ENVIRONMENTAL MATTERS IN FINANCIAL REPORTS: CURRENT AUDIT APPROACH CHANGE??

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ABSTRACT

Purpose – This paper examined how New Zealand auditors could be motivated to step up current practice and prioritise the consideration of environmental matters in the audit of financial reports. Institutional Theory is the relevant theory for framing the research.

Design/methodology/approach – This research is qualitative. Twenty-seven New Zealand auditors were interviewed using semi-structured questions covering the research topic.

Findings – The interview evidence indicate that a legislated mandate enforced by the New Zealand Government is the most powerful driver of change to current audit practice. All other drivers and strategies for further advancing current practice identified by the interviewees would easily follow on from the legislative mandate.

Practical implications – Understanding what the potential drivers and strategies for further development in financial auditors' current practices would (1) assist in aligning financial audit practices with current audit practices of public sector auditors; (2) assist the audit profession and financial auditors to benchmark improvements to current audit. If the changes are implemented, then the New Zealand auditing profession would be meeting overseas expectations for auditors' role in environmental risk assessment and management in corporate governance.

Originality/value – This research will contribute (1) generally to qualitative research in audit practice; (2) specifically to the extant literature and will also 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.

Keywords – Financial Auditors, Environmental Matters, Audit Change, institutional Theory, Institutional Isomorphism.

Paper type – Research Paper

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1. INTRODUCTION

Environmental matters have drawn attention at a global level (Gamble, Hsu, Jackson, & Tollerson, 1996) as major business and social issues for several decades (Ashcroft & Smith, 2008). Public and political concerns regarding environmental issues have been brought into sharp focus by highly publicised environmental disasters such as the BP Oil spillage in the Gulf of Mexico, Exxon Valdez, Chernobyl, Love Canal, Union Carbide at Bhophal, the explosion of the AZF chemical plant in France and the massive coal-ash spill at a Tennessee Valley Authority power plant (Anonymous, 2008, 2009; Cho, 2009; Cho, Chen, & Roberts, 2008; Engelhaupt, 2008; Kripalan, 2008; Reed, 2010; Smith, 2008; Stromberg, 2009).

Internationally, a concern for accountants to engage with this important issue has been widely voiced. Authors observe that some professional accountancy bodies have responded by addressing environmental questions and bringing them into the open (Bebbington & Gray, 1990; Collison & Slomp, 2000). Various overseas professional accountancy bodies (such as the International Federation of Accountants (IFAC), the Association of Chartered Certified Accountants (ACCA), the Canadian Institute of Certified Accountants (CICA) and the Federation des Experts Comtables Europeens (FEE)) acknowledged the relevance of the environmental agenda and that the effects of environmental matters for financial reporting are complex. These professional accountancy bodies reflect, respond and raise awareness of the issues amongst their members through their sponsorship of academic research (CICA, 1993, 1997; Collison, Gray, & Innes, 1996; FEE, 1995, 1999; Gray et al., 1998; Gray, Collison, French, McPhail, & Stevenson, 2001; ICAEW, 2009; Macve & Carey, 1992). Their initiatives and concerted actions are also driven by the actions and influences of regulators and legislators and standard setters (ASB, 1998; IAPC, 1995, 1998). For example, the U.K. Companies Act 2006 contains many new responsibilities for directors on how businesses handle environmental matters amongst other community focussed issues (Anonymous, 2006) and the Australian Corporations Law 1998 requires disclosing companies to include in the directors' report information regarding compliance with relevant state, territory and Commonwealth environmental regulations (Cowan & Gadenne, 2005). Such legislated responsibilities and reporting has directly affect on financial accountants and auditors in their traditional and statutory roles as financial report preparers and verifiers.

In the auditing sphere, a number of professional accountancy bodies (AICPA, 1992; ICAEW, 2000) and top ranking officers (Lickiss, 1991; Sylph, 2005) urge financial auditors (from now on will be known as auditors) not to neglect their role in environmental risk assessment and management in corporate governance. For example, the Executive Director of the International Federation of Accountants (IFAC) expects auditors to strive in ensuring greater corporate environmental accountability, asserting that accountants [and auditors] "have a role in making corporations and governments sensitive to the environmental results of their actions" (Sylph, 2005, p. 1). Similarly, Lickiss (1991), the ex-president of ICAEW, asserts that accountants and auditors must measure up to the environmental challenge if they are to fulfil their duty to promote public interest. ICAEW (2000) notes the important implications of environmental matters for businesses, and cautions auditors and accountants not to ignore them.

