LEGITIMACY THEORY OR SOMETHING ELSE? THE AUDIT OF ENVIRONMENTAL MATTERS: A NEW ZEALAND STUDY

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Abstract

The research presented in this paper examined the audit of ‘environmental matters’ and asks the question whether legitimacy theory provides an explanation for the observed audit phenomenon. This task is important because, as members of the accountancy profession, auditors are expected to act in the public interest (ICANZ, 2003, Code of Ethics, paragraphs 14 and 15) and environmental matters are issues of public interest.

The evidence for this study was collected using semi-structured in-depth personal interviews with twenty-seven auditors: eighteen were financial auditors in chartered accounting practice (FA); seven were public sector auditors (PS) and two were from the office of the Auditor General (OAG). The interviews which were guided by a small number of broad open-ended questions were conducted in the interviewees’ offices by the researcher.

The research findings indicated that legitimacy theory does not provide the appropriate explanation for the audit of environmental matters in accordance with Audit Guidance Statement (AGS) 1010: The consideration of environmental matters in the audit of financial reports. The introduction of AGS-1010 by the New Zealand Institute of Chartered Accountants (NZICA) was due to a necessity to maintain equivalence with global partners. Public Sector Auditors’ explicit focus on environmental matters for every public sector and government entity is in compliance with the legislated mandate as required by the Auditor General and the Local Government Act 2002. On the other hand, the financial auditors’ consideration of environmental matters is no different from their consideration of other audit issues. At the present time, there is no apparent tension between the New Zealand public and there is no public outcry which causes the organisation to perceive that its reputation or legitimacy is threatened, thus the notion of legitimacy theory would not come into play in regards to environmental matters, i.e. business is as usual.

Findings from this study substantiate and explain more clearly the underlying concepts in legitimacy theory. Very obviously, organisational survival must be present (Bansal & Roth, 2000). Something drastic must also have happened that impacted detrimentally on an organisation’s reputation or legitimacy (Patten, 1991) and social pressure had caused management to perceive that there is a legitimacy crisis that led to a legitimacy gap. Only in such circumstances would legitimation strategies be considered for narrowing the gap.

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1 Introduction

The role of the auditor continues to expand in scope and complexity as stakeholder demands for improved corporate accountability grow. A key issue auditors have faced in recent years is the audit of 'environmental matters' that impact financial reporting appropriately. The research presented in this paper examined the audit of 'environmental matters' and asks the question whether legitimacy theory provides an explanation for the observed audit phenomenon. Environmental matters are initiatives to avoid, remedy or mitigate any adverse effects of activities on the environment, or to deal with the conservation of renewable and non-renewable resources, in the audit of a financial report. This task is important because, as members of the accountancy profession, auditors are expected to act in the public interest (ICANZ, 2003, Code of Ethics, paragraphs 14 and 15) and environmental matters are issues of public interest. To assist them in this task, in 1998, International Auditing Practice Statement (IAPS) 1010: *The consideration of environmental matters in the audit of a financial report* was issued, followed by, in New Zealand, Audit Guidance Statement (AGS) 1010: *The consideration of environmental matters in the audit of a financial report* issued in 2001. Whether legitimacy theory appropriately explains the audit of environmental matters in relation to AGS-1010 is largely unknown, however.

This study aims to fill a substantial knowledge gap in three areas. First, it is in response to Beattie, et al.'s (2001) Power's (2003) observations that overall, the study of auditing in action is lacking; and particularly to Humphrey's (2008) and Power's (2003) request for more accounts of auditing in practical settings and its role in producing legitimacy. Second, this research should enhance the understanding of an audit phenomenon that is not widely known because few empirical studies have been carried out internationally (and none to date in New Zealand) on the auditing of environmental matters, an area seemingly neglected by researchers and commentators since the completion of a study by Collison (1996). Third, the reporting of this study should add a geographical variation to existing literature, making a timely contribution to the international literature on audit practice at both theoretical and professional practice levels.

