10

Auditing

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Overview

There are numerous reasons for companies[2] to undergo an audit. Watts and Zimmerman (1983: 614) famously characterise it as a mechanism to enable managers to add credibility to their position as stewards or to confirm the reliability of information issued to investors. Others argue that audit is not market-driven: companies undergo audit when it suits their needs – for instance as a means of avoiding stringent regulation of their financial reports or to obtain professional advice. Historical evidence provides an opportunity to study the adoption of audit in a variety of different legal and economic environments.

Closely linked with this is the question of the role of audit within corporate governance. Is the auditor's primary responsibility that of defender of the shareholders' interests or as advisor to the directors; are the two roles complementary or competing? This has implications for audit objectives – should the audit be primarily directed at statement verification, or fraud detection, or at preventing error and misstatement? The desired audit objective also has an impact on audit technique – the relative importance of testing the substance of transactions versus the testing of accounting controls, the use of sampling and the emphasis on risk in planning audit work. These are issues which began to be debated during the nineteenth century as investors took an increasing interest in financial statements and auditors' reports. These same issues continue to be controversial.

In the late-twentieth century, the audit of public sector bodies, including local and national government, education authorities and the health service, was centralised and intensified with the aim of economising on resources and promoting efficiency and effectiveness. Commentators suggested that there was an inherent tension between a public sector ethic of delivering services and an audit approach derived from private enterprise. The history of public sector audit provides a useful insight into the extent of the changes wrought in the 1980s and the factors behind those changes.

Auditing practices are converging worldwide because of the demands of globalised markets. This convergence and the economic changes in Eastern Europe, China and other emerging economies have led to the development of professional accounting bodies which are heavily influenced by UK/US models. Growing research interest in aspects of the development of auditing in different environments, especially those that do not follow the Anglo-American pattern, offers a critical perspective on the forces underlying change and the prospects for success.

In addition, the audit 'explosion' has seen approaches, technologies and skills honed in, or based on, the audit of financial statements being applied in many

other contexts. The growth of 'assurance services' provides audit firms with new income streams and researchers with a potentially rich source of material.

Introduction

A recurring theme in academic accounting journals of the late-twentieth/early twenty-first centuries is that of a major expansion in writing about accounting history.[3] Work on the history of audit is part of that expansion, as is evident from the dates of the majority of the pieces cited below. This chapter will attempt to identify the major themes and controversies that have emerged in writing about audit history during this busy period, and suggest future directions that research might take. The view given here is inevitably a partial one; what follows is intended to help stimulate further discussion and research activity.

The chapter does not offer a detailed chronological study of audit – although key events are briefly outlined below – nor does it attempt to be comprehensive in its coverage of relevant themes. It begins by reviewing work on the reasons for the growth of both the audit function and the accounting profession and, in particular, the links between audit and the development of corporate governance. The chapter gives an overview of literature on the history of audit objectives and audit techniques, with particular attention to the continuing argument about auditors' responsibility for the detection of fraud. Much of the above (like most historical writing about audit) has dealt with the private sector and the UK. The later sections of the chapter address the history of audit in the public and non-profit sectors and the research on audit outside of the Anglo-American sphere.

Before 'The Roaring Nineties' (Fleischman and Radcliffe 2005), when accounting history was a field that attracted less academic attention, a number of publications nevertheless studied topics in audit history.[4] Examples include Moyer's (1951) concern with the diffusion of audit techniques, Brown (1962) with changes in audit objectives and practices, Jones (1981) with the role of audit in the growth of the accounting profession and Watts and Zimmerman (1983) with audit as evidence of the validity of agency theory. A common feature is that they were inspired by what Moyer (1951: 8) calls 'auditing as we have come to know it' – that is, the professional audit of limited companies and the associated arguments about what shareholders, managers and a variety of other stakeholders expect the auditor to do. These are all themes which subsequently recur in various forms in writing about audit – indeed they are among the most popular topics in subsequent historical writing.

Miller and Napier (1993: 631), writing about the 'genealogies of calculation', warn against the '*a priori* limiting of the field of study to accounting as it currently exists'. In some of the early papers cited above, the *a priori* temptation is strongly apparent – that of framing audit as having always been, or always having tried to be, the activity of that name in the late-twentieth/early twenty-first centuries. The papers by Moyer and Brown, for instance, are both about the development of audit, and both are written from the perspective that history is valuable because it enables modern practitioners to chart the course of future events from what has happened in the past. Moyer (1951: 3) hopes that a study of early developments

‘may lead to a better understanding of what is happening in the present and offer clues to what future trends may be’. Brown (1962: 703) is more confident in regarding auditing as following a predictable trajectory: ‘In most professions it is rather difficult to predict the future, but there are some significant trends revealed by the history of auditing which should carry forward into succeeding years’.

When Humphrey *et al*. entitled their 1992 paper ‘The audit expectations gap – plus ca change, plus c’est la meme chose?’ and Chandler and Edwards (1996) called theirs ‘Recurring issues in auditing: back to the future?’ they were arguably taking the same perspective as Brown and Moyer, with the difference that they saw unsatisfactory stasis whereas the earlier writers had looked towards a future of improvement. This is not to deny that there are points of comparison between audit practice in the nineteenth, twentieth and twenty-first centuries – but it is to suggest that historians should be prepared to recognise differences as well as similarities. It can be argued that there is a need to see audit in the nineteenth century as other than the twenty-first, and attend to ‘the different meanings that have been attached to practices at different moments in time’ (Miller and Napier 1993: 632). It also carries with it the possibility that historians will have a better understanding of accounting and auditing change if they stop looking for what Miller and Napier call ‘immobile forms that appear to move without difficulty across time and space’ and attend to ‘the piecemeal fashion in which … technologies have been invented and assembled’ (ibid.). The history of audit in times and places other than the UK and the end of the nineteenth century deserves exploration in pursuit of that possibility.

Audit chronology

There is evidence for auditing, in the sense of a review of accounts being rendered, from Babylonian times onwards (Edwards 1989: 23-31). In England, manorial and government accounts were the subject of a highly-developed system of public audits (see below), and audit was rapidly introduced to joint-stock companies (as discussed below for the East India Company in the seventeenth century). The late eighteenth and nineteenth centuries saw the growth of the joint-stock company – most importantly at first the formation of canal, utility and railway companies. The Acts of Parliament instituting these often called for shareholder audits (Matthews *et al*. 1998: 35) but, as discussed below, there was a steady transition to professional audit. Mid-nineteenth century legislation first made the audit of joint-stock companies compulsory (Joint Stock Companies Act, 1844) then, after the introduction of limited liability, put both reporting and audit on a voluntary basis (Joint Stock Companies Act, 1856) (Edwards 2019: 79-80). It was not until 1900 that audit was again mandatory for the generality of joint-stock companies, and only with the 1947 Companies Act that companies were required to appoint a professionally qualified accountant as auditor. Despite this apparently slow growth in regulatory requirements, demand for professional audits became a crucial factor in the growth of accountants’ occupational groupings in Great Britain (see below).

