

**GUIDING BEST PRACTICE, OR LEGITIMATING CURRENT PRACTICE? AN
EXAMINATION OF AGS-1010 ON THE CONSIDERATION OF ENVIRONMENTAL
MATTERS IN THE AUDIT OF A FINANCIAL REPORT**

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ABSTRACT

The primary aim of this paper is to report interview evidence on one aspect of a doctoral work-in-progress which covers the consideration of environmental in the audit of a financial report. This study particularly considers whether *AGS-1010: The consideration of environmental matters in the audit of a financial report* is guiding best practice or legitimating current practice. This research study, undertaken in the context of *AGS-1010*, has not been researched before, thus it contributes to the literature on environmental matters from an audit perspective. It also provides substantial evidence in support of AGS-1010 as a 'symbolic ceremonial conformity' legitimization strategy (Ashforth & Gibbs, 1990).

Key words: Financial audits, audit materiality, environmental matters, auditing profession

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1. Introduction to This Study

The primary aim of this paper is to report interview evidence on one aspect of a doctoral work-in-progress which covers the consideration of environmental in the audit of a financial report. This study particularly considers whether *AGS-1010: The consideration of environmental matters in the audit of a financial report* is guiding best practice or legitimating current practice. This research study, undertaken in the context of *AGS-1010*, has not been researched before, thus it contributes to the literature on environmental matters from an audit perspective. It also provides substantial evidence in support of AGS-1010 as a ‘symbolic ceremonial conformity’ legitimization strategy (Ashforth & Gibbs, 1990).

The following section review the literature on the auditing profession, AGS-1010 and legitimacy theory and section three outlines the research method. The interview findings are reported in section four and the paper ends with section five on a discussion of the implications of the interview findings, some concluding comments and recommendations for future research.

2. The Auditing Profession, AGS-1010 and Legitimacy Theory

The audit profession functions “within a society’s framework of legitimate authority” (Pasewark, Shockley, & Wilkerson, 1995, p. 77). For its status and position, it relies on public perception that its members perform an important task with proficiency and with the backing of a legitimate professional body (Weirich & Rouse, 2003). Hence its central focus is the ‘social contract’ (Deegan, 2006) which requires the audit profession to provide socially valued audited financial

statements in exchange for a virtual monopoly of audit practice and self-regulation (Baker, 1977). This enables the audit profession to continue its pursuits and activities for their long-term survival (Ashforth & Gibbs, 1990; Guthrie & Parker, 1989; Savage, Cataldo, & Rowlands, 2000). Therefore, 'legitimacy theory' is an appropriate theoretical frame for this research and maintenance of organisational legitimacy is critical to upholding the status of the audit profession (Weirich & Rouse, 2003).

In recent times, media and public scrutiny of a number of high profile corporate failures such as Enron, Parmalat, Health International Holdings (HIH) Insurance (Mak, Deo, & Cooper, 2005) have resulted in significant mounting criticism of the auditing profession (Chandler, 1999). As Savage, Cataldo and Rowlands (2000) observe, the media is a powerful constituent and news media reports are indicators of societal norms and values. The media also seek opportunities to publicise environmental disasters. Commentators observe that highly publicised news coverage on environmental disasters at Exxon Valdez, Chernobyl, Love Canal, and Union Carbide at Bhopal have changed public and political general awareness, attitudes and concerns for environmental issues (Gilkison & KPMG, 1999; Gray & Bebbington, 2000; Rubenstein, 1992; Watson & Mackay, 2003). Hence, there is tremendous turbulence in this aspect of the area in which the auditing profession operates (Baker, 1977). Prevailing environmental crises and audit failures have resulted in the auditing profession facing a crisis of investor confidence in financial reporting and auditing (Weirich & Rouse, 2003). Hence:

[The auditing profession as] a professional body could lose its legitimacy if the public expected a change in performance that was not forthcoming. In the present dynamic social environment, continuance of previous practices may not be sufficient to maintain legitimacy, even if the performance related to that practice is maintained or even improved. Legitimacy is a moving target. If society recognises a need for either different or additional information, than

accountants [and auditors] are expected to provide the needed information” (Reynolds & Mathews, 1999, p. 89).

It is in the midst of high profile corporate failures, environmental disasters and criticisms of the auditing profession in 1998 that *International Auditing Practice Statement (IAPS) 1010: The consideration of environmental matters in the audit of financial statements* was issued. In 2001, New Zealand’s *AGS 1010*, “consistent in all material respects” with *IAPS 1010* (ICANZ, 2001, Appendix 1), was promulgated. The espoused purpose of the promulgation is to guide current practice in the consideration of environmental matters in the audit of a financial report.

Prior research showed that in some cases, the issuance of auditing standards and guidelines resulted in only little or no change in audit practice. Ashforth and Gibbs (1990, p. 181) describes this strategy as a “ceremonial, symbolic strategy”, a strategy used by organisations to maintain or enhance their legitimacy. This strategy requires an organisation to adopt practices that are seemingly “consistent with social expectations while leaving the essential machinery of the organisation intact”. Its enactment is strictly “for its symbolic quality... to provide the appearance of action without the substance, [with the intention of fostering] a belief among constituents that the organization’s activities and ends are congruent with the expectations, values, and norms of constituents” (p. 182). Thus, this research will determine whether AGS-1010 issued with the aim of guiding audit practice in considering environmental matters in the audit of a financial report constitutes a legitimation strategy to ensure the accountancy profession maintain their state of legitimacy in current turbulent times.

