no information about the perceptions of the auditors in the three countries of investigation toward BRA to having some information in the form of preliminary surveys.

The preliminary surveys attempted to get an understanding of the popularity of BRA in the three nations and also, the extent to which auditors rely on them in these nations.

The aim was to get a fair understanding of the depth and width of the usage of the BRA as a method of auditing in these nations.

This initial information gathered from the preliminary surveys is then used to develop primary research interviews with the goal of collecting additional, more specific data. The final step in the process is to draw conclusions regarding perceptions of auditors in the three investigative countries relating to BRA methodology from the research.

6.4 Research Methods

This study will use a combination of qualitative and quantitative methods in order to obtain the data necessary to address the research questions that have been posed.

Because this research uses both research methodologies, it is vital to understand what is meant by each research methodology, and the intended outcome of each. Qualitative researchers use information gleaned from the stories and information provided by participants, and attempt to provide an understanding of the interactions taking place between the stories. In other words, qualitative researchers look for common themes and ideas between the different stories they receive from participants (Thomas, 2003).

The strength of qualitative research comes from the fact that a great deal of information can be obtained from participants. Rather than requiring participants to answer specific questions with no other way of providing an in-depth explanation, qualitative research allows participants to expand upon answers in an interview setting. Rather than obtaining a surface-level response or opinion, a researcher is free to ask questions that elicit further details. The information obtained may provide information that the researcher would not have even considered important otherwise (Jex, 2002).

Quantitative research, on the other hand, is generally concerned with being able to measure actions, opinions, or events in a manner that will allow for generalization to a larger population of people. This research involves the careful selection of a sample of people that represent a larger population related to what is being studied. By using careful measurement, statistical tests can be used to examine relationships and interactions that may be present (Thomas, 2003).

The strength of quantitative research is that there are many statistical tools that can be used to understand relationships between people and events. A researcher can use a survey to obtain a larger amount of data in a relatively short amount of time. Then, the data can be analysed using statistical methods to provide an understanding of interactions and relationships. If the proper statistical methods and data collection procedures are used, then the information obtained can be used quickly and with little actual interpretation for a specific outcome (McQuarrie, 2005).

There are downsides to both types of research methods. In terms of qualitative research, one of the important downsides is the amount of time required to conduct interviews or observe participants in their day-to-day activities. If a researcher attempts to observe or interview a large number of participants, the required amount of time increases dramatically. This is one of the reasons why many qualitative research studies have what might be considered as relatively small sample sizes, especially when compared to

quantitative research. There is simply not enough time for most researchers to be able to interview or observe more than a few people (Woodruff & Gardial, 1996).

Another downside to qualitative research, at least in the eyes of some researchers, is that a great deal of interpretation and objectivity is used in understanding what the data mean. Rather than being able to show that a certain statistical procedure is appropriate for the data and then showing the outcome of a statistical test that relies on mathematics, qualitative research involves interpretation of the data. One researcher may interpret the data in one way, while another researcher may provide a different interpretation. The fear is that a researcher can bring his or her own biases to the interpretation (Kvale, 1996).

It should be noted, however, that while qualitative research does involve objective interpretation, scientific methods are followed to interpret the data. In addition, researchers have to show how they have drawn their conclusions and how they have interpreted the data (Kvale, 1996). Qualitative research is not a form of investigation without rules and procedures. Instead, it simply requires a greater level of interpretation, which can actually be more difficult than interpreting quantitative data when done properly.

On the other hand, there are some important downsides of quantitative research. One of the first downsides is that surveys usually do not provide for a complete understanding of how people act or think about a specific topic. This is especially true if survey

questions are close-ended. While a person taking a survey will likely choose between a yes or no response, this may not be exactly how he or she feels about an issue. Instead, there may be a great deal of middle ground that cannot be understood (Lankshear & Knobel, 2004).

Another important downside of quantitative research can involve how a researcher interprets the data. Because surveys and other quantitative methods may not elicit participants' complete attitudes or opinions, the overall results may not be truly representative of the sample or the larger population. However, a researcher may infer the findings to the larger population, which can mean that the findings do not provide the entire story of how specific events or variables interact with each other (Kandampully, Mok & Sparks, 2001).

6.4.1 Benefits of Mixed Methods

The use of the mixed method approach, or the use of both quantitative and qualitative methods, can compensate for the downsides of each individual research method (Axinn & Pearce, 2006). Using a combination of qualitative and quantitative research methods provides a way to triangulate the findings and determine if the interpretations made or the information collected are truly accurate and representative of the participants.

Rather than relying on a single method, which may leave out information, a researcher can use the benefits of both methods to provide a validation of the larger findings and interpretations (Creswell, 2002).

It has also been noted (Axinn & Pearce, 2006) that combining qualitative and quantitative research can help a researcher illustrate relationships in his or her investigation. Rather than simply interpreting the information gained from interviews, a researcher can also use the data collected from surveys of those same people to show that certain variables are related to the larger issue being examined. In this regard, the use of the mixed method allows for the interpretation of the interview data, as well as showcasing the statistical analysis of the survey data.

The use of the mixed method approach in this research will allow for a more complete understanding of why auditors are using the business risk audit methodology and how they are working with it in terms of standards and practices within the industry. At the same time, the research methodology employed will allow for a more thorough examination of the specific factors related to this decision in a significant way. For example, interviews with the participants in this study may show that all of them are using the business risk audit methodology because it is where the industry has been heading in the last few years. However, the examination of survey data may indicate that the financial incentives that can be gained are more strongly related to the reasons for adoption of the business risk audit methodology than other factors.

6.4.2 Questionnaires

Before starting the interviews, a separate questionnaire was created in order to assist with the creation of a list of questions that would guide the researcher towards the answers sought in the interviews. Appendix 2 presents the questions that were asked of

the participants that took part in the initial questionnaire. During the preparation of the questions, the research objectives and the participants' background were taken into consideration. Black (1999) and Riley et al. (2000) present a list of guidelines to keep in mind when constructing questionnaires. Some of these relevant guidelines are:

- The length of the question
- Running order or sequence
- Avoid statements that sound like facts
- Questions should be unambiguous to prevent misinterpretation
- Avoid statements that encourage a specific response or bias

The research questions presented were the same questions used during the interviews:

- What were the motivations for adopting the business risk audit methodology?
- What were the benefits and disadvantages of adopting the business risk audit methodology in terms of audit process and risk concepts?
- Regarding the aftermath of adopting the business risk audit method, did this new method improve the audit process? Is there a downside to the BRA method from the perspective of the auditing?

The questions are open-ended, or free response, to allow participants to answer freely and provide their own views.

6.4.3 Interviews

Several different types of interviews can be conducted. Some of the most common types of interviews are face-to-face interviews, telephone interviews, email interviews and group interviews (Punch, 2005). In this research, a total of 30 interviews were conducted.

Table 6-1
Number of participants in the main interview

	Face-to-face	Telephone	Total
UK	6	4	10
USA	0	10	10
Canada	8	2	10
Total	14	16	30

The benefit of conducting face-to-face interviews is that the researcher can obtain information not only from what is said by the participants but also from the visual cues and gestures made while responding to questions (Maxim, 1999). For example, a participant may state that the business risk audit approach has been good for clients, but then may make a gesture with his or her hands that would indicate that he or she is being facetious. This is something that could not be seen over the phone and would certainly not be conveyed in an email interview.

Also, a participant may be a person who needs to be in front of another person in order to feel comfortable providing information. He or she may not like talking on the telephone for an extended period of time, or trying to type out thoughts on an in-depth subject. The level of ease in answering questions can be increased for the participant. This can increase the amount, as well as the quality, of information obtained.

Another reason for using face-to-face interviews in this study is that an interview time must be scheduled and participants will treat their interview as an appointment that they have to keep. It would be easy to be unavailable for a telephone interview or to forget about it. In addition, forgetting to return an email interview would not be difficult. In choosing face-to-face interviews, the idea was to give the participants as much incentive as possible to keep the interview and to be available to answer questions. The researcher did not want to provide any reasons for the participants to postpone or forget about the interviews.

Using telephone interviews was necessary to reach participants who were far away from the researcher, such as in the USA, or who could not schedule a face-to-face interview. These participants' contribution to the research is important. The advantage of conducting telephone interviews is that it is far cheaper and quicker to administer compared to face-to-face interviews (Bryman & Bell, 2003).

Telephone interviewing requires the same planning as face-to-face contact. It requires a structured approach and careful follow-up with the participant to make sure all

questions are answered. It is not good practice to call back a second time for clarification (Riley et al., 2000).

In terms of the actual structure of the interviews, Saunders, Lewis & Thonhill (2007) explain that there are three types of interviews that can be conducted:

Structured interviews: here the questionnaires are predetermined and standardised, which can also be referred to as interviewer-administered questionnaire. The interviewer reads the questions as written and in the same tone of voice, so that there will be no bias indication. The interviewer will then collect the data through writing or taping. These types of interviews are suitable for quantitative research.

Semi-structured interviews: the purpose here is to cover a list of questions; the researcher may omit or add questions depending on the circumstances and the nature of the event. The order of the questions may vary depending on the flow of the interview.

Unstructured interviews: these are informal interviews used to explore a general idea the researcher is interested in. They are in-depth interviews. There is no predicted list of questions prepared, although a clear idea about the theme of the interview is necessary. The interviewee will have the opportunity to talk freely about the topic.

Semi-structured interviews are used with participants in this study. The reason for choosing semi-structured interviews is that the interview begins with a question on the part of the researcher, to focus the interview. The researcher is then free to take the interview in another direction based on the information that provided by the subject.

However, should the interview get off-track, the researcher has other prepared questions that can help re-focus the interview and bring the participant's attention back to the topic at hand (Pole & Lampard, 2002).

In this way, the researcher does not have to ignore important information or feel as though he or she must keep the interview on a certain track if the participant raises important information that deserves further questioning. However, should the interviewee begin to talk about unrelated topics that are irrelevant to the larger goal of the interview, the researcher can quickly return to the prepared questions. Having prepared questions also helps the researcher should a participant have little to say. The researcher is not left trying to think up questions in the middle of the interview, which can cause the participant to quickly lose interest completely (Pole & Lampard, 2002).

The interview questions used are intended to begin a more in-depth discussion with each of the participants about the business risk audit methodology and its future use within the auditing industry. These questions are all open-ended and broad, while still being related to the specific research topic and the research questions guiding this investigation, to encourage participants to take the interviews in the directions that they feel are most important. For example, some participants may want to talk about the benefits of the business risk audit methodology while others may want to talk more about the risks and downsides. Others may simply want to talk about the future of the business risk audit methodology and whether it will even be around in the next few years.

Each of these directions can yield valuable information. In addition, the direction in which the participants want to take the interviews can be just as important as the information that is provided. If the majority of the participants want to talk about the benefits while not discussing the risks, this can be useful information. It might be an indication that the participants do not think that the risks are as important as other issues. On the other hand, it might also be an indication that they are somehow afraid or cautious of talking about the risks. However, if the participants spend more time talking about the risks and downsides of the business risk audit methodology, this is also important information that can be useful in broader interpretation of the data.

It is clear that interviews can yield a large amount of valuable information. Not all of the information is necessarily about what is said. Some of the information can be about what is not said, or the topics that participants may not feel comfortable discussing. All these points demonstrate why face-to-face and telephone semi-structured interviews are used. The idea is to gain as much information as possible in order to obtain a complete understanding of ideas within the auditing industry about the business risk audit methodology and its use.

6.5 Limitations of the Study

After the discussion of the benefits of the current study and what is hoped to be obtained with the methodology and procedures used, it is just as important to consider the limitations of this study.

One of the limitations of this study is that the participants have been pre-screened to fit a certain criteria. Rather than randomly selecting participants and discovering that they may not have heard of the business risk audit methodology or that they are not familiar with it, the participants in this study were selected because of their involvement with the methodology and their experience in the auditing industry. While this may yield a larger amount of useful information for interpretation and analysis, it also means that the information is not completely representative of the entire auditing industry.

A second limitation of the current study involves the countries from which the participants have been drawn. The participants for this research come from three countries: the United States, Canada and the United Kingdom. It is believed that similar opinions are held by auditors in other countries as those held by auditors in these three nations.

The final limitation of this study is an important one that is present in any qualitative study, and one that has already been discussed: the issue of opinions and bias on the part of the researcher or interviewee. While there are ways to control this, it is still important to recognise that no qualitative research can be completely free of the opinions or ideas of the researcher. It is important for the researcher to recognise that they bring preconceived ideas to the investigation. By understanding that these preconceived ideas exist, the researcher can do everything possible to limit the way in which they influence the investigation and the ultimate analysis of the collected data.

6.6 Data Collection and Analysis

The data for this research was collected into two parts. The first part was preliminary quantitative data collected at an early stage of this research, to get an initial idea about the subject of the research and to see if there were sufficient grounds to continue with the research. The second part of the data collection was conducting 30 qualitative interviews with auditors; these comprise the main source of data to perform the research.

6.6.1 Preliminary Survey

The purpose of the preliminary surveys was to gather initial information that was used to construct the questions that formed the basis for the primary research interviews. The use of the preliminary survey informed the construction of the primary research questions by allowing for insights to be gained from a relatively small sample of people within the auditing industries of the United States, United Kingdom, and Canada about their audit work and their perceptions and attitudes toward the business risk audit methodology. The data obtained from the preliminary survey was to used to refine and focus the primary research questions with the aim of providing more targeted results regarding the elements of BRA that were salient to the research participants, ultimately creating validity and reliability in the resulting conclusions and theory.

Without the focus and guidance provided by the preliminary surveys on BRA in practice in the nations under examination, it is very much likely that questions would have been included in the primary research interview that would have had little relationship to the actual practices of the research participants. This includes the risk of asking questions in the primary research interview that research participants would have deemed irrelevant. This would only promote an attitude of disinterest in the participant, leading to lack of commitment to the completion of the interview and a lack of commitment to the reliability of information given, presenting validity risks for the overall investigation. The preliminary survey allowed for questions to be tested for relevance, consistency and validity; and for initial insights identifying common impacts across the scope of the industry sample to be gained that were used directly in the creation of the primary research interview.

The preliminary survey was collected from 40 participants from the three geographical areas (13 from the USA, 13 from the UK and 14 from Canada). This helped the researcher determine if the semi-structured interview questions were appropriate for face-to-face and telephone interviews. The data from the preliminary survey was entered into statistical software (SPSS); a full analysis and presentation is presented in Chapter 7.

6.6.2 Conducting Interviews

The face-to-face interviews were carried out at a location of the participants' choice. This option was given to the participants as a way of making them feel most comfortable. This is especially important if the participants would not feel comfortable

taking part in the interviews at their place of business, for whatever reason. Regardless of where the interviews were conducted, every effort was made to have the greatest amount of privacy. For those interviews carried out at the participants' workplaces, a quiet place away from co-workers was used. This was done to ensure that others in the same workplace would not listen to the responses. This was also done to ensure the most accurate and truthful answers from the participants.

The telephone interviews were conducted after brief instruction about the researcher and the purpose of the interview. The time taken to complete the interview was shorter than the face-to-face interview. The average call lasted about 15 minutes, with some longer calls of about 30 minutes. During all calls the researcher made sure all questions are answered.

The timeframe of the face-to-face interviews was up to the participants. It was assumed going into each interview that the amount of time needed would be between 30 minutes and one hour. However, if any participant was providing useful information, an interview would not be stopped exactly at the one hour mark. However, it was also assumed that about one hour would be a useful limit for information gathering. Any time over that might only provide repetition of information already provided by the participants.

The goal of the interviews was to provide information without wasting the time of the participants or the researcher. Interviews going over one hour may not provide any

more useful information than those lasting only 30 minutes. For the most part, the researcher did not end the interviews before one hour unless the participants had answered all of the prepared questions and showed no willingness or ability to provide further information.

This is an area where the researcher must make a judgment about when it is appropriate to end an interview. Interviews will likely come to an end when participants show that they cannot provide any more information. However, if a participant stated that he or she only had a specific amount of time before the interview begins, those time constraints were respected. In addition, any participant that stopped an interview because of other obligations or any emergencies was shown respect for these situations and the interview ended. It should be noted that interviews shorter than 30 minutes were not an issue, since none of the interviews lasted less than 30 minutes. All of the participants were more than willing to discuss the business risk audit methodology with the researcher. In fact, bringing an end to the interviews after an hour of discussion was the concern that existed most often.

It is worth mentioning that with the face-to-face and telephone interviews the BRA concept was discussed at the beginning, to make sure that the subjects interviewed were aware of the concept being researched. Specifically, the business risk audit methodology was described using the explanation provided by Knechel (2006): that BRA is focused on assessing the business risks present within a company.

The interviews were audio recorded in order to preserve all information provided by the participants. In addition, some light notes were taken by the researcher during the interview. However, these notes merely acted as reminders for the researcher once the examination of the data occurred. The reason for not taking more complete notes during the interviews was so as not to distract the participants from feeling as though they were having a conversation with the researcher. If the participants felt as though they were being interrogated, they may not have been comfortable providing information.

At the same time, trying to have a conversation with someone who is writing and does not appear to be listening can be a distraction on its own. The researcher wanted to make the participants feel as comfortable as possible, as well as feeling like the center of attention. The idea was not to try and take complete notes to the point that the participants were more interested in what the researcher was writing than in providing information.

The recorded data was then transferred into text format for easy use, and each interview was given a reference number, such as CAD # 4 and UK #9, to preserve the privacy of the participants.

