

Impact case study (REF3b)

Institution: University of Glasgow
Unit of Assessment: C19 Business and Management Studies
Title of case study: Examining the role of auditors in line with global regulatory transformation
1. Summary of the impact (indicative maximum 100 words)

In the wake of the Enron Scandal in 2002, the global landscape of auditing practices radically changed, significantly transforming the UK regulatory system. University of Glasgow research into the high-level financial reporting interactions between UK companies and external auditors has influenced public debate in the House of Lords and prompted several recommendations of the Select Committee on Economic Affairs. It has also contributed to an ongoing Competition Commission investigation into the market concentration of audit companies, and shaped the working practices at Deloitte, one of the Big Four international audit firms, influencing the industry at a global level.

2. Underpinning research (indicative maximum 500 words)
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In the wake of the Enron Scandal in 2002, the global landscape of auditing practices radically changed. Enron's accounting practices were unethical, illegal and allegedly overlooked by its auditors, Arthur Anderson, one of the five largest auditing firms in the world at the time. Enron declared bankruptcy in December 2001, leading to approximately \$11 billion in shareholder losses and prompting a major re-regulation of global auditing practices.

From 2005 UK company directors and auditors were regulated by International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA), with these standards enforced by the Financial Reporting Review Panel and the Audit Inspection Unit of the Financial Reporting Council (FRC), through extensive engagement with audit committees.

Between 2007-08, Professor Vivien Beattie (University of Glasgow, 2003-2013) as Co-Principal Investigator, coordinated research along with Professor Stella Fearnley (University of Bournemouth) and Mr Tony Hines (University of Portsmouth) into the effect of the post-Enron regulatory changes on audit interactions and financial reporting in the UK. The academics had a long-standing collaborative research relationship having worked together previously on research into audit practices.

As part of the research (funded by the Institute of Chartered Accountants for England and Wales (ICAEW)), questionnaires were sent to the Chief Finance Officers (CFOs), Audit Committee Chairs (ACCs) and Audit Engagement Partners (AEPs) of UK listed companies; 498 usable responses were returned. The questionnaires sought to reveal the frequency with which financial statement and audit-related issues were discussed and negotiated, and the perceived effectiveness of factors impacting upon audit quality. To complement the evidence gathered in the questionnaires, in-depth interviews were conducted with CFOs, ACCs and AEPs in nine UK listed companies.

The study provided an opportunity to examine the extremely private audit process in light of the changes to financial reporting standards and procedures recently introduced at the time of the research.

The study provided evidence that ACCs – generally the most financially literate members of the audit committee – were fully engaged in the financial reporting process. It revealed that they managed the business of the audit committee and decided which issues were worthy of consideration. The research showed that ACCs often exercised more agency than was intended under the new regulatory arrangements, personally taking on key aspects of the monitoring role

that were formally assigned to the wider audit committee, leaving the committee to play a more ceremonial role (reviewing or approving proposed solutions).

The study also demonstrated that, in a culture where all parties share the objective of compliance with standards to avoid intervention from enforcement bodies, the CFO and AEP were keen to take an agreed position to the ACC and/or audit committee so that there was no loss of personal reputation (particularly as non-member company directors are likely to attend audit committee meetings). Equally, the research showed that ACCs wanted to be kept informed of emerging issues and did not appreciate being placed in the position of arbiter. While the audit committee and ACC have been given more formal power for accounting and auditing under the new regulations, they accepted that other parties were likely to have a richer understanding of technical accounting requirements and the business itself. The findings appeared to suggest that confrontations which characterised financial reporting interactions in the past have been replaced by problem-solving behaviour.

The research was the first work to provide insights into the new reporting and audit procedures implemented in the UK following the Enron scandal, which saw the role of the audit committee significantly strengthened. The results showed that many of those involved had key concerns about the new accounting and auditing model, including: (i) a concern that working under International Financial Reporting Standards led to dysfunctional outcomes; (ii) that financial statements had become excessively lengthy and too complex and (iii) that the principles of truth and fairness have been lost as auditing and accounting becomes a compliance-driven 'tick box' process.