This paper begins with some background information which provides context for the research study, followed by a brief discussion of legitimacy theory and studies within the legitimacy theory area. Next, the paper then discusses the methods used to capture empirical evidence and then reports on the ‘raw findings’ of the empirical analysis. Finally, conclusions are drawn from the analysis and comments on the appropriateness of legitimacy theory offered for empirical interview evidence on the audit of environmental matters and the introduction of AGS-1010.

2 Background

It is not uncommon for company activities to impact the environment adversely. Within the last decade, greater public knowledge of adverse environmental impacts has made the general public more aware of environmental matters (Holmes, 1999; Surma, 1992). Examples of environmental disasters were well discussed: The sinking of the Erika tanker, leading to a major oil spill along the Atlantic coast of Bretagne in 1999; and the 2001 deadly explosion of the AZF chemical plant in the suburb of Toulouse, France (Cho, 2009); the Lapindo mudflow disaster in East Java province (McMichael, 2009); the 1.1 billion gallon coal-ash spill at a Tennessee Valley Authority (TVA) power plant (Anonymous, 2009); the environmental catastrophe at Chernobyl, Union Carbide (at Bhopal); the toxic waste dumps discovered at Love Canal, New York, which took twelve years to clean up (Milne & Patten, 2002); and the Alaskan oil spill, whereby Exxon Valdez, a super tanker fully loaded with Alaskan crude oil, struck a reef in Prince William Sound discharging more than eleven million gallons of its cargo. It required two billion dollars to clean up the spill and restore the Alaskan coastal environment (Economist, 1990). It is therefore not surprising that society’s concerns over pollution, resource depletion, and other environmental issues have become widespread (Rezaee, Szendi, & Aggarwal, 1995).

Researchers and commentators also recognised the importance of environmental matters in the economic functioning of entities whose activities affect the environment (Collison, 1996; Collison & Gray, 1997; Collison, Gray, & Innes, 1996; Medley, 1997). Environmental matters also impact different aspects of accounting (Collison & Gray, 1997; Collison et al., 1996; Gray & Bebbington, 2000; Gray et al., 1998; Todd & Stafford-Bush, 1995), manifesting themselves as contingent liabilities, provisions, reserves, valuation of fixed assets and depreciation policy (Collison et al., 1996). More specifically, the financial implications of environmental issues are usually in the form of liabilities for cleaning up contaminated land and liabilities for being in breach of environmental legislation and regulations (Gray & Bebbington, 2001). For example, some companies with contaminated land will eventually have the problem of cleaning up the contamination, and at some stage they obviously have to pay for and consequently account for this (Munter & Sacasas, 1996). The problem is pervasive and a significant issue for financial reporting.

It is generally assumed that a company will survive beyond the short term as a going-concern. However, a company may face closure if it is sanctioned by law for any detrimental effect (Fiedler & Lehman, 1995) its business activities may have on the environment. Beyond any doubts, environmental matters can very quickly lead to serious ‘going-concern’ issues. As such, environmental matters are important accountability issues (Fiedler & Lehman, 1995, p. 196) with significant implications for financial reporting and auditing (Blokdijk & Drieenhuizen, 1992; Browning, 1994; Cornell & Apostolou, 1991).

The accountancy profession is impacted by environmental concerns (Gray, 1990), and to some extent, accountancy professional bodies across countries are responding to the emerging audit issue by addressing and raising their concerns amongst members of the profession and others (Bebbington & Gray, 1990; Collison & Slomp, 2000). In New Zealand, whether audit practitioners are similarly responding to environmental matters and whether this study may be framed within legitimacy theory has not been previously examined. This gap in the research literature on the audit of environmental matters is the motivation for this study. The next section discusses legitimacy theory and its consideration for this study.

