

# Auditing Standard Change and Auditors' Everyday Practice: A Field Study

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## Abstract

The analysis of inertial phenomena in business context has been developed with reference to management and financial accounting (Hopwood, 1990; Hopwood and Miller, 1994). In the auditing field, however, only a few studies have attempted the inertial phenomenon (Salterio, 1996; Salterio & Koonce, 1997; O'Reilly, et al., 2004; Messier, et al., 2012). An opportunity to investigate more in depth the topic of auditing inertia is offered by the recent change of the auditing principles in Italy.

Stemming from the aforementioned consideration, this paper aims to analyze the phenomenon of auditing inertia making reference to a case of change in the auditing standards and procedures to which auditors refer to in performing audit works. In order to achieve this aim, a field study methodology was adopted.

The main findings are the following. First, it emerges that the reactions of the audit firms to the analyzed change of auditing standards are different. Second, the analyzed cases have shown that single auditors have undergone passively through the process of change. Third, the collected evidences also suggest some of the items that contribute to the adoption of an inertial behavior. Fourth, it emerges that the aim of the EU project, the harmonization and adaptability-flexibility of auditing procedures, is only partially achieved as sometimes occurs a substantial harmonization while in other cases it is only formal.

**Keywords:** auditing, change, audit practice, case study

## 1. Introduction

The analysis of change and inertial phenomena in business context has usually been developed with reference to management and financial accounting (Hopwood & Miller, 1994, Hopwood, 1990). Some scholars, indeed, have highlighted that against the possibility of adopting new practices and undermine the old ones, i.e. of innovating accounting rules and routines, accountants show a certain degree of resistance to changes (Barley & Tolbert, 1997, Burns & Scapens, 2000, Burns & Vaivio, 2001, Hannan et al., 2004, Zambon & Saccon, 1993).

In order to explain this phenomenon, among others, the ideas of institutional theory (Scapens, 1994), rules and routines (Burns & Scapens, 2000) and organizational memory (Becker et al., 2005, Winter & Nelson, 2009) have been introduced in the accounting issue. The way in which the inertia or resistance to changes manifests itself, depends on the strength of the connections between rules and routines: the more the existing rules and routines are strongly intertwined, the more the new rules are swiftly dismissed because they are inconsistent with existing practices (van der Steen 2009). While the phenomenon of accounting inertia has been already object of several investigations, the case that also auditing practices can be affected by inertia seems to have been overlooked.

In the auditing field, only few studies have attempted the inertial phenomenon, focusing on the role of previous experiences or on the effects on the auditing practice of a change in the accounting principles (O'Reilly et al., 2004, Salterio, 1996, Salterio & Koonce, 1997, Messier et al., 2012). The recent change of the auditing principles in Italy offers an opportunity to investigate more in depth the phenomenon of auditing inertia. As Member State of the EU, Italy has been involved in the harmonization process initiated by the EU and has adopted the EC Directive 43/2006 by means of Legislative Decree 39/2010, which has reformed the entire auditing legal framework, and thus it has also imposed the adoption of clarified ISAs as reference standards in conducting audit works. By this reform, the auditing practice in Italy moved from rules-based standards dictated by the national principles, to principles-based ones, i.e. the ISAs (International Standards on Auditing), dictated by the EU.

Stemming from the aforementioned consideration, this paper aims to analyze the relationship between auditing standards' change and auditors' everyday life, i.e. if and how auditors' behavior changes in dependence of a change in the auditing standards. Previous literature on the same topic suggests that the auditing standards system represents not just a set of techniques through which auditors conduct audit works, but rather it constitutes a set of organizational routines which legitimates auditors' behavior (Power, 2003). Thus, it becomes of interest to analyze if, how and why the auditing process changes, i.e. if an inertial or innovation-oriented behavior is adopted. In order to achieve this aim, a multiple case study methodology has been applied and the partners and the senior managers of some of the "Big 4" and "non Big 4" audit firms have been interviewed.

This paper is structured as follows. After a brief overview of the Italian audit environment, section three gives a brief review of the prior knowledge of the basic elements of the study, while section four gives a description and in-depth analysis of the collected empirical material. In the central part, an attempt will be made to understand the case findings and to develop the theoretical arguments of the study. Finally, some valuable insights are extracted and systematized in order to draw some conclusions and to propose future research opportunities.

## **2. Auditing Change and Auditing Standards: The State of the Art**

In the auditing literature, the phenomenon of change seems to be poorly investigated even though auditing is an object of study since decades. In fact, researchers have focused mainly on the effects produced on the audit opinion by changes in the accounting standards applied by the audited companies (see, among others, Salterio & Koonce, 1997; Messier et al., 2012; O'Reilly et al., 2004).

This study starts from the assumption that auditing standards' system represents not just a series of techniques through which auditors may conduct their work, but also a set of preferences and organizational routines that legitimize auditors' behavior (Power, 2003). Pentland (1993) argues that auditing is a ritualistic and collective activity that brings order in a non-interpreted world and requires ritual procedures in order to produce trust in financial markets. Auditors, in fact, judge and attest the validity of corporate financial statements, which are stylized interpretations of a corporation's health. Accountants construct these interpretations, but auditors reassure stakeholders that they are trustworthy. According to this perspective, the legitimacy of audit rituals derives also from the distinction between the auditor and the client because of the assumption that the management acts opportunistically in disclosing corporate information, while professional auditors can be trusted in performing the steps of the audit ritual. In this respect, it is interesting the metaphor made by Pentland (1993) and Power (2003), according to which auditors act as ritual priests that transform the client's inherently untrustworthy explanations into inherently trustworthy ones. In such a context, therefore, the adoption of any change in ritual procedures depends on the legitimacy that auditors give to the new methodology (i.e. to the new ritual).