6.6.3 Software

The analysis of information from the interviews was complicated because of the sheer volume of available data. While it is possible to go through the notes and audio files without any assistance, this can make the process even more complicated. In order to

provide some way of organizing the data from the interviews, software such as NVivo 8 was used. NVivo 8 software is intended for researchers conducting qualitative research. The software provides a system for organizing files and notes in one place (QSR International, 2008).

The goal of using the software was to transform the collected data into findings that make sense, such as identifying significant patterns and highlighting ideas of importance to be followed up (DeNardo & Levers, 2002).

In addition, the software allows the researcher to enter notes and ideas that come from analysing the data. This type of software was used as a way of ensuring that full attention was given to the information from the interviews. It would be quite easy to leave an interview and think that a particular participant provided an important insight. However, if there was no way to mark the interview as a reminder for the researcher, the importance of that insight could easily be forgotten in the analysis.

NVivo 8 is designed to help manage and analyse qualitative data, such as text format. The organisation of the software allows the researcher to store data as text, after converting audio files to text files. The data are then organised as source documents and used as the primary source of information. Ideas from the data are grouped into what NVivo 8 calls nodes. Nodes are best described as containers of themes or ideas; it is a way of bringing together ideas, thoughts and definitions about the data. The next step is

finding patterns and creating relationships among the ideas (Gibbs, 2002; DeNardo & Levers, 2002; QSR International, 2008).

The researcher used the data input in NVivo 8 to create the nodes that are used in the research. For each theme used, such as motivations for adapting BRA, or advantages of using the BRA, a separate node was created to collect all the relevant data from all interviews into the one node. This activity is similar to using a manual cut-and-paste method to collect all relevant ideas in one location.

6.7 Summary

The purpose of this chapter has been to outline the research methodology used in this study, as well as important background information. It is extremely important to thoroughly plan the methodology that will be used for an investigation and to understand the potential problems and limitations that methodology presents. By understanding the limitations and problems that may be present, the researcher can attempt to overcome them, or at least work around them to obtain the highest level of validity for the study.

This research will be based on a mixed method approach employing both quantitative and qualitative methods. While the framework for the research will be qualitative methodologies involving semi-structured interviews, the use of questions asked during the interview will provide an additional method of triangulating the findings from the interviews. In addition, the use of surveys to obtain some quantitative data will allow for a more in-depth analysis, as statistical methods can be used to examine some of the

relationships that may be present between demographic variables, such as years in the auditing industry or location of the participant, and overall attitudes toward the business risk audit approach.

This type of triangulation is important because it can help to understand if auditors completely understand the full ramifications of using the business risk audit methodology. It may be that they are not trying to intentionally misrepresent themselves when they talk about the approach. Instead, they may have become accustomed to discussing the business risk audit methodology in one way in front of clients, but an interview may bring out their inner feelings about the approach and what it means for their clients and their firms.

The purpose of this study is to understand the use of the business risk audit methodology and its ramifications on the audit industry. The use of grounded theory makes entering the data analysis without any preconceived notion of what will be found possible. The analysis can be pursued in such a way that the ultimate outcome is to provide a theory for understanding what is taking place within the industry.

The use of grounded theory is appropriate for qualitative studies, as well as studies that combine both qualitative and quantitative methods. In the case of the current study, quantitative methods are used as a way of providing an additional means of triangulation of the data collected from the semi-structured interviews. The foundation for this study is the qualitative method. However, additional demographic data allows

for an even stronger understanding of what is taking place within the auditing industry in relation to the use of the business risk audit methodology.

The semi-structured interviews have been structured in such a way as to provide the least amount of disruption to the participants while also eliciting the most valid and truthful data possible. The concern is that trying to get busy auditors to answer long questionnaires or sit for a long period of time in an interview would simply result in less reliable and valid data. It is better to obtain accurate data in a short amount of time than a large amount of data over a longer period of time that is not useful or relevant to the research.

Furthermore, semi-structured interviews were chosen as the method in which to conduct the interviews as a means of allowing participants to talk about the issues related to the use of the business risk audit methodology that are important to them. Again, the idea is to make the participants as comfortable as possible and elicit the most valid information possible. Rather than trying to force participants to answer questions in which they may not have a great deal of interest or knowledge, the participants can talk about the areas of the topic they deem important.

However, the researcher has prepared questions that can help maintain the focus of the interview. This is important because it allows the interviewer to quickly direct the attention and focus of the interview participants to the purpose of the interview, should their comments or discussion move away from the business risk audit methodology.

This also allows the participants the freedom and ability to discuss information that may not have been considered by the researcher, while still keeping the interview focused on the topic at hand. The use of semi-structured interviews allows for these things to take place.

The end result is that the methodologies used in this study have been formulated after consideration and analysis of their benefits, downsides and limitations. Because all of the limitations have been examined, and because methodologies, including the use of mixed methodology, have been employed, the current study has taken as many precautions as possible to ensure that the interpretation and analysis from the collected data have validity in terms of understanding the business risk audit methodology within the auditing industry.

In the next chapter the preliminary survey results will be discussed in depth, to present the findings revealed from this survey.

Chapter Seven

Preliminary Survey Results

7.1 Introduction

This chapter uses the research methodology described for the preliminary surveys in the previous chapter to present the findings of the data collected from the participants. The preliminary data were collected at an early stage of this research in order to obtain an overview regarding the opinions and ideas from non-Big-4 firms in the United Kingdom, the United States and Canada about the business risk audit methodology. Based on the information collected in the preliminary data it was possible to construct a more specific interview instrument for the participants that agreed to take part in the primary data collection efforts.

The preliminary data is examined in this chapter separately, followed by the main interview data, because they provide different levels of information. The preliminary data are quantitative in terms of showing the number of participants in each of the three countries included in this research who stated that they understand the business risk audit methodology, as well as their years of experience in the auditing industry. The information from the primary data collection effort, which will be examined in the next chapter, is much more exhaustive in terms of qualitative responses to the interview questions.

7.2 Data Collection Methodology

Before analysing the preliminary data it is important to explain the procedures that were followed to obtain access to the research participants, as well as administer the

questionnaires. For the preliminary survey, a first batch of 86 emails was sent to auditors in the United Kingdom, the United States and Canada, to see the percentage of responses. The auditors selected to receive the surveys were randomly selected from an internet search, based on their profile and location. There was no desire to obtain a specific number of auditors. After searching the internet, it was only possible to find 86 auditors for whom enough contact information was available from the three countries to send them email surveys directly.

The initial effort to obtain surveys back was unsuccessful. Only one of the participants actually returned a survey, while four others returned an email containing answers to some of the questions that were presented. Following the unsuccessful initial attempt to use the emails, a much larger effort with 300 potential participants was undertaken. Each of the 300 people chosen received a more in-depth letter by post, explaining the purpose of the research and the reasons for undertaking the investigation (see Appendix 1). Again, only five replied. With a much more focused effort, as well as some personal follow-up phone calls made to potential participants, the targeted number of 40 people was reached to take part in the preliminary survey.

7.3 Overview of Survey Participants

The analysis involves data collected from a survey administered to auditors of non-Big 4 auditing firms in the United States, Canada and the United Kingdom. The purpose of the survey was to determine participants' awareness of the BRA methodology, as well as its use among these firms. The survey was provided to partners, managers and senior members of auditing firms. It should be noted that senior members of auditing firms

were defined as people who had supervisory roles in their firms but who were not directly classified as partners or managers. Participants were asked questions relating directly to the BRA methodology, such as whether their firms had changed their audit approach, if they were familiar with the BRA approach, and if they would recommend it to others in the industry. The participants were also asked questions regarding the size of their firms in terms of professional staff and number of partners. In addition, they were asked about the number of years of auditing experience they had. The questions contained in the survey are provided in Appendix 2.

The breakdown of participants from each of the three countries is almost exactly evenly dispersed, with 13 participants from the United States, 13 participants from the United Kingdom and 14 participants from Canada. In terms of the breakdown of participants based on their positions within their firms, 29 of the participants are partners in their firms and 10 are managers. Only one participant is an audit senior. In terms of the size of the firms with which the participants are affiliated, the average staff size of the firm was between 16 and 20 auditors, with an average of 16-20 partners in the firm. The average number of years of experience participants had was between 16 and 20 years in the auditing field.

When the data from the preliminary surveys are broken down by country, the characteristics of the firms for which the participants work are somewhat different. For example, the UK firms had an average of one to five partners with between 11 and 15 years of experience in the auditing industry. In addition, of the 13 participants from the United Kingdom, eight are partners in their firms, while four are managers and one was

audit senior of the firm. Finally, most of the firms in which the UK participants worked had more than 25 employees. The data from the United States show that the participants' firms had anywhere from one to 10 partners, on average, and between 21 and 25 employees. The participants had 11 to 15 years of experience. Of the 13 US participants, 10 were partners in their firms while three were managers. Finally, the data from Canada show that the participants worked in firms with between 6 and 10 partners, and they had between 6 and 15 years of auditing experience. The firms for which they worked generally had between 11 and 15 employees. Ten of the Canadian participants were partners, while three were managers. Table 7-1 presents this information with the proportions in each category for the three countries.

Table 7-1

Country Demographics from Preliminary Survey

Staff Size					
	1-10	11-15	16-20	21-25	More than 25
UK	31%	0%	8%	8%	54%
USA	7%	7%	0%	14%	71.40%
CA	15%	15%	8%	8%	53.90%

Number of Partners					
	1-5	6-10	11-15	16-20	More than 20
UK	39%	15%	0%	8%	39%
USA	36%	36%	14%	0%	14%
CA	31%	46%	15%	0%	8%

Years of Experience						
	0-5	6-10	11-15	16-20	21-25	More than 25
UK	0%	15%	31%	7%	7%	39%
USA	7.10%	0.00%	28.60%	14.30%	21%	31%
CA	7.70%	23.10%	23.10%	7.70%	15%	23%

Position			
	Partner	Manager	Senior
UK	62%	31%	8%
USA	79%	21%	0%
CA	77%	23%	0.00%

The survey results indicate that most of the participants were familiar with the BRA methodology, which means that they were familiar with the term “business risk audit”. It is important to explain that all the participants were told about the business risk audit methodology before beginning the surveys, to ensure that everybody was using the same definition throughout. A copy of the letter mailed to the participants is in Appendix 1. Even after providing an explanation of BRA before beginning the surveys, three of the 40 participants stated that they were not familiar with the BRA approach or with what the term “business risk audit” means as an audit methodology.

In addition, seven participants stated that their firms had not changed audit approaches in the past 10 years. Finally, 10 participants stated that their firms did not use the BRA methodology at all. It is important to note that 12 of the participants would not recommend the BRA approach to others. Furthermore, 24 participants used an audit methodology other than the BRA approach. In total, the firms represented by the participants used the BRA approach on an average of 41%-60% of their audit engagements.

The preliminary survey did not ask respondents to provide reasons for not recommending the business risk audit methodology to others. The preliminary survey was intended to identify areas in which more in-depth questions need to be developed for the primary data collection. The fact that so many of the respondents to the preliminary survey stated a reluctance to recommend BRA to others indicates that more in-depth questioning regarding the reasons for this were needed. This area was addressed in the primary interviews.

Once again, the scope of the preliminary survey was not in-depth enough to be able to understand what other audit methodologies participants were using, or why they would state that they were using other audit methodologies while recommending the business risk audit methodology to others. However, the purpose of conducting the preliminary survey was to determine areas deserving greater investigation and analysis during the primary interviews. In relation to the research questions, the preliminary surveys allowed for a better understanding of the types of questions that needed to be raised during the full data collection process in order to obtain the information necessary to answer those questions. A possible reason why some participants stated they would recommend BRA to others but did not use it themselves may be due to the policies and methodologies required by their auditing firms. In any case, the discrepancy that seems to exist between recommending BRA to others and actually using it certainly deserves further attention.

On a broad scale, it does appear that there is some discrepancy between participants' ideas about the BRA approach compared to their actual use of this audit methodology. However, it is important to remember that this survey only involved partners and managers of auditing firms. These results may be skewed because of the number of years that the participants have been employed in the auditing profession. These individuals may be accustomed to an older method of auditing procedure and have not fully embraced the BRA methodology.

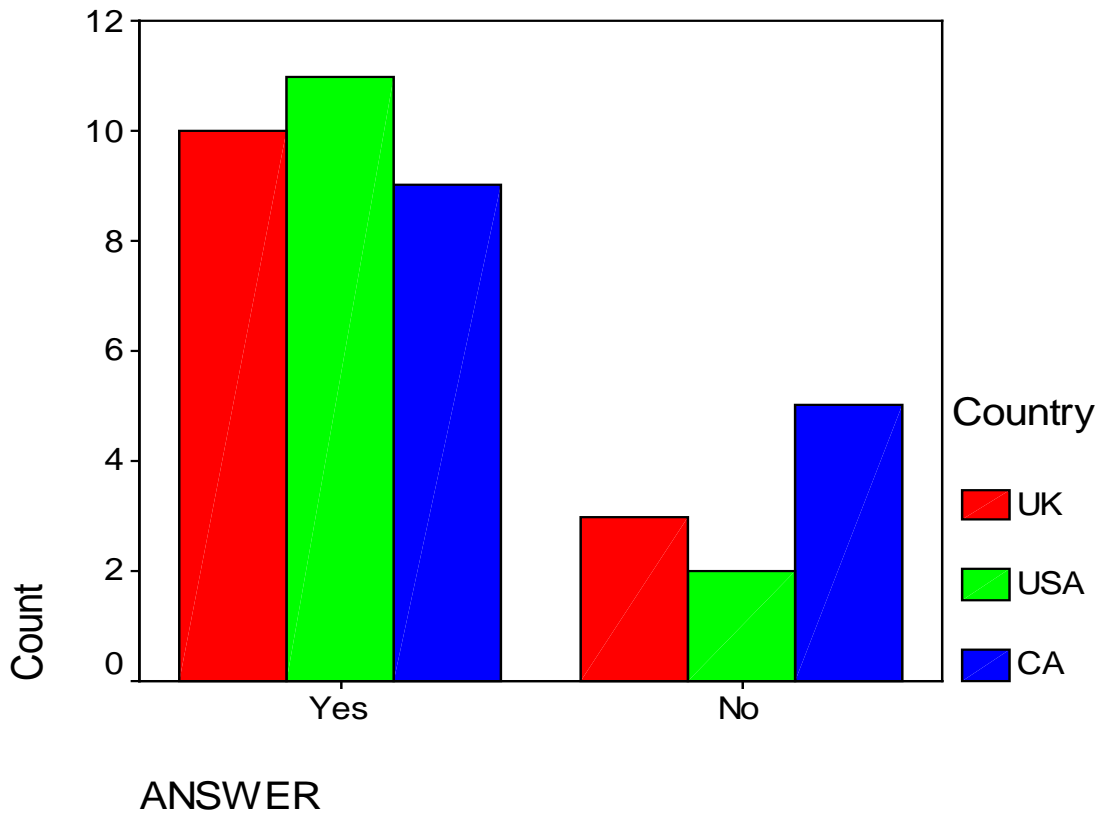
Of course, the fact that 75% of the participants, 30 out of 40, are currently using the BRA methodology does show that the BRA approach is being used by these participants. A last note about the percentage of participants using the BRA approach is that while 10 of the participants reported absolutely no use of the BRA methodology in their firms, 20 reported that between 81% and 100% of the audit engagements at their firms used the BRA methodology. Because this was a preliminary survey, questions were not asked about the reasons for not using BRA with all audit assignments. However, the fact that BRA was not used in all audit assignments needed to be addressed during the primary interviews.

7.4 Breakdown of BRA Use by Country

It is worth examining any differences in the familiarity and use of the BRA approach across countries. The survey data indicate that familiarity with the BRA approach is essentially the same between participants from the United States, the United Kingdom and Canada. A total of 76% of UK auditors reported using the BRA methodology at least once, while 79% from the United States and 69% from Canada reported using the business risk audit methodology at least once. Figure 7-1 presents the responses from the three countries.

Figure 7-1

BRA Use by Country



Furthermore, the actual percentage of audit engagements using the BRA methodology is also quite similar across all levels of usage, as shown in Table 7-2. For example, about 7% of the participants from all three countries reported that between 1% and 20% of all audit engagements involved BRA. About 50% of the participants from all three countries stated that their firms used the BRA approach for 81% to 100% of their audit engagements.

Table 7-2

Percentage of Audit Engagements Using BRA

	UK	USA	Canada
0	15%	29%	15%
1%-20%	8%	7%	8%
21%-40%	0	0	15%
41%-60%	15%	7%	7%
61%-80%	8%	7%	7%
81%-100%	54%	50%	46%

These findings show that there is no major difference in knowledge or usage of the BRA approach, at least among the participants of this study, across the three countries. Furthermore, the very nature of the auditing profession has changed equally in these three countries. Auditors have seen the actual percentage of business coming from auditing activities decline and the amount of revenue from consulting activities increase dramatically. The end result is that the survey data shows levels of difference or similarity of BRA use across countries that are about what would be expected. Auditors in all three countries have shifted how they perform their duties and the types of services they provide to clients.