3 Legitimacy Theory

Legitimacy theory is based on the notion of a ‘social contract’ between an organisation and the society in which it operates (Deegan, 2002; Guthrie & Parker, 1989; Llewelyn, 2003). To fulfil the terms of a social contract, an organisation agrees to perform various socially desired actions “in return for approval of its objectives, other rewards, and its ultimate survival” (Guthrie & Parker, 1989, p. 344). In so doing, society ‘confers’ upon the organisation a “state of legitimacy” (Deegan, 2002, p. 292). Legitimacy is said to “attract resources and the continued support of its constituents” (Ashforth & Gibbs, 1990, p. 177). Therefore, a legitimated organisation is able to continue its pursuits and activities and provide for their long-term survival (Savage, Cataldo, & Rowlands, 2000). Organisational legitimacy is clearly linked with organisational survival (Bansal & Roth, 2000), and also communication between the organisation and the various ‘relevant’ public (Suchman, 1995).

An organisation’s contract to continue functioning in society could effectively be revoked if societal expectations of the legitimacy of an organisation’s operations are not met (Deegan, 2002). It is important to note however, that perhaps a particular event must have occurred which has impacted detrimentally the organisation’s reputation or legitimacy (Patten, 1992) which caused the management of the organisation to perceive how society views the organisation in terms of whether what is done is acceptable or that it has led to a legitimacy gap in the first place (Deegan, 2002). Social pressure must be evident to have led the management of the organisation to perceive the existence of a legitimacy gap (O'Dwyer, 2002). When placed in this circumstance, an organisation’s pursuit for legitimation can lead to strategic tactics aimed at convincing the wider public that the organisation is a legitimate organisation (Deephouse, 1996). Many of these tactics are aimed at concentrating or controlling the public’s perception of an organisation in response to threats to its legitimacy arising from social pressure (Bansal & Roth, 2000; Neu, Warsame, & Pedwell, 1998; O'Donovan, 1999).

Whilst there are a large number of studies that support the tenets of legitimacy theory – including those discussed above – it should be acknowledged that there are also a number of studies that have *not* provided strong support for legitimacy theory. For example, the research conducted by O'Dwyer (2002) found that social and environmental disclosure policies *only sometimes* appeared to be motivated by legitimacy-related factors. Also, when Campbell (2000) reviewed the social disclosures of the UK organisation Marks and Spencer, he found that legitimacy theory *did not* provide any explanation for its social disclosure practices; instead individual traits, such as the identity of the chairman, seemed to provide better explanations of the corporate disclosure policies. Similarly, Guthrie and Parker (1989) found that apart from in regard to environmental disclosures, their research failed to find strong support for legitimacy theory. Thus empirical support for legitimacy theory is *not* universal.

Deegan (2002) explained the findings of the studies by O'Dwyer (2002); Campbell (2000) and Guthrie and Parker (1989). Legitimacy theory is based on *perceptions* of: (1) how the public (or a particular group of stakeholders) views the organisation; (2) whether what the organisation has done is perceived as acceptable to the public (or a particular group of stakeholders). That is, only when an organisation faces a legitimacy crisis, and public concerns (and pressure) are raised, would the organisation adopt whatever legitimating strategies necessary for complying with the expectations of society and safeguarding its own self-interest (Pasewark, Shockley, & Wilkerson, 1995; Savage et al., 2000). Otherwise, the organisation carries on business as usual. The implication is that organisational strategies driven by management's requirement to comply with certain rules, or a need to keep up with bigger players in a similar organisational or professional environment or accepted by management as part of their responsibility or accountability role are not legitimating strategies. Deegan, Rankin and Tobin (2002) reasoned that where there is no perception of any social threat and an organisation is simply reacting or responding to existing operating conditions, then the notion of legitimacy does not come into play. The many studies that provide results consistent with legitimacy theory demonstrate also that unless specific concerns (and social pressures) are raised, no legitimacy strategies appear to be required (O'Dwyer, 2002; Campbell, 2000 and Guthrie and Parker, 1989). In the light of the above discussions and reflections on legitimacy theory, this study aims to find out if legitimacy theory is an appropriate theoretical framework able to explain the empirical findings for this research. The next section discusses the extant audit literature framed with legitimacy theory.