Regarding the role of "organizational memory" in auditors' everyday practice, Fisher (1996) has observed that auditors tend to rely heavily on past experiences as a guide in planning current audits. His study, indeed, has shown that auditors are reluctant to place reliance in new audit technologies and that they continue to rely on traditional sources of audit evidence even though they are also physically using new audit technologies. Basing on the studies conducted by Berger and Luckman (1966), Fisher (1996) articulates the audit process in three main phases. The externalization phase, in which auditing practitioners take actions when they plan the nature and the extent of procedures to be performed in a particular client situation, and then they execute those procedures and issue their audit report. During the second phase, named objectivation, auditors rely strongly on objectified knowledge (i.e. what they did the last year), so that the type and level of work that has been performed may come to be taken for granted and its appropriateness is not even questioned. Finally, auditors internalize the planned and executed level of audit work as knowledge of how to conduct an audit. This institutionalized knowledge can serve as a valuable guide to the auditor in carrying out his work; however, it may also severely constrain the auditor's ability to assimilate new sources of audit evidence. It seems to emerge, therefore, that the mere adoption of a new technology is not sufficient to ensure the achievement of purposed benefits (i.e. enhanced audit efficiencies). Rather, it appears that the efficiencies of the new approach could not be realized until practitioners accept that it provides sufficient evidence. In other words, the process of technical change requires that a new technology must be "real-ized" (i.e. made real) and thus legitimated by the actions of auditors (Fisher, 1996). Without this legitimation, states Power (2003), it is possible to find two audits, one dealing with compliance with the traditional structured approach, and the other only formally conducted and supported by new technologies. In this respect, it emerges that official guidance issued by standard setters plays a little role in auditors' everyday practice and that there is a gap between the official view of the audit process and what actually happens in the everyday audit practice (Humphrey & Moizer, 1990).

Summarizing, in the auditing field, because the legitimization of new practices is a complex process and there is a gap between the official and the real auditing practice, it becomes of interest to analyze how new auditing standards affect auditors' everyday activity, i.e. if a phenomenon of innovation/inertia occurs.

Newton's first law of motion states: "when viewed in an inertial reference frame, an object either is at rest or moves at a constant velocity, unless acted upon by an external force". In this study, we consider the auditing organizations, rules and routines as "the object" and the dictated change in the auditing principles as "the external force". Therefore, in order to understand the phenomenon of auditing inertia, it is important to focus also on this last element. Specifically, it is relevant to remember the differences between rules-based standards and principles-based standards and to explore how a change from the former to the latter has been defined and implemented in Europe, in general, and in Italy, in particular.

### **3. An Overview on the Audit Profession and on the Auditing Standard Setting Process in Italy**

Knechel (2013) defines auditing as a profession awash in standards, which dictate how auditors should structure and perform their work and evolve depending on the changes in regulations as well as on the relative influence of the affected interested groups (Ye & Simunic, 2013). According to Jeppesen (2010), the general purpose of a standard is to limit or to direct the behavior of those who must comply with it, and this implies that the standard setting process inevitably has political implications. Adopting an actor network perspective, the author states that the standard setting process primarily aims to create social order by eliminating or limiting freedom of behavior. Because of this, any attempt to create a specific form of social order has to face an immanent resistance from those who give up their autonomy without getting an adequate degree of influence on the standards that affect their behavior.

In the Italian context, the first attempt to create a form of social order by means of a set of auditing standards was in 1981, when the National Council of Certified Public Accountants has released 18 auditing standards structured according to a rules-based approach. Each standard, indeed, provided technical procedures and operational methodologies that auditors must follow in order to audit the single financial statement items. These structured auditing standards have remained into force until 2002, when the Consob (the national oversight body of the Stock Exchange) has charged the National Council of Certified Public Accountants with starting a process of revision of the auditing standards in order to align them to the ISAs issued by the IAASB (i.e. the pre-clarified ISAs). Italian auditors, therefore, have experienced a radical change in the audit approach they must follow in performing audit works because ISAs were developed according to a principles-based approach, without any reference to technical rules or mandatory audit procedures referred to the single financial statement items.

In recent years, the European Commission (EC) has given answer to the need for a substantive harmonization in auditing practices and for a high quality of audit works within the European Union (EU) by means of the Directive 2006/43/CE, under which the EC has imposed the adoption of the ISAs for the European auditors. Moreover, in 2009 the IAASB has concluded the so-called Clarity Project, which aimed to revise and redraft the ISAs in order to improve their clarity and understandability, as well as to help the harmonization of auditing practices within the EU (Dennis, 2010). The EC, however, has not yet concluded the adoption process of clarified ISAs, so they do not have any legal imperativeness for European auditors. In response to the EC directive, the Italian legislator has issued the Legislative Decree 39/2010, which has reformed the entire legal framework. One of the most relevant interventions on this topic is represented by the provision according to which clarified ISAs must constitute the reference standards for every audit work. Specifically, the Decree impose the transition to a new set of auditing standards.

At the end of the Decree, however, the Italian regulatory body has set a batch of transitory rules according to which clarified ISAs do not have mandatory effectiveness for national auditors until the EC will not complete the process of adoption of the new auditing standards. Currently, therefore, Italian auditors must comply only with pre-clarified ISAs and only have the opportunity to apply the clarified ones, when their use increases the effectiveness and the quality of audit. Some professionals, however, have stated that, in conducting their works, auditors must comply also with the first set of auditing standards issued by the national Commission between 1975 and 1981, i.e. those developed according to a rules-based approach. In their opinion, in fact, the analytical procedures imposed by the first set of national standards constitute a significant practical reference for the profession and enable auditors to carry out their work with professional diligence.