7.5 Years of Experience and Use of BRA

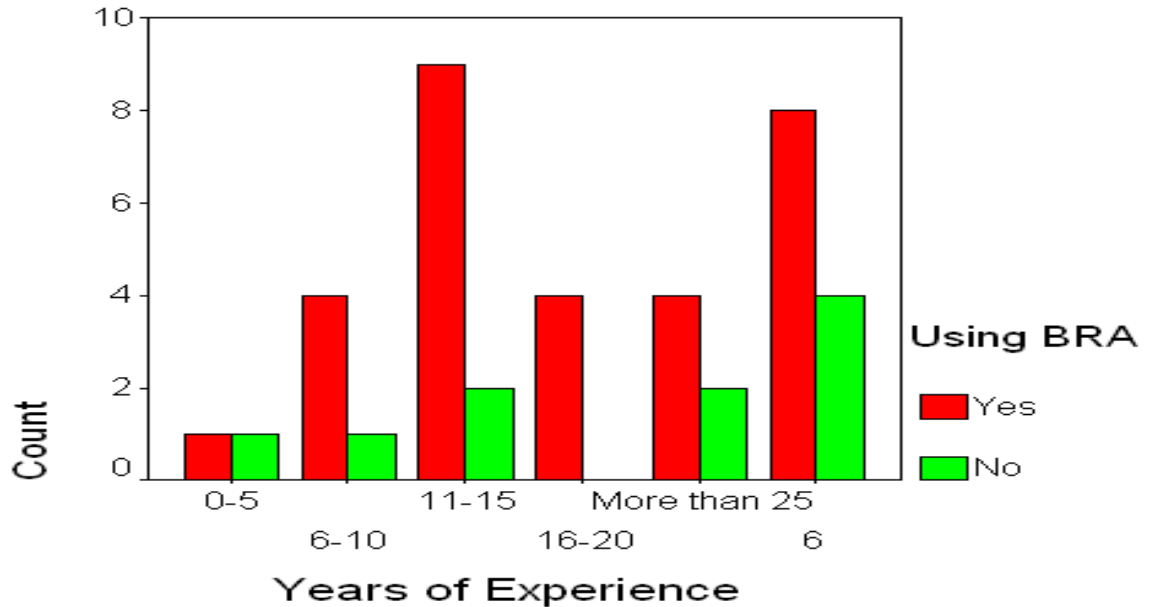
The participants had an average of between 16 and 20 years of experience. Interestingly, it is this level of experience that appears to be the threshold in terms of experience where differences occur in opinions and use about the BRA approach. Seven

participants stated that their firms had not changed their audit methodology in the past 10 years; six of those participants had at least 21 years of experience. Furthermore, the three participants who stated that they were not familiar with the BRA methodology at all each had at least 21 years of experience. The finding here is that those who have been in the auditing profession the longest are likely to be using a so-called more traditional auditing methodology.

However, the number of participants that would recommend the BRA approach to others is evenly split between auditors with 1-15 years of experience and those with more than 16 years of experience. A total of six participants with 1-15 years of experience and with more than 16 years of experience would not recommend this audit approach to others. This indicates that reluctance to recommend the BRA approach to others is not restricted to auditors with the most experience. Figure 7-2 presents BRA use in relation to years of experience of the survey participants.

Figure 7-2

The Use of BRA in Relation to Years of Experience



The number of years of experience in the auditing profession ultimately has some effect on attitudes toward BRA. Those who have been in the auditing profession longer are less likely to be familiar with the business risk audit methodology and more likely not to have changed the audit methodology they use with their clients. This finding ties in directly to what Knechel (2006) discusses in his research, which is that the business risk audit methodology is a concept that is largely being embraced by younger members of the profession as part of the continuing evolution of auditing methods. However, the data from the survey participants were split in terms of years of experience, willingness to recommend the BRA methodology, and whether or not they personally used this audit approach. This indicates that, at least among these participants, use of the BRA approach is not completely based on years of experience.

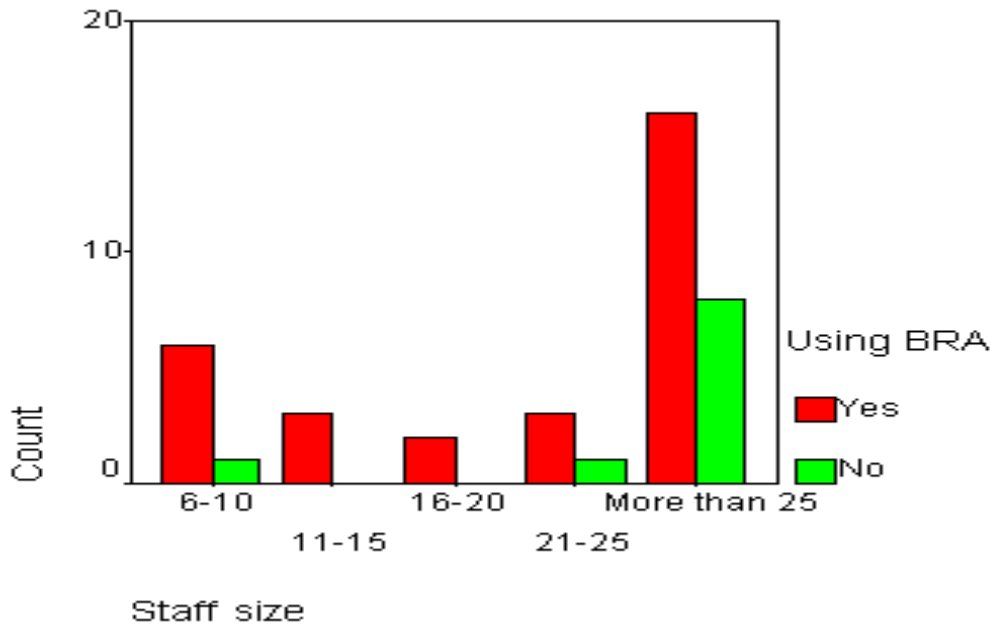
7.6 Staff Size and the Use of BRA

Of all the demographic factors examined, the size of the firm as measured by the number of auditors working there appears to have a very important relationship to the use and application of BRA. While some of the firms in the sample are relatively small, firms with more than 25 auditors clearly have the largest majority of participants who reported having changed their auditing method in the past 10 years. Even more, these same participants also reported familiarity with the BRA methodology. In addition to this, participants from firms with more than 25 employees overwhelmingly reported that their firms used the BRA methodology with a larger number of their clients. In fact, the participants from the largest firms in the sample had a much larger use of BRA methodologies on 81% to 100% of their audit engagements.

It is also interesting that participants from the smallest firms reported not changing their audit methodologies and not being familiar with the BRA approach. The same is true for respondents who stated that they did not use the BRA methodology at all and would not recommend this audit approach to others. The analysis of these numbers would appear to be in line with what the research indicates about the larger auditing industry. Larger firms have been quicker to embrace, or at least transition to, the BRA approach. Figure 7-3 shows the use of BRA based on the number of staff in the participants' firms.

Figure 7-3

The Use of BRA in Relation to Firm Size



The survey also asked about the number of partners in respondents' firms. While this might not seem very important at first, analysing how the number of partners interacts with attitudes and application of the BRA methodology reveals interesting information. Participants from firms with fewer partners reported being familiar with the BRA methodology. However, this basic trend does not continue with the actual use of the BRA approach and whether participants would recommend the approach to others. Instead, as shown in Figure 7-4, participants working in firms with 10 or fewer partners, as well as those working in firms with more than 20 partners, were more likely to be using the business risk audit methodology. Table 7-3 shows the proportion of BRA use based on the number of partners in the firm.

Figure 7-4

The Use of BRA in Relation to the Number of Partners in the Firm

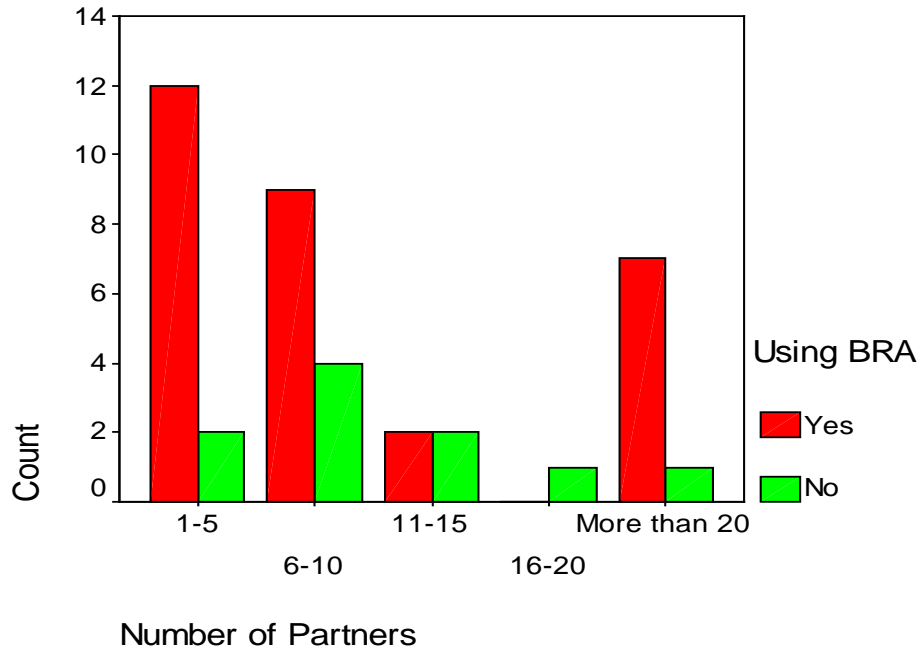


Table 7-3

Use of BRA in Relation to Number of Partners in the Firm

	0%	1-20%	21-40%	41-60%	61-80%	81-100%
1-5 Partners	14%	21%	0	7%	7%	50%
6-10 Partners	31%	0	8%	8%	15%	38%
11-15 Partners	25%	0	25%	0.00%	0	50%
16-20 Partners	0.00%	0	0	100%	0	0
More than 20 Partners	13%	0	0	13%	0	75%

Overall, these findings seem to indicate that firms with fewer than 10 partners and those with more than 20 partners are more likely to embrace the BRA approach. It is interesting that firms likelier to use BRA are those with the most or fewest partners. It

can be speculated that this is because firms with only a few partners might be more likely to embrace BRA in order to attract more clients. At the same time, firms with more than 20 partners might also feel that embracing the BRA methodology is good for the financial bottom line of their companies. However, this finding may simply be an outcome of the small sample size of the preliminary questionnaire.

7.7 Other demographic Analysis

Beyond the comparisons that have been discussed based on country, it is worthwhile to examine other demographic aspects in the data and their relationship to the perception and usage of BRA. Specifically, an examination of the relationship between the years of experience of the participants in relation to the size of the firm for which they work and also in terms of the number of employees and the number of partners may be useful in understanding the background to the responses provided to the primary research interview and the resulting affect on the perception of BRA. In order to test for relationships between the years of experience of the participants and the size of the firms for which they work, chi-square tests are performed.

The purpose of a chi-square test is to compare the observed frequencies of a set of categorical variables with the frequencies that would be expected based solely on chance (Urdu, 2005). By performing this statistical test, it is possible to determine whether two variables are related to each other in a significant way, meaning that one variable influences the other. In this case chi-square analysis will be used to analyze

the demographic characteristics of years of experience of the participant and size of the firm they work in as relating to how these participants answered the research interviews of their perception or usage of BRA. This is important because it allows for an understanding of how demographic variables related to the participants in the preliminary survey may be related, or may influence the outcome of the research.

The following table shows the cross tabulation between years of experience and size of the firm with regards to the number of employees. The table shows that most of the participants worked for firms with more than 25 employees. In addition, the participants that had more experience in the industry seemed to work for the larger firms. The results of the chi-square test on the data showed that a significant relationship existed between years of experience and the size of the firms for which the participants worked (chi-square=33.207, df=20, $p < .05$). It should be noted that the reason for the table only totalling 39 as opposed to 40 is because one of the participants did not respond to the question about his or her years of experience.

Table 7-4

		Size of the firm					Total
		1-5	11-15	16-20	21-25	Up to 100	
Years of Experience	0-5			1			1
	6-10	1	1		2	2	6
	11-15		1	1	1	8	11
	16-20	1				2	3
	21-25	3				5	8
	More than 25	1	1		1	8	11
Total		6	3	2	4	25	40

A chi-square test was also performed between the variables of years of experience and the number of partners in the firms for which the research participants worked. The following table shows a wide dispersion of the participants in terms of their years of experience and the number of partners in their firms. The results of the chi-square test indicate that there is not a relationship between the years of experience of the participants and the size of their firms in terms of the number of partners (chi-square=8.617, df=15, p>0.05).

Table 7-5

Years of Experience and Number of Partners in the Firm						
	Years of Experience	size of firm – number of partners				Total
		0-5	1-5	11-15	16-20	
	0-5	1				1
	6-10	2	3		1	6
	11-15	3	4	1	3	11
	16-20	1	1		1	3
	21-25	4	1	2	1	8
	More than 25	3	3	1	4	11
	Total	14	12	4	10	40

In terms of actual BRA usage, the following table shows BRA usage on the part of the participants based on country. Interestingly, the usage of BRA as compared to non-usage of BRA between the three countries is nearly identical. Three of the participants in each of the United States, United Kingdom, and Canada stated that their firms do not use BRA. Not surprisingly, the results of a chi-square test indicate that there was no difference in the use of BRA between the three countries in the study (chi-square=0.014, df=2, p>0.05).

Table 7-6

Usage of BRA by Country

	Using BRA		Total
	No	Yes	
UK	3	10	13
USA	3	10	13
Canada	3	11	14
	9	31	40

Next, the relationship between the size of the auditing firms in terms of number of employees and the use of BRA is examined. The following table shows that most of the firms that are not using BRA have 25 or more employees. However, the results of the chi-square test indicate that there was no significant relationship between the size of a firm in terms of number of employees and the use of BRA (chi-square=2.017, df=4, $p>.05$).

Table 7-7

BRA Usage Based on Size of Firm

	Using BRA		Total
	No	Yes	
1-5	1	5	6
11-15		3	3
16-20		2	2
21-25	1	3	4
More than 25	7	18	25
	9	31	40

The number of partners working for the firms to which the participants belong is also examined in relation to BRA usage. The following table shows that firms with 11-15 partners had the single largest number of participants that worked for firms that did not use the business risk audit methodology. However, each of the categories of firm sizes in terms of numbers of partners had at least one participant that worked for a firm that did not use BRA. Overall, the results of a chi-square test indicate that no significant relationship existed between the number of partners in a firm and the usage of BRA (chi-square=1.4, df=3, p>0.05).

Table 7-8

Number of Partners and BRA Usage

	Using BRA		Total
	No	Yes	
1-5	2	12	14
11-15	4	8	12
16-20	1	3	4
Up to 100	2	8	10
	9	31	40

Finally, the following table shows BRA usage based on the number of years of experience of the auditors. As with all of the other demographic variables, the results of a chi-square test indicate that no significant relationship existed between the number of years of experience of the auditors and the use of BRA.

Table 7-9

Years of Experience and BRA Usage

	Using BRA		Total
	No	Yes	
0-5		1	1
6-10	2	4	6
11-15	2	9	11
16-20		3	3
21-25	1	7	8
Up to 100	4	7	11
	9	31	40

Overall, the results of the chi-square tests are important because they indicate that those participants in the preliminary survey with greater experience are more likely to work for larger firms when compared to those with fewer years of experience. It is hypothesized that these participants with greater experience, more likely in larger firms would have more exposure to BRA and a broader experience lending the understanding of how it may be incorporated into a firm.

However, the increased size of firm of those participants with a greater number of years of experience is likely to mean that they work in firms with a larger number of auditors and support staff and not a larger number of partners, increased number of auditors and support staff will directly impact on attitude towards the implementation of BRA into their environment.

This may also influence attitudes toward BRA and its impact on the industry because the participants in this research working in firms with fewer partners, smaller sized firms, may be more concerned about revenues and profits rather than the impact of the services that are provided on clients.

7.8 Conclusion of Preliminary Data Analysis

Analysis of the data collected from the surveys provided to partners, managers and senior members of non-Big-4 auditing firms in the United States, the United Kingdom and Canada provide some useful information for this research. However, in terms of audit firms in general, the findings were not extremely different from each other or unique. Specifically, it appears that the staff size and the number of partners in an auditing firm have an important relationship to the use and application of BRA methodologies. Firms with more employees appear to have embraced BRA and use it more often. As has been noted, however, this may be more of an effect of the small sample size of participants and less of an effect generally present in the auditing industry.

The data also seem to show that firms, on the highest and lowest categories, in terms of having less than 10 partners or more than 20 partners are more likely to fully use the BRA methodology with their clients. The nature of the survey does not allow for an

understanding of the reasons for this finding. However, it is speculated that the potential to gain as many clients as possible might be involved in the decision to embrace the business risk audit methodology. Firms with fewer than five partners may be concerned that not embracing BRA might make them appear out of touch with current accounting and auditing practices, which would deter clients from hiring them. On the other hand, firms with more than 20 partners may be concerned about the financial gains that may come from embracing BRA because of the number of partners seeking to enhance the value of ownership of these firms. In both cases, money may be a major factor in the desire to embrace BRA.

7.9 Summary

This chapter presented the results of the preliminary survey that was conducted. The purpose of this survey was to find out if non-Big-4 auditing firm are aware of the BRA concept. The results obtained show that there is awareness among the non-Big-4 auditing firms of the BRA and 75% of the firms are using the method. These surveys impacted the primary interviews because the information collected was integrated into the interview questions that were formulated. The preliminary survey provided a framework for the type of questions that needed to be asked to elicit information about opinions on the business risk audit methodology and other variables that might be associated with the interviewees' opinions.