4 Audit Literature and Legitimacy Theory

The phenomenon of auditor activities has precipitated a substantial body of audit research. The literature in the field using legitimacy theory as the interpretive lens seem to fall broadly into two broad strands. The first strand comprises of those papers that discuss the role of audit in producing legitimacy in organisations and society (Humphrey & Owen, 2000; Pentland, 2000; Power, 1997; 2003), and the second strand covers the audit profession itself as a legitimacy-producing and legitimacy-seeking institution.

The first strand of the audit literature considered accounting and auditing positioned as legitimation tools that business entities use to manage perceptions of their constituencies and to legitimise their behaviour (Humphrey & Owen, 2000; Pentland, 2000; Power, 1997; Power, 2003). Power (2003) explained that audits produce assurance or increased confidence in the subject matter of the audit and "financial statements are regarded as more reliable than they would be without an audit" (Power, 2003, p. 380). Some authors explained the process of environmental accountability and issues related to it in terms of legitimacy theory. Power (1997), for example, indicated that accounting is an important means by which organisations respond to environmental pressures in order to enhance their legitimacy. Taylor, Sulaiman, and Sheahan (2001) provided evidence that environmental management systems and related environmental audit functions are impositions to be complied with so as to maintain the credentials of ISO 14001 certification. Further, O'Dwyer (2001) expressed concerns that financial auditors were called upon to audit environmental reports, even though they lacked experience and expertise in qualitative aspects of social audits, because of management's need for the company to be seen as being audited. Arena and Azzone (2007) observed that organisations adopt internal audit departments in order to increase their legitimacy and their survival prospects. Hence it appears that auditing practices legitimise corporate disclosures, property rights and social relationships of power (Mitchell & Sikka, 1993).

The second strain of audit literature locates the accountancy professional body as an organisation functioning "within a society's framework of legitimate authority" (Pasewark et al., 1995, p. 77). Chandler (1997) explained that a legitimation crises occurs when the accountancy profession is perceived to have broken the (unwritten) code of conduct in protecting the public interest. At such times, the accountancy profession must respond to public concerns or risk losing its own legitimacy in the form of its authority to act for the public interest (Pasewark et al., 1995). Thus, to respond to public concerns and to justify the accountancy profession's co-existence with society in the midst of 'problematic legitimacy', authors suggested that the accountancy profession adopt whatever legitimation strategies are required in order to comply with the expectations of society and safeguard its own self-interest (Pasewark et al., 1995; Savage et al., 2000). For example, Okike's (2004) study illustrated 'role performance' as a legitimation strategy. When the Nigerian government was dissatisfied with the performance of auditors in Nigeria, the legitimacy of the auditing profession and its members were challenged and questioned. This led the auditing profession to step up on their 'role performance' in order to restore public confidence in their members and to re-establish the legitimacy of their continued existence. The profession made substantial changes to their roles and practices and as a result, they had to discipline and make examples of members who contravened the Code of Ethics. The profession also started issuing audit standards and guidelines for its members and paid closer attention to the activities of one-partner firms.

In another study, Neu (1991) found that the issuing of audit standards was a significant legitimation strategy. Many authors were critical of the intentions behind the issued audit standards and guidance statements as legitimation strategies. Byington and Sutton (1991, p. 318) observed that the mere issuance of published standards could "provide the perception of significant change to external parties", even though audit practice did not change. van Peursem, Locke and Harnisch (2005, p. 128) found that 'expanded' standards "give the appearance of improving professional benchmarks by virtue of greater volume, a volume not necessarily commensurate with a greater quality or a more forceful mandate". Humphrey et al. (1993a) commented that the significance of audit standards is not in the detailed matters of practice, but in the potential power of the image it created, using them to reassert auditors' public interest commitments. Generally, much of the critical literature argued that audit standards have been ineffective, and that they are mere articulations of existing auditing practice, driven by professional self-interest

(Humphrey & Moizer, 1990; Humphrey et al., 1993a). The next section discusses the research method.