3. The Research Method

This research is qualitative and adopts a naturalistic inquiry approach (Lincoln & Guba, 1985).

The research evidence was gathered by interviewing twenty-seven senior financial audit

practitioners in New Zealand. Of the participants, ten auditors were from the Big Four firms, eight auditors were from medium sized firms, seven were public sector auditors and two were government auditors. They are all chartered accountants and members of NZICA with access to AGS-1010. Audit partners and managers were selected for interviews because they are usually the ones who plan and manage audit clients. The interviews were conducted over a period of six months (June to December 2005); they were taped and then transcribed for data analysis.

Data analysis for this study was informed by a range of literature (Appleton, 1995; Burnard, 1991) but focussed specifically on the work of Miles and Huberman (1994). Data analysis for this study was directed by semi-structured interview questions and the research topic. NVivo 7, a computerised qualitative data analysis software programme was used to manage the data analysis process.

The next section reports the interview findings on the research issues. The confidentiality of the auditors was assured, hence when quoting the auditors, they are referred to by a numbering system, for example an audit partner is 'AP' and an audit manager is 'AM' and 1, 2 etc are code numbers for each of the individual interviewees.

4. The Research Findings

A discussion of the literature in section two led to the belief that legitimacy theory is the appropriate theoretical frame for this research study. This belief led to the questioning of whether AGS-1010 actually guides audit practice in the consideration of environmental matters in the audit of financial reports or is it merely a legitimation strategy to ensure the accountancy profession maintains its state of legitimacy in current turbulent times. Evidence for the first research issue is reported in two parts. The first part covers interview findings on auditors'

perceptions of *AGS-1010*; and its *actual* impact on current audit practice. The second part reports an analysis and evaluation *AGS-1010* to determine whether it has the *potential* to provide guidance to improve auditors' practice. The implications of the research findings are reported in section six. The next section covers interview findings on auditors' perception of *AGS-1010*.

4.1 Auditors' Perception of AGS-1010

The letters of introduction sent to auditors to invite them to participate in this research explicitly referred to *AGS-1010* as the basis for the study. However, a majority of the auditors admitted that they had not read *AGS-1010* prior to the interviews. Hence, they were unable to comment on it. In fact, some of the auditors were not even aware of its existence:

To be perfectly honest I haven't read it [AM 10].

I'd be completely honest and say I'm not aware of its existence [AM 11].

I didn't read it thoroughly. I am not an expert on environmental matters, so I do not know if *AGS-1010* gives sufficient guidance on how auditors should recognise environmental issues in the audit process [AP 2].

On the other hand, the auditors who did read *AGS-1010* considered it to be an introductory discussion paper; a very long document setting out some principles but not providing any detailed procedural steps:

Yes, the introduction of *AGS-1010* is an improvement, but really does it go far enough? I'm not sure [AP 2].

As a guideline, *AG-1010* did not give direction on methodology. It is very much a discussion paper in my mind [AM 27].

AGS-1010 sets out in principle the general approach to the audit of environmental matters. It is a very long document but it doesn't give enough detail, a bit like the valuation, it doesn't give you enough details on the steps to perform and ticking them off when you get your conclusion [AP 4].

The next section presents interview findings on auditors' perceptions of the *actual* impact of *AGS-1010* on audit practice.

4.2 Auditors' Perceptions of the Actual Impact of AGS-1010 on Audit Practice

A number of the auditors felt that *AGS-1010* has insignificant impact on audit practice. They commented on it being just an audit guideline, and thus not mandatory like an audit standard. None of the auditors interviewed seemed to pay serious attention to it and most indicated they were likely to ignore it unless they were auditing an entity obviously exposed to environmental risks. One auditor even considered *AGS-1010* as a "non-event" and another went further to say that auditors are simply not using *AGS-1010* or considering environmental matters in their audits:

You know it is an audit guideline as opposed to being an audit standard. As an audit standard, it supposedly becomes compulsory and then you start paying closer attention to it. It is a case of being aware it is there. When your client operates in an industry that specifically has an environmental issue, that's when it is taken out and sits in front of the desk, and you go right through it for the audit [AM 1].

I think it's a good starting point, raising your awareness that you should look beyond the straight numbers. But it is difficult. It's a guideline and you know it can't cover everything. You know it's not as weighty as the standards [AM 14].

AGS-1010 is pretty much something that's a non-event [APR 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 [AP 19].

The auditors who had been auditing environmental matters indicated they had been relying on international standards, which they considered to be of a higher standard and more stringent than *AGS-1010*:

The audit work I do requires me to comply with the *Local Government Act 2002* which is more prescriptive than *AGS-1010*. The calibre of work we already do is at a level higher than that proposed in *AGS-1010*. We haven't

really changed our approach and we tend to get guidance from our international offices which deal with the matter for numerous countries and numerous issues [AM 13].