In 2001, the New Zealand Institute of Chartered Accountants[i] (NZICA) issued Audit Guidance Statement (AGS) 1010*: The consideration of environmental matters in the audit of a financial report.* "AGS-1010 is consistent in all material respects with International Auditing Practice Statement (IAPS) 1010: *The consideration of environmental matters in the* *audit of a financial report"* which was issued in 1998 by the International Auditing and Assurance Standards Board (IAASB) (ICANZ, 2001, AGS-1010, Appendix 1). As indicated by Chiang (2010), NZICA as a member of the Global Accounting Alliance had merely adopted a mimetic approach when it issued AGS-1010. AGS-1010 is intended to assist auditors in developing good practice in applying audit standards when auditing significant environmental matters for a company (AGS-1010, paragraph 6). However, the audit guidance statement itself is not mandatory for auditors (NZICA, 2010, ISA (NZ) 200: *Overall Objectives of the independent auditor and the conduct of an audit in accordance with International Standards on Auditing (New Zealand)*). Other than issuing AGS-1010, to-date NZICA has not raised any awareness of the issues impacting environmental matters amongst their members in its technical journals and professional development seminars.

A study was conducted on New Zealand auditors' current practices in auditing the effects of environmental matters for financial reporting. The first part of the research findings from that study was reported in Chiang (2010); and the second part is being reported in this paper. Chiang (2010) reported the current practices in auditing the effects of environmental matters for financial reporting. Evidence from that study indicated that in spite of the introduction of AGS-1010 in 2001, auditors' focus on environmental matters appeared to have remained the same and the scope of audits not usually extended to specifically consider environmental matters. Chiang (2010) also found evidence which indicated that public sector auditors are compelled by the Local Government Act 2002 to prioritise environmental matters for every audit, and to do so, they are intensively trained in auditing environmental matters. The study also found that these public sector auditors conduct the most rigorous examination of environmental matters in published financial reports, and set best practice standards from which all auditors and NZICA have much to learn. Regardless of the current litigious climate, the position appeared unchanged since Collison's studies (Collison, 1996; Collison & Gray, 1997; Collison et al., 1996) in 1996. Then, it was already apparent that financial auditors in chartered accounting practice risked under-emphasising environmental issues and their financial consequences. On the other hand, the financial auditors and public sector auditors who audit public sector organisations are mandated by the Local Government Act 2002 to prioritise environmental matters. This paper reports the second part of the study which examined the drivers and strategies for motivating New Zealand auditors to prioritise the consideration to environmental matters in the audit of financial reports. Understanding the potential drivers for further development in financial auditors' current practices would assist in aligning financial audit practices in auditing environmental matters with public sector auditors' current practices. It would also assist NZICA as a member of the Global Accounting Alliance to meet overseas expectations for auditors' role in environmental risk assessment and management in corporate governance,

The remainder of this paper is organized as follows. Section 1 is an introduction to the research. Section 2 provides background to the audit of the effect of environmental matters relevant to financial reporting and section 3 discusses prior research on changes to audit methodologies and approaches. In section 4, 'institutional theory' identified by the 'bottom-up' approach to theorisation is discussed and its relevance for the present study explained. Section 5 outlines the research methods. Section 6 presents the research findings and discussions of the implications of the findings. The final section summarises the conclusions.

2. THE AUDIT OF ENVIRONMENTAL MATTERS

The effect of environmental matters[ii] may impact the financial reports of some entities. Arising from such matters is a potential risk of material misstatement (including inadequate disclosure) in the financial report. In these circumstances, the auditor needs to give consideration to environmental matters in the audit of the financial report (ICANZ 2001, AGS-1010, paragraph 3). A typical sequence of the audit process is as follows. Having acquired sufficient knowledge of the audit environment, the auditor assesses the risk of a material misstatement in the financial report. This assessment includes consideration of environmental laws and regulations that pertain to the entity. It also provides a basis for the auditor to assess the materiality of environmental matters for the company and then to decide whether there is a need to pay more attention to them in the course of the audit of the financial report (ICANZ 2001, AGS-1010, paragraph 4). If the auditor considers that environmental risk[iii] is a significant component in the inherent risk assessment, the auditor should consider the assessed levels of environmental risk in determining the nature, timing and extent of substantive procedures required to reduce the risk of not detecting a material misstatement in the financial report to an acceptable level, including any material misstatements if the entity fails to properly recognise, measure or disclose the effects of environmental matters (ICANZ 2001, AGS-1010, paragraph 41). The auditor then relates this assessment to material account balances and classes of transactions at the assertion level when developing the audit programme (ICANZ 2001, AGS-1010, paragraph 25). The audit programme is then applied and audit procedures are carried out to verify the validity, completeness and accuracy of the effects of material environment matters, after which an opinion on its truth and fairness is given. The next section discusses prior research on changes to audit methodologies and approaches.