Thus, it becomes of interest to analyze the differences between rules-based and principles-based standards, as some nations have experienced the transition from rules to principles or vice-versa because of the ongoing harmonization process of auditing practices promoted by the EC.

In general, the rules-based approach occurs when the standards impose technical rules and analytical procedures

that auditors must follow in performing audit works while a principles-based approach constitutes an approach where the standards propose only a “framework” without any reference to mandatory audit procedures that, therefore, can be defined by each user according to the framework.

Knechel (2013) observes that both rules-based and principles-based standards share the same goal, i.e. to guide auditors in providing reasonable assurance for the fair presentation of the financial report, in accordance with applicable reporting standards. Nonetheless, the two approaches affect differently the auditing practice and, according to the study conducted by Jeppesen (2010), they meet different degrees of resistance by the recipients of the standard setting process. If auditing standards have to create homogeneous auditing practices, states Jeppesen, they must become what Latour (1987) defines as “immutable mobiles”, i.e. objects that allow instructions to be spread from the center (the standard setter) to the periphery (the single auditor) without being altered throughout the process.

Starting from this perspective, therefore, the adoption of a rules-based approach or of a principles-based one in the auditing standards setting has a significant impact on the auditing practices as well as on the way in which auditors react to a new auditing standards system. In fact, some scholars state that the adoption of one of the two considered approaches implies not only the presence of formal differences between auditing standards, but also the definition of two completely different audit styles (Dirsmith & McAllister, 1982). Specifically, Dirsmith and Haskins (1991) make a distinction between a highly structured audit approach, named mechanistic, and a so-called organic audit approach that leaves more room for the exercise of auditor’s professional judgement.

The mechanistic approach is based on standards that not only provide mandatory audit procedures, but also impose the way in which the auditor must conduct these procedures (Burns & Fogarty, 2010). On the one hand, such an approach facilitates the homogenization of auditing practices, because the standards are based on a high level of “hard” and non-interpretable knowledge, thus they are less exposed to distortion when auditors must apply them in conducting their work. Moreover, the adoption of a mechanistic audit approach facilitates the legitimacy and the control of audit works, because it idealizes the audit process as a logical series of steps and models the audit process as a system of rules. On the other, however, these pre-determined representations of the audit process can never really inform the auditor what to do or substitute the auditor’s professional judgement (Francis, 1994). Finally, according to the analysis conducted by Jeppesen (2010), rules-based standards attract more resistance from the groups who must comply with them, just because rules cannot be interpreted and thus they leave scarce room for the exercise of auditor’s professional judgement.

Principles-based standards and the organic audit approach, instead, emphasize the exercise of auditor’s professional judgement in defining the more suitable auditing procedures related to the specific circumstances (Ojo, 2010). Standards developed according to this approach allow a certain degree of interpretation and thus they attract less resistance from the auditors who must comply with them because critics can interpret the standards according to their own preferences (Jeppesen, 2010). Principles-based standards, moreover, are broadly applicable and do not need constant modifications or additions; however, they do not create homogeneity in auditing practices and this implies a less comparability of the audit outcomes and a greater uncertainty with reference to the audit quality level. Finally, with principles-based standards, the inspection of audit works may become more difficult and dependent on subjective judgements (Burns & Fogarty, 2010). In all, moving from a principles-based auditing standards system to a rules-based one or vice-versa should lead to a change (i.e. an innovation) in the auditors’ everyday activity.

Summarizing, as Italy has recently experienced a change in the auditing standards system, it represents an interesting context in which observe if and how a phenomenon of auditing innovation or, on the contrary, of auditing inertia has occurred.

In comparison to the extant literature, this study sheds light on the phenomenon of auditing inertia which is far less investigated than the accounting inertia one (Hopwood, 1990; Hopwood & Miller, 1994). Moreover, this investigation does not analyze the effects of a change in the accounting standards on the audit profession (Messier, et al., 2012) but it is more centered in the “audit world” as it focuses on the relationship between auditing principles and auditors’ activity. Finally, this study deepens the analysis conducted by Jeppesen (2010), because it has been adopted a perspective of analysis that is downstream in the auditing standard setting process. While Jeppesen has observed the way in which standard setters can face the immanent resistance showed by the recipients of the auditing standards, this investigation aims to analyze if and how this resistance manifests itself as well as which are the underlying causes of auditors’ inertial or proactive behavior.

#### **4. Design of the Study**

Understanding the phenomenon of auditing inertia requires focusing on the practice of auditing, i.e. on what

auditors do in practice. More in depth, the underlying question of this paper is: have the auditors been proactive or inert against the opportunity offered by the new legislative framework of adopting clarified ISAs?

Despite concerns that case studies of specific situations do not afford results that may be regarded as generally applicable or generalizable, according to Yin (2003) the case study is an appropriate choice of method when the research area is explorative in nature. The case study method has been selected for this investigation because of its potential to provide a richer, more detailed understanding of specific phenomena (Eisenhardt, 1989; Yin, 2003), such as audit practices, which seem to be still under-investigated, at least from a field-study perspective (Power, 2003; Arena, et al., 2006; Humphrey, 2008). It could be argued that, in studying organizational change, it would be more appropriate to carry out a longitudinal study. However, some scholars argue that multiple cases enable comparisons that clarify whether an emergent finding is simply idiosyncratic to a single case or it is consistently replicated in several cases (Eisenhardt, 1989; Eisenhardt & Graebner, 2007), i.e. multiple cases allow observing companies in different possibilities of change (Greenwood & Hinings, 1988; Laughlin, 1991). Thus, this study is based on explorative case studies of six auditing companies.