I think we are already doing a number of those things stated in *AGS-1010* anyway. Our bar is higher [AP 15].

No. I don't think it has really changed the way we do our audits. It's because of the way our files are set up. We refer to international auditing standards and our audits are in line with overseas auditing standards which tend to be more stringent than what we have here in the first place, so I can't think of any thing which has really changed [AM 3].

Some auditors felt that *AGS-1010* is subject to different interpretations and although the underlying theory looks easy the practice is not:

However, it's all in the interpretation. It's quite interesting, when you read *AGS-1010* and when you apply it, they are two different things. The theory looks easy but the practice is not as easy. Often you have feedback that says someone knows the guidance statement, but really they don't have a clue what it involves. At the end of the day, when it comes to application, you know the guidance statement is subject to interpretation [AM 22].

One auditor felt that *AGS-1010* in its present form would not facilitate any move forward because it does not provide any assessment criteria:

AGS-1010 is very broad. Unless we have something specific to look at in order to give us some kind of assessment criteria, how can we move forward? [AP 26].

Many of the auditors seemed comforted that *AGS-1010* is something they can show to their clients to provide assurance that they have appropriate guidance on the audit consideration of environmental matters, regardless of whether *AGS-1010* is referred to or not:

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 [AP 5].

In view of the above interview findings, and particularly the indication that *AGS-1010* has insignificant impact on audit practice, *AGS-1010* was critically reviewed in order to make sense

of the reason(s) behind the interviewed auditors' perceptions. Findings from the review of *AGS-1010* are discussed next.

4.3 A critical review of AGS-1010

The aim of reviewing *AGS-1010* was to analyse its effectiveness and to evaluate its potential impact (based on what *AGS-1010* states) on current audit practice. However *AGS-1010* was reviewed more critically only *after* the auditors were interviewed. In so doing, the reasons for the interviewed auditors' perceptions that *AGS-1010* is not (actually) impacting current practice and the reasons for auditors not adhering to the requirements of *AGS-1010* were capable of being explored. The purpose of *AGS-1010* is discussed next, followed by a discussion of each of the identified issues that impact its effectiveness.

The purpose of AGS-1010

AGS-1010 was first promulgated in 2001 by ICANZ (renamed NZICA in 2005). ICANZ acknowledged in *AGS-1010* that environmental matters were becoming significant, and financial statement users were especially interested in its impact on the financial reports of those entities (*AGS-1010*, paragraph 1). Hence the stated purpose of *AGS-1010* was “to assist auditors in developing best practices in the application of auditing standards” in cases where environmental matters were significant to the financial report of the entity. It did not, however, establish any new basic principles or essential procedures (*AGS-1010*, paragraph 6). *AGS-1010* applied the business risk assessment model in audit planning and elaborated on specific factors and procedures that may be helpful in identifying environmental risk, defined as “the risk of material misstatements in the financial report due to environmental matters” (*AGS-1010*, paragraph 10d).

However, the review of *AGS-1010* carried out as part of this study revealed significant concerns on its ability to achieve its espoused purpose. The identified issues impacting the effectiveness of *AGS-1010* are (1) the exercise of professional judgement, (2) auditors' greater reliance on client management and other experts (3) the consideration of environmental laws and regulations and (4) the existence of incidences of "doublethink" and "doublespeak" (Orwell, 1949) (which are internal contradictions) in *AGS-1010*. These issues are being discussed in the following sections.

The exercise of professional judgement

Professional judgement is emphasised in *AGS-1010*, as evidenced by the number of references to it and by its relationship with other issues raised in *AGS-1010* itself. *AGS-1010* expects auditors to rely on professional judgement: (1) when identifying the existence of environmental matters for the entity (*AGS-1010*, paragraph 3); (2) when assessing its significance to warrant its consideration in the audit of financial reports (*AGS-1010*, paragraph 2); (3) when assessing its impact on the financial report of the entity (*AGS-1010*, paragraph 4), and when evaluating environmental risk (which is the risk of material misstatements in the financial report due to environmental matters (*AGS-1010*, paragraph 10d); all summed up as follows:

The extent to which any of the audit procedures described in the statement may be appropriate in a particular case requires the exercise of the auditor's [professional] judgement in the light of the requirements of the auditing standards and the circumstances of the entity (*AGS-1010*, paragraph 6).

In acknowledging that environmental matters may be complex, *AGS-1010* again emphasised the importance of exercising professional judgement:

The use of professional judgement may become even more important because of the number of difficulties with respect to the recognition and measurement of the consequences of environmental matters in the financial report (*AGS-1010*, paragraph 44).

Professional judgement determines what constitutes ‘sufficient appropriate audit evidence’ and such judgement is influenced by ‘audit materiality’ and business risk considerations. However, the relationship is not uni-directional because sufficient appropriate audit evidence significantly influences professional judgement that leads to giving the audit opinion (ICANZ, 1998, AS 500: Audit evidence). Therefore, exercising the professional judgement required by *AGS-1010* is challenging because existing audit standards do not provide guidance in exercising judgement or identify the characteristics of good judgement.