Reasons why companies undergo audit

One of the most frequently-cited pieces of work on the origins of audit – Watts and Zimmerman (1983) – puts forward the thesis that audit arose as a solution to the problem created by the separation of ownership and control. They cite Jensen and Meckling's identification of audit as 'one type of monitoring activity that increases the value of the firm' (Watts and Zimmerman 1983: 613), that will therefore be welcomed by both main parties – principals and agents, here owners and managers. Owners want the audit because it confirms the reliability of information being provided to them; managers because it confirms their trustworthiness as stewards. In support of their argument, Watts and Zimmerman (ibid.: 614) point to the existence of audit as 'part of the efficient technology for organising firms' which existed from the fourteenth century onwards, as firms' legal status altered from merchant guilds to joint stock companies to limited liability companies (ibid.: 618-26). It is an explanation which suggests that legal and regulatory interventions are unnecessary because market demand will elicit a supply of suitably independent auditors at a fair price.

Their argument has substantial advantages since it explains the persistence of the activity over a long period – auditors' faculty of being 'invulnerable to their own failure' (Power 1994a: 7; see also Chapter 20): whatever the shortcomings of the individual audit, the provision of the service remains desirable because it reduces the risks inherent in agency relationships. It also suggests that there is no need for 'government fiat' (Watts and Zimmerman 1983: 613) in the form of legislation, or for professional regulation. Audit services, Watts and Zimmerman argue, alter in response to market conditions. The transition from shareholder to professional auditors in the mid-nineteenth century, they contend, is an example of the work of market forces, due to an expansion either in the demand for audit (because of the increase in the number of limited companies) or in the supply of auditors (because accounting firms had grown in response to a new demand for insolvency services). Audit anticipated legislative provisions; it did not follow them. The agency model therefore enjoys considerable popularity – see for instance Lee (1993: 23), Nikkinen and Petri (2004) on audit fees and agency theory, or the Institute of Chartered Accountants in England and Wales' (ICAEW 2005: 8) *Audit Quality: Agency Theory and the Role of Audit*, which summarises audit history by stating that 'the modern audit function has evolved over centuries, apparently in response to agency issues'.

A number of objections have been raised to the agency theorists' explanation for the rise of audit, which suggest that the motives for audit are more complex than Watts and Zimmerman believe, and that audit needs to be understood as an activity changing within, and shaping, a changing environment, rather than as 'static and purely technocratic' (Hopwood 1977: 277).

One major objection relates to the terms of the contracts under which agency relations operate. Watts and Zimmerman (1983) argue that the need to maintain a reputation for acting independently was, and remains, a crucial asset for auditors who wish to protect their credibility and thus their value in the market. Armstrong (1991: 1), in his 'attempt to re-think the theory of agency', points out that the agency theoretical explanation of audit 'immediately raises the question of how the independence of third party monitors [auditors] is to be guaranteed, particularly

when these are normally engaged by agents [management] rather than principals [shareholders]' (ibid.: 12). In Armstrong's words (ibid.: 13) 'monitors are agents too'. Auditors' agency duties concern oversight and review rather than control of resources, but their function for owners is as much a delegated one as that of managers. If 'both managers and monitors are agents … the analysis of how independence in monitors might be secured leads to an infinite regress within the present paradigm of agency theory' (ibid.). Although the auditing profession is likely to benefit from being viewed as independent, it may, he points out, be in the interests of individual auditors *not* to act independently, and it is possible for the auditor to decouple reputation from behaviour (ibid.). If there is no foundation to Watts and Zimmerman's assumption that individual auditors will see themselves as contractually obliged to act independently, agency theory is in trouble. Armstrong proposes instead a 'radical agency theory' which bases relationships between agents and principals not on contract but on 'seeking and allocating trust' (ibid.: 20) – and hence on the mechanisms for creating and identifying a *reputation* for trustworthiness. Armstrong's account touches on a number of issues in audit history: the role of the auditor within corporate governance, the continuing debate about auditor independence, and the increasing importance of audit as a management tool within organizations.

The paradox of Watts and Zimmerman's paper is that, in offering a *history* of audit, it ignores the possibility of historical change. They trace the recurrence of audit from the fourteenth century to the beginning of the twentieth, in what they describe as 'early English business corporations' (Watts and Zimmerman 1983: 615) and subsequently in joint-stock and limited companies. Underlying their history is the assumption that the members and the managers of guilds, merchant adventurers and railway companies all had the same expectations and incentives, and thus that both the agency relationship and the audit passed fundamentally unchanged from the middle ages to the end of Queen Victoria's reign. Napier (2006: 449) criticises this approach when he refers to accounting research that treats the subject as 'a phenomenon of the present' and the textbooks that

> discuss different aspects of the … discipline … in terms of the recognised rules and practices of the day, with little or no suggestion that these might have been different at some earlier time (and therefore by implication might be different again in the future).

Mennicken (2006: 22), writing about the introduction of Anglo-American auditing techniques to post-Soviet Russia, describes the import of auditing textbooks which treat audit as an 'a-contextual, universal and homogeneous activity' that can fit seamlessly into any setting. This description could equally be applied to Watts and Zimmerman's conception of audit.

A variety of writers challenge Watts and Zimmerman from different perspectives such as the context in which audit took place and the possibility of understanding audit as a product of political, legal and social as well as economic factors. Some of this work is discussed in the following sections of the chapter, looking first at audit and corporate governance.

Audit and corporate governance

An analysis of the function of audit in corporate governance needs to assign the auditor a role within the governance structure: is the audit conducted primarily for the benefit of shareholders or for that of managers, or can the auditor hold the ring between the two? Agency theory suggests that the last is the case – the manager gains assured reputation and the shareholder has the value of information confirmed. But historical studies have suggested that audit can be understood as a service principally to *one* of these groups, and that the demand for audit comes from this understanding among contemporaries.

An early instance is given in Bryer's study (2000) of the East India Company at the beginning of the seventeenth century. He charts the dissatisfaction of the 'generality' of investors with the small, elite mercantile group of governors. The resulting 'revolution' in the Company 'abolished its feudal directorate and replaced them by modern managers, specialised wage workers accountable to a social capital' (ibid.: 328). As the number of investors increased, 'the generality' demanded more frequent and accurate information about the performance of their capital. The audit was part of a seizure of power by the investors, because it was part of their campaign to be given more frequent and reliable information than they believed the Company was prepared to volunteer to them. The nature of the audit and the character of the auditor's position also changed from one of ex ante approval of expenditure by unpaid members taken from the generality of the shareholders to a verification of the financial reports after the event undertaken by a paid individual who no longer needed to be a shareholder (Dobija 2018).

The Lancashire cotton mills, the 'Oldham Limiteds' of the late-nineteenth century, operating on the principle of one shareholder, one vote, had widely dispersed share ownerships, amateur shareholder auditors and intense investor involvement in their governance. Quarterly cash accounts with detailed information about performance were discussed at general meetings and reported in local newspapers. Toms (2002) treats this as part of the continuing process of socialisation of capital which Bryer discerns in the East India Company – except that, in the Oldhams, socialisation is conducted via co-operation rather than capitalism. Toms (2002: 81) describes the amateur audit, together with cash-based accounting, as 'imposed' by shareholders as a means of carrying out socialisation. 'Socialized capital … demanded accurate accounting information (and got it) … through cash based accounting and amateur audit'. After the cotton slump, at the end of the century, financial cliques bought out the local shareholders, building up large blocks of investment. It was at this stage that amateurs were replaced by professional auditors. For Toms, the change of ownership marks a turning-point in the use of audit in these companies. The new owners amended the companies' articles from 'one shareholder, one vote' to 'one share, one vote' effectively giving themselves block votes, and excluded mill managers from boards of directors. These owners could monitor performance via financial controls such as the review of bank balances and the authorisation of expenditure; unlike the former dispersed owners, they placed 'little reliance … on the publication or auditing of financial statements' (ibid.: 77).