3. CHANGES TO AUDIT METHODOLOGIES AND APPROACHES

Changes in societal attitudes towards audit have been a catalyst for change. Hanlon (1993) observes that in accountancy the client for auditing services is increasingly viewed as the company managers rather than the shareholders, the public or the state. This led Hanlon (1994) to examine the impact of the changes on the professional workplace in relation to the society within which these professionals operate. In particular, he analysed the socialisation processes experienced by auditors in the chartered accountancy profession and the evaluation criteria involved in the promotional process to partnership. He found that the process entails a shift from a "social service" evaluation mechanism to a "commercialised" mechanism. Criticisms have also encouraged accounting firms to want to be seen to revise their approaches. Baker (1993) examined the manner in which large accounting firms manage a changing environment in order to defend against threats to the firms' dominant position in public accounting. He observes that in the midst of recurrent criticism and threats of external regulation, large audit firms adopted strategies of 'doing, representing and being' which enabled the firms to achieve financial and professional success. For example, criticisms of the assurance practices and providers in verifying public reporting of social, ethical and environmental performance has moved the Institute of Social and Ethical AccountAbility to revise and further develop AA1000S Assurance Standard, which is underpinned by three principles (completeness, materiality and responsiveness) in the AA1000 Framework (Dando & Swift, 2003).

Power (1995) argues that public dissatisfaction with the quality of audit services and the reliability of information has prompted the profession to rethink the process of audit delivery. At the audit practice level, Martinov and Roebuck (1998) found that the audit methodology for inherent risk and materiality assessments (which formed an integral part of the audit planning process under the current 'audit risk model') and how they are integrated in the planning of audit testing was driven by severe competition in the audit market. Power (1992) argues that the rise of audit sampling is not simply an enhanced technique conditioned by external developments in statistical theory; instead it has been motivated by "attempts to legitimate, rationalize and reinterpret and improve practices that *were already in place*" (p. 59). Vilsanoiu and Serban (2010) discuss the shift in methodologies applied by financial auditors from transaction cycle orientations to business process orientations. According to Curtis and Turley (2007), the change in the audit approach was achieved by focusing the audit to business risk (BRA) rather than financial statement risk; by changing the nature of audit work from substantive procedures which used more resources (Peecher, Schwartz, &

Solomon, 2007) to the testing of supervisory controls, supported by high precision analytical work.

A number of research identified various drivers of and strategies for change in large audit firms' methodologies to business risks assessments: attempts to increase their revenues by widening their areas of expertise from audit to consulting services (Knechel, 2007; Robson, Humphrey, Khalifa, & Jones, 2007); changes in technology that increased the likelihood of financial misstatements which caused auditors to look for methods of incorporating business risks more directly in their audit risks assessment in order to respond to their clients' need for assurance (Robson et al., 2007; Schultz, Bierstaker, & O'Donnell, 2010). Sullivan (1993) observed that many of the changes in audit approaches adopted by major audit firms are the result of special research studies conducted by such firms on individual audit problems.

Prior research investigated the drivers of change to audit *methodologies* and the *consequential* changes *made* as a result. The research question for this study investigated the drivers of and strategies for *motivating* New Zealand auditors to prioritise the consideration to environmental matters in the audit of financial reports. Prior studies targeted *only* auditors from the large audit firms however, the participants for this research were not only auditors from large audit firms; they also included also auditors from middle-sized audit firms and public-sector auditors. Evidence from this study would therefore contribute to the literature on 'audit change'. The next section outlines institutional theory as providing the appropriate insight and understanding for the empirical findings for this study.