3. References to the research (indicative maximum of six references)

1. Beattie V, Fearnley S and Hines T. *Auditor/Company Interactions in the 2007 UK Regulatory Environment Discussion and Negotiation on Financial Statement Issues Reported by Finance Directors, Audit Committee Chairs and Audit Engagement Partners*. Briefing, Institute of Chartered Accountants in England and Wales, London, April 2008 (15pp). ISBN 978-1-84152-553-2 ([Link](#))
2. Beattie V, Fearnley S and Hines T. 2011. *Reaching Key Financial Reporting Decisions How UK Directors and Auditors Interact*, Wiley: Chichester. (Available from HEI)
3. Beattie V, Fearnley S and Hines T. 2012. Do UK audit committees really engage with auditors on planning and performance? *Accounting and Business Research*, 42(3), 349-375 2012 (DOI:[10.1080/00014788.2012.698090](https://doi.org/10.1080/00014788.2012.698090)) (Output in Journal which operates a rigorous peer-review process- article has had 420 views by October 2013).
4. Beattie V, Fearnley S and Hines T. 2013. Perceptions of factors affecting audit quality in the post-SOX UK regulatory environment, *Accounting and Business Research*, 43(1), 56-81, 2013 (DOI:[10.1080/00014788.2012.703079](https://doi.org/10.1080/00014788.2012.703079)) (Output in Journal which operates a rigorous peer-review process- article had 745 views by October 2013).
5. Beattie V, Fearnley S and Hines. 2009. *The Impact of Changes to the Non-audit Services Regime on Finance Directors, Audit Committee Chairs and Audit Partners of UK Listed Companies*. Briefing, Institute of Chartered Accountants in England and Wales, London, November 2000 (23pp). ISBN 978-1-84152-852-6. ([Link](#))

*Professor Beattie was awarded the British Accounting and Finance Association Distinguished Academic Award in 2012 for her research and work in accounting and finance.

Funding

Institute of Chartered Accountants in England and Wales: *An Empirical Investigation into the Effect of Recent UK Regulatory Changes on Audit Interactions and the Integrity of the Financial Reporting Process*; £154,839.

4. Details of the impact (indicative maximum 750 words)

In line with global changes, the UK auditing regulatory system was significantly transformed from the mid-2000s onwards with an increased role for audit committees and independent inspection of audit firms. University of Glasgow research into the high-level financial reporting interactions between UK companies and external auditors has:

- formed the basis of evidence to the House of Lords Select Committee on Economic Affairs, influencing the policy debate and prompting several of the Committee's recommendations;
- consequently influenced an ongoing Competition Commission investigation into the market concentration of audit companies; and
- shaped audit industry working practices on a global level.

The House of Lords Select Committee on Economic Affairs

In October 2011, Beattie and Fearnley gave oral evidence to the House of Lords Select Committee on Economic Affairs at the first of 11 evidence sessions that scrutinised auditors. They provided detailed written evidence in advance of the oral session and supplementary evidence afterwards. In her opening statement to the Select Committee, Beattie explained how their research had demonstrated:

... strong concern amongst expert preparers in the UK, by which I mean finance directors, audit committee chairs and auditors of listed companies. They are concerned about the accounting model; they are concerned that we have lost the true and fair view and these principles of substance over form and prudence, that we have moved to a compliance-driven tick box kind of process where judgment has been lost; they are concerned about the excessive length and complexity of financial statements nowadays; and are concerned that, under IFRS, there are a number of quite dysfunctional outcomes [1].