A number of historians, like Toms, contribute to a view of nineteenth-century audit as a weak discipline on directors. Jones (1995) looks at the recommendations by witnesses to various committees on company law between the 1830s and the 1890s in Great Britain to assess the level of support for mandatory auditing. He concludes that witnesses, in general, favoured mandatory audit over compulsory financial reporting as a means of control. Jones (1995: 181) suggests that this preference existed despite the fact that the scope of audit was 'quite restricted' and 'there was little sense of the auditor as an independent third party'. Audit was preferable to a requirement for financial reports because the latter entailed the disclosure of information to competitors; thus there was a 'trade-off' between audit and reporting (ibid.: 182).[5] A similar point is made by Collier (1996) about the rise of the audit committee in the US following the McKesson & Robbins fraud of the late 1930s when he suggests that, both there and later in the UK, this innovation occurred less because of audit committees' effectiveness than as 'an attempt to avoid legislative solutions to deficiencies in corporate governance' (ibid.: 135).

The development of audit is inextricably linked to the growth of the accounting – and the auditing – profession.[6] Self-promotion as skilled, reliable and independent auditors was crucial to the profession in establishing its jurisdiction over an area that was contested between accountants, lawyers, and amateur shareholder auditors.[7] Matthews *et al*. (1998: 35) stress the importance of auditing in Britain – 'the basis of the accountancy profession's future growth' from the early nineteenth century onwards. They emphasise that, although insolvency was a major activity in the early years of accounting firms' formation, it was audit that took firms into the 'upper echelons' (ibid.: 36). Audit was remarkably effective at giving some accounting firms a leading position that they maintained for more than a century. The table of 'top auditors 1891-1995' contained in Matthews *et al*. (1998: 46-7) shows that four of the five leading audit firms in 1995 (Coopers & Lybrand, KPMG, Price Waterhouse, Ernst & Young) had predecessors in the top ten in 1891.

Maltby (1999) explores the extent to which the nineteenth century auditing profession depicted itself as the ally of directors and large shareholders, *against* small (and feckless) speculators. This promoted the profession's strategy for establishing its area of jurisdiction, as did the view of informative financial reports as unnecessary and possibly damaging – the directors knew what was going on, and would communicate to shareholders that which was in the company's and their own interests to disclose. The professional accountant could portray himself as a 'sort of guide, philosopher and friend' as one contributor to *The Accountant* put it (quoted ibid.: 43), providing expert knowledge for directors, rather than as the representative of the interests of the mass of shareholders. Popp (2000) confirms this view of the auditor-director relationship in the audit reports sent to Mintons Ltd between 1876 and 1900. The reports 'did focus on the veracity of … the financial statements' but 'very frequently far exceeded this brief and contained detailed discussion of and recommendations concerning production strategy' (ibid.: 357), apparently with the aim of improving the company's profitability in a period of severe financial difficulties. Popp (ibid.) concludes that the reports 'were used as a vehicle for expanding the role to be played by auditors'.

The evolution of the concept of auditor independence in the US context is examined by Nouri and Lombardi (2009) through their analysis of the various editions of a leading textbook, Montgomery's *Auditing*, from 1905 through to the late twentieth century. They reveal that although the notion of objectivity as a 'state of mind' was recognised and valued from the first, the word 'independence' made its first appearance in the 1934 edition. It is not surprising that given the growth in regulations over auditor independence and ethical matters, later editions contain much more material and discussion on these issues.

A similar approach is taken by Roberts (2010) who looks at the treatment of independence and other ethical issues in *The Journal of Accountancy* during the 1930s – a particularly turbulent time for the American profession. The decade started with the profession contending with the aftermath of the 1929 Wall Street Crash and ended with the more profession-centric McKesson & Robbins scandal. Roberts also notes that matters of independence and ethics were considered to be a 'state of mind' – or principles-based approach – at the start of the 1930s. Over the next decade the arguments used in editorials and elsewhere in the *Journal* appear designed to deflect attention and the risk of greater government regulation away from the profession and on to its clients by prescribing a more rules-based approach.

Napier (1998: 117) draws on the changing role of the auditor when discussing the contemporary arguments for and against limiting auditors' liability for negligence. He traces a movement in the nineteenth century from a view of the company as 'a collectivity model of the interests of shareholders, with directors and auditors being elected from the mass of shareholders' (ibid.: 117) to a 'business company' where 'the auditor "intermediates" between shareholders and directors *whose interests are not necessarily aligned with those of the shareholders*' (ibid.: *emphasis added*). Here there is a similar path to that outlined above – from Bryer's and Toms' auditors as representatives of socialised capital to the auditors as allies and advisors of the directors – and it makes up a strand in the 'running debate' about the objectives of the audit, discussed below, which drew in the accounting and legal professions as well as shareholders.

The collectivity model places auditors on a par with directors and hence confines their liability to that of directors. In cases such as the Kingston Cotton Mill (1896), an action brought by the official receiver on behalf of the failed mill, 'judges were reluctant to impose on auditors a duty of care more onerous than that imposed on (non-executive) directors' (Napier 1998: 125). Judges were, arguably, slower than accountants to move to the business company model in which the auditor would not necessarily stand as a representative of shareholder interests. Napier, writing before the Companies Act 2006 enabled accountants to set a contractual limit on their liability, warned that auditors' attempts to move in that direction reflected 'a trend away from regarding auditing as a profession' (ibid.: 126).

The argument about limitation of liability continues. Opponents of extended liability claim that a system that imposed more detailed regulation (i.e. extension of auditors' liabilities to third parties) would reduce the scope for auditors to apply professional judgement and would also open them up to 'opportunistic' behaviour

by dissatisfied investors who could treat them as a form of insurance (Grout *et al*. 1994: 343). The Grout argument is of interest as evidence of the extent to which auditors have been decoupled from shareholders by some commentators. In the same vein, O'Sullivan (1993: 417) warns that increased auditor liability would encourage investors to place too much reliance on the audit report. Others argue that there seems to be little value in the audit function if only clients can sue those auditors who perform negligently. Support for this latter view can be found in the judgement of Lord Denning in *Candler v. Crane Christmas* ([1951] 2 KB 164) (emphasis added):

> to whom do these professional people owe this duty [to take care]? They owe the duty, of course, to their employer or client; *and also I think to any third person to whom they themselves show the accounts, or to whom they know their employer is going to show the accounts*, so as to induce him to invest money or take some other action on them.

The argument about auditors' liability that went on through the nineteenth and twentieth centuries and beyond was a continuation of the dispute about the place of the auditor within corporate governance that had begun in the Victorian era. It linked with new situations and expectations – a change in the composition of the shareholder population, more detailed financial reporting regulation, the move of accounting firms to limited liability partnerships, for instance – but in Napier's words (1998: 126), it took shape 'against the shadows and residues of the past'.