4. INSTITUTIONAL THEORY

Institutional theory is the appropriate theory used to explain the findings of the study by Chiang (2010) and it is also used to explain the findings of this study. Institutional theory offers a powerful explanation because it explicitly considers processes and internal factors (Adams & Larrinaga-Gonzalez, 2007). Institutional theory asserts that competition for political power and institutional legitimacy motivates organizations to adopt similar policies and practices. This generates institutional isomorphism, which may be coercive, mimetic or normative in nature (DiMaggio & Powell, 1983). Coercive isomorphism refers to external pressures on an organization to conform to the requirements of a more powerful organization (for example the Government, regulatory bodies and others). Normative isomorphism refers to homogenization arising from the influences of professions on the norms, structures and practices of organizations. Mimetic isomorphism is the result of pressures to conform which emerge from uncertainty – that is, in an uncertain environment organizations often choose to mimic their peers. Aspects of institutional isomorphism provide explanations for the findings of the current research. In general, institutional isomorphism is perceived as the force for motivating New Zealand auditors to step up their current practice and give more serious consideration to environmental matters in the audit of financial reports. The next section outlines the research method.

5. RESEARCH METHOD

This is an qualitative and interpretive study (Cavana, Delahaye, & Sekaran, 2001; Silverman, 2005). Altogether, twenty-seven New Zealand auditors were interviewed - Eighteen financial auditors from chartered accounting firms and nine public sector auditors. Only audit partners, directors and managers were selected because they have overall responsibilities for their audit clients. Out of the twenty-seven participants, seven Big 4's financial auditors, three medium-sized firm auditors and all nine public sector auditors have clients with environmental matters as audit issues, and experience in auditing the effects of material environmental matters in financial reports. Table 1 below categorises the auditors interviewed.

Table 1: Categories of financial auditors interviewed

	Total	Experienced*	Auckland	Wellington	Christchurch
Financial auditors (FA)					
The Big 4's					
Partners	5	4	3	2	
Managers	5	3	5		
Medium sized firms					
Partners	4	2	4		
Managers	4	1	4		
Total FA Interviewees	**18**	**10**	**16**	**2**	
Public sector auditors (PSA)					
Directors	5	5	2	2	1
Managers	4	4	1	2	1
Total PSA Interviewees	**9**	**9**	**3**	**4**	**2**
Total auditors Interviewees	**27**	**19**	**19**	**6**	**2**

*These auditors have experienced auditing clients operating in environmentally sensitive industries

Semi-structured questions were used to direct each interview and the maximum number of interviews was reached when participants started to give similar information (i.e. saturation point). The interviews were generally no more than an hour long each; taped-recorded and transcribed. The selected interview quotations presented in the next section best captured the spirit of the common themes extracted from interviewees' comments. Interesting and discordant views were also included to provide context. The next section presents the interview findings and discussions of the implications of the findings.

6. RESEARCH FINDINGS AND IMPLICATIONS

The interviewees were asked for their perceptions on the drivers and strategies to motivate New Zealand auditors to step up current practice and prioritise the consideration of environmental matters in the audit of financial reports. The interview evidence and their implications for auditors and NZICA are reported next.

Auditors' mindset change

The auditors acknowledged that they are presently not sensitive to environmental matters in their professional life.

> *We* [auditors] *would like to think that we are environmentally responsible, but actually I don't think we are. At the moment all we have done is to introduce AGS-1010.*

According to Chiang (2006), auditors are unable to translate their personal views on environmental issues to their professional practice. Their personal beliefs did not seem to impact their professional practice and they did not feel they had the technical knowledge required to audit environmental matters. The interview findings for this research support that finding. Gray (2000, p. 248) comments that although "accountants are well trained in auditing (as in accounting)…universities need to produce "independent critical thinkers", and particularly, "…in the field of social, environmental…accounting, reporting and auditing" (p. 263). Hence, for auditors to become more concerned with environmental matters, as individuals and as a group, their attitude needs to shift to where their boundaries of consideration extend (Bebbington, Gray, Thomson, & Walters, 1994; Deegan, Geddes, &

Staunton, 1996). Moreover, as Chiang (2006, p. 23) indicates "the mechanism for translating the consideration of environmental issues into audit practice needs improvement before auditors can become confident and fully engaged in their consideration of environmental matters in financial audits".

