

Institution: London School of Economics and Political Science
Unit of Assessment: 19: Business and Management Studies
Title of case study: Reforming auditing and risk management to improve governance
<p>1. Summary of the impact</p> <p>LSE research has become a focal point for understanding how the ‘crowding’ effects of auditable targets can have unintended and often dysfunctional consequences for organisations and the public. The impact has two elements. First, <i>challenging conventional wisdom</i> and <i>stimulating debate</i> among stakeholders and practitioners in their search for best practice. The reach of this challenge has been global and across different fields, including accounting, risk management, public administration, social policy, education and psychiatry. Second, influencing actual <i>changes to auditing and risk management policy and practice</i> arising from these debates.</p>
<p>2. Underpinning research</p> <p>Power’s early work on auditing (1, 2) was the first to look beyond the technicalities of auditing practices (financial, environmental, social) and to identify a systemic <i>explosion of auditing</i> as a form of governance and control. It argued that the expansion of auditing and evaluation practices in the UK was the result of a transformation of governing – from direct to indirect methods via delegation to regulatory bodies and the utilization of organisational self-control practices. This analysis gave rise to the theory that auditing practices, far from involving neutral evidence-gathering, were a force for unintended change. Organisations were being transformed to make them ‘auditable’ and ‘inspectable’ by the creation and expansion of quantitative measures of performance. In this way, performance culture and audit culture became deeply linked. The empirical question posed by this research was simple: what were the effects on organisations and the individuals working in them, of this imperative to ‘make things auditable’? Power (1) was a condensed and popular version of this argument. Power (2) deepened the analysis, also developing the idea of a gap between the aspirations of this expanded control mandate for auditing and its real capabilities. The research shows how Value-for-Money auditing promised to deliver a focus on outcomes and policy effectiveness, but in reality tended to focus on measurable outputs and cost-efficiency.</p> <p>The <i>risk management explosion</i> of the mid-1990s is a continuation of developments begun by auditing. Power (3) provides a popular version of the key argument that organisational control systems have been transformed into risk management, since risk was always implicit in their functioning. Internal control and risk management systems also became more public and auditable objects via regulatory regimes. Organisations were being turned ‘inside out’ and became vulnerable to reputational damage in adversarial media and consumer environments. These ideas are developed further in Power (4) which notes the worldwide expansion of risk management designs. This is less a reaction to increased real risk in the environment – organisational and natural – and more to do with risk as the new language of accountability, and hence blame. In this respect, the ‘risk management of everything’ is a continuation of audit culture. Risk management systems must be auditable, and this has resulted in what many practitioners now call the ‘box-ticking’ approach.</p> <p>Although it was implicit in Power (4) that risk management may not be as functional as its practitioners imagine, this became more apparent with the onset of the financial crisis. Power (5) argues that the ‘risk management of everything’ was also reckless and epistemologically flawed. The focus on firms as entities ignored interconnection risk. Easily auditable risks received more attention than difficult and complex risks.</p> <p><i>Key researcher:</i> Professor Power has been at LSE since 1987.</p>
<p>3. References to the research (indicative maximum of six references)</p> <p>(1) Power, M. (1994) <i>The Audit Explosion</i>. London: Demos. http://eprints.lse.ac.uk/51265/</p>

Impact case study (REF3b)

- (2) Power (1997) *The Audit Society: Rituals of Verification* (Oxford). (Translated into French, Japanese, Italian) (in top 3 cited works in accounting field) 2nd edition.
<http://eprints.lse.ac.uk/21408/>
- (3) Power, M. (2004) *The Risk Management of Everything*. London: Demos.
<http://eprints.lse.ac.uk/21057/>
- (4) Power, M. (2007) *Organized Uncertainty: Designing a World of Risk Management* (Oxford) (Translated into Japanese) <http://eprints.lse.ac.uk/3045/>
- (5) Power, M. (2009) 'The risk management of nothing' *Accounting, Organizations and Society*. 34: 849-55. DOI: 10.1016/j.aos.2009.06.001

Evidence of Quality: Academic citations are spread over many academic fields (accounting, risk management, education, nursing, psychiatry, social work and many others). Honorary doctorates awarded by both the University of Uppsala in Sweden (2013) and by the University of St Gallen in Switzerland (2009) for this work. The latter cites *contributions to practice in auditing and risk management*.