For all companies, there is a greater potential for omissions and non-disclosures of environmental matters in financial reports (rather than misstatements) because, by their nature, environmental matters are usually negative information which entities would rather omit from public disclosure. However, omissions and non-disclosures are much harder to search for than reported misstatements. Nonetheless, when identifying environmental risk factors, *AGS-1010* requires auditors to exercise professional judgement based on ‘technical skills’ which the profession acknowledges ‘the auditor cannot be expected to possess’ (*AGS-1010*, paragraph 14). Auditors are not expected to have a higher ‘level of knowledge with regard to environmental matters than that normally possessed by management or by environmental experts’ (*AGS-1010*, paragraph 18). This presents a major challenge for auditors. If *AGS-1010* acknowledges that auditors are not technically competent in environmental matters, how then will they exercise professional judgement when dealing with environmental matters?

The interviewed auditors who have audited environmental matters commented that the guidelines in *AGS-1010* are not prescriptive enough and are rather subjective. They also indicated that even though the theory embodied in *AGS-1010* appears easy to understand, its practical application is not. This is confirmed by a review of *AGS-1010*. Although *AGS-1010*

contained many examples of environmental matters, it lacked useful guidelines on appropriate audit procedures. The second issue that impacts the effective of *AGS-1010* is its suggestion for auditors to place greater reliance on management and other experts, and this is discussed next.

Greater reliance on management and other experts

AGS-1010 accepted that auditors do not have adequate technical and general knowledge to deal with environmental matters (*AGS-1010*, paragraph 14), and therefore it suggested that auditors rely more on management (*AGS-1010*, paragraph 13) and client internal documentation. In particular, *AGS-1010* indicates that:

To obtain a general understanding of relevant environmental laws and regulations, the auditor normally...enquires of management (including key officers for environmental matters) concerning the entity's policies and procedures regarding compliance with relevant environmental laws and regulations; enquires of management as to the environmental laws and regulations that may be expected to have a fundamental effect on the operations of the entity; discusses with management the policies or procedures adopted for identifying, evaluating and accounting for litigation, claims and assessments (*AGS- 1010*, paragraph 39).

However, such reliance on management and working in close proximity with the client raises potential concerns for auditor independence. The auditor is also directed in *AGS-1010* to rely on experts (lawyers, engineers and environmental experts), and in particular to use "the findings of environmental audits as appropriate audit evidence" (paragraph 51). In this matter, *AGS-1010* refers to *AS-606: Using the Work of Experts*. *AS-606*, paragraph 8 which indicates that the expert may be one engaged either by the entity or auditor, or employed by the entity. If the auditor relied on an expert engaged or employed by the entity the issue of auditor independence arises again.

Auditor independence is a significant issue in the *Code of Ethics: Independence in Assurance Engagements* (ICANZ, 2003) which states that auditors "must not allow prejudice or bias,

conflict of interest or influence of others to override objectivity” (p. 460, paragraph 33). However, as indicated by Bazerman, Loewenstein and Moore (2002), auditors are vulnerable to bias and have “a tendency to be influenced by clients’ or experts’ biases; and that audit judgements are perceived as strongly biased toward the interest of their clients” (p. 101). These authors also argue “that it takes very little ambiguity to produce biased judgement” (p. 101). Therefore, the guidance in *AGS-1010* for auditors to significantly rely on management and other experts (engaged or employed by the client) is somewhat problematic as it may lead to a compromise of auditor independence resulting from (1) “‘advocacy threat’, when the auditor’s dependency on the client [or expert] ‘subordinates’ [his/her] judgement to that of the client, or (2) ‘familiarity threat’, when the auditor becomes too sympathetic to the client’s interests” (ICANZ, 2003, *Code of Ethics: Independence in assurance engagements*, paragraph 33).

Cheney (2005) reported Chuck Landes, the director of auditing and attestation at the American Institute of Certified Public Accountants (AICPA) as saying that audits have become more complicated and auditors are increasingly relying on experts. Landes is concerned that practical guidance given to auditors relying on experts “may be out of date and weak, not recognising what’s happening in the work of using experts and specialists today” (Cheney, 2005, p. 14). He also raised several practical questions:

- (1) To be entrusted with an audit role, what qualifications does an expert need?
- (2) If an expert is hired by management, do auditors test their work as if it were management’s?
- (3) When relying on the work of expert and specialists, has the auditor exercised sufficient due diligence and applied appropriate scepticism?
- (4) When an expert is hired by an auditor, is that expert integral to the engagement team and does that expert comply with the audit firm’s quality control standards and procedures?
- (5) Has the audit firm defined the parameters that determine whether an expert is integral to the team?
- (6) To what extent do auditors as general practitioners take responsibility for the work of experts?

(7) Should expert opinions be reported separately in financial reports?

(Cheney, 2005, p. 14).