Public and Investor Demands

Public and investor demands for the reporting of the effects of environmental matters in financial reporting is perceived as another powerful driver of change in audit practice. Mandatory disclosures of information on the material effects of environmental matters in financial reporting which requires auditing would force auditors to seriously consider them for audit planning:

> *If investors put great pressure on companies to fully disclose their environmental obligations and liabilities in financial reports, financial auditors are then obliged to audit those disclosures.*

However, it seemed unlikely that investors would force the issue because profit-making is more important to them:

> *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. In this case, taxpayers may get some action. Information will be provided only if the investors want them badly enough. However, company shareholders have one and a half eyes on the size of the dividend cheque.*

Media Publicity and the 'Fear Factor'

Alarming media publicity on high-profile environmental problems and disasters is certainly an attention-grabber which may trigger off 'the fear factor'. It would undoubtedly force auditors to focus on companies' responsibility for environmental management and reporting. It would also cause the auditors to prioritise the consideration to environmental matters in the audit of financial reports. Illustrative quotations include:

> *Until the horror stories on environmental matters start coming out, we would not be particularly aware of them.*
>
> *You would probably need some real high-profile cases like AFFCO* [a New Zealand meat works company] *which 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 a general awareness of the possibility of environmental matters for a company.*
>
> *Well, the only way to make anything work infallibly in audit is for some auditor to get it wrong and be sued and lose a lot of money. That's been a real attention grabber. And until that happens it's quite difficult to make them take it seriously. I'm being a little bit facetious here because there are many auditors in New Zealand who have high professional standards, and certainly take their work very seriously, but they will take it a lot more seriously if someone's been sued and lost. Fear is a great motivator.*

Media-publicised high-profile environmental debacles are powerful means of advancing current audit practices. Porter (2008) indicates that auditors tend to be more reactive than pro-active. It took the recent accounting debacles around the world to introduce more stringent auditor independence requirements and major revisions to the international auditing standards on the audit planning and consideration of fraud and material misstatements in audit practice.

It may therefore also require highly publicised environmental debacles for auditors to become more urgent in auditing environmental matters.

NZICA providing the strategies for substantive change to audit practice

Auditors must comply with Audit Standards (NZICA, 2010; ISA (NZ) 200: Overall Objectives of the independent auditor and the conduct of an audit in accordance with International Standards on Auditing (New Zealand)). However, AGS-1010 is an Audit Guidance Statement which merely guides practice. AGS-1010 issued as an Audit Guidance Statement is perhaps indirectly signalling to the financial audit community that environmental matters are of lesser importance than they really are. To push auditors to regard environmental matters more seriously when auditing financial reports, there was again a unanimous agreement amongst the interviewees for the status of AGS-1010 to be changed to an Audit Standard:

> *Change the status of AGS-1010 from an Audit Guidance Statement to an Audit Standard. It would then force auditors to seriously consider environmental impacts. This change would force auditors to pay more than just lip service to environmental matters because they are expected to comply with the Audit Standard.*

NZICA is perceived to be well positioned to spearhead improvements to current practices by providing education on and a general awareness of environmental matters amongst its members. Illustrative quotations include:

> *Although auditors themselves are obliged to further develop current audit practices, I think it's going to be a long term process. One of the big problems an organisation faces is that management responsible for preparing the financial accounts is not dealing with the effects of environmental matters for financial reporting. The way forward is to have NZICA focus some of their attention on education and awareness of environmental matters and its effects for financial reporting. Maybe partner with universities to start off that process because universities start people's careers.*

> *Bring environmental matters back as a regular issue in the New Zealand Accountants Journal to provide education and general awareness. Awareness is probably the biggest thing. I cannot think of ever having seen an NZICA training session or anything on environmental matters. Certainly I could see the usefulness in using real examples of environmental disasters as horrors stories on contingent liabilities or whatever.*

> *I think NZICA could play a role here. In some cases, environmental matters are in a similar area as other non-financial reporting issues which are not that easy to audit. Since you cannot specify it, you have to consider its reasonableness; and find what evidence is available and get experts in if necessary…all those sorts of things, but it is not easy to do. Thus, its something NZICA could provide some assistance with.*

Collison and Gray (1997) found that the extent of an auditor's consideration of environmental matters was a function of the individual's awareness of, and training in environmental matters. Thus, promoting education, starting at university level, on general awareness of environmental matters, is in line with their views. The comments made clearly indicated that NZICA, as a professional accountancy body has a huge normative influence upon auditors. NZICA would have to lead in working out the different strategies to educate and promote general awareness of environmental matters and their effects for financial reporting.