The choice to focus this research on the Italian context is due to the following reasons. First, because of the opportunity offered by the EU directive and the national decree 39/2010. Second, the Italian context has been chosen as the author is Italian and thus she was able to develop good relationships with the interviewees. Third, the Italian accounting practice has been already object of investigations dedicated to the issues of change, innovation and inertia (Zambon & Saccon, 1993; Caccia & Steccolini, 2006; Paglietti, 2009).

Limited resources meant that the study could not cover all Italian auditing firms. Moreover, not all the contacted companies were willing to take part in the research. Finally, as this study is not based on a quantitative approach but on a qualitative one, it is not necessary to have a statistically relevant number of cases but, instead, to have cases that highlight differences. Thus, cases have been selected because of their suitability for the phenomenon under investigation (Eisenhardt & Graebner, 2007). The author had the opportunity to investigate three of the “Big 4”, 2 national auditing firms which belong to an international audit network as an independent member and a small local audit firm. The investigated companies are the only ones that accepted to be part of the research project.

Table 1. Case study organizations listed under a pseudonym, in order to guarantee their anonymity

Alpha	International auditing firm. Auditors of listed and unlisted companies and of SMEs
Beta	International auditing firm. Auditors of listed and unlisted companies and of SMEs
Gamma	International auditing firm. Auditors of listed and unlisted companies and of SMEs
Delta	National audit firm, belonging to an international audit network. Auditors mainly of unlisted companies and SMEs
Epsilon	National audit firm, belonging to an international audit network. Auditors mainly of unlisted companies and SMEs
Zeta	Local auditing firm. Auditor of SMEs

Although it may be objected that the study covers a very limited number of audit firms, it must be taken into account that the Italian audit market is highly concentrated (Note 1) (Cameran & Scimeca, 2016). The analyzed firms, therefore, allow a coverage higher than 80% of the entire audit market in Italy.

The main data-gathering technique was semi-structured interviews because the aim of the analysis was to reach a deep understanding of the phenomenon under research (Carrington & Catusus, 2007; van der Steen, 2009; MARC, 2010) and to compare the behavior assumed by auditors up against the opportunity of adopt clarified ISAs even though they still have no legal imperativeness. Each interview was designed to develop around two topics: organizational impact of the auditing standards' change (i.e. did they change something in the organization? Did they carry out specific training sessions? Did they change the relationship with the headquarters, in case of multinational companies? Etc.) and professional impact of the auditing standards' change (i.e. what did it change in your daily activity? What do you want/would like to change in your internal procedures? Etc.). Interviews were conducted during fall 2013-spring 2014 and lasted from one to two hours and were all tape-recorded and then transcribed for analysis. In each firm, two to three interviews were carried out with the partners and/or senior managers of the firm.

The analysis of the evidence was carried out in three phases. First, preliminary documentation of each case was used to priori identify the companies' pattern of change (see Table 1). Once data collection was completed, the research team analyzed all the evidence of each organization, in order to investigate whether they matched the theoretical model developed in section two, and produced an individual case report. In order to overcome bias, analysis was carried out through analyst triangulation (Patton, 1990; Yin, 2003). Two members of the research team, always different from those who carried out the interviews, analyzed the data. Finally, all the individual case reports were discussed, following a theoretical replication design (Yin, 2003).

## 5. The Case Study

The interviews were designed around two main topics. The first issue has concerned the organizational impact of the transition to the new set of auditing standards. Specifically, respondents were asked if this change has determined the need for specific training sessions in order to reach a deeper understanding of the new auditing standards system and, for multinational companies, how the change has influenced their relationship with the headquarters. The second main topic addressed with the interviewees has concerned the professional impact of the auditing standards change. In other words, respondents were asked whether the adoption of ISAs has determined any change in their everyday professional practice. The analysis revealed that the audit firms involved in the study have faced the auditing standards' change in a rather different manner, partially due to their different organizational complexity.

### 5.1 The Organizational Impact

The first matter worth of notice is that almost all respondents have stated that the change in the auditing standards' system has determined the need to revise the overall audit approach. In this respect, one of the senior manager of Alpha affirmed.

*«With the first adoption of ISAs in Italy in 2002 (ISA pre-clarified) there has been a real change in the audit approach. The focus of the analysis, indeed, has shifted from the single financial statement items to a more risk-based approach. Auditor is required to value more the riskiness of financial statement as a whole, than the accuracy of the balance sheet accounts, considering also the needs of both shareholders and stakeholders. Shareholders and stakeholders, indeed, are more interested in firms' risk profile, within which they are directly involved, also with their own financial resources» (a senior manager of Alpha).*

A senior manager of Beta and one of Gamma have expressed the same opinion, stating, respectively:

*«Actually, the real change in the overall audit approach has happened more than ten years ago, with the first adoption of ISA, in their pre-clarified version. In 2002 indeed we shift from a set of auditing standards which imposed a batch of check lists in order to audit each single financial statement item, to a set of auditing standards according to which the audit engagement must be conducted following an overall audit strategy. The real innovation, therefore, was represented by the central role assumed by the auditor's professional judgement in evaluating several aspects of the client firm (i.e. the internal control system, the control environment etc.) in order to define a suitable audit strategy and to develop an audit plan» (a senior manager of Beta).*

*«The most relevant and, at the same time, the most complex activity within an audit engagement is the preliminary evaluation of client's level of risk» (a senior manager of Gamma).*