Chapter Eight

Interview Data Analysis

8.1 Introduction

This chapter presents the analysis of the full interviews that were conducted based on the insights gained from the preliminary surveys presented in the previous chapter, as well as the primary surveys that were designed to gain information from auditors in the United Kingdom, the United States and Canada regarding their knowledge of the business risk audit methodology and its impact on their respective auditing firms

8.2 Data Collection Methodology

For the primary data collection, the individuals that had taken part in the preliminary survey were asked to take part in a more in-depth interview. The participants were informed that the in-depth interviews were being conducted in order to understand some of the issues about the business risk audit methodology that were raised from the results of the preliminary survey. It should be noted that the findings from the preliminary surveys did not change any of the research questions that guided the work. 31 of the 40 participants in the preliminary survey agreed to participate in the primary data collection interviews. Unfortunately, when contacted by the researcher, only one from the UK and two from Canada agree to participate in the primary data collection interview. Efforts started again to secure another 27 participants to agree to be interviewed either in person or by telephone, to secure the sought 30 participants, as discussed in Chapter 6.

It can only be speculated about why so few of the participants from the preliminary survey agreed to take part in the primary data collection. One of the reasons for the lack of desire to participate in the interviews might have been something as simple as a lack of time to devote to the interviews, or a lack of willingness to make the time available. However, the participants in the preliminary survey might have thought about the questions that they were asked in the surveys and been concerned about being asked to provide more detailed answers to questions about the business risk audit methodology and their opinions about the auditing standards in place in their respective countries.

The data collection instrument used for the interviews is shown in Appendix 3.

Responses were entered into NVivo 8.0. The software allows for a large amount of data to be catalogued and arranged according to the themes contained in the information, or according to specific categories. NVivo 8 also allows text files, quantitative data and interview transcripts to be sorted and analysed. NVivo 8 was used in the analysis of the interviews in order to sort the responses according to specific participants, the questions asked and the participant's country. Once the data were sorted, responses related to motivations for adopting the business risk audit methodology, an explanation of the advantages and disadvantages of BRA, and perceptions of the aftermath of the implementation of the business risk audit methodology were analysed.

8.3 Motivation for Adopting the BRA Methodology

The first research question for this investigation asks about auditors' motivations for adopting the business risk audit methodology. The responses provided by the

participants in Canada suggest that their motivation for adopting the methodology was the general momentum within the audit industry to adopt BRA. For example, several of the auditors either directly or indirectly pointed to the risk that auditing firms faced in light of the recent accounting scandals that have affected major companies like Enron. One of the participants stated that the partners within his firm were motivated to minimize audit risk when conducting audits. Even though the business risk audit methodology existed before Enron or any other recent accounting scandals, these events were still relevant and resulted in many of the participants thinking about BRA in terms of these events. The responses provided by the Canadian auditors suggest that many of them did not use BRA before the accounting scandals. However, once the scandals came to the attention of the public, there was a feeling that BRA should be used to minimize their audit risk.

In addition, almost all of the participants from Canada stated that their motivation to adopt the business risk audit methodology was because the BRA approach to auditing is required in Canada. Specifically, the Canadian Institute of Chartered Accountants Handbook Section 5150 and ISA 300, Planning an Audit of Financial Statement, make reference to methodologies that are part of the business risk audit methodology.

However, some Canadian participants stated that the change in auditing requirements was not the only reason for their adoption of BRA. They stated that the industry was moving toward use of the business risk audit methodology and they wanted to stay current with what was taking place within the auditing industry. This point of view agrees with Curtis & Turley's (2007) view that auditors are looking for more than mere compliance with standards. Some of the Canadian participants stated:

Well from our firm perspective we want to stay up on all the trends. So if there is something going on, new guidelines or new audit standings, we want to make sure that we are on there. But we all know that all the changes were basically a direct result of all the problems ahead in the USA as far as some of the ENRONs, WorldCom, and some of that stuff (CAD # 3).

The standards made us change our method; I think it's a bit cumbersome myself. I think we were doing the risk-assessments it's just not as thoroughly as we do now, so we wouldn't have changed to the standards if it wasn't imposed (CAD # 5.)

It's a standard, it's required. You have no choice; you have to do it that way otherwise in a peer review you'd get written up for it (CAD # 9).

It is interesting to note that two of the participants from Canada alluded to financial gain as a motivator for their firms to adopt the business risk audit methodology. One of the participants directly stated that the partners in his firm were motivated by making money, and the ability to make more money by providing business risk audits was part of the reason for using the approach with their clients. Extra revenue would be earned because additional consulting services could be provided to clients in order to help them understand the business risk audit process, as well as advising them of how to deal with the risks identified during the audits. Another participant from Canada explained that the partners in his firm believed the BRA approach would reduce the overall costs of audits for their clients because the business risk audits would be more focused and

involve less time obtaining information that might not be relevant to the identified risks. Furthermore, the entire process would allow for some functions to be moved to a period during the year when the firm was less busy.

You have to motivate the partners and there are two things that will motivate them and that is; minimizing the risk, the business risk and making money (CAD # 1).

Partners believed control testing at interim periods would reduce cost of the audit and move work to a less busy time of the year (CAD # 7).

Overall, the participants in Canada were generally in agreement that their firms adopted the business risk audit methodology because it is required in Canada. In addition, they stated that the general trend within the industry is to use the BRA approach with their clients, to follow trends and remain current with industry standards. A small number of participants explained that their firms were actually using some level of the business risk audit methodology before the standards in Canada changed. However, they also explained that the new standards forced them to be more thorough in how they conducted business risk audits.

Well we changed it before the standards and we did it just to audit more efficiently and it cut out different areas but it wasn't really significant anyway, and it really took up a lot of time (CAD # 8).

The respondent did not provide any further explanation for why his firm chose to implement BRA before any change in auditing standards in Canada. Based solely on the response provided, it seems as though the auditor's firm believed that BRA would provide more efficiency in how the auditors conducted their jobs. This auditor, however, believed that the transition provided no significant change, and actually resulted in wasted time during the implementation process.

In some ways, it is significant that only two of the participants from Canada even alluded to potential financial benefits as a motivator for adopting the business risk audit methodology. Given the reduced amount of respect that some people have developed for the auditing industry in the past decade, the idea of mentioning the opportunity to collect additional fees and increase revenue might seem taboo to many auditors.

The fact that only two of the participants raised the issue of money may be because the other participants and the firms for which they work are concerned about following trends and regulations within the industry, while the participants that mentioned financial incentives are more concerned about the financial issues associated with the BRA approach. However, this desire to remain current with trends in the audit industry raises the issue of what participants might have thought would occur if they had not remained current with trends and changes in the industry. It would seem that the concern about remaining current with trends would be related to concerns about losing clients, as well as the inability to gain future clients. While concern about maintaining current clients and obtaining new clients for auditors in small and medium-sized firms

might indeed be secondary to the issue of following trends and changes in regulations, it would still seem related to the motivation for adopting the business risk audit methodology, given that the Big-4 firms have adopted the BRA approach and a fear might have existed that the small and medium-sized firms would not be able to compete against them otherwise.

The responses from UK participants were somewhat different from those provided by Canadian auditors in that all of them discussed the need to remain compliant with national or international accounting standards. As in Canada, financial regulators and organisations that set auditing standards in the United Kingdom have adopted the concepts of the business risk audit methodology and have stated that auditors should be using this approach in their work with clients (Robson, Humphrey, Khalifa & Jones, 2006).

Several participants from the United Kingdom explained that changes in regulation are forcing them to adopt the business risk audit methodology. Two participants also explained that the general trend on the part of the International Accounting Standards Board is to adopt more of a business risk audit approach to how audits are conducted. With these changes and trends within the industry, the adoption of the BRA approach was necessary.

I think part of it is about having the right documentation to satisfy the [International Accounting Standards], there has been great focus on that over

time. Not only to satisfy the client but also to satisfy the various independent external corporate reviews that will look to see that it's all documented as stated but I think there's also a question of there has been some high profile audit failures (UK # 5).

You know the standards I think maybe 3 or 4 years ago changed . . . to say that when the new ISA came out . . . you need to understand the clients business, you need to spend a lot more time planning, you need to have proper strategy documents in place, and you need to target your audit work to where your risks are, so International Auditing standards now require you to adopt a risk base approach (UK # 6).

However, when the issue of trying to compete with the Big-4 firms was raised, some of the UK participants explained that they needed to adopt the BRA methodology as a way to remain competitive against larger auditing firms. The Big-4 firms began to adopt the use of the business risk audit methodology on a widespread basis in the late 1990s and into the 2000s. The full adoption of the business risk audit methodology became evident by the Big-4 firms as they published working papers and explanations of how they used the business risk audit methodology in practice (Robson, Humphrey, Khalifa & Jones, 2006). KMPG's 1997 publication is a good example and explanation of their use of the BRA (Bell et al., 1997). One participant, who explained that his firm was not trying to compete with the Big-4 because the desired clients for his firm were smaller companies, stated that the firm had adopted something of a scaled-down approach to the business risk audit as a way to be more responsive to the clients they sought. One respondent

explained this pressure in some detail, especially in relation to operating as a smaller auditing firm:

For example, an audit tends to be more of these than ever before, and you get the business invites a couple of the Big-4 and a couple of the large medium firms in Edinburgh. Inevitably they're going to ask who's going to do the work, how long its going to take and what we're going to charge. Now if they actually see a significant deviation between the amounts of time going into by a large firm to a medium sized firm they're going to ask why. And I think the medium sized firms I come across try to be very efficient in the amount of time resource into any particular assignment. But I do think they make a big difference in medium size firms because there are fewer people to deal with so they have more partner contact compared to larger firms (UK #5).

This idea of a scaled-down version of BRA is interesting because it suggests that the firm for which this auditor worked liked the basic ideas and concepts of the business risk audit methodology, but believed that it was too complicated for small clients. By making changes to the BRA, it could be adjusted for use with small clients while still providing improvements in audit risk for the firm.

On the surface, all of the responses provided by the auditors in the United Kingdom seem related to adopting the BRA approach for the sake of compliance with standards. However, when the responses are examined more closely, it is possible to recognise

issues related to the financial aspects of operating an auditing firm. Small and medium-sized firms recognise that they are competing with larger firms for clients.

Based on the responses from auditors in the United Kingdom, financial issues were clearly part of the motivation and rationale for many of the participants and their firms. While the larger issue might indeed be related to changes in regulation, the responses provided indicate a desire to remain relevant within the industry. If the firms had not adopted the BRA methodology, then the concern was that they would appear out of date in terms of the trends within the industry. Participants were also concerned that not using the business risk audit methodology might reveal a lack of training and knowledge to clients with regards to providing the risk auditing that even small and medium-sized companies want, given the recent history of companies like Enron and WorldCom.

One of the respondents from the United States stated what he viewed as something of a dual purpose for using the business risk audit methodology. As he states, the business risk audit methodology is required, but it is also making firms more efficient:

Everything we're doing is due to the impact of what happened to the profession, after everything that happened to ENRON. Now it's like a duality, we want to be more efficient but at the same time we see in ourselves trying to do more planning, so I guess our focus now is to do more planning and put more time into the areas that are the more risk areas (USA #1).

Another auditor from the United States explained that he had already been using the business risk audit approach even before auditing standards organisations began telling members to adopt greater use of the methodology. However, he explained that the BRA approach is actually more efficient because it allows for an examination of the company and then an examination of the company's environment to determine where additional risk may exist. In essence, the business risk audit methodology is viewed by some US auditors as making them more efficient in conducting audits for their clients.

On the other hand, one of the auditors in the United States not only stated that the motivation for adopting the business risk audit methodology was because of changes in professional standards related to the rules implemented by accounting standards organisations, but blamed the changes in standards on the Big-4 firms. He stated:

It was definitely imposed by professional standards and I think that the professional standards were imposed because the Big-4 firms weren't doing what they were supposed to be doing (USA #2).

It is important to recognise that none of the US participants mentioned financial incentives as a motivator adopting the business risk audit methodology in any way. However, there was some mention of using the BRA methodology because it is viewed as being more efficient, which makes the firm more efficient in conducting audits. For example, one of the participants stated that his firm's motivation was

Basically to comply, because now the profession requires that. But at the same time we feel that it does serve a purpose so definitely we can access where the risk is, then we can be more efficient at the same time (USA #1).

Overall, the responses from the United Kingdom, Canada and the United States were similar in that the two main themes arising were the issue of compliance with standards and the issue of remaining current or being efficient in terms of interaction with clients. However, the general tone of the responses was different between the three countries. In Canada and the United Kingdom, the tone of many of the participants was one of almost annoyance at the fact that the trend was for regulations based on the business risk audit methodology. Some of the respondents stated that their motivation for adopting the BRA approach was only because of changes in regulatory standards.

The information provided about the motivations for adopting the business risk audit methodology from all three countries reveals interesting ideas about small and medium-sized auditing firms. While there are some subtle differences in the responses from Canada, the United Kingdom and the United States, there was general consensus about the position of small and medium-sized firms within the larger auditing and accounting industry. Small and medium-sized firms are indeed competing for space within the industry. They are also competing for their reputations in an industry dominated by the Big-4 firms. This competition means that small and medium-sized firms must show that they have the knowledge and ability to conduct themselves and their services in the same way as larger firms.

It is somewhat counterintuitive to think of small and medium-sized firms in the auditing industries of the United Kingdom, Canada and the United States being concerned about competing with the Big-4 firms when they also indicate that part of the reason for new auditing standards is the accounting scandals that have impacted the Big-4 firms.

Finally, with regards to the information provided about the motivations for adopting the business risk audit methodology among small and medium-sized firms in the United Kingdom, Canada and the United States, there is some agreement that the BRA approach provides a more thorough way to conduct audits. Even those participants who explained that their firms had previously used some form of BRA in the past stated that the new regulations and standards provided more structure in how business risk audits were conducted. This may indicate that even if some participants were motivated by nothing more than ensuring compliance with changing standards, there was some recognition that the changes may be positive in terms of how they conduct their businesses.

Overall, the data gathered from the interviews about the motivations for adopting the business risk audit methodology between the United States, Canada and the United Kingdom do reveal differences between the three countries. Specifically, the auditors from Canada and the United Kingdom generally stated that they had adopted the business risk audit methodology out of a need to adopt changing standards in the profession. The auditors from the United States also explained that they had adopted

BRA because of changing auditing standards. However, they also stated that there was a financial incentive for adopting BRA. At least for some of the US auditors interviewed, the motivation for adopting BRA was related to the increase or potential increase in revenues.

8.4 Advantages of BRA

While the previous section analysed firms' motivations for implementing the business risk audit methodology, information was also collected with regards to the perceived advantages of adopting BRA. While it could be argued that the motivations and advantages of adopting the business risk audit methodology are essentially related, this may not be true at all. The motivation for making a change in auditing methodologies may have little to do with the advantages auditors perceive from the change. It can be speculated that the auditors and their firms were motivated to adopt the business risk audit methodology out of a sense of competition with larger firms, or a concern about appearing to lack the appropriate auditing skills in their clients' eyes. However, the advantages auditors recognised after adopting the business risk audit methodology may be largely unrelated to the initial motivations for implementing BRA.

The participants from Canada seemed to have varying views about the advantages provided by adopting the business risk audit methodology. Some of the participants explained in some detail the ways in which the business risk audit methodology made them more aware of problems and concerns with their clients. However, other participants stated quite clearly that the only advantage they saw from adopting the

BRA approach was the reduction in audit risk for themselves and their firms. For example, one participant stated:

The only benefit is that we sleep better. As a result of it we think we've done a better job for the same price. We haven't increased the labor rate, and we're more sure that the work that went out was correct and that we've caught more errors than we would have otherwise. That's the big benefit. And the risk is lower to us and at the end of the day it's the name of the game (CAD #2).

This participant explains that more errors have been caught and reported. However, he seems more concerned about the way in which the BRA methodology reduces his firm's audit risk throughout the entire auditing process. It is also interesting that he explains that his firm has not increased overall labour costs in relation to the BRA audit approach. It seems as though he is quite proud that his firm has been able to reduce their overall risk from the business risk audit methodology without incurring any additional costs. In the end, it is not possible to know from the information he provided whether this participant truly sleeps better at night because use of BRA ensures a better job because of the details that must be obtained, or whether he sleeps better at night because his firm is saving money. This view agrees with the research done in that regard, reviewed in Chapters 3 and 4, of the application of BRA (Bell et al., 1997; Lemon et al., 2000; Winograd et al., 2000; Eilifsen et al., 2001; Knechel, 2001; Bell and Solomon, 2002),

Other participants from Canada were somewhat more reflective on the benefits of using a more thorough business risk audit methodology in conducting the audit process. One of these participants explained:

Well I think from my perspective, we had a much more detailed understanding of the client systems, like their approval processes and controls, stuff like that. We would have had somewhat of these and of course we went back to it and then we got a lot more details. So any documentation that we have within our files we really understand our client systems a lot more then we would have before (CAD #3).

Another respondent stated that his firm was putting much more planning into place before conducting audits because of the business risk audit methodology. Rather than simply jumping into the auditing process or having an informal methodology for conducting risk audits, the advantage of the business risk audit methodology is that there is indeed a specific set of guidelines that have to be followed and documented in order to meet regulatory guidelines (SAS 109; CAS 315; ISA 315). Other participants stated that documentation and planning had improved because of the BRA approach. With the issue of improvements in the auditing process because of the documentation and planning requirements, the issue of reductions in audit risk because of how the business risk of client firms seems relevant to the responses that were provided.

Well with the new risk-assessment standards changing we put a lot more pre-planning in our methodology. But we still had a risk-base method, it was done on an informal basis by the audit partner who just knew a lot about the account and wrote a planning memo that included risk-assessments (CAD # 4).