Audit objectives and audit techniques

The early development of audit objectives

Jones (2009) shows that from the beginning of the twelve century medieval administrative and accounting systems in Britain drew on a battery of internal control mechanisms, including accountability, supervision and audit. Oschinsky's (1971) collection of texts on medieval estate management and accounting includes reference to internal controls including the division of duties.

There are frequent references in the medieval accounting literature of the thirteenth and fourteenth centuries to the manorial audit. It was an oral examination, a structured process designed to challenge the fairness of the accounts rendered and to arrive at an agreed value. Harvey (1994: 101) describes an audit of the mid-thirteenth century as 'virtually a dialogue, a debate between local official and auditors'. The auditors frequently annotated and amended the accounts presented to them, adding to the cash liability of the local official if expenses were disallowed or output was below fixed minimum returns (ibid.: 104).

Harvey's description is supported by texts such as the *Husbandry* of 1300, which includes a manual of audit procedures. The audit began with an oath by the accountant 'that he will render true accounts' (Oschinsky 1971: c1, 419). The auditor should proceed by investigating the corn account (c2, 419) working out the desirable yield (c3-c9) so that any shortages could be charged against the

accountant, then the stock account, including cattle, sheep, poultry, pigs, the output from the dairy, and cash income including rents in cash and in kind, and finally proceeds from sales of wood, stock, dairy products and wool. The auditor was then told:

> After the account has been heard compare how the figures differ from the particulars, and if they show any deficiencies in cash, corn or stock, or any other items commute all of them into cash: to charge the accountant with these deficiencies must be your first duty before you can total the account.
> (Oschinsky 1971: c40, 435)

As a result, accounts of this period show:

> what happened at the audit: we see what the local official claimed, what was queried or disallowed by the auditors, and very often why, for revealing notes and comments may be added to explain the alterations made on the account [such as] – 'In future so much will not be allowed' … 'This has been sworn to at the audit'
> (Harvey 1994: 101)

The audit was an integral part of estate management: the auditors were engaged in making sure that the official rendering account was not merely telling the truth but was thereby producing an acceptable yield.[8] Hoskin and Macve (1986: 122) describe manorial accounting as 'rudimentary indeed' – but the audit was part of a managerial system structured to convert measures of agricultural production into cash values that could be recovered from officials.

The medieval case is of particular interest because there is substantial documentary evidence of the techniques employed by manorial auditors of the period, both in the various treatises on audit which have survived (see Oschinsky 1971 for a collection of short texts) and in manuscript accounts with auditors' amendments (as discussed by Harvey 1994). But the early modern period, and indeed the nineteenth century until the accession of the professional auditor, has not been studied for evidence of audit objectives and audit techniques. Bryer, as discussed above, refers to the importance of the East India Company auditors as investor representatives, but the nature of the work they carried out is not part of his analysis. Forrester (1994) notes the recurring concern amongst shareholders and managers of the Forth and Clyde Navigation that the accounts should be audited, but he does not quote evidence of the type of work involved.

The auditor and fraud in the nineteenth century

Brown (1962: 696), in an early contribution to the history of audit techniques identified possible audit objectives as detection of fraud and/or clerical error, and 'determination of fairness of reported financial position'. According to his summary, audit verification in pursuit of these objectives could be either 'detailed' or 'testing', and the importance of internal controls, 'not recognized' from ancient times until 1905, progressively attracted 'slight recognition … awakening of interest … substantial emphasis' in the course of the twentieth century (ibid.).

Brown matched the move to the audit of internal control with a change in audit emphasis from detecting fraud to identifying misstatement; he was confident that this process would continue as 'the modern audit … has shifted from a review of past operations to a review of the system of internal control' (ibid.: 703, quoting Nielsen 1960).

Brown sees audit techniques as following an orderly progression based on a shared professional understanding of their objectives. He links advances in audit with a development in client systems that began with the emergence of internal control – an 'order and method' – in the mid-nineteenth century (ibid.: 697). But subsequent research has suggested that audit objectives changed in a much less orderly fashion, and that their relationships with techniques and with client internal controls were less direct and consequential.

In 1849, a Select Committee (1849: i, xvii) set up by the House of Lords 'with a view of providing for a more effectual audit of [railway] accounts' (the Monteagle Committee) stated that an independent public audit would be 'indispensable' in ensuring the reliability of their published accounts. The committee further stated that the auditor's duties should be limited to 'verification [of the accounts], to the comparison of the entries with the vouchers, and to the investigation of the authorities under which payments are made, and their legality' (ibid.: xv). But the auditor must not 'acquire any power whatever to interfere in the internal administration of the company as a commercial enterprise' (ibid.). It is not clear from the evidence whether the Committee was setting out its requirements on the basis of existing practice or was designing a programme of work to eliminate existing shortcomings.[9] Odlyzko (2011) suggests that the crisis following the railway mania started a revolution in shareholder attitudes towards accounting (and audit) with greater recognition being given to the need for more professionalism in both disciplines, although it took time for this to be generally accepted even by those who stood to gain from such advances.

There was a running debate throughout the latter part of the nineteenth century, contemporaneously with the growth of professional audit, about the extent to which the auditor could be held responsible for the detection of fraud. Chandler *et al.* (1993) describe it as a 'continuing and fluctuating theme', with a shift in emphasis between responsibility for statement verification and fraud detection, rather than the steady progress which Brown identified from fraud detection in the mid-nineteenth century to opining on fairness by the early twentieth century. The disagreement about audit responsibility was a major part of the audit expectations gap, which Teo and Cobbin (2005) recognise within the accounting profession, as well as between auditors and users of accounts. They quote Dicksee's 1892 *Auditing* text which remarked that some auditors:

> claim an auditor's duty is confined to a comparison of the Balance Sheet with the books, while others assert that it is the auditor's duty to trace every transaction back to its source. Between those two extremes every shade of opinion may be found and among others the opinion of most practical men.
>
> (Teo and Cobbin 2005: 42)

The recurrent nineteenth century argument about the auditor and fraud has attracted considerable attention (e.g. Humphrey *et al*. 1992; Chandler 1997; Chandler and Fry 2005). The moral drawn tends to resemble that of Chandler and Edwards (1996: 5-6) that 'the essential problems which troubled the auditing profession at its birth remain unresolved and recur through its maturity'. Teo and Cobbin (2005: 53, 54) describe the situation within the profession at the end of the nineteenth century as 'precarious' with an 'abject lack of guidance' about responsibility. But the profession has survived this continuing crisis without decisive clarification of its responsibility. Research has concentrated on the judicial battles of the late-nineteenth century and the discussion within the profession (e.g. in journals, as reviewed by Teo and Cobbin 2005); it has paid less attention to what the profession had to gain from downplaying its responsibility for fraud.

Relevant here is the work of Power (1992: 58) on a subsequent episode in the history of audit techniques which has attracted less attention – the emergence in the 1930s of what he describes as 'a discourse of sampling'. He argues that the *use* of selective audit testing preceded by thirty or so years its *discussion* in professional texts such as those of Montgomery or Dicksee, and consequently that the installation in textbooks of scientific sampling was intended 'to rationalise practices that had been in place for some years and to invest auditing with a new scientific authority' (ibid.: 37). Power's paper is of interest for a number of reasons. He is directing research attention to the development of audit in the early twentieth century, which has attracted far less concern than the late-nineteenth century, and he is making the important point that historical writing needs to avoid assuming 'a historically neutral concept of auditing' (ibid.: 38). The 'neutral' characterisation of audit is liable to view it as a process whose objectives are given, so that changes in technique are evolutionary stages leading to a more perfect exercise of the craft. Power challenges this stance by suggesting that the discourse of sampling was intended to justify and to rationalise techniques which had already proved to be cost-saving, and to reinforce the image of accountants as part of a scientific profession.