Differences emerge, instead, when considering one of the national audit firm, which is generally charged with the audit of unlisted companies and SMEs. One respondent from Epsilon, indeed, has stated:

*«With the introduction of ISAs, there has been definitely a greater attention to analyze the internal control procedures of the client firm and its risk profile, but this tendency depends much on the type of audited firm. Risk analysis is highly effective when the audited firm is a big company, while the audit of SMEs should be focused more on substantive analyses» (a partner of Epsilon).*

This might suggest that a change in the set of auditing standards has a different impact on the overall approach of each audit firm depending on the fact that we are considering a multinational or a local audit firm. Moreover, the audit approach seems to vary depending on the type of client firm. In fact, multinational audit firms (Alpha, Beta and Gamma) have experienced a relevant change in the audit approach, and they have shifted from the audit of the single financial statement items to the analysis of the client's risk profile in order to define a suitable audit strategy according to the auditor's professional judgement. The national audit firm, instead, has formally recognized the change determined by the adoption of ISAs, but this has not implied a change in its audit approach due to the type of audited firms, which are mainly SMEs and thus they require an audit approach that is more focused on balance sheet accounts than on risk assessment.

Another significant difference emerges with reference to the way in which companies have faced this change in the audit approach. In other words, it emerges that firms react differently to the same "external force". All respondents, except those from Zeta (the small local audit firm), have pointed out that, as a consequence of the transition to ISAs, it has emerged the need for specific training sessions in order to improve auditors' understanding of the new auditing standards system.

*«We attended a specific training session about the new auditing standards, especially because inspections on audit work, both internal and external (i.e. conducted by the headquarters or by Consob), are focused on the auditors' degree of understanding and awareness about the applicable auditing standards, rather than on the adequacy of auditing procedures» (a senior manager of Alpha).*

*«A proper education is the real center of the audit profession. When ISAs (the pre-clarified and the clarified ones) were introduced in Italy, our firm has imposed a specific education course with two different objectives. On the one hand, it aimed to improve our understanding of the new set of auditing standards and, specifically, of the changes linked to the adoption of the new standards system. On the other, moreover, the course aimed at identifying the new audit procedures that we must apply in conducting audit engagements. In fact, in order to comply with the international policy imposed by the headquarter, we must have a deep understanding of the auditing standards on which our audit procedures are based» (a senior manager of Beta).*

The partners of the national audit firms, which however belong to an international audit network (i.e. Delta and Epsilon), expressed the same opinion:

*«We started to attend education courses since the introduction of ISAs in Italy. Our company, indeed, was involved in the team charged with the translation of the guidelines issued by the IFAC for the application of clarified ISAs in the audit of SMEs. Moreover, a specific internal education course was started by the international network to which we belong» (a partner of Delta).*

*«The research unit of our company is responsible for the adoption and the diffusion to the staff of the information about the new auditing standards. Moreover, the inspections of the oversight body (the Consob) aim to assess the auditors' degree of awareness about the auditing standards system» (a partner of Epsilon)*

Respondents from Zeta, instead, affirmed:

*«We didn't do anything special, just the normal courses, nothing more intense...at the end we use the same procedures as before, as they are already ISA-compliant» (a senior manager of Zeta).*

The way in which auditors perceived the change in terms of training needs is not the same. The need for a specific education course about the new set of auditing standards has concerned all the bigger audit firms, which have an international imprint (multinational audit firms and firms that belong to an international audit network), while the local audit firm has not perceived any need for a deeper understanding of the new auditing standards. Thus, while Alpha, Beta, Delta and Epsilon approached to change in a proactive way (developing their understanding through training courses), Zeta seems to adopt a sort of "passive resistance", where the organization did not try to develop a deeper understanding of the new standards or consider them as an opportunity, but has continued to use the same rules and routines as they were compatible. With reference to the parallelism with Newton's law, it seems that Zeta has adopted an inertial behavior, keeping its position of rest or developing its activities with the same velocity.

Again, we might argue that the perception of the change and the need for specific education courses varies depending on the size of the audit firm and on its degree of internationalization. Multinational audit firms as well as those belonging to an international network have perceived the need for a specific education because of two main reasons. First, according to all respondents, a proper understanding of the current auditing standards system is essential to comply with the obligation imposed by the oversight body. Auditors' liability as well as audit quality is evaluated with reference to the degree of compliance with the applicable auditing standards. Second, the international policy imposed by the headquarters of multinational audit firms or by the network to which the audit firm belong requires that auditors have a deep understanding of the standards on which auditing procedures are based. The local audit firm, instead, is not subject to an international policy, thus it does not perceive an urgent need for a specific training about the new set of auditing standards.

Another difference has emerged also with reference to the way in which audit methodologies are defined, revised and shared within the organization. The headquarters of Alpha and Beta, as multinational audit firms, issue practical guidelines regarding audit methodologies that local offices must apply in their daily practice. One of the respondents of Alpha, indeed, has affirmed that:

*«The company's headquarter issues mandatory guidelines, which impose the overall methodology in valuing the client firms' degree of riskiness and the mandatory analytical procedures that each national office must apply in conducting its work. These guidelines are particularly binding, so that whether local*

*offices do not intend to apply a specific audit procedure, they must be authorized by the headquarter » (a senior manager of Alpha)*

*«Our company is an international audit network, thus we need to standardize as much as possible our auditing practices. Because of this, we conduct audit works according to the company's international policies. The audit guide issued by the headquarters imposes mandatory rules that we must follow throughout the entire audit process. Each national office, however, integrates the overall audit guide with a distinct library, which includes all the integrations prescribed by national regulation. Each rule imposed by the central office must be applied during the audit work, unless the auditor does not give a great emphasis to the circumstances because of which a specific rule cannot be applied. Anyhow, it is necessary to start a consultation process with the risk management unit of the company that must approve the non-application of a specific mandatory rule » (a senior manager of Beta).*

It emerges that Alpha adopts a strictly top-down approach where the practical rules and routines are defined by the headquarters and the local offices and the single auditors can only undergo them, without any active role; their subjectivity is thus irrelevant and auditors can just move from an inertial position to another. Although also Beta adopts a top-down approach in elaborating and sharing the audit rules and routines within the organization, the local offices are involved in this process and thus they gain an active role, while only the lower level of the organization (i.e. the single auditor) keeps its passive position.