More emphasis is put on planning, so more tailored methods of auditing can be employed. More thought goes into performing an audit, instead of the usual “just do what we did last year” mentality (CAD # 8).

One of the participants from Canada explained the advantages of the business risk audit methodology in light of client interaction. He explained that at first clients were concerned about the information being collected, and why so much information was collected. However, after some time they were able to understand the work that was going into the audit and the way in which risk was identified. An important part of the response that is provided is that this auditor specifically mentions business risk and the ability to better identify business risks, which also relates to reductions in audit risk.

A lot of clients were put off by how much detail we went into and they were trying to understand their value to them. But the ones that worked with us, they were able to see, they were able to tell you there was quite a good deal of information, more details we gave them about their system. More detail to say that listen these are some of the risk areas we see. And they are seeing a lot more of that. It's a tough one though because the fees have crept up there because of the extra work (CAD #3).

Overall, the participants from Canada generally viewed the advantage of the business risk audit methodology as being the level of detail required when collecting information from clients and documenting the findings of the audits. Furthermore, as a result of the increased level of documentation and planning required, personnel at the auditing firms had a better understanding of the clients. The audits are not conducted in an informal manner with decisions being made at the last minute. Instead, most aspects of the audits are planned and information is given to staff members before further action is taken. In addition, one of the participants stated that not only is the information collection process better but the collected information can be used from year to year as a way to further improve the understanding of clients and their operations. As more information is collected in the long term, the participant stated that not only does the auditing firm benefit, the client also benefits because of the ability to better detect risk.

Participants from the United Kingdom appeared to have a very different idea about the advantages of the business risk audit. Many of the UK participants stated that the advantage to the BRA approach was being able to more easily identify key areas of a client's operation requiring investigation and examination. As one participant explained,

I would say it was more advantageous. It definitely gives you a much more clear understanding of what the key factors are for the business or for the client. And what we think are the key driving points and driving forces for the business. If we are looking at key risks, sorry if we're going into substantive testing, we are just looking at the figures as a whole and we're going back and checking our invoices and we can agree what's actually there. When we looking at the

business risks we're actually looking at what started factors and what will affect the business, what things could change, what could drive them forward, what things in their control could affect the audit and how things can be affected in the future (UK #2).

With specific regard to small and medium-sized auditing firms, one of the participants explained that even for firms of this size, the business risk audit provides the advantage of letting people know that there is a standard process or methodology being followed. Another participant explained that the business risk audit methodology provides firms with a way to help their clients plan for the future. The BRA methodology allows firms to move beyond simply looking at what is occurring at the present time, and move toward helping clients achieve their goals and objectives for the future because of the identification of risk. This participant also explained that because clients know that the auditors are looking for risks, clients themselves are doing a better job of finding and preventing risk before the audits occur.

A lot of our clients are interested in planning of the future now. By undertaking the BRA method we feel that we can now provide more than just confirming a true and fair view of the financial statements, but we can also help our clients to assess their current positions and then help them to achieve goals and objectives for the future i.e. get them to where they want to be (UK # 7).

Another UK participant felt that an advantage of the business risk audit methodology was that it involves an ongoing process as opposed to merely a yearly task. The

improved level of documentation and need to better know the client means that the task of identifying risk becomes a normal part of how clients operate. He stated,

There are some benefits for adapting BRA methodology, it is mainly to get you to know the client better, and identify the risk area for audit and communicate this with the clients, makes them more aware of risky areas they were not aware of. It also improved the audit quality in terms of documentation and keeping the risk assessment at ongoing basis, rather than updating once a year (UK #10).

What is perhaps most interesting about the ideas expressed by the participants from the United Kingdom about the advantages of the business risk audit methodology is that they focus heavily on the advantages to the clients rather than the advantages to the firms. The advantage to the firm of using a more detailed and focused methodology is indeed discussed by the participants. However, the UK participants focus on the ability to determine areas in which greater risk exists and provide more information to the clients in this regard.

In addition, several participants specifically used the term “communicating” when talking about the changes in relationships between firms and clients when discussing the advantages of the business risk audit methodology. The participants mentioned that the BRA approach requires more communication and explanation in terms of what audit firms provide to clients, as well as what clients can expect with regards to information

and documentation. Again, it seems as though these are things that are discussed in terms of benefits for the clients.

Overall, the information obtained from the participants in the United Kingdom suggests that auditors in that country feel that the business risk audit methodology has made them more aware of their clients' business and more focused on the activities involved in performing an audit. For the auditors, there also appears to be a general feeling of more effective audit performed because of the use of BRA. In the United Kingdom, the real advantage of using the business risk audit methodology, at least according to the information obtained from the participants in that country, is a general feeling that they are providing a better service to clients in terms of identifying risk.

The participants from the United States focused almost exclusively on the benefits of the business risk audit methodology in relation to the benefits to auditing firms (Knechel, 2006; Lemon et al., 2000). For example, one participant from the United States explained the benefit of the BRA methodology in relation to the involvement of upper management, such as senior managers and partners, in the audit process:

I think the clients were more satisfied with this method and it did improve the risk identification process and management. It made the upper management be responsible for everything with the audit program and stuff. . . . But the upper management took more responsibility on the audit programs now, which I think made more sense, in risk-area (USA #8).

The participants from the United States also focused on the advantages related to BRA in terms of their own knowledge and level of planning before conducting audits (SAS 300). The participants talked about feeling more knowledgeable going into an audit and more prepared when talking to clients and examining the environment in which clients operate. Furthermore, being able to perform an audit in less time helps avoid wasting time for the client, which in turn allows the firms to save money:

The advantages are you are more knowledgeable, you have more tools to do your work and make decisions. You have an economic advantage (USA #9).

You get a better understanding of the company before you get into the numbers (USA # 10).

Well with the new standards there's been a lot more time spent planning upfront, like trying to get a lot of information from the client upfront, trying to get a better understanding of what took place during the year to do our planning, more time spent upfront with the audit team including the partner who does the planning and making sure we have the risk assessments that we feel are appropriate so that we can assess the risk (USA # 6).

This mention of the economic advantages of using the business risk audit methodology from a participant in the United States is interesting because economic advantages were

not mentioned when discussing firms' motivations for adopting the BRA approach. They may have recognised that because of the strict focus on specific actions with the BRA methodology, an audit can actually be conducted in less time when it is conducted in a focused manner.

Another participant from the United States mentions the shorter amount of time required to conduct a business risk audit as opposed to other audit methodologies. This participant does not talk about the shorter amount of time in relation to economic advantages for auditing firms but does discuss details related to being able to use intellect on the part of auditors and being able to focus on understanding the client as a way of reducing the amount of time spent on fieldwork.

You can do a better audit with less time, I know that's not what you hear but if you do this right you could do this in less time than a regular audit (USA # 9).

In general, the participants from the United States saw the advantage of the business risk audit methodology in relation to their own performance during the audit process. The auditors in the United States indicated that BRA makes them better prepared before the actual audit begins. They believed that the need to collect more detailed information translates into a greater knowledge of their clients and better decisions regarding whether business risk exists and, if it does, in which areas (Lemon et al., 2000; Higgson, 1997; Knechel, 2006).

Responses from all three countries regarding how the participants view the advantages of the business risk audit methodology clearly show a difference in attitudes between small and medium-sized firms in Canada and the United Kingdom compared to small and medium-sized firms in the United States. The participants from the United Kingdom and Canada stated that they performed better because of the reduction in risk caused by more thorough audits which examined the full range of risk to clients. However, they also stated that they better understood their clients and were better able to provide information that resulted in firms making more of an effort to reduce risk. The participants from the United States, however, seemed to focus heavily on what the business risk audit has done for them and their auditing firms. There appears to be little recognition of possible advantages for their clients from the methodology associated with the business risk audit. Even when the participants from the United States talked about gaining a better understanding of their clients through the BRA approach, they talked about this advantage in terms of the benefit for the firm, or the reduced amount of time needed to conduct fieldwork for an audit.

In relation to the cultural literature that was examined, the difference in attitudes about BRA between the three countries is not surprising. The auditors in the United States are more individualistic in nature, so the concern is likely to be about them first and their audit clients, or even the public, second. In contrast, auditors in the United Kingdom would actually like to think that they can regulate themselves without a great deal of government intervention or oversight (Zeff, 2007). Being able to regulate themselves,

however, requires being concerned about clients and being concerned about the way in which audits are conducted even when it may cost an audit firm more time and money.

The issues of having a better understanding of a client and being able to reduce the overall time needed to conduct audits have been discussed in the literature concerning the business risk audit methodology (Bell et al., 1997; Jeppesen, 1998). These results concur with the information obtained from the existing literature on the business risk audit methodology.

The conclusions that have been drawn regarding the auditors' attitudes, especially those in the United States, deserve to be examined in relation to the accounting scandals that have plagued the industry over the past decade. While a discussion of auditing practices may immediately conjure images of Enron or WorldCom, the collected data indicate that issues related to Enron or WorldCom are not foremost in auditors' minds (Knechel, 2006). Instead, auditors in the United States are more concerned about the advantages that they perceive to their firms in terms of reduced costs or more focused audits.

Concerns related to avoiding misidentification of risks or other fraudulent activity on the part of clients appears to be secondary at best to the US auditors.

This difference in how the advantages of the business risk audit methodology are perceived is an important difference between firms in Canada and the United Kingdom versus those in the United States. This difference in attitude may be an indication of differences in general attitudes about the nature of audits or even how auditing firms

should conduct themselves from an economic perspective. It may be that firms in the United Kingdom and Canada view themselves as more than just businesses, also helping ensure the public's trust in companies. In the United States, however, auditing firms may view themselves largely as business entities that exist to make money for their own shareholders and partners.

On the other hand, firms in the United Kingdom and Canada may have different attitudes toward BRA and the nature of audits because of cultural differences.

Specifically, the auditors in the United States may not like that they have to prove that they are identifying all of the business risks that are present with a client. In essence, they may feel that they are being second-guessed. In contrast, the auditors in Canada and the United Kingdom may believe that the business risk audit methodology allows them to better serve the public, so any increase in cost or time to them, or any change in the requirements that they have to follow to perform audits, is acceptable.

Nobes & Parker (2002) explain that there are cultural influences on the way auditing firms operate based on the country in which they exist. Variations in attitudes and practices with regards to accounting and auditing are influenced by cultural differences and seen in attitudes toward the role that auditors and accountants serve. Furthermore, differences in the history and practices of accounting in various countries are also likely to influence current auditing standards and practices. The differing attitudes of participants in the United States as compared with Canada and the United Kingdom may reflect differences in ideas about accounting and differing industry history and practices.

The differences in responses between the auditors in the United Kingdom, Canada and the United States with regards to the disadvantages of the business risk audit methodology mirror the general focus of the comments that were provided about the advantages of the audit methodology. Auditors from the United Kingdom and Canada focused much more on clients than auditors in the United States. Furthermore, the focus of both stated advantages and disadvantages seemed to be small and medium-sized firms and how they are affected by the business risk audit methodology.

In terms of the research question guiding this investigation that asked about the benefits of adopting the business risk audit methodology, the data obtained from the interview participants show that the benefits of BRA are that less time and resources are used by auditing firms. For clients, the benefit of the business risk audit methodology is the ability of auditing firms to better identify business risks in their operations. These findings do concur with the information contained in the literature about the benefits and advantages for adopting the business risk audit methodology (Bell et al., 1997; Jeppesen, 1998).

8.5 Disadvantages of BRA

With so much discussion about US participants' concern about possible economic savings resulting from use of the BRA methodology, it is interesting to note that many of the Canadian participants explained that the disadvantage of the business risk audit is

the costs associated with the approach from the standpoint of clients. Several participants from the United Kingdom explained that the BRA approach is designed more for large companies. For smaller companies, the detailed work required with a business risk audit means greater expense that may not be necessary. One participant stated that the concerns over cost were especially true for private firms that do not have outside shareholders:

Risk based audit approach is providing to be very expensive for owner manager type of clients and ultimately has seen small and medium sized firms walking away from audit engagements (CAD # 4).

The issue of the effect of the business risk audit methodology on small firms was raised by several of the participants from Canada not only in terms of wasted money, but also in terms of wasted time. The participants explained that with small firms, the real concern is with the balance sheet and financial reports, and not with hidden risks in operations or business environments. However, the requirements of the business risk audit methodology still require in-depth documentation that really provides nothing more for the client.

Overall, the participants from Canada focused mostly on the disadvantages incurred by their clients because of the business risk audit methodology. The issues that arise consistently are the fact that more time and money are required from clients because of the work that must be performed. It could certainly be argued that concern about the costs for clients also translates into concern for the economics of the auditing firms, if

they are losing a large number of privately-owned companies as clients. However, the tone of the Canadian responses is not about the disadvantages for the financial futures of their firms but genuinely about the negative effects for small and medium-sized companies that are not helped by the details of the BRA methodology as much as large companies.

It's directed mainly towards upper-middle to big because the small have very little internal control as we know. It's all substantive testing at the end of the day. There's very little compliance testing, therefore risk-base is mainly for upper companies, whereas with smaller companies, everything is material to them anyway so we're still 'killing the balance sheet' concept and we're still doing very little sampling. Our main issue is still to go in and also look at revenue recognition because that's where we feel that there are a lot of problems, still (CAD # 2).

I think the case here is that this method from the standards is beneficial to bigger clients rather than smaller clients because of the time-consumption and documentation. Our audits are smaller audits and there's just way too much documentation than necessary (CAD # 5).

However, this testing took more time than typical substantive procedures and often the client didn't have procedures in place on a monthly or quarterly basis that mirrored the controls in place at year end resulting in wasted time. Many of our clients are small accounting offices with few controls. As a result, we end up doing pretty much the same substantive work but have a lot more

documentation to do. I do not believe it has improved anything for small clients (CAD # 7).

I have seen some improvement in quality but the method suits more for large companies, but not so much for mid-sized companies (CAD # 9).

In comparison with the responses from Canadian participants, the participants from the United Kingdom took an almost neutral view of the disadvantages of the business risk audit methodology in relation to whether the impact is greater on their firms or on their clients. Some of the participants expressed concern that they were limited in how they could serve smaller clients. One participant explains:

You're much more limited because a lot of smaller [businesses want a] manager who knows the business inside out. There are a lot of controls and procedures that are obviously negated because you have one authoritative figure looking over it. Where possible we will provide that service, some clients are not interested and just bare bone it, they already know their business. Some clients are happy to hear it. Particularly we have regulated business audits, like charities, pensions. So where there's a board of trustees from a charity that are separate from business operations they quite like to hear that sort of stuff, so it really depends on the client (UK #1).

Several other participants alluded to the idea that the business risk audit methodology takes a great deal of time with regards to smaller client firms. They explain that larger client firms are likely to benefit greatly from business risk audits because of the nature of their businesses and the amount of information that is available to be reviewed. However, for small client firms, there is less information and fewer areas for risk. While the audit has to be conducted in the same way, the benefits are greatly reduced. One participant specifically stated that small client firms are not helped as much as larger client firms by the business risk audit methodology:

With the new standards, we have to change it and it doesn't really improve the quality for us because the audits that we do are so small and the type of clients and amount of activity of the risk-assessment standards and all the steps you have to go through to get where you're going is for bigger firms, and for smaller firms it doesn't seem [beneficial] (UK # 9).

The general tone of the responses from participants in both the United Kingdom and Canada seem to show a greater level of concern for clients and the impact that the business risk audit has on them. As with the issues discussed by these participants in relation to the advantages of using the business risk audit methodology, the primary focus appears to be on the clients. The issues, even when they are phrased in relation to the auditing firms, seem to show great concern for the clients who are ultimately affected.

The responses from the participants in the United States, as they were in relation to the advantages of the business risk audit methodology, seem largely focused on the problems faced by the auditing firms. For example, one of the participants stated quite directly that implementing the BRA methodology required a great deal of investment on the part of his auditing firm. A second participant stated that the hours and fees required to complete a business risk audit constitute the primary disadvantage for the auditing firm. A third participant went into more detail to explain that firms have to provide more supervision for auditors because of the level of personal judgment required to fulfill the details necessary to complete a business risk audit:

A disadvantage is that there is a whole lot of judgment involvement and so you might need more supervision than we had provided in the past; I mean whether this is right or wrong is debatable. But I think that there is a different level of professional judgment involved so that it is not easier to allow inexperienced staff to do things without a whole of supervision (USA #2).

These attitudes about the downside of more oversight and more supervision from the US participants are not surprising given the information reviewed about differences in cultural attitudes. Auditors and accountants in the United States tend to be more individualistic in nature, and dislike the idea that they have to be watched while doing their jobs (Chan, Lin & Mo, 2003). Interestingly, another US participant expressed the idea that auditing in general faces the whims of people and the accounting industry. Because of changes in how people feel about auditing and how audits should be conducted, unnecessary changes are made. He explains,

Well I can't say I know the client a lot better, but I think that these things are cyclical and as we loosen and tighten audit standards over the past couple decades based on how the climate is you know, and how audits are viewed. And audits are viewed as commodities; it's pretty hard to add to the audit process. If they're not viewed as commodities then you can do more in-depth auditing (USA #3).

What is perhaps most important about this statement is that it seems to indicate the auditor's general dislike for the changes that have occurred within the industry in relation to the accounting scandals in the United States. The participant explains that he did not know the clients any better than he did with previous auditing standards. This view was shared by another participant from the United States, who stated that he actually thought the process used to conduct audits before the transition to the business risk audit methodology was better than what is currently used. As was noted in the literature reviewed, previous studies have noted that the business risk audit methodology could cause auditors to actually overlook information, as well as avoid doing all of the work required to identify material misstatements on the part of clients (Srivastava & Mock, 2002; Houston, Peters & Pratt, 1999). This participant stated that looking for risks was something that was always performed, so the change to the business risk audit methodology had not changed anything on the part of auditors.