This idea offers another perspective on the argument about the auditor's responsibility for fraud detection – that the recurrent debate did not represent a failure by the profession in the nineteenth century to come to an agreement with the users of accounts. Rather, it needs to be understood in its context, as the outcome of the professional orientation towards the interests of social capital – the mission of the accountant to be seen as the 'guide, philosopher and friend' of management and large insider investors (Maltby 1999). The development of the professional auditor's role in the late-nineteenth can be understood as a social process rather than a project aimed at aligning nineteenth century audit with a timeless 'best practice'. A comment by A. E. (1883) in a leading article in *The Accountant* is particularly telling in this context:

> A *true* audit … goes far beyond the checking of vouchers, items and balances. It means going behind the scenes, searching out the causes by which the effects have been created, the discovery of managerial errors, and the suggesting of remedies.

> A true auditor is in the confidence of his client. The latter almost invariably consults him on matters far removed from the simple question of the balance-sheet and profit and loss. The power we thus hold is great; it should be used with intelligence and earnestness, and not abused, as is the case where work is done in a perfunctory manner, without real interest in our client's welfare.

It is instructive to compare this mission statement with the Monteagle Committee's 1849 recommendations for the duties of the auditor, quoted above, which focussed on verification and vouchers, and stipulated that he should not 'interfere' in the running of the company. The late-nineteenth century orientation of the audit away from fraud detection reflected the developing idea of the auditor as an ally of management (the singular 'client' in the extract above) rather than of small outsider investors. But note also the warning against auditors concentrating only on increasing their income – this would be a lesson that needed to re-learned frequently over the coming years.

Robson *et al*. (2007) develop the idea of the continuing process of professional legitimation – the extension of the field of professional jurisdiction. They perceive it at work in the continuing development of risk-based methods of auditing, which reduce audit time (and hence costs) and can be presented as a business advisory function rather than merely audit testing:

> [N]ew business risk audit techniques, and their associated discourses and rationales, can be seen as being intertwined with the status accountants and auditors perceive of themselves and their craft, and with their identity as auditors or, rather, as 'business advisers'.
>
> (ibid.: 431)

They conclude (ibid.: 430) that business risk audit:

> offered to the audit industry and the profession a new form of rationality and legitimacy for the audit task. It occluded the distinction between audit and business (or value-adding) services in a seeming harmony of interest between auditor and corporate management.

Their analysis is consonant with the interpretation offered by Maltby (1999) and Power (1992) of audit techniques being developed in line with the interests of the audit profession rather than in the service of a timeless notion of best audit practice. From this viewpoint, the argument within the profession about fraud detection may be attributed to divided views about the way forward for the profession. Was the audit client the shareholder, who was served by fraud detection, or the corporate manager who would pay for business advice? The comments by Robson *et al*. suggest that this dichotomy persists, and is a major contributor to the audit expectations gap.

The function of auditing of course is not confined to the private sector though for many years academic research tended to focus on that arena. Indeed, the early history of auditing shows that a great deal of effort was expended in developing

systems of accountability and audit for governmental expenditure. Research into public sector auditing is further reviewed in the next section.

Audit in the public sector

In one of her Reith Lectures, part of a series titled 'A Question of Trust', O'Neill (2002) attacked the extent to which audit in the public sector had subverted previous relations of trust:

> The idea of audit has been exported from its original financial context to cover ever more detailed scrutiny of non-financial processes and systems … This audit explosion, as Michael Power has so aptly called it, has often displaced or marginalised older systems of accountability.

O'Neill is voicing here a widely-held view that public sector audit was a product of the 1980s, part of a 'proliferation' (Power 1994a) which also included the arrival of environmental audit, value for money audit and many others. Power's prolific writing on audit (Power 1994a, 1994b, 1997, 2000a, 2000b, 2003) has promoted the idea of public sector audit as colonisation of 'older systems' by private-sector practices. According to Power, the explosion of audit has introduced alien values into the public sector, promoted by a 'rhetoric of accountability' which has imposed a model of financial accountability on a disparate collection of activities and outcomes. The mere fact of undergoing audit, under this new dispensation, confers legitimacy, replacing trustworthiness with submission to inspection. The intrusion of audit, according to Power, leads to a preoccupation with 'making things auditable' by producing quantifiable results, however inappropriate these are to the organisations or activities under inspection.

There is nevertheless scope for this view to be challenged on the basis of the historical development of public sector audit. The fundamental question is how far it is valid to regard audit as a new activity which is necessarily inimical to the objectives of the public sector. Jones and Pendlebury (2000: 233) claim that government audit is 'the oldest aspect of the auditing profession'. Yet public sector audit has not been the subject of as much historical research as corporate audit, although there are a number of relevant studies of various periods and in various contexts.

Descriptions of early government audit do not suggest that it was introduced as a reflection of commercial audit practices. Hoskin and Macve (1986: 113) note that accounting and auditing change took place in 'the administrative arena before … the merchant world'. The *Dialogus de Scaccario* (1177-9) provides an overview of the internal control and audit methods of the Royal Treasury, giving evidence of concern with systems and of confrontational dialogues between the accountant and the auditor.[10] Exchequer audit was a powerful practice, part of what Hoskin and Macve term an 'examinatorial discourse'. Jones (2008, 2009, 2010) reveals a great deal about how early forms of accounting, audit, and division of duties were established in order for the King of England to exercise remote control over the estates he owned but could not personally supervise.

The history of public sector audit between the middle ages and the nineteenth century, even more than that of corporate audit, has been neglected by accounting historians: the early modern period has not so far attracted attention. Studies by Funnell (1994, 2004) deal with the resurgence of government audit in the early Victorian period. Funnell points to the importance of government audit as part of the reforms undertaken by Gladstone's government, and to their continuing significance in saving taxpayers' money: 'The purpose of writing this paper is to identify the origins of economy as a concern of modern central government auditors by recognising the irresistible influence … of the belief that Gladstone, Graham and Trevelyan had in the virtue of economy' (Funnell 2004: 28). Funnell (2004: 27) suggests that public sector audit's 'arid technicalities' ensured its neglect by government reformers until crisis made it a matter for urgent attention; it may be that the same has been true of historical research in the area.

Work by Coombs and Edwards (1990 and 2004) has covered the growth of the local authority audit, again a relatively neglected area despite its long history. They focus on the nineteenth century development of audit, when there was an urgent need to adapt and to reform practices in response to the pressures of very rapid urban growth. Audit grew in response, in a piecemeal fashion and with various clashes between new and existing structures. The auditor regularly challenged expenditure on the grounds of value for money as well as compliance with regulations.[11] A further complication was the continuing tussle between three groups – the elected ratepayer auditors, government-appointed district auditors, and professional accountants – for auditing municipal corporations. Arguments about democratic representation, efficiency and technical expertise suffused a 'strenuously contested power struggle between vested interests' (Coombs and Edwards 2004: 80) that continued from the early nineteenth century to the 1930s. When the municipal corporations were dissolved in 1974, 202 had moved to professional audit, 119 to district audit and 21 still had elected auditors (ibid.: 82).