Beattie's evidence directly informed and influenced the extensive policy discussion and was quoted in the Select Committee report, 'Auditors Market Concentration and their Role' (published March 2011). The House of Lords made the following recommendations as a direct result of Beattie's evidence:

1. The IFRS should not be extended beyond large, listed companies in the UK, where it is mandatory [2]

Beattie, Fearnley and Hine's research findings suggested that many respondents were critical of the impact of International Financial Reporting Standards (IFRS) and 'fair value' on the integrity of financial reporting. According to the research, expert preparers did not believe that IFRS had improved UK financial reporting.

2. The Office of Fair Trading (OFT) should initiate an investigation into the audit market [3]

The OFT referred the audit market to the Competition Commission, the investigation being justified by Beattie's and her colleagues' research findings. Specifically, the research based evidence provided by Beattie underlined that the audit market, currently dominated by four main firms, risked a monopoly if the number ever decreased to two or three firms.

The Competition Commission - Statutory Investigation

On the basis of Beattie's evidence to the House of Lords Select Committee, she was approached by the Competition Commission in early 2012 to undertake a literature review as part of their statutory investigation [4]. The literature review was a central feature of the provisional findings report issued by the Commission in February 2013, acting as part of an evidence-base from which

it could draw [5]. Beattie's review was one of only two pieces of research commissioned by the Competition Commission during its investigation. The Commission further utilised the research by eliciting comments from accounting and auditing stakeholders which were considered as part of the investigation.

Shaped audit industry working practices on a global level

Notwithstanding the impact of the research on the regulators, it has also influenced the working practices of some of the UK's leading companies in the field. Specifically:

1. [text redacted]. [text redacted] Managing Director wrote to the researchers in September 2013 to advise that the research, in particular the 2011 book *Reaching Key Financial Reporting Decisions How UK Directors and Auditors Interact*, had been of great value to their work and [text redacted] [6].
2. Deloitte UK is one of the Big Four global audit firms, with tens of thousands of professionals in independent firms throughout the world who collaborate to provide audit, consulting, financial advisory, risk management and tax services to selected clients. It employs around 169,000 people and conducts around 20,000 audits annually in the UK. In January 2010, the National Audit Technical Partner at Deloitte UK wrote to inform Professor Beattie that the research 'had more impact upon [their] auditing processes than any other research in almost twenty years'.

In his letter, the Deloitte Partner goes on to explain that the research provided a rare 'light-bulb moment' for the company in terms of its audit behaviour, prompting it to adapt not only the timing of its audit practices but to alter the nature of its interaction with clients [7].

5. Sources to corroborate the impact (indicative maximum of 10 references)

[1] House of Lords Select Committee on Economic Affairs, Oral Evidence, Professor Beattie, October 2011 ([Link](#))

[2] House of Lords Select Committee on Economic Affairs (2nd Report of Session 2010–11), '*Auditors: Market concentration and their role*' (See paragraphs 113; 139 for references to research and recommendations at paragraphs 129-33) ([Link](#))

[3] The Office of Fair Trading Statutory Audit Market investigation reference to Competition Commission, October 2011 (cites Beattie's House of Lords evidence, pp. 28-9, 35-6, 39, 41) ([Link](#))

[4] Commissioned research by Professor Beattie (for Competition Commission), April 2012, *Competition Commission Statutory Audit Market Investigation: Initial Review of Relevant Academic Literature* ([Link](#)).

[5] The Competition Commission, Statutory Audit Services for Large Companies Market Inquiry , 2013 Provisional Findings Report (the report cites Beattie's commissioned report Initial Review of the Academic Literature 2.11. Also cites Beattie et al. (2012) at 11.45 and 11.55. Further citations in Report Appendices at A1 10, A8 64; A12 43, 45,46 and 60; A2fn7, fn8, fn22; A21 fn25; A26 68; and A28 41 and fn15 ([Link](#))

[6] Letter of support of 12 September 2013 from Managing Director, [text redacted]. Available from HEI.

[7] Unsolicited letter of 12 January 2010 from , current VP ICAEW and National Technical Partner Deloitte, to Professor Beattie and Principal Muscatelli, University of Glasgow. 12 Jan 2010. Available from HEI.