Personally I haven't seen much of change because now because of the new standards, I just see more documentation. But the risk audit method that we

used before the standards came out, it was pretty much the same, just more documenting. The traditional method was always risk-base, we did the controls first, look at the company and what areas appear to be risky this year and develop from that (USA # 10).

Another participant also explained that the issue of risk was always handled, especially in relation to smaller clients. He stated that auditors have always talked to their clients about areas of risk and ways in which to reduce the risks that were present. Aside from the sentiment that is directly expressed, there seems to be an underlying feeling that the business risk audit methodology has been widely adopted only because of public concerns resulting from accounting scandals, and not because of any real need for changes in how audits are performed. This sentiment is noteworthy because it mirrors some of the issues discussed by the auditors in the United Kingdom and Canada.

One participant from the United States explained that the learning curve required to fully use the concepts behind the business risk audit methodology is a disadvantage to adopting this audit process. The explanation given is that for auditors who have been in the business for 20 years, changing the processes that have been previously used is problematic (Khalifa et al., 2007). However, the participant stated that he does not believe the problem of the learning curve will persist for very long:

The disadvantage, the biggest disadvantage I find is the learning curve for some firms, and understanding this concept, buying into it. Whenever you have changes in the firm, you have someone who's been doing it for 20 years and

they're like why do we have to this now. So I think some firms are going to have a learning curve disadvantage but I don't think its an advantage that will persist (USA # 9).

The general tone of the responses from the participants in the United States is one that could be best described as irritation or annoyance. There appears to be a level of irritation that standards of how auditors are expected to perform their jobs have changed at all. In addition, there appears to be annoyance on the part of the auditors in the United States that they have to devote more time and energy to the audit process. There is very little discussion about any negative impact to the clients of these firms. The client almost seems to be a secondary issue to how the auditors and auditing firms are affected by the BRA methodology.

When comparing the responses from Canada, the United Kingdom and the United States, it is quite clear that there is a definite difference in attitudes and opinions on the part of the auditors from Canada and the United Kingdom as compared with the auditors from the United States. The auditors from Canada and the United Kingdom were much more focused on the concerns of their clients in terms of additional costs incurred because of the business risk audit methodology. There was also much more reference to the issue of whether small firms receive any advantage from the business risk audit methodology for the money they spend.

The difference in focus and concern between the auditors from the United States, Canada and the United Kingdom is not surprising given the literature that has shown that there are cultural differences between countries that impact the auditing profession (Gray, 1988). Cultural differences can result in auditors in different countries having different concerns with regards to how they carry out their responsibilities and how they interact with their clients (Tsakumis, 2007). Cultural differences have also been shown to impact how auditors make professional judgements (Chan, Lin & Mo, 2003).

The auditors from the United States were truly only focused on their own concerns and the concerns of their firms with regards to the disadvantages of the business risk audit methodology. Only one participant from the United States even mentioned any disadvantages related to clients. This individual's comment about the affect of the BRA methodology on clients was combined with a comment about the negative impact on the auditing firm. This is important in terms of understanding the priorities of the US auditors with regards to the business risk methodology and how it is implemented. There was more concern about the firms being able to save money and time than about what the clients face, especially clients who may receive no additional benefit from the BRA approach (Khalifa et al., 2007).

The differences in responses between the auditors in the United Kingdom, Canada and the United States with regards to the disadvantages of the business risk audit methodology mirror the general focus of the comments that were provided about the advantages of the audit methodology. The auditors from the United Kingdom and Canada focused much more on the clients than the auditors in the United States. Even

more, the focus in terms of both advantages and disadvantages seemed to be small and medium-sized firms, and how they are affected by the business risk audit methodology.

Once again, the culture theory of differences in the accounting industry noted by Nobes & Parker (2002) may be related to the differences in responses regarding the disadvantages in BRA that are present on the part US participants as compared to those in Canada and the United Kingdom. As with the differences in the responses that were provided with regards to the advantages of the BRA, these responses about the disadvantages of BRA may show a genuine cultural difference in the attitude toward the role that auditors and auditing firms serve in terms of working with clients. For firms in the United States, concerns about running profitable businesses may be much more strongly embedded than any concerns for clients. In Canada and the United Kingdom, however, a history of showing concern for both clients and firms, or at least recognizing that auditing firms are expected to serve a vital function for investors and the public, results in firms that are as concerned about clients as they are about their own profits. Once again, these differences concur with the information contained in the literature regarding how auditors in different countries have different concerns and areas of focus in how they carry out their duties (Gray, 1988; Chan, Lin & Mo, 2003; Tsakumis, 2007).

These findings are also important given that many of the accounting scandals that have led to changes in the auditing industry originated in the United States. The auditors from the United States that participated in this research saw nothing generally wrong with previous approaches to conducting audits. This attitude may exist because the

participants are from small and medium-sized firms, while the major accounting scandals largely involved the Big-4 auditing firms.

The auditors from small and medium-sized auditing firms in the United States may feel that they have been unfairly targeted by the public as unprofessional or financially motivated in light of the recent major accounting scandals in the United States. They may feel that they have been punished for something for which they were not responsible. It is also possible that auditors in small and medium-sized auditing firms in the United States were indeed performing very detailed audits in the past, so the specific requirements of the business risk audit methodology may seem unnecessary.

Whatever the reason for the annoyed and irritated attitude that US participants demonstrated in the responses they gave about disadvantages to the BRA methodology, it is clear that the auditors in the United States have different opinions and concerns than the auditors in Canada and the United Kingdom. This is important because it indicates that small and medium-sized auditing firms in the three countries are not the same in regards to their feelings and attitudes about the business risk audit methodology.

In terms of the research question about the disadvantages of adopting the business risk audit methodology, the data obtained from the interview participants from the United States, Canada and the United Kingdom state that the business risk audit methodology had disadvantages for to their clients. Specifically, there was a view that BRA resulted

in increased costs to client firms. There was also a view that the business risk audit methodology caused smaller client firms to do more work than is truly necessary for them to avoid making material misstatements and identify business risks in their operations. However, the auditors in the United States generally viewed the disadvantages of BRA as being the requirement of more work for them that resulted in no measurable benefit in terms of their ability to identify business risks. In other words, the auditors in the United States shared the same views about the disadvantages of BRA, but related these views to themselves as opposed to any perceived problems for their business clients.

8.6 Aftermath of the BRA Methodology

The final issue to be examined is how the participants feel about the aftermath of the business risk audit methodology; in particular, whether additional changes need to be made or whether any drawbacks have been identified. The research question asked about the aftermath of the use of the business risk audit methodology. Aftermath here means the results and implications noted after using the BRA method; whether auditing firms considered moving away from this method or whether they like it and want to continue its use. For the participants in Canada, one of the issues raised with regards to the aftermath of the BRA approach was the need for changes to make the process more efficient and less complicated. As one of the participants explains,

The methods used to be made more efficient. I mean right now the system is good, I don't think there should be a drawback but I do think that it needs to be

made more efficient and more simpler. Also they should work on making the qualitative analysis and the quantitative analysis to be understood better by most people. There needs to be a training process in it that goes beyond just checklists and filling them in (CA #2).

It is interesting that even after comments from Canadian participants about the need to change some details of the business risk audit methodology, none of them expressed the need to fully abandon the BRA approach. In fact, a small number of participants stated directly that no retreat from the business risk audit methodology should be made. The opinions expressed were that the BRA methodology has improved the overall audit approach because they are more focused on finding business risks in their clients, and on documenting their findings and justifying their professional judgements.

It is very noteworthy that one of the Canadian participants viewed the aftermath of the use of the business risk audit methodology as one part of a history of the auditing industry in which changes have constantly been made and where changes are likely to continue, even to the point of actually reducing the requirements that now exist with the BRA approach because of the industry's belief that the business risk audit methodology has been implemented with too many rules for auditors and too many requirements regarding the information that must be examined during the audit process. This participant uses his own experience in the auditing industry, which spans nearly three decades, to make his point:

Well with my history, I started this in 81 and got my CA in 85, and I've seen a whole cycle now, and if that cycle repeats itself which is a potential, as they will ease off on the details and allow a little more substantive work. I can see a new method approach maybe 5-6 years down the road, who knows. Life is moving very fast (CA #3).

Responses from the Canadian participants regarding the aftermath of the business risk audit methodology show a general consensus that it should not be abandoned. Instead, what is generally expressed is that changes may be needed to reduce the number of details that must be collected during an audit, or the level of documentation that is required.

The responses from the auditors in the United Kingdom, as in other areas of examination in this research, are very similar to those provided by the auditors in Canada. The general consensus among the UK auditors is that the business risk audit methodology is a good thing, but that changes may need to be made with regards to how it is used with small companies. In essence, the comment from this participant relates to the larger issue of the evolution of changing standards within the audit industry that have occurred over the past century (Robson et al., 2007). One of the participants stated:

The new method has advantages and disadvantages, but I believe the advantages are more than the disadvantages. What we require as small and

medium size audit firm maybe a modified method, that considers the [business] risk, that's OK, but also it has to take into consideration that client size does matter in audits and the purpose of the audit itself. For example when auditing non-for profit organisation, a lot of the [business] risk assessment procedures are not necessary to perform, but we still have to do and perform (UK #8).

Other participants expressed similar views that the business risk audit provides more advantages than disadvantages but that changes are needed to take into account the fact that small and medium-sized companies are indeed different from large companies and have a different set of issues that need to be audited with regards to risk. Furthermore, it was expressed that the move to the business risk audit methodology was needed not only for the sake of working more closely with clients but also to provide something more for clients than simply looking at the previous financial statements to make sure that they were materially correct. However, the opinion that those changes need to be made and are being made in regards to different sizes of companies and the different industries in which they operate is still held:

In my opinion it has brought in aspects which helped the audit process but I think there is this factor round about it which makes it seen as this value-added service. Due to the current market climates this is particularly relevant and no longer can firms afford to just look at what has happened historically but they also need to have some confidence that going forward they will cope with the demands that markets throw at them today. With regards a drawback – I don't believe that there is a drawback as such but I do believe that different variations

of it are now starting to take place. Particularly with different market pressures which exist today (UK #7).

Overall, the responses from the auditors in the United Kingdom are generally positive about the business risk audit methodology in the aftermath of its use. There are no major concerns that the business risk audit methodology has harmed auditing firms or the industry. Instead, the general feeling is that improvements may be needed to make the BRA approach more effective in dealing with small and medium-sized companies. However, abandoning the business risk audit methodology is not seen as necessary or likely to happen by the auditors in the United Kingdom.

In fact, one participant from the United Kingdom went so far as to state that the only problems arising from the business risk audit methodology are poor judgments on the part of auditors using the methodology and incorrectly identifying business risk. As he explains,

Problems with business risk assessment only arise when the judgment assesses the risk wrongly. If the risks are correctly identified - there is not a problem. If the risks are wrongly identified – there will be a problem. The issue is not with the methodology, but with the quality of the judgments (UK #8).

The opinions provided by the auditors from the United States might be most surprising given the differences in opinion in other areas between US auditors and auditors in

Canada and the United Kingdom. Overall, the auditors in the United States agreed with those in Canada and the United Kingdom that abandoning the business risk audit methodology was not necessary. Instead, changes are needed to make the process more effective and efficient for companies. One of the participants from the United States stated that after the hard work of the first year of using the business risk audit methodology, the process becomes easier and more efficient:

No, I guess not. Because the first year is probably the hardest, but once you have a better understanding of everything it should just be a matter of updating that information but the first year I guess is what's going to be a little hard to get to that point, to document that part well. But after that it shouldn't be that hard (USA #1).

Another US participant stated that the aftermath of the business risk audit methodology has probably been good because it has tightened some of the processes that auditors use after many years of actually loosening standards. Another participant concurs with this opinion by stating that while there is more paperwork involved with the business risk audit methodology, the advantages of the approach outweigh the disadvantages. The opinion that the advantages of BRA outweigh any disadvantages contradicts what Khalifa et al. (2007) stated in their research – that the BRA method is still struggling to displace the reliance of the previous audit methods. What is meant by this is that auditors are using some of the concepts of the business risk audit methodology while relying on the statistical sampling and the focus on examining financial statements.

Despite the similarities in responses from auditors in the United States as compared with those from Canada and the United Kingdom, there is one important difference: some auditors in the United States believe that the business risk audit methodology should be abandoned. One participant from the United States explained that he would give up the business risk audit methodology because the old standards were better than the current standards.

I think we were better off to what we were doing before the standards came in. Because the audit risk method that we had already been using was good for the privately-held companies. I think that what it might do is that it might make you focus on the assertion, you know if you're talking about evaluation and distance. We have a lot of risks in assertion and you can focus on your additional procedures on that, on where the risks are. It kind of correlates the risk to the assertion which drives the procedure and that kind of helped. But we always did it, it was nothing different. And again, we had to do extra services for the clients anyway. So I think that it doesn't recognise a smaller company, and by smaller I don't mean by dollars, like in the hundred millions clients, you know privately held companies (USA # 7).

Another US auditor explained that the only reason to abandon the business risk audit methodology is the amount of work involved, and that fully using the BRA methodology means performing double the work in some areas. He explained his ideas in detail:

The only reason I would say to retreat from this method is that it is difficult to implement and if you're not using it correctly then you're just doubling things up. And when you used to just default to standard and default to maximum risk and not really think too much about specific risks and testing controls and those kinds of things, you know if you continue to do your audits that way and add those on top then I think that adds a lot of additional time, and it's probably real inefficient. You're over-audited which I think it's a tendency for smaller firms anyway cause we're afraid we under-audited so we over-audit (USA #2).

While only two participants from the United States supported abandoning the business risk audit methodology as opposed to making changes to the approach, no auditor from the United Kingdom or Canada expressed such an opinion. It seems as though some of the auditors from the United States continued to show their annoyance at being required to make changes at all. Some of them continued to argue that the aftermath of the business risk audit methodology has truly produced nothing positive for the industry. As one participant from the United States explained about the level of documentation used before the business risk audit methodology was implemented,

I'm not sure if the documentation will protect you as a CPA or if it will expose you more. I mean we've been doing the same work papers and everything. So I'm not sure if the documentation is a good thing or not, it is still to be seen. I think our old documentation was very adequate, I don't think it really makes a difference one way or another, with respect to better work papers, or efficient

audits or protecting the account. Concerning liability I don't know if it will be very efficient (USA #7).

However, it should be noted that some auditors from the United States expressed the opposite sentiment. One participant from the United States actually stated that a retreat from the BRA methodology should not occur because it is easy to teach and staff members at his auditing firm understood it more quickly than other audit methodologies. Again, what is clear from these results is the greater variability in responses from US auditors, as well as the greater concern about the issues faced by the auditing firms because of the business risk audit methodology as opposed to the issues faced by their clients.

Participants from Canada and the United Kingdom expressed much more concern about the aftermath of the business risk audit methodology with regards to the impact on their clients. It seems as though there is a greater level of concern about what has taken place in terms of how auditors have had to use audit methodologies that may not truly benefit their clients, especially if their clients are small or medium-sized companies (Robson et al., 2007; Khalifa et al., 2007). In addition, the auditors from Canada and the United Kingdom seemed to accept the fact that the business risk audit methodology has become popular and entrenched in regulatory policy because of accounting scandals (Knechel, 2006). The auditors in the United States, however, display a general attitude of annoyance at the aftermath of the accounting scandals in their opinions on whether the BRA approach should be given up.

One research question asked whether the business risk audit methodology improved the audit process. In general, the participants from the United States, Canada and the United Kingdom actually stated that BRA had improved the audit process. The improvement in the audit process occurred due to the business risk audit methodology's more focused approach to examining business risk on the part of clients. In addition, the participants stated that the documentation required by the business risk audit methodology was a benefit for both clients and particularly for auditors to reduce audit risk.

However, a research question was also asked as to whether any downsides had occurred in the aftermath of the adoption of the business risk audit methodology. The participants in this study stated that they were concerned that the business risk audit methodology was too stringent in terms of requirements about the information to be examined for small and medium-sized clients. In addition, some of the auditors in the United States expressed a concern that a downside of the business risk audit methodology was to actually put them at a greater chance of facing audit risk. Specifically, it was stated that more documentation can actually result in more questioning of the professional judgement of auditors and the ability to find fault with the work that they perform.

The concern seems to be that a requirement to provide greater documentation and maintain in-depth records of the work performed during an audit provides clients and shareholders with a paper trail that can be followed and examined in the event that business risks are not identified during the audit process. Rather than reducing the audit risk by improving the likelihood of identifying business risks, the result of increased documentation might be that audit risk is increased because there is a greater likelihood

of an audit firm being faulted for how they performed an audit and why a business risk was not identified.

8.7 Issue of Business Risk and Audit Risk

An important issue that was raised several times, both directly and indirectly, in the information gathered from the participants is the issue of risk. The issue of risk was raised both in terms of the risk to the auditors, known as audit risk, in relation to not identifying material risks associated with their client, as well as helping clients understand the risks that are present in their operations, known as business risk. Examining the issues of business risk and audit risk is important to be able to further examine the research question about the benefits and downsides of the business risk audit methodology.

As mentioned previously, one of the auditors from Canada stated quite directly that the advantage of using the business risk audit methodology is that errors are caught that might otherwise be missed:

We're more sure that the work that went out was correct and that we've caught more errors than we would have otherwise. That's the big benefit. And the risk is lower to us and at the end of the day it's the name of the game (CA#2).