The Westminster-style of administration of public finance was exported to the British colonies. Bunn and Gilchrist (2013) examine the early years of the third colony established in Australia, the Swan River Colony. They describe the weaknesses in the system of checks and balances over public finances in the colony brought about through lack of clear direction from central government in London and the paucity of personnel to carry out separate functions. In spite of the potential for loss through misappropriation, Bunn and Gilchrist find no evidence that such loss occurred. This they attribute to the careful appointment to key posts of individuals with the personal qualities of honour and loyalty.

Given space constraints and the endeavour to supply a coherent narrative, this chapter has focused principally on the UK. However, a growing body of research examines the history of audit in other countries, some of which closely follow the Anglo-American model while other work reflects quite different conditions and cultures. Some of this research is reviewed in the next section.

International aspects of auditing

The widely accepted model in writing about audit outside Great Britain is that practices which originated in Great Britain were transmitted overseas, firstly to the US and subsequently to the Empire/Commonwealth, to Europe and finally to the developing world and to the former Communist countries of Eastern Europe and Asia.

USA

Moyer (1951: 3) states that 'The first audits in America were of course patterned after the British general model' because of the influence of British auditors retained by British investors. The pattern of US and British work diverged at the end of the nineteenth century, according to Moyer, because 'bookkeeper audits' on the British model, with 'endless checking of postings' were too expensive for the US. Moyer (1951: 7) ascribes the growth of sampling and systems in the US to the profession's need to demonstrate value for money. Flesher *et al.* (2005) contest Moyer's premise that US practice derived from UK corporate audit. They suggest that audit activity had begun in the seventeenth century with the companies financing settlers, and continued through the colonial period, with a government auditor appointed by Congress in 1789 (ibid.: 22-6). In the nineteenth century, the growth of the road, canal and railway companies produced a demand for accounting and audit which generated 'a pool of talent' (ibid.: 36) for the new profession. Feeney (2013: 3) provides examples of early railway audits although he certainly exaggerates when he claims that early in the nineteenth century 'the concept of an external audit just did not exist'. Nevertheless, it was not until 1898 that the first auditor's report on an American railway company was published. For much of the twentieth century American railroad companies appear to have been exempt from the sort of regulations that were mandating other companies not only to publish financial statement but also to have them audited. As the century wore on, much as happened elsewhere and in other industries, railroad companies increasingly opted voluntarily to publish audited financial statements.

One problem which, although not unique to the USA, was certainly felt more keenly there than elsewhere was the pressure placed on audit firm employees because so many clients had the same year end, December 31. To cope with the workload, through the first half of the twentieth century, audit firms would recruit armies of temporary audit clerks. The American Institute of Accountants (AIA) championed a more satisfactory solution by encouraging corporations to select their natural business year rather than the calendar year as their accounting period. Doron (2013) credits the AIA with taking a leading role in setting up the Natural Business Year Council. It was claimed that spreading the workload more evenly over the year would improve the quality of audits. To some extent the campaign was successful as a number of corporations did change their year ends. Audit firms also began to develop more formalised interim audit procedures. However, it was not until the 1960s that US firms no longer used temporary audit staff.

Perhaps some of the most interesting research about the development of audit internationally focuses on issues that arise when new practices are introduced to existing structures and norms. Some of the varied instances of this phenomenon are discussed below.

Germany

Evans (2003) and Quick (2005) trace the history of the German auditing profession, and point to significant differences between the Anglo-American and German regimes: the long-established limited liability partnerships in Germany, the specialisation of audit firms and the low level of auditor liability. They stress the extent to which these features are embedded in the history of corporate governance in Germany – the key role played by banks as both shareholders and investors thereby reducing the separation of ownership from control. Evans (2003: 56) quotes a German lawyer who commented in 1930 that 'the "auditors" of the English law have to fulfil a large part of the functions of the German supervisory board'. Gietzmann and Quick (1998: 81), in their discussion of proposed changes in auditor liability in the EU, make the point that audit is embedded in a 'model of corporate governance' and that one feature of audit cannot sensibly be changed without considering the corporate governance system as a whole. This is an issue that recurs in other studies of international change.

France

Praquin (2012) charts the growth of limited liability companies in France from the early nineteenth century to the middle of the twentieth. The development of the audit function was fraught with confusion about the exact nature and purpose of the audit – was it simply to verify the profit figure from which dividends could be paid or was it also appropriate for auditors to comment on operational matters within the company (effectively to interfere in the management)? Praquin casts doubt on both the independence and competence of auditors. These key audit qualities were neither defined in the statutory regulations nor through jurisprudence. It was not until the mid-1930s that legislation was introduced to modernise the conception of the audit function. Fournès Dattin (2014) uses two case studies of French companies whose auditors in the late nineteenth century and early twentieth century were quite clearly more concerned with maintaining good relations with management rather than acting as guardians of the shareholders' interests. In a later paper, Fournès Dattin (2017a) again illustrates her analysis of developments within the French profession using these two major companies. She describes the resistance felt by men of business to the idea of outside auditors who may be critical of management. Against this sort of attitude, French accountants had to battle to achieve the professional kudos that their British counterparts had enjoyed for many years. It would be late in the twentieth century before some parity was obtained.

Fournès Dattin returns to the subject of independence when considering whether European Union proposals to introduce mandatory auditor rotation would be likely to assist French auditors in achieving greater independence from management (Fournès Dattin 2017b). On balance she concludes that such a move would not be effective since France, unlike many other countries, already has an effective auditor rotation regime as well as a ban on non-audit services and a system of joint audits.

Scandinavia

Holm (2014) examines how the regulatory regime over the auditing profession developed in Denmark. Although, as elsewhere, the practice of some form of audit had been carried out for centuries it was not until the early years of the twentieth century that regulations were proposed to cover the competence and effectiveness of corporate auditing. Initially these were resisted by a senior government minister who later became embroiled in a massive fraud for which he was convicted and jailed. A system of dual auditors (which required one of the two to be a state authorised auditor) was introduced and remained in place until 2005. Holm traces the regulatory response to fraud cases and the evolution of enhanced auditor responsibilities in relation to fraud through legislation, case law and the findings of professional disciplinary tribunals.