5 The Research Method

The evidence for this study was collected using semi-structured in-depth personal interviews with twenty-seven auditors: eighteen were financial auditors in chartered accounting practice (FA); seven were public sector auditors (PS) and two were from the office of the Auditor General (OAG). The primary objective was to obtain detailed insights into perceptions of the auditors on current practices in the auditing of environmental matters and from the empirical findings, to determine if legitimacy theory is an appropriate explanatory lens. The interviews which were guided by a small number of broad open-ended questions were conducted in the interviewees' offices by the researcher. Each interview was for one hour at most and audit partners (AP) and audit managers (AM) were selected for the interviews. They are all chartered accountant members of the New Zealand Institute of Chartered Accountants (NZICA); and would be experienced and technically competent in assessing potential environmental risks at the audit planning stage.

Conducting the Interview

Introductory letters sent to the interviewees gave a standard definition of "environmental matters". Before each interview, each interviewee was given information on the nature of the research. The interviews focussed on the semi-structured interview guide and the interviewees covered most of the questions in the interview guide. The interviews were recorded by tape and then transcribed. Although this approach led to a rather structured interview situation, it helped to frame the subsequent analysis. Effort was made not to directly "put things into the [interviewee's] mind[s] but to access *the[ir]* perspectives" (Patton, 1990, p. 278. emphasis added). To invite the interviewees to participate in a conversation, the questions were deliberately open-ended (Maykut & Morehouse, 1994).

Analysis and Reporting of the Interview evidence

The analysis of the interviews was managed by using NVivo 7, a qualitative data analysis software program. The analysis was directed by the semi-structured interview questions and the research topic; it is subjected to "the three-stage analysis method" described by Huberman and Miles (1994, p. 10): (1) reducing and coding the interview evidence; (2) reporting the interview evidence and (3) drawing conclusions. The next section reports the interview evidence which captured best the spirit of common themes.

6 The Research Findings

The International Auditing Practice Statement (IAPS) 1010*: The consideration of environmental matters in the audit of financial statements* was issued in the midst of high profile corporate failures, environmental disasters and criticisms of the audit profession. From the events that took place, the issuing of IAPS-1010 in 1998 could be seen as a strategy designed to close the legitimacy gap and to ensure the audit profession's continued legitimacy (Dowling & Pfeffer, 1975). IAPS-1010 also appeared timely in detracting attention from the huge impact the high profile accounting debacles had on auditors and accountants' role in accountability, protecting the public interest (Pasewark et al., 1995), and self-regulation (Baker, 1977). Lindblom (1993) considered this strategy as a *symbolic* activity which served to deflect attention from the main issue of concern (accounting failure) by portraying the audit profession's activities in environmental accountability as being compatible with societal norms and values (Ashforth & Gibbs, 1990; Pfeffer, 1981). However, the above points were based on reflections made from an analysis of the extant literature. Since interview evidence is not available from the promulgators of IAPS-1010, firm conclusions cannot be made that legitimacy theory provides an explanation for the issuance of IAPS-1010.

In the New Zealand context AGS-1010, "consistent in all material respects" with IAPS-1010 (ICANZ, 2001, Appendix 1), was issued in 2001. Interview comments made by members of the NZICA Professional Standards Board (PSB) indicated that there were no serious debates within the Institute on environmental matters. The Institute, as a member of the global accounting alliance, decided to adopt international auditing standards. Thus, the PSB simply adapted international auditing standards and guidance statements for New Zealand. In so doing, the PSB merely accepted IAPS-1010 and re-issued it as AGS-1010. The three years time difference between the issuance of IAPS-1010 in 1998 and AGS-1010 in 2001 was a result of the due diligence and exposure draft process. which involved the required process of issuing an exposure draft, calling for comment and then confirming the issuance of the actual AGS. Pragnell (2004), a member of the PSB, said that very little feedback was received on AGS-1010 as an exposure draft. Hence, the final AGS-1010 remained substantively unchanged from IAPS-1010.