When auditors rely on the work of experts when auditing environmental matters, they too should concern themselves with these issues raised by Landes. However, a review of *AS-606: Using the work of an expert*, confirmed that *AS-606* does not provide any standard requirements on the above identified significant issues. Since *AGS-1010* expects auditors to refer to *AS-606* when they rely on the work of experts, and *AS-606* does not provide any guidelines covering the above seven questions, the boundary between the auditor's position and the expert's position may be somewhat blurred, especially when the auditor is ultimately responsible for the overall audit opinion even though the auditor relied on the work of the expert. Auditors are therefore unavoidably exposing themselves to legal liability, especially when the interviewed auditors indicated that 'they do not have the same expertise as experts and therefore *cannot* always challenge the expert's assumptions, criteria and methods' (emphasis added). The next section discusses the third issue impacting the effectiveness of *AGS-1010*.

The consideration of environmental laws and regulations

Often, it is incidences of non-compliance with environmental laws and regulations that lead to environmental matters which materially affect the financial report. Hence, when an auditor is able to detect such non-compliance, the auditor is potentially more able to determine the existence of environmental matters for the entity and assess the corresponding risk of misstatements, omissions or non-disclosures in financial reports. However, guidance given in *AGS-1010* on the consideration of environmental laws and regulations as a means of detecting environmental matters is not straightforward.

AS-208: Consideration of laws and regulations in an audit established the standard for New Zealand auditors' responsibility to consider laws and regulations when auditing a financial report. 'Laws and regulations' mean statutes, regulations and common law. As with all other audit standards and in terms of Rule 11 (paragraph 97) of the *Code of Ethics*, auditors are compelled to comply with *AS-208* for all audits. *AS-208* states that some laws and regulations are relevant to the entity and will therefore determine "the form or content of an entity's financial report or the amounts to be recorded or disclosures to be made in the financial report" (*AS-208*, paragraph 10). Therefore, there is an expectation that auditors understand those laws and regulations "that may have a fundamental impact on the operations of the entity and thus have financial consequences that are material to the financial report" (*AS-208*, paragraph 10). Hence, the auditor is required to plan and perform the audit with an attitude of professional scepticism and awareness "that the audit may reveal conditions or events that should lead to questioning whether an entity is complying with laws and regulations" (*AS-208*, paragraph 15). In so doing, the auditor has to recognise that non-compliance with laws and regulations could result in fines, litigation or material liabilities; could jeopardise the viability of the entity; could affect the ability of the entity to continue to operate as a going concern (*AS-208*, paragraph 25b) or could cause the entity to cease operations (*AS-208*, paragraph 26).

Non-compliance with legislation governing environmental protection is specifically mentioned in *AS-208*, paragraph 25c, highlighting its significance in the audit standard. In the context of laws and regulations covering environmental protection, *AS-208* also asserts that the auditor "must obtain a general understanding of the legal and regulatory framework applicable to the entity and the industry and how the entity is complying with that framework" (*AS-208*, paragraph 23) (emphasis added). The legal and regulatory framework relevant to the current New

Zealand study is the *Resource Management Act 1991 (RMA)*. Therefore, in accordance with *AS-208*, the auditor is expected to have sufficient understanding of the laws and regulations covered in the *RMA* when auditing assertions related to the recorded amount and disclosures of environmental matters (*AS-208*, paragraph 30). In particular, auditors are expected to plan and perform audit procedures to detect instances of non-compliances with the *RMA*. When non-compliances are detected, auditors then have to consider “whether the act of non-compliance itself is a matter to be reported in the audit report because it is material to the readers of the financial report” (*AS-208*, paragraph 39) even though the non-compliance does *not* have a direct potential financial consequence on the financial report. Audit reporting will also be affected by non-compliance which has a material effect on the financial report, but has not been properly accounted for or disclosed in the financial report.

Non-compliance with environmental laws and regulations is a significant example of the existence of environmental risk exposure in relation to environmental matters. Yet a review of *AGS-1010* pointed to delimitation in auditors’ responsibilities as outlined in *AS-208*, since *AGS-1010* appeared to guide auditors towards a different level of responsibility when dealing with environmental laws and regulations. Although *AGS-1010* asserted that “auditors should recognise that non-compliance by the entity with laws and regulations may materially affect the financial report”, it accepted that a breach of environmental laws and regulations is a legal determination, *beyond* the auditor’s professional competence (*AGS-1010*, paragraph 14). Besides, even though consequences of violating environmental laws and regulations were given as examples of environmental matters with implications for environmental risk (*AGS-1010*, paragraph 10b (ii)), *AGS-1010* did *not* require auditors to “plan the audit to detect possible breaches of environmental laws and regulations” (*AGS-1010*, paragraph 12). Therefore, the

guideline in *AGS-1010* contradicts and delimits the requirements of *AS-208* in so far as environmental matters were concerned. This is not the only contradiction found in *AGS-1010*. Other contradictions point to the fourth and most significant issue that impacts the effectiveness of *AGS-1010* - the existence of 'doublethink' and 'doublespeak', examined next.