Another auditor from Canada stated that the use of BRA also allowed clients to be notified of more risks present in their operations, and made them able to address them more quickly. As the auditor explains:

They were able to tell you there was quite a good deal of information, more details we gave them about their system. More detail to say that listen these are some of the risk areas we see (CA #3).

However, the opinions about the direct and indirect benefits regarding reduced audit risk for auditing firms and reduced business risk for clients are not only expressed by the auditors in Canada. One of the auditors in the United Kingdom actually went into great detail to explain how the business risk audit methodology provides a framework for being able to not only identify business risks but to test the identified business risks and determine the severity of the risk that has been identified with regards to the client and their operations:

For every risk we've got, we've got to have numerous controls in place. Whether we test the control or not is dependant whether we think we'll get enough comfort from testing it, to investigate not having to do your substantive testing and if you think your control is strong enough we will do one of either analytic testing, and it has to be proof and meaningful testing or actual substantive testing (UK #3).

Another auditor in the United Kingdom goes one step further by explaining that he believes that the business risk audit methodology not only allows for a clearer identification of risk by clients, but also a clearer explanation of the risks that have been identified. For the auditors, it is easier to explain to clients why certain risks have been identified, as well as the information that led to the actual identification of the risks that are noted:

The advantage of a risk-based one, you can quite clearly articulate where you actually see the risks are in the business and exactly how we're going to audit them. I think in years gone by very possibly the same approach was actually being taken but it wasn't documented in a way that lead to that as easily (UK #5).

Overall, the general attitude from the auditors in Canada and the United Kingdom is that the business risk audit methodology reduces the probability of not identifying material risks. However, it also reduces the likelihood of clients not understanding why auditors identified certain risks. With the information presented to them, clients can also more easily implement controls and activities that will reduce the risks that are present that could harm their operations.

The auditors in the United States provided nearly identical responses as the auditors in Canada and the United Kingdom. The auditors indicated that the business risk audit methodology reduced their own risk in terms of not identifying material risks in the

operations of their clients, as well as helping clients know which risks were most important and providing them with the information needed to overcome those risks. Quite directly, one of the auditors in the United States stated that the business risk audit helped to “*reduce the risk of failing to detect an error - minimize the chance of receiving a legal claim*” (USA #3).

Another auditor from the United States addressed the issue of risk for both auditing firms and clients. This auditor explained that the business risk audit methodology also requires that companies think about more than just financial statements and actually look at the risks that may be present that are not easily identified solely by examining financial reports:

It makes the auditors more focused on where that risk is then they might have been in the past. I'm starting to see some benefit on the clients side because it makes the auditors step away from a lot of what the client has historically relied on us for – preparing financial statements, preparing the footnotes, doing the depreciation schedules for them. Those sort of tasks which are really for the clients anyway, it forces them to do that themselves and the result is that they'll think about that stuff more (USA #5).

Based on the information presented in previous sections of the analysis and in this section, it does seem that the business risk audit methodology may have been embraced by auditors, if for no other reason than because of its ability to reduce risk for the auditing firms and more easily identify risk for clients. These findings concur with the

literature reviewed that has demonstrated that auditors want methods that enable them reduce both business risk and audit risk (Johnstone, 2000).

8.8 Summary of Primary Data Analysis

Table 8-1 presents a summary of the major findings of this research for each of the three countries examined. The table shows the findings in relation to the five areas that were examined from the information provided by the participants: motivation for using BRA, advantages of BRA, disadvantages of BRA, aftermath of BRA, and the issue of risk in relation to using BRA.

Table 8-1**Summary of Findings from Main Data Analysis**

	Advantages	Disadvantages	Motivation	Aftermath	Risk
Canada	<ul style="list-style-type: none"> • Conduct better audits • Reduce risk to the firm 	<ul style="list-style-type: none"> • Increased cost of audits for clients • Burden for small companies 	<ul style="list-style-type: none"> • Following general trend within the industry • Increase revenues by meeting customer demands 	<ul style="list-style-type: none"> • Some changes needed to BRA 	<ul style="list-style-type: none"> • Lower level of risk to firms and clients
United Kingdom	<ul style="list-style-type: none"> • Conduct better audits 	<ul style="list-style-type: none"> • Increased cost of audits for clients • Burden for small companies 	<ul style="list-style-type: none"> • Comply with national and international accounting standards • Ability to compete with larger firms 	<ul style="list-style-type: none"> • Some changes needed to BRA 	<ul style="list-style-type: none"> • Lower level of risk to firms and clients
United States	<ul style="list-style-type: none"> • Benefits firms because of efficient work on audits 	<ul style="list-style-type: none"> • Increased cost for auditing firms • Greater level of supervision required for lower level auditors 	<ul style="list-style-type: none"> • Follow general industry trend • Increase efficiency 	<ul style="list-style-type: none"> • Some changes needed to BRA 	<ul style="list-style-type: none"> • Lower level of risk to firms and clients

The information analysed as part of the primary data analysis regarding the motivations for adopting the business risk audit methodology, the advantages and disadvantages of BRA, and the aftermath of the BRA approach for auditors in the United Kingdom, Canada and the United States has revealed important differences between the three countries. In all areas that were examined based on the research questions presented, the participants from the United Kingdom and Canada had similar attitudes. The concerns

they expressed were largely based on how audit clients were affected by the business risk audit methodology. The participants from the United States, however, focused much more on how they and their firms have been affected by the business risk audit methodology, and much less on any impact faced by their clients.

Even when participants from the United Kingdom and Canada talked about their motivations for adopting the business risk audit methodology as being related to changes in auditing and accounting regulations, they still mentioned their clients' desire to have access to the business risk audit methodology. The participants from the United States, however, took a different tone when discussing the changes in audit regulations and requirements that essentially forced them to adopt the BRA approach. Their tone expressed a lack of desire for the adoption of the business risk audit methodology. US auditors also named the accounting scandals that faced Enron and other companies in the United States as being related to the larger motivation for the changes to the way that audits are conducted.

The differences in responses across the three countries with regards to attitudes about the business risk audit methodology and its impact on both business risk and audit risk may be due to cultural differences stemming from the histories of the accounting profession and financial scandals. It has been noted that auditors in the United States may see the aftermath of Enron, WorldCom and similar accounting scandals as affecting their status within the financial industry (Robson, Humphrey, Khalifa & Jones, 2006). Rather than these previous events dictating policies and procedures with regards to the use of the business risk audit methodology, auditors in the United States

may feel compelled to accept this methodology less because of mandates or regulations and more because they are worried about how their profession is perceived. In Canada and the United Kingdom, however, those accounting scandals occurred some time ago, resulting in less pressure from the public or regulators because of past mistakes in the industry.

Major differences in attitude and tone were seen in responses to the questions regarding the advantages and disadvantages of the business risk audit methodology. The participants in the United Kingdom and Canada talked mostly about the positive and negative impacts that the BRA approach had on clients, especially small and medium-sized firms that must deal with the added costs and time required for the business risk audit to be conducted. The participants from the United States focused largely on the impact that the business risk audit had on their firms, such as being able to save time on fieldwork because of the large amount of information that is collected, or the extra cost and time that must be put into the audits to complete the documentation requirements.

Previous research (Curtis & Turley, 2006) has questioned whether the business risk audit methodology is indeed effective in relation to the amount of time required to conduct these audits. The findings show that some of the concern over the added costs to the auditing firms, especially those in the United States, may be founded, given that there is no guarantee of finding more errors or preventing material risks. However, it has also been noted that the business risk audit methodology can help overcome some of the complacency that led to events such as Enron and WorldCom (Knechel, 2007).

It seems important to recognise that the business risk audit methodology should not be framed around the events of Enron and WorldCom. Instead, it must be framed as part of the evolution occurring within the accounting industry related to creating standards and practices that are meant to improve the way auditors perform their jobs and serve their clients. Furthermore, differences in opinion about the advantages and disadvantages and even the motivations for adopting the business risk audit methodology must be understood separately from any past events. Instead, they should be analysed in relation to the duties that auditors perform and whether BRA allows for more efficient and better audits.

Even the comments related to whether the business risk audit methodology should be abandoned showed differences in terms of concerns about clients versus concerns about auditors and their firms. The auditors from Canada and the United Kingdom talked about a partial revision of the business risk audit methodology in order to better focus on small and medium-sized clients, and the ability to tailor audits to the particular industry in which clients operate. None of the participants from Canada or the United States raised the issue of completely retreating from the BRA approach and returning to an older audit methodology.

Some participants from the United States, however, expressed the view that a full retreat should be made from the business risk audit methodology because it is a more stringent version of what was already being done in their audits. It may be that small

and medium-sized auditing firms in the United States have indeed been using the business risk audit and are more aware of their clients' risk concerns and issues than the Big-4 firms in the United States.

The relationships that were found to exist between the demographic variables in the preliminary surveys were also found to exist with regards to attitudes toward BRA in the interviews. In order to examine the relationships between attitudes toward BRA from the qualitative interviews and the demographic variables of the participants, the number of references from the interview participants toward advantages and disadvantages of BRA were examined. The following table shows the relationship between advantages and disadvantages of BRA and the number of partners in the firms for which the interview participants worked. The results of a chi-square test indicated that there was no significant relationship between the number of partners and the number of references to the advantages or disadvantages of BRA by the interview participants (chi-square=0.34, df=4, p>0.05)

Table 8-2

Number of Partners and BRA References

	Advantages	Disadvantages
1-5	9	8
6-10	6	4
11-20	8	5
21-100	4	3
101+	2	2

The following table shows the relationship between the number of years of experience of the participants and the references to advantages and disadvantages of BRA. Once again, the results of a chi-square test indicate that no significant relationship existed between the number of years of experience and references to advantages and disadvantages of BRA (chi-square=0.56, df=3, $p>0.05$)

Table 8-3

Number of Years of Experience and BRA References

	Advantages	Disadvantages
1-5	2	1
6-10	6	6
11-20	14	11
21+	7	4

Next, the table shows the references to advantages and disadvantages of BRA in relation to the size of the auditing firms for which the participants worked in terms of the number of staff members. Yet again, the results of a chi-square test show that there was not significant relationship between these two variables (chi-square=0.36, df=4, $p>0.05$).

Table 8-4

Size of Firm and BRA References

	Advantages	Disadvantages
1-10	3	3
11-20	5	3
21-50	8	6
51-100	3	3
101+	10	7

8.9 Relation of Findings to Grounded Theory

The theoretical foundation of this research has been the use of grounded theory, which is used to understand an issue based on time and context (Belk, 2007). This is important for the findings that have been presented from the preliminary survey and the interviews that were conducted. The data were gathered at a specific time in which auditors appear to have been generally concerned about the perception of how they served their clients, as well as the costs and outcomes associated with adopting the business risk audit methodology. The question might arise as to whether the opinions expressed by the participants can be related to the current financial crisis that is occurring in many countries around the world. Unfortunately, the time and context in which the data for this study were gathered do not allow for a full examination of the business risk audit methodology in relation to the current financial crisis. The data were collected just as many of the events that have been blamed on the current financial crisis were beginning, which means that for the participants in this study, the issue of

activity in the credit markets and the actions of banks with regards to risky investments were not being considered. However, this can also explain why some of the auditors wanted to discuss previous accounting scandals even though those events occurred after the business risk audit methodology was implemented within the auditing industry.

In terms of grounded theory, the findings presented do allow, however, for a general understanding of how auditors in the United States, Canada and United Kingdom perceive the business risk audit methodology in terms of motivations for adopting BRA, the advantages and disadvantages of adopting BRA, and the way in which BRA may have improved the audit process. These findings are important because they demonstrate the perceptions and opinions of auditors in these three countries about the business risk audit methodology as part of the larger evolution of auditing standards and practices that have occurred over the past century.

8.10 Summary

In summary, the information that has been analysed shows that small and medium-sized auditing firms in Canada and the United Kingdom have a different general attitude about the business risk audit methodology than their counterparts in the United States. The auditors in Canada and the United Kingdom from small and medium-sized auditing firms show a greater level of concern about how the BRA approach has impacted their clients, especially small and medium-sized clients. The auditors in the United States, on the other hand, show much more concern for how the business risk audit methodology has impacted them and their firms in terms of the additional time required for audits and the ability to cut costs because audits can be conducted with less fieldwork.

In terms of the motivations for adopting the business risk audit methodology, the data indicate that the auditors in all three countries wanted to be able to better identify business risk for their clients. However, the auditors in the United States also seem to be motivated by financial concerns in terms of being able to reduce costs and increase profits by adopting the business risk audit methodology. In addition, the auditors from the United States, Canada and the United Kingdom stated that the business risk audit methodology brought about the advantages of being more focused on business risks and documenting the work performed during the audits and the information that was gathered. However, at least for the auditors in the United States, the greater level of documentation was viewed as a potential disadvantage of the business risk audit methodology because of fear that greater documentation could mean the ability to scrutinize their work and find fault with their professional judgements. The auditors from all three countries also stated that the business risk audit methodology was too stringent in terms of the work required to conduct audits for small and medium-sized firms.

Chapter Nine

Overall Summary and Conclusion

9.1 Introduction

This chapter provides an overview summary of the results of the research, as well as conclusions about the information that has been presented. This chapter will provide an in-depth discussion about the implications of the research findings with regards to the auditing industry. In addition, suggestions for future research are made based on the results of this investigation, as well as some of the questions that exist based on the findings obtained.

9.2 Overview, Summary of Results

This research was conducted in order to understand the attitudes and behaviours of auditors working for small and medium-sized auditing firms in the United Kingdom, the United States and Canada with regards to the application of the business risk audit methodology. Specifically, three research questions guided this investigation. The research questions asked about the motivations of auditing firms in adopting the business risk audit methodology. In addition, one of the research questions asked about the benefits and disadvantages of adopting the business risk audit methodology. Finally, the question of whether the business risk audit methodology improved the audit process was asked.

The respondents from the United Kingdom generally stated that the advantage to the business risk audit methodology is that better audits are performed for clients. The

respondents from Canada and the United Kingdom largely provided responses about the advantages of using the business risk audit methodology in terms of possible benefits for clients. Even the respondents from Canada who explained that the level of risk for auditing firms was reduced stated this advantage in relation to the higher quality audit that is performed.

The respondents from the United States, however, gave very different responses regarding the advantages of the business risk audit methodology. Overall, they explained that the business risk audit methodology made their work more efficient, which benefited the auditing firms because of the reduced wasted time and effort in terms of information that had to be collected or the amount of time spent collecting information at the client site as opposed to data analysis that could be performed within the auditing firm. Almost none of the responses from US participants addressed the advantages of using BRA in terms of the benefits for clients.

In terms of the disadvantages of using the business risk audit methodology, respondents from Canada stated that BRA resulted in increased costs for clients because of the extra work that had to be performed. These respondents also stated that BRA caused an increased burden on small companies because many of the areas of focus in business risk audits were unnecessary when conducting audits for small companies. Respondents from the United Kingdom had nearly the same responses as Canadian respondents. The participants from the United Kingdom stated that the disadvantages of using BRA were largely related to the added cost of audits for clients, and the burden placed on small

businesses because of the guidelines and regulations related to how a business risk audit should be conducted.

The respondents from the United States were once again focused on the disadvantages for their firms and not their clients. These respondents explained that even with greater efficiency in conducting audits using BRA, there were added costs to their firms because of the strict requirements that had to be followed and the amount of interaction required between firms and clients. The auditors in the United States also explained that BRA required greater supervision on the part of managers and partners of auditing firms over the work conducted by lower level auditors.

The responses provided about the motivation for adopting the business risk audit methodology were somewhat similar across all three countries. The participants from Canada explained that their motivation for adopting BRA was to follow the general trend within the auditing industry of using the business risk audit methodology. They also stated that increased revenue from clients was a motivation for using BRA. Specifically, the use of BRA provided increased revenue from clients because more customers are demanding that business risk audits be performed. The participants from the United Kingdom provided the same responses about their motivations for adopting BRA. They explained that their motivations were related to complying with the standards that focused more on business risk audits, as well as being able to compete within the industry by providing clients with the business risk audits that are in greater demand.

Unlike the responses provided with regards to the advantages and disadvantages of using the business risk audit methodology from the participants in the United States, the responses provided about motivations for using BRA were almost identical to those of UK and Canadian participants. The participants in the United States explained that their motivation for adopting BRA was to follow the general trend in the industry. They did explain, however, that another motivation was to increase the efficiency of audits, which was possible using the business risk audit methodology.

The auditors were also asked their opinions of the aftermath of BRA use. Respondents from all three countries expressed the general idea that the business risk audit methodology should not be completely abandoned. They felt that BRA has many benefits that provide a stronger audit for clients and auditing firms. However, some changes are needed in order to provide more flexibility to auditors, especially when conducting audits of small companies who do not have the same level of risk as large corporations.

Finally, the participants raised the issue of risk as it pertained to conducting business risk audits. For the most part, all the participants from the United Kingdom, Canada and the United States explained that business risk audits reduce the level of risk to both themselves and their clients. The reason for this reduced risk is related to the specific requirements and recommendations for how business risk audits should be conducted. The participants explained that the business risk audit methodology requires a more

thorough knowledge of their clients and their clients' actions, as well as future plans. The result is that this knowledge can be used to better identify material risks that may negatively impact their clients.