Although the promulgation of audit standards and audit guidance statements has been identified in the literature ((Byington & Sutton, 1991; Neu et al., 1998) as a legitimacy strategy, the issuing of AGS-1010 by the PSB cannot be explained by legitimacy theory. The Institute was merely following what had already been done overseas, i.e. they adopted a mimetic approach in order to maintain equivalence with global partners and not seen to be slipping behind them. In other words, there appears to be significant grounds for arguing that NZICA did not actively pursue a legitimation strategy with respect to AGS 1010. This research finding adds to the scant literature that reports a lack of support for a legitimacy theory perspective.

The following evidence were derived from interviewing the financial auditors in chartered accounting practices. As indicated in the earlier section, the evidence reported here are those that best captured the spirit of the common themes. Generally, financial auditors considered environment matters as one of the many audit issues considered in audit planning if they significantly impact financial reporting. Presently there is no legislated requirement for explicit focus:

> *At the present time, reporting of environmental matters is by way of implication of generally accepted accounting practices (GAAP), but GAAP is not explicit about the accounting treatment and disclosure requirement for environmental matters. There is also no legislated requirement for the audit of environmental matters* [FA_ AP 19].

The initial consideration of environmental matters in the audit is often triggered by its reporting in the financial reports:

> *All the planning is 'client specific'. When you're assessing business and the accounting processes within the business risk model, you have to assess all the factors that impact a client's risk profile. The environment is one of them that would be assessed as part of the planning process* [AM 1].
>
> *The initial consideration of environmental matters is really initiated by the fact that the company has something in the accounts that would indicate the existence of significant environmental matters* [AM 11].

Since clients are generally not interested in environmental matters, auditors are not pressured to directly focus on them.

> *There is high risk in audit work on environmental matters. How much detailed consideration is given to environmental matters for each audit depends on the clients; and for the large majority, truthfully it's not much.* [FA_ AP 4].

Company shareholders are much less interested in a company's environmental responsibility than taxpayers. Generally, taxpayers would be very interested to know if the government or quasi government bodies are being environmentally responsible. Since company shareholders are far more interested in company profits, financial auditors tended to focus more on ensuring that profits for the company is true and fair:

> *I think it [environmental matters] is going to have to be driven by the users of financial reports demanding for reporting on environmental matters and also that the information be audited. But really it depends on who the users are; who are the owners? In the public sector the users are the taxpayers who want to know if the government or quasi government bodies are being environmentally responsible. The taxpayers may get some action. However, company shareholders have one and a half eyes on the size of the dividend cheque. So it has to be driven essentially and eventually by the investors. Information will be only provided if the investors want them badly enough* [FA_ APR 18].

Whether environmental matters are fully disclosed and audited would depend very much on investors' pressure:

> *If investors put great pressure on companies to make full disclosures in the financial reports on their environmental obligations and liabilities, then companies which want to gain public attention and favour will make those*

> *disclosures in the financial reports. Then you will have financial auditors auditing those disclosures as part of their audits* [FA_ AP 12].

When asked whether the introduction of AGS-1010 has impacted audit practice, the financial auditors admitted that nothing has really changed:

> *We [auditors] would like to think that we are environmentally responsible, but a lot of times I don't think we have been actually. At the moment all we seem to have done is introduce AGS-1010* [FA_ AP 7]. *AGS-1010 is pretty much something that's a non-event* [FA_ AP 1].*AGS-1010 is only a guideline and I do not think that auditors are using it or even considering environmental matters in their audit* [FA_ AP 19].

However, the financial auditors would not hesitate to take advantage of AGS-1010 to give a general impression that environmental matters are generally considered during audits:

> *If anything goes wrong, if you get into a dispute or clients complain and ask "what are you doing?" You have AGS-1010 to pull out to show the client and say "there you go". It helps us in that way* [FA_ AP 5].