Öhman and Wallerstedt (2012) trace developments in the rise of the auditing profession in Sweden, noting that progressive steps were often taken only after scandals and crises had prompted action (as in Denmark and elsewhere). Although there is evidence that voluntary audits were performed from the seventeenth century onwards, as in Britain, company auditing really only began to be significant from the middle of the nineteenth century although in the absence of criteria over independence and competence, it remains doubtful whether this activity was very effective. Öhman and Wallerstedt report that most Swedish companies were being voluntarily audited by the end of the nineteenth century. They also note the existence of a legal requirement that auditors examine the management's administration of the company. The Swedish auditing profession developed through the twentieth century mirroring in many ways changes that had been introduced in the British professional bodies, for example, making the occupation a full-time one and requiring adequate education and training. Such steps must have improved the quality of Swedish practitioners but were not sufficient a safeguard to unmask the Ivar Kreuger fraud (it was Kreuger's suicide in 1932 which initiated a full investigation). When it was discovered that the auditor was an employee of Kreuger's and had signed the audit report without having done any audit work, there was an outcry. The Swedish professional body woke to the need for a more explicit code of ethics and rules began to be issued from 1933. More importantly, the Swedish authorities took tighter control of the licensing of audit practitioners. The protected market that Swedish auditors had enjoyed for much of the twentieth century began to be eroded when the small company audit exemption was introduced in 2010. This forced Swedish audit firms to become more commercial. Despite this changed environment, Broberg *et al*. (2018) nevertheless find from their survey of Swedish auditors that generally a sense of professional identity has not been eclipsed by loyalty to the firm they work for. They also find that auditors from the Big 4 audit firms are more likely to be commercially-driven, perhaps reflecting the greater emphasis on commercialism ingrained in the culture of those firms.

Japan

Matsumoto and Previts (2010) explore how the concept of the audit of corporate financial statements has evolved in a fundamentally different way in Japan. At the

end of the nineteenth century regulations in the form of a Commercial Code (CC) were introduced to establish company auditors but these individuals were closely linked to the companies that they audited since most corporate finance was provided by a relatively small group of investors. The needs of these investors centred on both accounting and operational issues which the CC auditor was expected to address. There was at the time no active stock market demanding the provision of reliable financial information to prospective investors. Despite the flaws in this system revealed by a number of corporate scandals, regulatory change was slow in coming. It was not until the middle of the twentieth century that Japan introduced a Western-style external audit – the Securities and Exchange Law (SEL) audit. Both forms of audit (CC and SEL) operated side by side giving rise to a 'dual system' of audit.

China

Lu *et al*. (2009) look at the difficulties caused by the simultaneous arrivals of corporate audit and of new corporate structures under different regimes in China during the twentieth century. As China has become a global economic player it has moved towards the Western model of accounting and in some respects auditing too, although it retains some unique features. For example, Lu *et al*. consider that if there has been any regulatory capture over the discipline of accounting it has been by government bureaucrats rather than accounting practitioners.

Tang *et al*. (1999) focus on the problems of introducing audit to the newly privatised state-owned enterprises during the 1980s and 1990s. They point to a shortage of audit staff, a mismatch between the commercial state-owned enterprises and the governmental auditors, and the change in the role of audit, from monitoring compliance with rules to verification of statements. Changes in regulation are found to be ineffectual if they do not address the network of structures and expectations that already exist.

Eastern Europe

Sucher and Zelenka (1998) outline the problems caused in the Czech Republic by the rapid transition to a market economy. Audit prior to 'marketisation' had taken the form of internal managerial 'revision' or of state control, in either case aimed at ensuring compliance with regulations. The adjustment to an audit based on systems review and an opinion on truth and fairness was problematical, partly because of the shortage of staff with relevant training, and partly because of clients' expectations of audit. They quote an auditor's comment that '[Czech companies] see the objective of the audit as the tax return' (ibid.: 739), and note that audit continues to be associated with regulatory inspection (ibid.: 740).

Similar issues are raised in papers by Bychkova (1996) and Mennicken (2006) about the development of audit in Russia after the collapse of the Soviet Union. Here again, audit is based on a tradition of state inspection and control (Bychkova 1996: 78-83). The arrival of an audit regime based on international standards demands the development of a new profession and client understanding of, and demand for, a new mode of audit. Mennicken (2006: 1) suggests that new audit

regulations have not necessarily arisen in response to investor demand, but rather as part of a drive towards modernisation and globalisation: a means of 'integrating the Russian economy into the international marketplace'. The absence of stable regulatory institutions means that there is no framework within which audit activity can be anchored. She concludes that 'the Russian auditing profession has emerged on the basis of highly rationalised and idealised imaginations of market-oriented development that are not tailored to the context of Russia's transitional economy' (ibid.: 27).

Case studies can be an effective means of highlighting interesting developments especially if they can be shown to have had some lasting effects or legacy. Some examples are provided in the next section.

Case studies

Heier and Leach-Lopez (2010) tell the story of a mill in the US that was the victim of a fraud committed by a trusted individual on secondment from the company's auditors. They claim that an indirect effect of the revelation of this fraud in the late 1930s brought about renewed and improved institutional concerns with matters such as auditor independence, the need for greater supervision of an audit firm's employees and a greater awareness that client management should accept its responsibility for the accuracy of its financial statements even if it is buying in help from its audit firm.

In the Hudson's Bay Company, audit arrangements were first put in place in 1866 even though the company had been in operation since 1670 (Spraakman 2011). The familiar dual auditor system was established with one auditor representing the interests of the shareholders and another looking after the interests of the management. In the first three years, the auditors prepared as well as audited the financial statements. Thereafter, although the establishment of an audit was brought about by shareholder pressure, only the management's auditor was left in place and he only acted as auditor, no longer taking part in the accounts preparation. That this individual happened to be William Quilter, one of the most respected practitioners in Victorian Britain, probably allayed any concern on the part of the shareholders.

The dangers of auditors being too close to those whose statements they audit are shown in the case of the Scottish brewer, R. D. Sharp Ltd (Sangster and Gibb 2017). In this case the auditor, a chartered accountant, who happened also to be an investor in the business appears to have allowed quite blatant manipulations of the measurement of accounting profit while hiding behind cleverly crafted words that seem designed to protect him (in the manner of the Royal Mail case – see Chapters 8 and 20) from liability should the worst happen.

A lack of independence and what we would now call 'professional scepticism' is demonstrated in a case involving a Victorian auditor connected with one of the most notorious financial scandals of the age, the collapse of the London and General Bank and the Liberator Building Society. Although a good deal has been written about the individual at the heart of the fraud, Jabez Balfour, rather less is

known about his acolytes and the external auditors who allowed the publication of balance sheets that they knew to be misleading. Chandler and Macniven (2014) report how the failure of the auditors, who were chartered accountants, brought discredit to the whole profession. 'What is the value of an audit?' was a popular headline during the debate about the scandal. That one of the auditors was a spiritualist who believed in the ability of a medium to communicate with the souls of dead relatives received almost no attention, perhaps because his beliefs were shared by many others at the time.

Antonelli *et al*. (2017) produce what they claim is the first English language case of auditing in an Italian private company, the Leopolda Railroad Company. Following the design of Robert Stephenson, work began in 1841 and when it was finished seven years later, the line ran from Livorno to Florence. Antonelli *et al*. unearth some interesting facts about the appointment of the auditor, a post which was often contested, the details of the audit work actually performed, the errors that the auditors found and their suggestions for improvements in running the company. In the fifteen-year period examined, the company's auditors' reports varied in length from 19 to 55 pages. Their reports had a standard heading but that was as far as uniformity went – each year's report was a unique specimen.

One of the less well-known cases of audit failure occurring right at the end of the twentieth century is examined by Agostini and Favero (2017). They dissect the machinations of the CEO of Sunbeam, an Arthur Andersen audit client. The authors coin the term 'creative auditing' to denote actions by auditors which, even if they are legal, are not considered ethical and which amount effectively to colluding with management. One facet of the Sunbeam case, once the accounting manipulations had been discovered, which is particularly noteworthy is the 'scapegoating' of the CEO rather than the auditors, as is usually the case. However, Sunbeam was just one of a long list of Andersen clients found to have produced misleading financial statements.