'Doublethink' and 'doublespeak' in AGS-1010

The notions of 'doublethink' and 'doublespeak' were first drawn from Orwell's (1949) literary classic 'Nineteen Eighty-Four'. 'Doublethink' means the power of holding two contradictory beliefs in one's mind simultaneously and accepting them both (El-Sawad, Arnold, & Cohen, 2004; Robb, 2003a). Lutz (1983) further explains:

It is to know and not to know, to be conscious of complete truthfulness while telling carefully constructed lies, to hold simultaneously two opinions which cancelled out, knowing them to be contradictory and believing in both of them (Lutz, 1983, p. 26).

'Doublethink' leads to 'doublespeak'. 'Doublespeak' is the ability to speak or write contradictory ideas without the writer or speaker being aware of the contradiction (El-Sawad et al., 2004; Robb, 2003a, 2003b; Styles, 1984).

'Doublespeak' is language which pretends to communicate but really does not. It is language which makes the bad seem good, something negative appear positive...It is language which avoids or shifts responsibility; language which is at variance with its real and its purported meaning; language which conceals or prevents thought. 'Doublespeak' is language which does not extend thought but limits it (Lutz, 1988/1989, p. 26).

Authors like El-Sawad et al. (2004), and Robb (2003a; Robb, 2003b) have already applied the idea of 'double-speak' in accounting contexts, hence the same idea is also being explored here. There is evidence to suggest that 'doublethink' and 'doublespeak' exist in *AGS-1010*. One example lies in the consideration of environmental laws and regulations. Detecting non-compliances with environmental laws and regulations is fundamental to determining the

likelihood of any environmental matters existing for the entity and, consequentially, the potential for environmental risks in misstatements, omissions or non-disclosures in financial reporting. At one point, *AGS-1010* noted the need for auditors to be alert to such issues:

An audit carried out in accordance with auditing standards is planned and performed with an attitude of professional scepticism recognising that the audit may reveal conditions or events that should lead to questioning whether the entity is complying with relevant environmental laws and regulations in so far as non-compliance could result in a material misstatement of the financial report (*AGS-1010*, paragraph 37).

Yet, in what appeared to be a case of ‘doublespeak’, *AGS-1010* assumed that:

... with respect to the entity’s compliance with environment laws and regulations, the auditor’s purpose is not to plan the audit to detect possible breaches of environmental laws and regulations... (*AGS-1010*, paragraph 12).

The language used has implications for avoiding or shifting responsibility for detecting environmental matters and allowed *AGS-1010* to promote two apparently contradictory ‘truths’.

Regarding auditors’ reliance on environmental experts, *AGS-1010*, paragraph 14 indicated that auditors cannot be expected to possess the technical skills of environmental experts. Thus they are guided to seek technical advice from experts. However,

...as the environmental area is an emerging speciality, the expert’s professional competence may be more difficult to assess...In this situation it may be necessary for the auditor to give particular consideration to the experience and reputation of the environmental expert (*AGS-1010*, paragraph 14).

The language here seemed to create confusion. If an auditor does not have the technical competence of the expert, how then is s/he expected to assess the expert’s professional competence? Besides, what qualifications does an expert need to be entrusted with a role in an audit?

And further,

There are few authoritative accounting standards that explicitly address the recognition, measurement and disclosure of the consequences for the financial report arising from environmental matters. However, existing accounting standards generally do provide appropriate general considerations that also apply to the recognition, measurement and disclosure of environmental matters in a financial report (*AS-1010*, paragraph 17).

But:

The use of professional judgement may become even more important because of a number of difficulties with respect to the recognition and measurement of the consequences of environmental matters in the financial report (*AGS-1010*, paragraph 44).

AGS-1010, paragraph 17 stated that existing accounting standards do provide appropriate general guidance on the accounting treatment and disclosures of environmental matters in a financial report, but paragraph 44 indicated that there are special difficulties with environmental matters that require even more professional judgement. Thus, are environmental matters adequately covered by existing accounting standards?

Yet another issue was the profession's acknowledgement that the accounting standards do not explicitly refer to environmental matters, hence recognising the difficulties in the reporting of environmental matters. However, instead of providing more explicit guidance on the reporting of environmental matters, *AGS-1010* placed an expectation on auditors to use greater professional judgement. As discussed previously, how does one exercise professional judgement in an area where insufficient guidance is given? Does this mean that auditors are allowed a different standard of responsibility because of complexities in the reporting of environmental matters?

The examination of *AGS-1010* presented here pointed to significant gaps in the guidance it provided. Despite its stated objective to provide guidance on best practices for the consideration of environmental matters in the audit of financial statements, it appeared to delimit auditors' responsibilities for environmental matters. A review *AGS-1010* confirmed that generally, *AGS-*

1010 is a lengthy document, in parts confusing, complicated and contradictory to the very audit standards it seeks to assist auditors in applying in their attestations on environmental matters and this has been alerted to by the interviewed auditors. A major weakness of this guideline is its failure to specify an auditor's planning responsibility. It also remains unclear whether an auditor is expected to plan an audit that provides reasonable assurance for detecting material misstatements arising from client violations of relevant environmental legislation. The next section summarizes the main research findings and discusses their implication for the research question.