Somewhat different, instead, is what respondents from Delta and Epsilon have said. Indeed, they have stated respectively:

*«The development of audit methodologies is mainly internal. Every three years, however, the international network carries out an inspection on our methodologies in order to ascertain their quality and their consistency with the applicable auditing standards system. However, this represents mostly a technical support and it does not impose any restriction in the choice of the audit approach » (a partner of Delta).*

*«We belong to an international audit network as an independent member. The network only provides an overall audit guide that may be applied by each audit firm belonging to the same network. The single independents units of the network, therefore, adapt this audit guide to the peculiarities of each national context and issue a specific audit guide » (a partner of Epsilon).*

In this case, the surveyed audit firms seem to have a more proactive role than multinational companies (such as Alpha and Beta) in the development of audit methodologies, as an audit innovation up against a change in the auditing standards system might be realized also within the single audit firm, not only at the central office level.

Completely different, instead, is the position of Zeta, whose respondent stated:

*«As local audit firm the development of methodologies which inform the audit works does not follow a structured approach but represents a flexible process in which the personal judgement of each auditor plays a primary role » (a senior manager of Zeta).*

Lastly, in Zeta, probably due to the lack of competences in structuring processes and to the idea that their competitive advantage relies on the fact that they can be more flexible than big companies, all the members of the organization seem to have an active role.

In summary, the size of audit firm as well as the degree of organizational coordination within the network to which the audit firm belongs seems to play, also on this topic, a primary role in influencing the way in which audit methodologies are defined and shared within the organization. Multinational companies, highly integrated under an organizational perspective and coordinated by their headquarters, seem to adopt a top-down approach in defining and sharing audit methodologies. As the respondents affirmed, the headquarters of the company elaborates and distributes a binding audit guide to the entire organization, and leaves more or less leeway in adapting and in integrating it depending on the needs arising from national peculiarities. Audit firms, which belong to an international audit network as independent members, instead, seem to adopt a different approach. In fact, each firm internally develops its own audit methodologies, while the network offers technical support and supervises the internal audit guide in order to verify its consistency with the international audit policy of the network itself. Finally, completely different seems to be the approach adopted by the small local audit firm, which follows an un-structured approach in defining audit methodologies, where the auditor's professional judgement plays a primary role. The auditor, indeed, develops and applies the most suitable audit methodologies depending on the circumstances of the single audit engagement, without following any binding audit guide.

In sum, it may be argued that the bigger the size of the audit companies and the more the headquarters or the

network coordinates the organization, the more the process of development of the audit methodologies is structured and the less is the independence of the single national audit firm in defining and in adapting them to local peculiarities.

Another interesting aspect emerged from the interviews is the fact that even if ISAs are based on a principles-based approach in order to allow auditors to adopt the most suitable audit procedures in each context, it seems that auditing companies seem to prefer tight routines, i.e. to be regulated by rules-based standards:

*«It's a matter of legal liabilities...if we use the previous procedures, as they were approved by the Consob and by the National Auditors' Association, nobody can say anything against us while if you start personalizing or changing you cannot be sure... Moreover, the previous standards are compatible with the ISAs» (a senior manager of Gamma).*

*«Essentially, the most relevant impact of the adoption of clarified ISAs is linked to the possibility of lightening audit procedures that were regarded as mandatory according to the auditing standards previously in force (and even more according to the standards issued since 80s by the National Auditors' Association) and according to the regulations issued by the Consob. Even if we have a new set of auditing standards, we continue to apply the same audit procedures as before, because we consider them essential in collecting information about the fairness of the clients' financial statements. ISAs, however, allow us to have greater flexibility, mainly in defining samples upon which we perform the audit procedures» (a partner of Delta).*

*«The adoption of ISAs has put greater emphasis to the assessment of clients' risk profile, however essentially we continue to apply the same audit procedures because we believe that they represent the best way to collect audit evidences about the fairness and trustworthiness of financial statements. Moreover, talking about an innovation in auditing practices is more a theoretical issue than a practical one. Whether, on the one hand, the ISAs enable auditors to define the most suitable audit strategy depending on the client's level of audit risk, on the other we must consider what type of client we have. Our firm, indeed, is usually charged with the audit of SMEs, and this implies the need for performing substantive audit procedures, which provide better results than the mere analysis of the risks and compliance procedures» (a partner of Epsilon).*

*«I was working before for a Big4, so I'm still in touch with some of my previous colleagues. If they didn't change anything, why shall I? Changing might be risky and expensive and as we are a small company we cannot effort either one or the other» (a partner of Zeta)*

It may be argued that the possible causes of auditing inertia can be summed up to the following: legal liabilities, auditors' past experiences and organizational costs. Almost all respondents, indeed, refer to the fact that the Italian oversight body (the Consob) performs controls on audit quality valuing the compliance between the audit procedures implemented in the audit engagements and what is asserted by the auditing standards. Thus, according to the surveyed auditors, to not apply the audit procedures already recommended by the Consob (although they are no more mandatory since the entry in force of pre-clarified ISAs) constitutes an unacceptable risk because they might be considered liable both in the case of supervision of audit quality and in case of litigation. Moreover, the firms usually engaged in the auditing of SMEs assert that those audit procedures, applied since decades and previously regarded as mandatory, constitute the best way to perform a financial statement audit. Finally, the smallest firm emphasizes the lack of the competences needed to cope with a change in the auditing procedures as well as to the need to contain the organizational costs linked to the change itself, which may lead to a deterioration of the audit quality.