The reality is that currently in New Zealand, the public has not demanded for explicit verification of environmental matters for companies:

> *You would probably need some real high-profile cases like AFFCO [a New Zealand meat works company] who failed their environmental obligation to clean up and to sort out their storm water problem to be highly publicised by the media, in order to make auditors have an awareness of the possibility of environmental matters for a company* [FA_ AP 11].

However, in contrast to the financial auditors' position, the public sector and government auditors interviewed generally presented an entirely different perspective. These interviewees formed part of the office of the Auditor General (OAG). The Auditor General is an appointed officer of the New Zealand Parliament. The public sector auditors were aware that their legitimacy is dependent on their safeguarding the public interest and environmental matters cover a significant part of that public interest:

> *Environmental matters have become so much more of an issue for public sector auditors in New Zealand simply because that's what the people*

> *expect. It is critical that we actually don't misuse that trust, and by that I mean, if the public expects us to be dealing with environmental matters, then we need to deal with them* [PS_ AM 10].

As part of their risk assessments, public sector auditors take into consideration public risk, health risk and safety risk factors:

> *Our materiality assessment takes into consideration public risk and safety risk. These are not financial risk. For example, if anything leaked into the water system, it's unsafe to drink the water. Council needs to meet the requirements of the health standards by ensuring that the water is safe for drinking and we should to able to assess the cost to meet health standards in order to safeguard the interest and wellbeing of the consumers. high public risk exposure that is the consideration. That means you have to concentrate on the exposure to high public risk. That is a major risk from the [public sector] auditor's perspective and so we need to make sure that the client report properly. Even if the figures are out by 0.1 %, it is still a big deal because the public is at risk, because the water is polluted. Hence we don't concentrate just on the financial aspects, but also the high public risk, health risk and safety risk factor* [AM 22].

It is the Local Government Act 2002 which mandates the consideration of environmental matters in their audits of financial reports:

> *The Auditor General has a very strict mandate about the environment which he's got to operate under and that is why he's got this wider focus which includes environmental matters. It's all driven by the Local Government Act 2002. So there's a whole lot of reporting requirements that public sector auditors have to do, but that is driven by legislation* [PS_ AM 22].

> *The new Local Government Act 2002 places a lot of emphasis on the environment, and the councils and local authorities now need to factor environmental consideration in their decisions making. From the [public sector] auditors' perspective, we need to audit and give an audit opinion on environmental considerations* [PS_ AP 21].

As a result of the legislative mandate to audit environmental matters, public sector auditors are given rigorous training to deal with environmental matters:

> *A lot of our focus comes directly from the Auditor General. We have many different sectors to audit: the local government sector, the health sector. For each of those sectors, the Auditor General makes sure that there is appropriate training provided on environmental matters and any other*

> *relevant audit issues. There's a big focus on training; a huge focus. I'd never done so much training in all my life until I joined the Auditor General's office* [PS_ AP 21].

Additionally, public sector auditors are expected to comply with the requirements of AGS-1010 even though it is merely a non-mandatory guidance statement:

> *The Auditor General issues his own auditing standards, which supplement NZICA auditing standards. We have to comply with both sets of standards as an auditor on behalf of the office of the Auditor General. But in this particular case the Auditor General hasn't issued any specific standard himself so we comply with AGS-1010, although it is only a guidance statement* [PS_ AP 24].

7 Discussions and Concluding Remarks

Both the financial auditors and the public sector auditors have similar qualifications and are chartered accountant members of NZICA. However, they operate in two different worlds; the financial auditors in the corporate world and the public sector auditors in the public sector, governmental and political world. Insights into current practices of financial auditors and public sector auditors are now being discussed. The Auditor General as an appointed officer of the New Zealand Parliament has a direct governmental duty and responsibility to safeguard the New Zealand public interest. Public sector auditors as part of the Office of the Auditor general are merely responding to the Auditor General's and the Local Government Act 2002's mandatory requirement to focus on environmental matters for audits of every public sector and governmental entities' financial reports. To assist public sector auditors with complying with the requirements of the legislated mandate, the Auditor General expects the public sector auditors to comply with AGS-1010 even though it is non-mandatory; they are also given vigorous training to assist them in their audit practice. According to Deegan et al. (2002), under such circumstances the notion of legitimacy does not come into play because the public sector auditors are merely complying with the legislated mandate.