5. Discussions and Concluding Remarks

The research findings indicate that auditors considered *AGS-1010* as a very long introductory discussion document that lacks detailed procedural steps; and auditors generally do not take it seriously. Hence it is not surprising that a majority of the auditors approached for the research interviews admit that they have not read *AGS-1010* prior to the interviews or were not even aware of its existence.

At least 25% of the interviewed auditors saw *AGS-1010* as something which gives the impression that a professional guidance on the audit consideration of environmental matters exist. Hence, the interview evidence supports Humphrey, Moizer and Turley's (1993) observation that the significance of audit standards and guidance statements is in the power of the image they create in asserting auditors' public interest commitments. The text of the guideline seems to also give external visibility to auditors' expertise and rigorous practices and the impression of a solution to the problem (Power, 1999).

The interviewed auditors commented that the application of *AGS-1010* is subject to different interpretations. Woolf (1994) and Power (1999) also identify similar difficulties in interpreting audit standards, even where they “did look practical enough to look like guidance to outsiders” (Power, 1999, p. 25).

Overall, more than 75% of the interviewed auditors perceive that *AGS-1010* has very insignificant impact on audit practice; a non-event in practical application; and that auditors are simply not referring to *AGS-1010* and not considering environmental matters in their audits. The general perception of the interviewed auditors is that *AGS-1010* in its present form would not facilitate any move forward in improving and further developing current practice to better meet the espoused aims of *AGS-1010*. A review of *AGS-1010* confirms the interviewed auditors’ general perceptions and provides explanations for the interviewed auditors’ perceptions.

First, *AGS-1010* does not establish any new basic principles or essential procedures (*AGS-1010*, paragraph 6). Therefore, as Humphrey and Moizer (1990) explain, audit standards and guidance statements are mere articulations of existing audit practice driven by professional self-interest. Power (1999) also made similar observations about the audit guidance on fraud when it was first issued. He criticised the audit guidance as a mere codification of common knowledge which, despite the rhetoric text, meant ‘business as usual’ for the auditors. Therefore, auditors are effectively directed to treat environmental matters no differently from any other audit issue, and it is business as usual.

Second, *AGS-1010* emphasises the exercise of professional judgement for every aspect of the audit consideration of environmental matters (*AGS-1010*, paragraphs 2, 3 and 4). However, professional judgement has many attributes, making the concept of professional judgement

complex (Morrill, 1996). *AGS-1010* requires auditors to exercise professional judgement based on ‘technical skills’, which the profession acknowledges ‘the auditor cannot be expected to possess’ (*AGS-1010*, paragraph 14). How could auditors exercise professional judgment when dealing with environmental matters, notwithstanding that professional judgement may be influenced by those attributes and factors identified in the literature?

Third, *AGS-1010* accepts the assessing of business risk in audit planning but highlights that auditors do not have adequate technical and general knowledge to deal with environmental matters (*AGS-1010*, paragraph 14). Therefore it suggests that auditors rely more on management (*AGS-1010*, paragraph 13); client internal documentation and experts engaged or employed by the entity. This raises potential concerns for auditor independence and ‘managerialistic orientations’ (Gray & Bebbington, 2000) which is problematic as it may lead to the auditor subordinating the auditor’s judgement to that of management or the expert; or the auditor may be too sympathetic to the client’s interests” (ICANZ, 2003, *Code of Ethics: Independence in assurance engagements*, paragraph 33). Since *AS-606: Using the work of an expert*, does not guide auditors in how they should manage the experts; this may lead to a blurring of the boundary between the auditor’s position and the expert’s position.

Fourth, *AGS-1010* requires auditors to comply with *AS-208: Consideration of laws and regulations* in an audit which expects auditors to understand those laws and regulations “that may have a fundamental impact on the operations of the entity and thus have financial consequences that are material to the financial report” (*AS-208*, paragraph 10). Hence, auditors’ understanding of environmental laws and regulation should enable them to recognise any non-compliance with environmental laws and regulations. Yet, *AGS-1010* seems to delimit auditors’ responsibilities required in *AS-208*, and appears to be guiding auditors towards a different level

of responsibility when dealing with environmental laws and regulations. Similarly, when van Peurseem, Locke and Harnisch (2005) examined the audit standard on 'Going Concern', they too found that the audit standard do not seem to impose any additional requirement on the auditor.

Fifth, discussions which highlight a number of incidences of 'doublethink' (El-Sawad et al., 2004; Robb, 2003a) and 'doublespeak' (El-Sawad et al., 2004; Robb, 2003a, 2003b; Styles, 1984) in *AGS-1010* strongly suggests that the language in *AGS-1010* was intended to create confusion by promoting two apparently contradictory 'truths' which have implications for avoiding or shifting auditors responsibility for detecting environmental matters. Hence Pong and Whittington's (1994) criticism that audit standard and guidelines do not attempt to re-think or extend the scope and technique of the audit. Rather, they attempt to consolidate the status quo and also to limit the obligations and responsibilities of the auditor.