## 5.2 The Professional Impact

Regarding the professional impact of auditing standards change, i.e. the changes in the everyday practice of the auditors determined by the adoption of clarified ISAs, the author has first investigated how the surveyed audit firms have faced the provision of adopting clarified ISAs, given that they have no legal imperativeness in Italy, since the EC does not complete their adoption process. Secondly, we investigated if the adoption of the new set of auditing standards has determined a change in auditors' everyday practices. On this topic, different scenarios have emerged. The central offices of both Alpha and Beta define binding guidelines in order to perform audit engagements and impose mandatory analytical procedures. As highlighted by some of the respondents:

*«We continue to apply the auditing standards recommended by the oversight body, i.e. the pre-clarified ISAs, because this represents both a formal and a substantial obligation. We do not take into account the provisions of clarified ISAs. We must perform all mandatory procedures imposed by the headquarter.*

*However, we also have the possibility to apply additional audit procedures according to the client firm's level of risk as determined in the preliminary phase of auditing. What has changed in practice is that, whereas in the past each financial statement item was audited on the basis of a materiality threshold, now you must look primarily at the risk profiles, which represent the basis according to which the definition of audit procedures takes place » (a senior manager of Alpha).*

*«Until the regulation does not formally impose the adoption of clarified ISAs there is a formal and substantive constraint in applying auditing standards approved by national standard setter (i.e. those issued according to pre-clarified ISAs). Auditors' legal liability, indeed, is mainly related to the degree of compliance with applicable auditing standards » (a senior manager of Alpha).*

*«In performing audit engagements, we apply the clarified ISAs according to the international policy imposed by the headquarters. Each national office, however, integrates the overall audit guidelines with all the procedures required by the national auditing standards. Therefore, the audit engagements must be performed according to both clarified ISAs (as imposed by the headquarters) and the auditing standards currently in force in Italy (pre-clarified ISAs) and this is possible integrating the auditing procedures issued by the central office with those required by the Consob » (a senior manager of Beta).*

It appears to emerge that, although multinational companies must follow the international policy imposed by the headquarters, they keep applying pre-clarified ISAs because of the lack of a mandatory legal provision and because both audit quality and auditors' liability are assessed making reference to pre-clarified ISAs.

*«After a cost-benefit analysis, we started to introduce some audit procedures based on clarified ISAs. In particular, one year ago we have introduced an audit software, shared with the our international audit network, developed according to clarified ISAs. It must be considered, however, that from a substantive standpoint no relevant changes have emerged in comparison with the audit procedures previously implemented and defined according to pre-clarified ISAs » (a partner of Delta).*

*«We did not experienced any relevant change with the introduction of clarified ISAs. I don't perceive any change in my everyday practice because we perform the auditing procedures always in the same manner and this happens because there is no other way to perform them. Maybe something has changed...but it is more in the formal aspects than in the practical ones, because the essential auditing procedures will always remain the same » (a partner of Epsilon).*

Although national audit companies have more autonomy in defining their audit methodologies and procedures, they seem to keep following the same audit procedures in their everyday practices because they do not perceive a real benefit in changing the procedures they have always followed.

On the same topic, respondents from Zeta have observed that:

*«Given that we have limited resources and that we are not part of an international organization, although the adoption of ISAs has resulted in a change in the overall audit approach, we did not experienced any substantive change in the analytical procedures applied in order to issue the audit opinion » (a partner of Zeta).*

Finally, the local audit firm assumes an inertial behavior because of the lack of both economic and organizational resources.

In sum, it seems to emerge that auditing companies operate in a kind of inertial reference frame due to different causes: the lack of mandatory legal provision, the conviction that a change in audit procedures does not lead to an improvement of the audit effectiveness or the audit quality and, finally, the scarceness of the resources needed to face a change in the overall audit approach.

## **6. Discussion and Conclusions**

Power (2003) refers to auditing practice as a self-regulating system, whose components (training programmes, professional standards, quality control sub-systems, and disciplinary mechanisms) are an interacting, semi-institutionalized and loosely coupled whole. The analysis of the cases previously described shed a light on how this whole innovates or remain inertial when an external force, represented by a new set of mandatory auditing standards, is applied.

The aim of this paper was to analyze the relationship between auditing standards' change and auditors' everyday life, i.e. if and how auditors' behavior changes in dependence of a change in the auditing standards determined by the adoption of the EC Directive 43/2006.