The reputation of the New Zealand Institute of Chartered Accountants (NZICA) had remained steady over the years and there had not been any obvious or publicised tension between the New Zealand society and NZICA. As such, despite the various overseas environmental disasters, the public interest in New Zealand had not been alarmed and

NZICA's legitimacy was not problematic at the time AGS-1010 was introduced. The introduction of AGS-1010 was not a legitimated strategy; actually it was introduced due to NZICA's necessity to maintain equivalence with global partners. Therefore, legitimacy theory also does not provide any appropriate explanations for the introduction of AGS-1010 in New Zealand.

At the audit practice level, the interview evidence confirmed that up until the present time, there is no legislated requirement or external pressure for financial auditors to explicitly focus on consideration of environmental matters. Considering that AGS-1010 is not mandatory, it is not surprising that AGS-1010 has not impacted audit practice, even though it is taken advantaged of as something that gives a general impression that environmental matters are generally considered during audits. The New Zealand auditing profession is presently not facing any apparent legitimacy crisis. Environmental matters, similarly with all other audit issues are being considered at the audit planning stage if they are deemed to have a material impact on financial reporting, thus it is business as usual. The findings from this study provided results consistent with studies by O'Dwyer (2002), Campbell (2000) and Guthrie and Parker (1989) in that unless specific concerns (and social pressures) are raised, no legitimacy strategies appear to be required. Yet again, the notion of legitimacy does not come into play (O'Dwyer, 2002; Campbell, 2000 and Guthrie and Parker, 1989).

The audit literature tended to be critical of audit practices, discussing the various legitimating strategies as means for complying with the expectations of society and for maintaining its own self-interest (Byington & Sutton, 1991; Humphrey et al., 1993a; Humphrey, Moizer, & Turley, 1993b; Neu et al., 1998; Pasewark et al., 1995; Savage et al., 2000; van Peursem et al., 2005). However, the findings from this study revealed the existence of other underlying factors that led the auditing profession to undertake certain activities and initiatives. This is certainly the case for the public sector auditors. Their direct focus on environmental matters for every audit is a requirement of a legislated mandate. Similarly, NZICA's introduction of AGS-1010 is not a legitimation strategy; they had simply adopted a mimetic approach in order to maintain equivalence with global partners and not seen to be slipping behind them. Additionally, evidence from this study provided a contrast to much of the extant audit literature that has discussed the promulgation of auditing standards as a legitimation strategy. It also adds to the number of studies that have *not* provided strong support for legitimacy theory (Campbell, 2000; Guthrie & Parker, 1989; O'Dwyer, 2002).

Findings from this study also helped to substantiate and explain more clearly the underlying concepts in legitimacy theory. Very obviously, organisational survival must be present (Bansal & Roth, 2000). Something drastic must also have happened that impacted detrimentally on an organisation's reputation or legitimacy (Patten, 1991) and social pressure had caused management to perceive that there is a legitimacy crisis that led to a legitimacy gap. This study showed that even if some New Zealand business activities had drastically affected the New Zealand environment, but the New Zealand public is not affected by any negative outcome, and there is no public outcry which causes the organisation to perceive that its reputation or legitimacy is threatened, then the notion of legitimacy theory would not come into play. In other words, an organisational activity carried out in the absence of any legitimacy crisis is obviously not a legitimation strategy as in the case for the introduction of AGS-1010 in New Zealand. The underlying intention and causal circumstance are keys to determining if it amounts to a legitimation strategy.

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