Therefore, the review of *AGS-1010* points to significant gaps in the guidance it provides. Despite its espoused purpose in providing guidance on best practices for the consideration of environmental matters in the audit of financial statements, it appears to delimit auditors' responsibilities for this task. In summary, it can be said that *AGS-1010* is a lengthy document, in many parts confusing, complicated and contradictory to the very audit standards it seeks to assist auditors to apply to their attestations on environmental matters. This confirms van Peurseem et al.'s (2005) observation that although greater volume may give the appearance of improving professional benchmarks, actually volume is not necessarily commensurate with greater quality or a more forceful mandate. Another major weakness of this guideline is its failure to specify an auditor's planning responsibility. It also remains unclear whether an auditor is expected to plan an audit that provides reasonable assurance for detecting material misstatements, omissions or distortions arising from client violations of relevant environmental legislation.

Overall it appears that the interviewed auditors are justified in saying that *AGS-1010*, in its present form, is unlikely to impact on audit practice and does not facilitate the development and improvement of current practice. Nonetheless, as Power (1999) indicated, issuing an audit guidance statement is a strategy for managing new demands in auditing. The next section discusses the implications of the evidence from this study in support of *AGS-1010* as a symbolic ‘ceremonial conformity’ legitimisation strategy for managing new demands in the consideration of environmental matters in the audit of a financial report.

AGS-1010: A symbolic ‘ceremonial conformity’ legitimisation strategy

This strategy requires an organisation to adopt practices that are seemingly “consistent with social expectations while leaving the essential machinery of the organisation intact” (Ashforth & Gibbs, 1990, p. 181). Commentators, authors (Bebbington & Gray, 1992; Gallhofer & Haslam, 1997; Medley, 1997; Rezaee, Szendi, & Aggarwal, 1995; Steadman, Green, & Zimmerer, 1995); and particularly the more ‘visible’ public criticism did lead to some disquiet in the arena which the accountancy profession operates and in 1998 (amidst the Enron debacle) IFAC released *IAPS-1010*.

In more recent times, criticisms of the audit profession have intensified as a result of media and public scrutiny (Chandler, 1999) of a number of high profile corporate failures such as Enron, Worldcom, Parmalat and Health International Holdings (HIH) Insurance (Mak et al., 2005). Hence, prevailing environmental crises and audit failures have resulted in the auditing profession facing a crisis of investor confidence in financial reporting and auditing (Byrnes, McNamee, Brady, Lavelle, & Palmeri, 2002; Thomas, 2003; Weirich & Rouse, 2003). Self-regulation has also been scrutinised (Kinney Jr, 2005). Therefore, a legitimacy gap is perceived to exist and the audit profession could lose its legitimacy if the continuance of previous practices is not sufficient

to maintain legitimacy, even if the performance related to that practice is maintained or even improved (Reynolds & Mathews, 1999).

It was in the midst of high profile corporate failures, environmental disasters and criticisms of the audit profession that in 1998 the *International Auditing Practice Statement (IAPS) 1010: The consideration of environmental matters in the audit of financial statements* was issued and later promulgated in New Zealand in 2001 as *AGS-1010*. This New Zealand guidance statement was “consistent in all material respects” with *IAPS-1010* (ICANZ, 2001, Appendix 1). From the events that took place, the issuing of *IAPS-1010* in 1998 could be seen as a legitimating strategy to close the legitimacy gap and to ensure the continued perceived legitimacy of the audit profession (Dowling & Pfeffer, 1975). The issuing of *AGS-1010* was also timely in detracting focus from the huge impact the high profile accounting debacles had on auditors and accountants’ role in accountability, in protecting the public interest (Pasewark et al., 1995); and the monopoly of self-regulation (Baker, 1977). Lindblom (1993) considers this as a *symbolic* activity which serves to deflect attention from the main issue of concern (accounting failure) by portraying the audit profession’s activities in environmental accountability as compatible with societal norms and values (Ashforth & Gibbs, 1990; Pfeffer, 1981).

Findings from the current research indicate that the issuance of *AGS-1010* did not result in any significant change in audit practice. Rather, they show that the interviewed auditors see the main value of *AGS-1010* in the impression it gives of professional guidance, which gains clients’ confidence that auditors are considering environmental matters in their audits of financial reports. This research finding also provides further support for Humphrey and Moizer’s (1990) observation that official audit guidance plays little role in everyday audit work, rather it gives the *appearance* of addressing the issue and providing comfort that it is being attended to, even

though the status quo is maintained (Fogarty, Heian, & Knutson, 1991). This has a role in *creating* an illusion which guide cognition and legitimize acceptance through the business community (Mills & Bettner, 1992; Pentland, 1993).

Therefore, the research findings confirm that the issuing of *AGS-1010* can be interpreted as a ceremonial, symbolic legitimation strategy used by the audit profession to maintain or enhance their legitimacy, with perhaps the intention of *fostering* the belief that the auditing profession's activities and ends are congruent with the expectations, values, and norms of constituents (Richardson & Dowling, 1986). However further research is required to investigate auditors' perception of what steps may be taken to improve and further develop current practice in the consideration of environmental matters in the audit of environmental matters in an effort to meet the espoused purpose of *AGS-1010*. Another research topic arising from this study is: how do or how should auditors manage their relationship with experts and management in view of the questions raised by Cheney (2005).

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