Conclusion and directions for further research

This chapter, in a necessarily brief and selective survey of historical work on auditing, has attempted to do two things. One is to draw attention to the main elements of historical writing to date, and the other to provoke further inquiry.

Humphrey (2008) writing about the same time as the publication of the first edition of this book set out an agenda for the future direction of auditing research and, even though more than ten years have now elapsed, many of his ideas retain currency. He decried the domination of quantitative research papers based on US data in what are regarded as the leading accounting journals. He urged researchers to become more involved in qualitative research into, for example, the political nature of standard-setting (auditing as well as accounting) and to question the grounds on which standard-setters claimed legitimacy. While acknowledging the difficulties of obtaining inside information about the true nature of audit practice, he suggested that more could be done by researchers to get into the mechanics of actual auditing procedures and approaches, perhaps using the reports of the disciplinary processes (and, one could add, published law reports where the

question of auditor negligence is being contested) and using case studies as a way of better informing those outside the audit firms.

Another of the major gaps in knowledge is that we know very little about the shareholder audits of joint-stock and limited companies during the middle of the nineteenth century, and hence little about the expectations that were brought to bear on the first professional corporate auditors. In addition, and perhaps more curiously, there is very little research into audit from the early twentieth century until its end.[12] The scandals that occurred in the last decade of the twentieth century and the first decade of the twenty-first (BCCI, Enron and the Global Financial Crisis 2007-8) have attracted a great deal of interest (see for instance O'Connell 2004; Carnegie and Napier 2010; and *Accounting, Organizations and Society* 2009, 34 (6/7)). Nevertheless, this period in time offers many opportunities for further research.

The development of audit and the legal and professional controversies of the mid- to late-nineteenth centuries, as they appeared in the press and in textbooks have been thoroughly researched. However, little is known about the nature of the work undertaken, as distinct from the debate about it. Subject to the limitations of existing material, there is a strong case for attempting further research to enrich our knowledge of actual audit practice.

Another major area that deserves further investigation is that of public sector audit. Power's writing on the subject (e.g. Power 1994a) is part of a large literature about its potentially disruptive arrival at the end of the twentieth century. Little work has been done about its earlier presence and impact, although existing studies (e.g. Coombs and Edwards 1990) suggest that it played an important, though contested, part in government from a much earlier date.

Auditing is an activity that appears capable of resisting severe challenges. In 2001 the collapse of Enron and the complicity of its auditors in misleading the public were claimed to have had a catastrophic effect on the reputation of both auditors and audit (O'Connell 2004; Carnegie and Napier 2010). During the Global Financial Crisis, a rather glib and perhaps complacent comment was made to the effect that the 'auditing profession was having a good crisis' insomuch as most of the criticism at that stage was aimed at the bankers. That began to change in the UK with the parliamentary investigations into the role of auditors in the banking crisis (House of Lords 2011) and the EU initiatives aimed at further strengthening auditor independence (see ICAEW 2016). Serious questioning of the value of the audit function and the conduct of the Big Four continues (see Brooks 2018). An examination of how the professional bodies and the large accounting firms responded to the crisis and subsequent criticism of the structure of the audit market and the independence of auditors would be a fruitful area for future research.

One of the abiding challenges for historians, in whatever context, is to understand and to explain why auditors, in the aftermath of a financial scandal, have so often been made the scapegoats (for one explanation, see Guénin-Paracini and Gendron

2010) and, paradoxically, how the auditing profession, despite a lengthy history of 'audit failure', continues to display such extraordinary resilience.

Herda and Herda (2016) lament the lack of positive news stories on auditors and auditing. They suggest that, whereas conventional auditing text books emphasise past cases where auditors got it wrong, more should be done to make students and the public aware of the audit success stories. We rarely hear of such cases but, one imagines, there must be many of them. The problem is that auditors do not tend to blow their own trumpet and in many cases could not even if they wanted to for fear of breaching duties of client confidentiality. How are we, as researchers, to get the inside story? Fewer accounting academics these days have any direct experience of auditing and, therefore, may lack the credentials and contacts to convince audit firms that it is safe to let them peer inside the 'black box' of auditing. Without such cooperation from practitioners, making the auditor into a 'hero', should they hypothesise that to be the case, is another challenge for the next generation of researchers.

Key works

Chandler and Edwards (1996) is a useful introduction to the growing literature on late-Victorian audit. It reviews the existence, from the late-nineteenth century onwards, of controversies about problems of audit independence, the expectations gap, reporting and regulation.

Fournès Dattin (2014, 2017a and b) presents an insight into the evolution of company auditing in France. At a time when the effect of EU regulations over auditor independence is being felt most keenly, it is enlightening to see how the French approach to auditing has developed.

Jones (2008, 2009, 2010) examines the details of the accountability and audit arrangements of the medieval system of the governance of Britain, with particular emphasis on the financial management and controls exercised over the Kingdom.

Mennicken (2006) studies the significance of the introduction of international audit practice as part of a wider economic and social change being attempted within Russia. The paper is particularly interesting as a basis for discussing initiatives for globalising audit practices.

Napier (1998) discusses the close relationships between audit and law and between audit and corporate governance, and the need to understand the auditor's role within changing systems of corporate governance.

Watts and Zimmerman (1983) introduced the widely-cited argument that audit has arisen as a voluntary response to agency problems in firms rather than because of legislative requirements.

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Notes

[1] Josephine Maltby sadly passed away in 2017 before she could revise this chapter. It is a great honour for me to be invited by the editors to update Jo's work. I have kept the same structure and much of the content of the original piece while trying to reflect more recent additions to the literature. I hope that I have done so in a way that does not detract from Jo's intelligent and insightful style of writing.

[2] This chapter focuses principally on the modern corporate audit though there is some discussion of prior developments on manorial estates as is also the case in Chapter 5.

[3] See for instance Fleischman and Radcliffe (2005) and Chapters 1-3 of the *Companion*.

[4] See Lee (1989) for an overview of the prior, sparse writing on the history of audit.

[5] Jones' discussion does not examine the witnesses' occupations. These may have had an impact on their support for audit, to the extent that the advocates of audit were suppliers, rather than users, of information.

[6] See also Chapter 12 on the importance of audit for the development of the accounting profession.

[7] See Edwards *et al.* (2007) on the 'jurisdictional battle' waged by the professional against, for instance, the shareholder auditor in the mid-nineteenth century, and Sikka and Willmott (1995) on the relationship between professional jurisdiction and independence.

[8] See Harvey (1994: 101-5) for a detailed exposition of the managerial function of the audit.

[9] Bryer points out (1991: 459) that railway audits were described during the mania of 1845 as 'the greatest farce possible … arithmetical rather than judicial' and 'a mere child's play'.

[10] See Baxter (1994, esp. 223-8) for a description of the highly ritualised process of the audit.

[11] See for instance Coombs and Edwards (1990: 161, 168) on clashes between district auditors and first poor law unions and later town councils on this matter.

[12] One rare study is that by Matthews (2005) of the audit failures which preceded the collapse of London and County Securities Bank in 1973.