The interviewees commented that to move current practices forward, they could look at public sector audit practices since they are up with the play with the audit of environmental matters:

> *The Auditor General directs public sector auditors to emphasise environmental matters for every audit and they are expected to comply with AGS-1010 even though it is an Audit Guidance Statement and not an Audit Standard. The directive came from the Local Government Act 2002. The Auditor General also makes sure that there is appropriate training on environmental matters and other relevant related issues. The Auditor General's focus on training is huge. I have not done so much training until I joined the Auditor General office.*

All public sector auditors are chartered accountant members of NZICA and they have to comply with the NZICA Code of ethics. They are also staff of the Auditor-General's office. The Auditor-General is an appointed officer of the New Zealand Parliament and he has a role in maintaining the integrity of public sector accounting and reporting systems, the reporting of financial and non-financial performance by public sector bodies; and ensuring better use of public resources (NZ Audit Office, 1995, p. 18). Public sector auditors carry out annual audits allocated by the Auditor-General, and all their audits are mandated by the Public Audit Act 2001 and the Local Government Act 2002. The comments made indicated that NZICA could be influenced by mimetic isomorphism and be led by what the Auditor General and the public sector auditors are already competent in doing.

A Legislated Mandate

According to current environmental law in New Zealand, entities are not obliged to remediate contaminated land unless the land is being sold. In this case, there is no requirement to provide for remediation in the financial report:

> *Current environmental law does not require companies to remediate their contaminated land if they are not selling the land. That's why there are so many 'abandoned' unoccupied meat work company sites in different New Zealand towns. All meat work companies have contamination on their sites, but so long as the sites are not sold, the companies never have to remediate them and would not provide for any remediation costs in their financial reports.*

'Materiality assessment' is the cornerstone of auditing. An audit issue would only be considered in the planning approach of a company if its effect is material for financial reporting, that is if there is likelihood that its misstatement, omission or non-disclosure is considered to be of such a magnitude that it would distort the decision-making of financial statement users. Since the financial effect of environmental matters is often immaterial, as an audit issue it usually falls through the materiality net. Consequently, auditors do not bother about them when auditing companies:

> *Fines and penalties must fit the crime. Currently, the statutory cap on company or directors' liabilities is two hundred thousand dollars fine and a maximum prison sentence of two years. However, I've never heard of any director or manager or whoever responsible for any environmental problems actually being sent to prison nor any company being fully fined up to the two hundred thousand dollars maximum* either. *It's normally twenty five thousand dollars or fifty thousand dollars. If you are looking at a corporation with a turnover of four hundred million dollars and a profit bottom line of say between twenty million dollars and fifty million dollars, a fifty thousand*

dollars fine is a small charge, so it would slip under the higher materiality level. Therefore auditors as part of the enforcers don't seem too serious about it.

More importantly, there is unanimous agreement among the interviewees that a legislative mandate is perhaps the only substantive driver of change for mandatory corporate reporting and auditing of environmental matters in financial reporting.

Mandatory disclosures of the effects of environmental matters in financial reporting would be a useful base for further development in its accounting and auditing. If it is not mandatory to report on environmental matters, people won't bother. If you have a big stick, if it's a legislative requirement, then accountants have to report on environmental matters and auditors have to audit them. At present, a lot of auditors would say, "Look, we've got other things to worry about. We are always interested, but until it is a mandatory requirement, there's not too much emphasis on that.

The research findings indicated that currently, there appears to be no incentive for New Zealand companies to fulfil their environmental obligation. The New Zealand Environmental Law is too lenient and the fines and penalties for environmental wrong-doings often immaterial. Current environmental laws must be toughened up and enforced seriously, and penalties and fines for breaching environmental laws should be of a magnitude that fits the 'environmental crime'. Collison and Gray (1997, p. 148) pointed out that "legislation at national level is clearly an important influence on audit change". This is confirmed by Frost (2007), in agreement with Porter's (2008, p. 6) observation that:

Given the exponential increase in societal, political and media interest in environmental and social (or ethical) matters in recent years, and in climate change in particular, it seems likely that, in the not-too-distant future, it will be commonplace for external auditors to be required by legislation or regulation to audit at least some of the information published by the entities on their carbon footprint and other environmental and social activity .