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

Nature of Impact: The beneficiaries of the research are mainly, but not exclusively, professional bodies and practitioners in many different fields. First, there are the *widely diffused challenges to conventional wisdom* about the consequences of auditing and risk management, specifically the costs of bureaucratisation. The research has influenced policy debate in many fields not only in accounting and auditing, but also in child care, higher education, medicine and psychiatry), and there has been an uptake of its ideas in policy and practice documents. The terms 'Audit Society' and 'Audit Explosion', coined by Power, have entered policy discourses, and Power (1) and Power (3) have circulated in policy and regulatory contexts. Second, the research has contributed to *practice reforms* in performance auditing in the UK, Canada and the Netherlands. Points of diffusion of the research into practice are very wide and mediated by other academics and think tanks, especially in the health field where, for example, the research was a reference point in a broad wave of criticism of 'targets' in the UK NHS.

Selected impacts on accounting and auditing practice:

In 2009, Power gave oral evidence to the Treasury Committee's inquiry into the banking crisis. He drew on ideas in Power (2) and the final report refers extensively to his submission and oral testimony. He is named explicitly in a recommendation (para 243). This was also the case for his evidence to the House of Lords Select Committee on Economic Affairs in 2010 dealing with auditor concentration (6).

This led directly to participation in discussions about audit report reform at the Auditing Practices Board of the Financial Reporting Council (FRC) and – via the FRC Reporting Lab – resulted in a new policy focus on audit committee reporting which is ongoing. Power was also an advisor to the Department of Business Innovation and Skills (BIS) that drew on his work in their audit reform proposals (7). The work has also directly shaped the reform of internal audit practices in the Pan-American Health Organisation (8).

Jeremy Lonsdale, Director of Value-for-Money at the UK National Audit Office (NAO) notes the influence of Power (2) in both the UK and the Netherlands (also Frans Leeuw), stating: "*The Audit Society* has been very influential in our thinking and in Treasury thinking. I was seconded to do Lord Sharman's Review of Audit and Accountability for central government, which the Chief Secretary set up in 2000 and I know at that time and in the subsequent discussions NAO had with Treasury several ideas from the book shaped the agenda. And in aspects of our practice they had an influence." He confirmed the continuing influence of this work on practice development when Power delivered a seminar at the NAO in July 2010 (9). It has also influenced public sector audit and evaluation reform processes in Canada (10).

Power's impact on general regulatory debate in social work gave rise to a full length feature on his

work in *Socionomen*, a practitioner magazine for social workers in Sweden. Conversations with Eileen Munro as she was preparing her review on child protection focused on how to restore professional trust and her final report cites Power (2). In addition, the work is influencing an official investigation into education evaluation in Sweden. Power met the Swedish Education Minister on 25 January 2013 and will be involved in the investigation via the Chair of the report, Leif Lewin, who draws on Power's ideas (11).

In 2010, at the request of the French Ministry for Higher Education and Research, Power participated in the design of an evaluation practice for Institutes for Advanced Study in France, the outcome of which was the creation of a system which avoided the worst 'Audit Society' side-effects. Power also advised OFGEM on impact assessments (12).

Selected impacts on risk management practice:

Power advised the UK Financial Reporting Council as a member of the advisory board of their Financial Reporting Lab and by providing input into the reform of the Turnbull Guidance on risk management (new draft guidance was published in November 2013). Chris Hodge at FRC notes: "Our discussions with you helped us to clarify what we were trying to achieve and the final version was improved as a result." At the practice level, Richard Sykes (a partner in PriceWaterhouse Coopers) cites the value of Power's contribution to their thought leadership in risk management (13). Power (3) is cited in Minutes of Evidence to the House of Lords Select Committee on Economic Affairs (13a).

Power disseminated ideas from the research via executive teaching on BP's CFO Excellence programme in 2012 and 2013, leading to discussions within the group risk function about BP's new risk management approach. In 2011, Power was invited to be an Honorary Fellow of the UK Institute of Risk Management in recognition of his 'considerable contribution to risk management' which included influencing organisations as diverse as the Railway Safety Standards Board and the Equality and Human rights Commission (14). Power (4) has also influenced the 2011 design of the UN Principles on Business and Human Rights (14a).