It should also be noted that the findings show a change in ideas of how audits should be conducted. The auditors from all three countries talked in some form about both business risk and audit risk, and the need to reduce material risks for both auditing firms and their clients. This concern about risk is shown in the responses about the advantages of conducting business risk audits, as well as in the responses about the issue of risk and its relationship to BRA. The respondents generally agreed that the business risk audit methodology reduced risks for auditing firms because of the ability to better understand their clients, which allowed material risks to be more easily identified and addressed. This finding concurs with the findings of previous studies that indicate that the business risk audit methodology can reduce both business risk and audit risk by creating a stronger framework in which auditors focus not simply on the financial statements of client firms but the larger interactions that occur (Johnstone, 2000; Bell et al., 1997; Eilifsen et al., 2001).

9.3 Implications of the Study

The results of the study provide a great deal of room for discussion about their implications with regards to the auditing industry and the use of the business risk audit methodology. One of the implications of the results obtained in this investigation is that auditors seem conflicted about the usefulness of the business risk audit methodology. The auditors who participated in the study seem to express at least some irritation with

the business risk audit methodology because of the often strict guidelines and rules that must be followed. However, they expressed the idea that the business risk audit methodology had the advantage of reducing the risk of not identifying material risks in the operations and actions of their clients, which concurs with the findings of previous studies and opinions of others in the auditing industry (Robson et al., 2007; Johnstone, 2000; Bell et al., 1997; Eilifsen et al., 2001).

Another implication of the results of this study is that there seems to be a clear difference in the attitudes and areas of focus between auditors in the United Kingdom and Canada as compared to those in the United States. Many of the attitudes expressed by the auditors from the United Kingdom and Canada showed a customer-centered focus on how the business risk audit methodology has affected the auditing industry, as well as how it has affected customers in terms of costs and burden. The auditors from the United States, however, were much more concerned about the burdens and costs that BRA created for them and their firms. The problems that the business risk audit methodology brought about for customers were secondary to the concerns of the auditors.

This information suggests that there is a cultural difference in the ways in which auditors in the United Kingdom and Canada think of themselves and their duties to the financial industry, in contrast to the ideas and beliefs held by auditors in the United States. The implication seems to be that auditors in the United Kingdom and Canada view themselves as an important part of maintaining honesty and transparency within the financial industry. While it is likely that auditors in the United States also hold this

view, the findings for this research would suggest that there is also a strong concern about their own work and their ability to generate revenue and profits. The data collected in this study would lead a person to believe that auditors in the United States are much more focused on profits and revenue, and less focused on the concerns of their clients. From the standpoint of auditing and culture, these findings show the impact that culture and auditing standards can have on each other. The standards and practices of auditing firms do not exist in a vacuum. Instead, larger cultural issues impact the auditing standards that are implemented and the way in which auditors view them (Chan, Lin & Mo, 2003; Tsakumis, 2007; Gray, 1988).

However, it should be noted that the information obtained in this study was taken from the information provided by participants in all three countries. This means that the auditors from the United States may have simply been more willing to be honest about their concerns and motivations for adopting and using the business risk audit methodology than their counterparts in the United Kingdom and Canada. The auditors from the United Kingdom and Canada may have felt that it would be wrong to focus on revenue and profit when discussing the business risk audit methodology. Even auditors in the United Kingdom and Canada stated that their motivation for adopting BRA was to increase their revenues by providing a service that is currently in demand with many clients. These auditors also explained that they have adopted and used BRA because they feel it makes them more competitive against larger auditing firms.

It must be reiterated that these ideas cannot be addressed with any level of clarity given the type of information obtained through this research. However, these issues and

potential implications certainly provide material for future studies. They also raise the point that additional research regarding a variety of topics on the auditing industry and its motivations and practices is needed. It must also be remembered that the auditors who participated in this study work for small and medium-sized auditing firms in the United Kingdom, Canada and the United States. This is important because the attitudes and potential implications that have been discussed may differ greatly from those that would be expressed by auditors working for the Big-4 auditing firms.

The larger implication from the information obtained from this study with regards to the setting of auditing standards is that attempting to use a single standard across all three countries may not be possible, and may not be the best thing to do. Cultural differences between the three countries with regards to the concerns of auditors and the expectations of the public may mean that different auditing standards are necessary. For example, it is possible that US auditors working for small and medium-sized auditing firms have to be overly concerned about their own revenue and profits in order to remain financially viable and competitive within the auditing industry. If they focus too heavily on client concerns, they may find themselves unable to compete with larger auditing firms that have larger clients and are able to generate larger revenues from each client they serve.

The level of competition may have further increased given the concerns about companies' economic condition and their transparency over the past few years in the United States. This is certainly not to overemphasize how events such as the Enron or WorldCom accounting scandals have impacted the auditing industry. Instead, clients

may simply want what they perceive to be audits with the strongest ability to detect business risks. At the same time, auditing firms in the United States may be overly concerned about not missing any material risks that could endanger their own financial futures from lawsuits and other actions from investors and regulatory agencies.

Again, the intent of this research and the data collected do not allow for an analysis of whether auditors in the United States feel greater professional pressure due to past accounting scandals. However, one implication from the results of this study with regards to the different attitudes and concerns between UK and Canadian auditors, and US auditors, is that there is a different focus on what is important with regards to the business risk audit methodology. Future studies may wish to investigate why these different attitudes exist.

More broadly, it should also be recognised that the methodologies and concepts used by auditors over the past century have changed over time. Attempting to connect specific audit methodologies and concepts to specific events that have occurred in the accounting and financial industries is too simplistic. In reality, fluid movement and transition of audit methodologies, standards and practices have occurred over time (King & Case, 2003; Kaplan, 1984; Brown, 1962). The goal of this investigation was to understand differences in ideas about advantages and disadvantages to the business risk audit methodology between auditors in the United Kingdom, the United States and Canada. Another goal was to determine if different motivations existed among auditors from the three countries in adopting and using the business risk audit methodology. This research did not intend to attempt to connect the adoption and use of the business

risk audit methodology to any specific event that has occurred in the accounting or financial industries.

The results of this research are important not only in relation to small and medium sized audit firms in the United States, United Kingdom, and Canada, but also because they allow for a comparison with the results of previous studies involving big-4 audit firms and the business risk audit methodology. As discussed in the literature review chapters, previous research has concluded that the use of BRA in the big-4 firms results in a broader consideration of the business risks of clients (Lemon et al, 2004). The results of the current research found that many of the participants stated that BRA did allow for a greater focus on the broader issues and concerns within an organization that might contribute to overall business risk. Anderson (2006) stated that the big-4 firms used somewhat more complex procedures than those used by other firms or non big-4, this is to be expected when the firm is focusing on broader issues and concerns.

The participants in the current research also expressed that while BRA was generally helpful, it could also use benefit from adjustment, particularly in the way that it is used with smaller clients. As was noted in the literature review, previous research previous research conducted with auditors working for the Big-4 firms found that there was a general attitude that BRA was helpful but also needed to be changed in terms of its use with smaller clients (Lemon et al., 2004). The argument that has been made is that BRA is appropriate and helpful for use among the Big-4 firms. However, changes and adjustments to the audit methodology are also needed in order to allow audit firms to more effectively work with smaller clients. Interestingly, the conclusion about the

types of changes that are needed to improve BRA for use among the big-4 firms is an expansion and broadening of the business risk focus. In comparison, the ideas related to adjustment among the participants in this research seemed to be that BRA needed to be adjusted to allow for a decrease in the types of business risk that were of concern because of the more specific business risks related to small and medium sized clients.

One speculation as to the divergence in the perception of whether the business risk audit methodology should be narrowed or broadened in relation to how business risks among clients are evaluated may be a function of the size of the clients. Small and medium sized audit firms are more likely to have smaller clients, and applying Anderson's (2006) theory, would require less complex procedures. Because of the work that is performed with smaller clients, auditors working for small and medium sized audit firms may perceive BRA as being too broad or too complex. In contrast, auditors working for big-4 firms are more likely to work with larger clients in which a much larger set of business risks may be present and require more complex procedures in the application of BRA. From this perspective, BRA should be broadened so that the full range of business risks that are present in the function of one of the big-4 firms can be evaluated.

In addition, previous research that was reviewed in this investigation noted that within the big-4 audit firms, the business risk audit methodology is perceived as being a way to provide value-added services to clients (Eilifsen et al., 2001). The participants in the current research viewed BRA as a way to provide additional services and information to their clients. This perception appears to be mirrored by their counterparts in the big-4

audit firms. The business risk audit methodology is perceived as providing auditors with the ability to provide services to their clients that add value beyond the actual audit services that are provided.

The issue of adding value for clients was also discussed in the literature review as one of the reasons that Big-4 auditing firms have adopted the business risk audit methodology (Jeppesen, 1998). The data obtained in the interviews showed that the auditors working for non-Big-4 firms also believed that BRA added value for their clients. The interview participants stated that the business risk audit methodology allowed them to better identify business risks for their clients and make that information known so that their clients would be aware of those potential risks.

Overall, the results of the current research concur with the findings of previous studies regarding the perceptions of auditors about the business risk audit methodology. The importance of the current research, however, is that it was conducted on non-Big-4 auditing firms. The previous literature was conducted using participants from the Big-4 auditing firms. This research has filled the gap that existed within the academic literature about the way in which auditors working for non-Big-4 auditing firms perceived the business risk audit methodology.

9.4 Suggestions for Future Research

One of the issues that formed the basis for conducting this research was the ability to compare and contrast ideas and attitudes held by auditors in the United Kingdom, the

United States and Canada. Additional research is needed to fully examine the differences that might exist between auditors in these three countries. One suggestion for future research would be to broaden the scope of the research from a single methodology, such as the business risk audit methodology, and ask auditors in all three countries about a variety of issues currently affecting the auditing industry.

For example, auditors in the United Kingdom, the United States and Canada could be asked how they think about audit methodologies in a global environment in which there a move toward global auditing and accounting standards are being pursued. The participants in this type of research study could be asked about their opinions and perceptions of whether the business risk audit methodology could be beneficial in other countries. They could also be asked whether they think that the business risk audit methodology will continue to be used in the future if global auditing standards are indeed achieved.

Further research would also provide valuable practical information for regulatory agencies and the academic community about the real-world concerns and issues that are important for auditors based on the size of the firm for which they work. Rather than discussing differences in auditors' attitudes and ideas solely based on theories and concepts, this research would bridge the gap between theory and real-world attitudes and actions.

Additional research is also needed that specifically investigates issues faced by auditors who conduct audits for small and medium-sized firms. One issue that was raised in this research was that the business risk audit methodology is too complicated and involved for the needs and risks present in most small and medium-sized companies. The issues auditors face when working with small and medium-sized companies in relation to audit methodologies and the identification of business risk deserve further attention from the auditing and financial communities. Issues such as how small and medium-sized firms react to providing the same type of information expected of large companies, as well as how small and medium-sized company leaders and executives feel about the identification and discussion of risks with auditors, deserve further investigation.

Finally, it deserves to be reiterated that any research that deals specifically with small and medium-sized auditing firms, regardless of country, is needed. The academic community has largely ignored the needs and concerns of small and medium-sized auditing firms. By conducting more scientific research specifically related to small and medium-sized auditing firms, the academic community can provide useful results for both teaching auditing procedures and advocating new regulations for small and medium-sized firms.

More research on small and medium-sized auditing firms is also needed in order to better understand how these types of auditing firms operate on a general basis. The Big-4 firms are not the only auditing firms that provide important services for the financial community. Small and medium-sized auditing firms are an important part of the financial community. They serve a large number of clients who have specialized needs

and concerns because of their status as small and medium-sized companies. The auditing industry needs to focus more on how auditors deal with the specific needs of small and medium-sized companies.

Often forgotten are the actual needs and concerns of the clients being served. Small and medium-sized auditing firms provide services to clients that are different from large multinational corporations. These auditors and their firms must deal with explaining auditing practices to these clients and working around the annoyances and outright contentions that may arise when small and medium-sized clients feel that their time and money are being wasted. It would be interesting to better understand the interactions that occur between auditors and small and medium-sized clients so that auditors can do their jobs and clients can feel they are receiving appropriate services for their needs.

9.5 Limitations of the Research

It is important to also discuss the limitations of this study. One of the limitations of this study is that the information collected from the participants constitutes the information that they were willing to provide in the interviews. It is certainly possible that the interviewees were not entirely honest with regards to their opinions about the business risk audit methodology. It has to be assumed that the interviewees were honest while also recognizing that there is a risk that they were not honest because of a desire to appear a certain way to the interviewer, such as not appearing to be entirely motivated by profits or appearing to be more concerned about their clients than might actually be the case.

Another limitation of the study is uncertainty as to whether the attitudes and opinions expressed by the interviewees did reflect their attitudes at the time in which the interviews were conducted. It is possible that the attitudes that were expressed about the business risk audit methodology were influenced by larger events occurring in the auditing and accounting industry. However, attempts were made to overcome this limitation with the questions that were asked. Specifically, asking questions that were broad in nature to allow the interviewees more freedom to provide their own ideas provided some protection that only current concerns were included in the responses as opposed to larger considerations for the business risk audit methodology and its impact on how they perform their duties as auditors.

One additional limitation to this study is that it was conducted on a macro level. This investigation was conducted with the intent of obtaining broad opinions and perceptions of the business risk audit methodology and its use among small and medium sized firms. The limitation in this is that a micro-level analysis might allow for different conclusions to be drawn. A micro-level analysis, such as a case study, in which more specific or lower level details are investigated might indicate different or additional perceptions on the part of participants with regards to the use of the business risk audit methodology. This type of study might result in more detailed perspectives about the interactions that auditors have with their clients when using the business risk audit methodology. Being able to conduct a case study of a single auditing firm would allow for more information about actual interactions with clients, and perhaps even interactions between auditors, as they use the business risk audit methodology.

A case study involving the use of the business risk audit methodology might also result in greater information about the internal perceptions of the business risk audit methodology among the partners of auditing firms. Rather than simply attempting to address on a broad level as to whether partners might want to use the BRA method because of financial concerns, such as generating additional revenues, a micro-level analysis might allow for an understanding of additional concerns of auditing firm partners, such as having their firms perceived to be using the up-to-date audit methods or being able to better compete with other firms in the industry.

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APPENDICES

Appendix 1

Date :

Dear *M.....*,

BUSINESS RISK AUDITING SURVEY

My name is Imad Kutum; I am a chartered accountant (Ontario, Canada) and a part time PhD student at the University of Stirling (Scotland, United Kingdom).

My PhD research concerns the contemporary Business Risk Audit methodology [or 'BRA']. Auditors have been under pressure to adjust their traditional substantive methods in the direction of methodologies grounded more explicitly in business risk, in the face of changes in technology and communication on the one hand, and to respond to the increasing incidence of corporate failures around the globe.

About 10 years ago, all 'Big 4' firms adopted 'BRA' and started applying it on almost all audit engagements. Some research has been done on 'BRA' and has studied its application and effectiveness. These studies however have focused on international auditing firms – not unnaturally, since they are the ones who invented the approach and apply it generally on audit engagements. There do not appear to be any studies that have investigated the actual or potential use of BRA in the context of small and medium sized auditing firms.

A key feature of 'BRA' is that substantial audit time is devoted to understanding the client's business environment, the critical risks of the business and the ability of the management to control those risks. The focus of the auditor's attention is on the client's critical business processes as opposed to transaction streams and the recording of systems; 'BRA' is intended to result in a greater focus on testing controls over critical business risks, greater use of analytics and a reduction in detailed substantive testing.

The aim of this brief survey is to investigate the application of BRA within the “non-Big 4” auditing firms. Based on the feedback received, more comprehensive research will be conducted in order to highlight the application of BRA within the “non-Big 4” firms and to produce recommendations that will be of benefit to professional auditors.

I appreciate very much your participation in this survey; for your convenience I added a self addressed envelope to be used to send your answered survey; if you would like to add any comments please e-mail me at imad@kutum.com.

Sincerely yours,

Imad Kutum, CA, CPA, MBA

Appendix 2

Name: Company:
.....

Address:
.....
...

Tel: Email:
.....

1) Your Position?

Partner Manager Senior

2) Size of your firm / employer?

Total Professional Staff:

Number of partners:

1-5

6-10

11-15

6-10

11-15

16-20

21-25

More than 25

3) Years of experience in auditing?

6-10 11-15 16-20 21-25 More than 25

4) Has your firm changed its audit approach/methodology over the past 10 years?

Yes

No

If you answered 'yes'; please give a brief explanation here:

5) Are you familiar with the Business Risk Audit (BRA) audit approach?

Yes

No

If you answered 'yes'; please give a brief explanation here:

6) Are you using BRA on any of your audit engagements?

Yes

No

7) On what percentage of your audit engagements do you apply BRA?

1-10%

11-20%

21-30%

31-40%

41-50%

51-60%

61-70%

71-80%

81-90%

91-100%

8) Do you recommend using BRA on all audit engagements?

Yes

No

9) Do you use an audit approach, other than BRA?

Yes

No

10) Can I contact you in the future to participate in a more detailed interview (in person or by telephone) about the application of BRA and the benefits of alternative audit methods?

Yes

No

Appendix 3

Research Questions

Name (optional):

Firm (optional):

Address:

Country:

Position:

Number of partners:

Number of total staff:

Years of experience:

1) What has been the firm's exposure in changing audit methods over the last decade?

2) What were the motivations to change to (Business Risk Audit) BRA method?

3) What were the benefits of changing to BRA method in terms of audit process and risk concepts?

4) The aftermath results of adopting the BRA method; was this new method to improve the audit process? Is there a draw back from BRA method now?

5) Reasons for retreat from BRA method? What is the firm Post-BRA experience? If applicable.

6) How the audit standards impact your adaptation and implementation of BRA method?