First, it emerges that the reactions of the audit firms to the analyzed change of the audit standards are different as

they vary from completely inertial behaviors to more proactive approaches, depending on the fact that the focus of the analysis is the headquarters or the local branches of multinational audit companies. Indeed, it seems possible to argue that a change in auditing standards' system has determined a proactive (or innovative) behavior only at level of head office of multinational audit firms, where new guidelines and new procedures are developed. National auditors, which are restricted to implement what has been imposed by the headquarters, with limited rooms for the exercise of their professional judgement, have assumed an inertial behavior. Thus, single auditors can only move from some rules and routines to others with no possibility of innovation unless dictated by the international headquarters. It is possible to find a more proactive behavior when analysing national audit companies, which belong to an international network as independent members. Audit innovation, in fact, may occur not only at the central office level, but also within the single audit firm, as the network only offers supervision and technical support with reference to the overall audit methodologies internally developed by each firm of the network. Finally, in the smaller and local audit firms, on the one hand, the leaner organizational structure allows every single auditor to exercise his professional judgment in defining firm-specific analytical audit procedures, on the other, the scarceness of resources, both financial and professional, determines the adoption of an inertial behavior.

Following Fischer's (1996) schema of the audit process, with the transition to ISAs, the headquarters of Alpha and Beta have given rise to an innovation in the externalization phase (i.e. the phase during which the audit work is planned and the audit methodologies are defined). National offices of these companies, instead, take part only in the objectivation and internalization phases, during which auditors implement the guidelines and procedures imposed by their central offices, which thus become institutionalised knowledge. In summary, audit innovation may be considered as very limited and reserved activity, where the headquarters take the opportunity for change and create new rules and organizational routines, which encase single auditors' action in an inertial behavior. With reference to Delta and Epsilon, instead, audit innovation is not only reserved to the network to which they belong, as each firm has great autonomy in the development of audit methodologies and procedures and in creating new rules and organizational routines. In this case, therefore, the single audit firm takes part in every phase of the audit process stylized by Fisher (1996).

From the analysis of the interviews, also the possible causes of auditing inertia emerge. More in depth, the "legal liabilities", i.e. the risk of being involved in litigation due to a mistake, represents the first cause. As stated by Power (2003), auditing practice is based on legitimacy and a change (with possible mistakes) would risk a loss of it. Moreover, as "old" procedures are tested, consolidated and known, a change is perceived as a step towards uncertainty, i.e. something negative for the company (e.g. the new stated procedures do not work adequately) or for the auditors themselves (e.g. they did not apply the new stated procedures properly as they did not know/understand them well enough). As Pentland (1993) argues, auditing is the 'certification of the unknowable' that requires ritual procedures to transform indeterminacy into institutionalized order. Mining the procedures would imply the impossibility to achieve the desired order and thus audit would risk losing its function. In all, a change is perceived as a source of possible loss of legitimization and reputation (external – organizational dimension) and of problems in the daily practice at a personal level (internal/individual dimension). Thus, regulation of auditors' legal liability represents one of the main constraints to audit innovation.

Second, auditing inertia may occur also depending on the size of the client firms and on the institutionalized knowledge of the auditor. When the audited firm is a SME, indeed, the audit approach defined according to ISAs and based on the assessment of client's level of audit risk is considered less effective than an audit approach based on substantive procedures, as that defined according to a rules-based set of auditing standards. In this respect, indeed, respondents from Delta and Epsilon (generally charged with the audit of SMEs) have affirmed that changing the audit procedures they always have performed does not lead to any substantive benefit in the audit work. This is consistent with Fisher's (1996) assertion, according to which no technical change may occur in audit profession, until it is accepted and "real-ized" by practitioners.

Another possible cause of auditing inertia is represented by the effective and potential costs of a change. As auditing is a ritualistic and collective process (Power, 1999; Power, 2003), moving to new procedures requires investing in time, training activities, redefinition of internal rules and routines, etc. According to the collected evidence, it emerges that while in multinational companies as well as in the audit firms belonging to an international network the costs linked to the change are perceived as less than the benefits related to an international harmonization, in the local company the cost-benefit relationship is inverted. In all, the cost factor seems to be a hurdle against innovation.

Finally, there is the dimension related to the available competences. While big firms can count on R&D offices and thus they have (potentially) competences for developing rules and routines according to changing standards,

small companies seem to have difficulties in defining their own procedures and thus they tend to replicate what bigger companies do. Consequently, small companies tend to be inertial and to change only when it cannot be avoided.

In light of the above, it may be argued that the aims set by the EC Directive 43/2006 have been only partially reached. While auditing standards was harmonized in some companies, most of the auditors prefers to have rules-based standards that dictate tight procedures rather than having the possibility to define tailor-made auditing procedures. More in depth, in Alpha and Beta, national branches of multinational audit firms that have adopted a proactive approach, the implementation of the ISAs has determined an innovation in the guidelines and methodologies issued by the head office of the firms. Thus, it has been realized a substantive harmonization of the audit practices, as advocated by the EC. In the other cases, instead, due to a more inertial behavior or to dimensional and resource issues a more formal (and not substantive) change of the audit approach seems to emerge. In all, it is also possible to conclude that, in order to have an auditing innovation, it is first necessary a change in the audit legal framework, because the assessment of auditors' legal liability depends on the degree of compliance of audit works with the auditing standards' system legally in force.

The results have both theoretical and practical implications. First, this study contributes to auditing literature, as it reflects on a still neglected issue, i.e. auditing innovation/inertia. Moreover, it provides a starting point from which it is possible to deepen qualitative research on "audit in practice", as suggested by several authors (Humphrey, 2008; Power, 2003). From a practical point of view, instead, the conducted analysis may be useful for both professional and regulators, as it provides a picture of the state of play in audit environment.

The study has, however, several limitations linked, first, to design of the study. It will be useful, therefore, further research conducted according to different sampling approaches as, in example, longitudinal case study.

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## Notes

Note 1. From the response given by the National Council of Corporate Public Accountants to the 2010 EU Green Paper "Audit Policy: Lessons from the crisis".