The above comments clearly indicate that the ultimate driver of any change is a legislative mandate. This has been the case for the UK, US and Australia Company legislations which mandate greater corporate responsibilities for and reporting of environmental matters (Anonymous, 2006; Cowan & Gadenne, 2005). Thus, cohesive pressures by the New Zealand Government in (1) mandating company reporting on environmental matters via the Financial Reporting Act 1993, (2) compelling company directors to manage and report on environmental matters by way of the Companies Act 1993; (3) Imposing substantial financial penalties ($100,000's and perhaps a jail sentence) for non-compliance with the legislated requirements of the Companies Act 1993 and the Financial Reporting Act 1993, would drive company accountants and directors to consider more seriously and urgently their responsibilities for managing and reporting environmental matters. Auditors would also then be driven to step up current practice and to prioritise the consideration of environmental matters in the audit of corporate financial reports.

Resistance to Change

Some auditors perceived resistance to change in audit practice will continue until generally accepted accounting practice (GAAP) is explicit on the accounting treatment of environmental matters. Until there is one, auditors would not show any interest in environmental matters. They also perceived that NZICA would prefer the status quo and better-defined targets. The cause of such a resistance must be addressed.

> *Currently, the accounting standard is not explicit on the accounting treatment of environmental matters. It is unlikely that auditors will move forward until an Accounting Standard is issued on environmental matters because it is not easy to audit environmental matters. Besides, we think NZICA prefers to deal with more defined targets.*

In summary, it would seem that the way forward in motivating New Zealand financial auditors in chartered accounting practices to step up current practice and prioritise the consideration of environmental matters in the audit of financial reports is complex, due to a wide range of factors as indicated in the findings above. However, perhaps the only practical and effective way forward is the implementation of a legislated mandate. This insight is based on the reported experiences of the New Zealand public sector auditors whose audit practice for environmental matters is actually forced upon them by the legislated mandate embodied in the Local Government Act 2002 (Chiang, 2010) and also the experiences of UK, US and Australian auditors. All other drivers and strategies for further advancing current practice identified by the interviewees would easily follow on from the legislative mandate.

7. CONCLUSIONS

This paper reports part two of the findings of a bigger research on the consideration of environmental matters and its effects for financial reporting. Institutional theory was used to frame the research. The first part of the research which studied the current practices in auditing environmental matters was reported in a paper by Chiang (2010). Following on from that study, this paper reports the second part of the study and it examined the drivers and strategies for motivating New Zealand auditors to prioritise the consideration to environmental matters in the audit of financial reports. The findings from this study suggests that a more stringent legislative framework, similar to that already governing public sector audits, may offer the greatest potential to redirect audit practice in the private sector, not only for financial auditors, but also for accountants and company directors. The Government has the potential to act as a coercive change agent in promoting this. To support such legislative changes, NZICA could be influenced by mimetic isomorphism and follow the lead of the Auditor General in prioritising and mandating the audit of environmental issues for all company audits by issuing an Audit Standard (on environmental matters) in place of the current Audit Guideline.

Coercive pressures on accountants, directors and auditors to report and audit environmental matters in accordance with legislated mandates (via the Financial Reporting Act 1993 and the Companies Act 1993) and an Audit Standard (from NZICA) would propel environmental matters to the centre-stage of the practice and professional agenda. This would position NZICA as a generator of normative isomorphic influence on the audit of environmental matters by developing the technical competency of all accountants and auditors. This perhaps is the only significant strategy that would force auditors, accountants and company directors to step up current practice and prioritise the consideration of environmental matters in the audit of financial reports.

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[i] Prior to 2005, the name of the Institute was "Institute of Chartered Accountants of New Zealand"

[ii] For the purposes of AGS-1010: *The consideration of environmental matters in the audit of a financial report*, Environmental matters are: (i) initiatives to avoid, remedy or mitigate any adverse effects of activities on the environment, or to deal with conservation of renewable and non-renewable resources (such initiatives may be required by environmental laws and regulations or by contract, or they may be undertaken voluntarily); (ii) consequences of violating environmental laws and regulations; (iii) consequences of environmental damage done to others or to natural resources; and (iv) consequences of vicarious liability imposed by law (for example, liability for damages caused by previous owners) (paragraph 10b).

[iii] Environmental risk means the risk of material misstatement of the financial report due to environmental matters.