The CARR research project 'risk culture in financial organizations' is on-going. Power gave evidence to the Salz Review, an independent review of Barclays' business practices, in April 2013 – his thinking influenced the section on 'complaints as a window on culture'. This is an example of impact of a research *process*, where the research itself is not yet published (15). Power (5) is on the reading list for Institute of Risk Management professional examinations and Power (4) is discussed in the CIMA study notes for professional examination in Management Accounting – Risk and Control Strategy 2009 (16).

Why the impact matters: Auditing and risk management should contribute to good performance by firms and their good governance. The underpinning research has addressed how transforming organisations to make them 'auditable' by the creation and expansion of systems and quantitative measures of performance can lead to an illusion of control, at best, and economic and social harm, at worst. By addressing these problems, the impact described above helps to improve the governance of firms.

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

All Sources listed below can also be seen at <https://apps.lse.ac.uk/impact/case-study/view/105>

Auditing:

- (6) House of Commons Treasury Committee (2009) *Banking Crisis: reforming corporate governance and pay in the City (2009) Chapter 6*. House of Lords Select Committee on Economic Affairs (2010) *Auditors: Market Concentration and Their Role. Volume 1: Report*, p. 10, *Volume II Evidence*, pp. 9-18; Email from Institute of Chartered Accountants of Scotland 26.10.10. <https://apps.lse.ac.uk/impact/download/file/1175>
- (7) 'Building the audit reporting enforcement pyramid: a discussion document,' paper presented

Impact case study (REF3b)

- to the UK Auditing Practices Board, March 2010. BIS (2010a) Memorandum of evidence for House of Lords Economic Affairs Committee on 'Auditors: Market Concentration and Their Role'. Also BIS (2010b) *UK government response to EU Green Paper on Audit*, citation of 'Audit Society' p. 5. <https://apps.lse.ac.uk/impact/download/file/1176>
- (8) Internal Auditor to the Pan American Health Organization, email 22.08.12. This source is confidential.
- (9) Director General, VFM Audit, UK National Audit Office, email 29.09.11; Maastricht Faculty of Law email 7.09.11; Assistant Auditor, NAO, email 28.07.10. This source is confidential.
- (10) For related influence on Canadian audit and evaluation thinking, citations in work of John Mayne formerly of the Canadian Office of the Auditor General. See Mayne, J. (2010) 'Performance auditing: cozy, comfortable and in need of challenge,' *Optimum online: The Journal of Public Sector management* 40(3) www.optimumonline.ca. <https://apps.lse.ac.uk/impact/download/file/1179>
- (11) Social work: Lennart Nygren (2012), *Sociomenen*, nr. 4, pp. 16-21; Munro (2011), *The Munro Review of Child Protection - Final Report: A Child-Centred System*, p. 19. <https://apps.lse.ac.uk/impact/download/file/1180>
- (12) Letter from French Ministry dated 18.05.2010; OFGEM email 25.09.13. This source is confidential.

Risk Management:

- (13) CIMA (2009) *Drivers of Risk Management: Adapting Risk Management to Organizational Motives* (cites Power 2007) p. 6; PriceWaterhouseCoopers email. CRO St James's Place plc email 23.08.12. Financial Reporting Council email 15.09.12 Financial Reporting Council email 01.09.11. This source is confidential.
- (13a) Minutes of Evidence; House of Lords Select Committee Economic Affairs 8.11.05.
- (14) Feedback from BP on risk teaching; also Head of UK Railway Safety Standards Board influenced by Power (2004), email from CEO of RSSB 8.2.11; Letter from chairman IRM; email from Equality and Human Rights Commission 15.12.09.
- (14a) Email from General Counsel for the Shift Project 15.10.13. This source is confidential.
- (15) Salz Review: *An Independent Review of Barclays' Business Practices*, pp. 84-85. <https://apps.lse.ac.uk/impact/download/file/1184>
- (16) CIMA Study note. *Financial management*, Feb 2009, pp. 50-52. <https://apps.lse.ac.uk/impact/download/file/1185>