Auditor-Client Relationships: An Assessment of Relationship Quality

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Dedicated to my wife and daughter for their unconditional support.

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To
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Le peu que je sache, je veux le faire connaitre afin qu'un autre, meilleur que je suis, découvre la vérité, et que l'oeuvre qu'il poursuit sanctionne mon erreur. Je m'en réjouirai pour avoir été, malgré tout, cause que cette vérité se fasse jour.

Albrecht Dürer (1471-1528)

The little I know, I want to make it known, so that another, better than me, discovers the truth and the work he/she does, sanctions my mistakes. I will be delighted to have been, despite all, the reason for this truth comes to light.

Albrecht Dürer (1471-1528)

ABSTRACT

Corporate failures and financial scandals are not a phenomenon of the 21st century. In the 1990s, the British economy witnessed the collapse of some well-known companies such as Polly Peck, Sock Shop, Coloroll, BCCI, Maxwell Group, etc. In the US, the problem has resulted in unprecedented financial scandals with Enron, WorldCom and others. Auditors for these firms gave a seal of approval to these companies. Later on the same companies faced liquidation and fraud. In this situation, which has brought the whole profession under scrutiny, the autonomy of auditing is being undermined. Hence, academics have raised the issue and called for government intervention and to make auditors responsible for detecting and reporting fraud.

Accountants as auditors find themselves in a conflicting situation. Therefore, the accounting profession faces a dilemma. On one hand, they have to remain independent and show their integrity: auditors are motivated to comply with professional ethics and acceptable auditing standards, while on the other hand, the pressure from competition and more demanding clients is forcing the profession to sell other services and become client-centred. This situation may lead to dilution of the professional standards, which the auditor wishes to avoid. Failure to comply with the client's (auditee) expectations may result in sanctions by them, including the possibility of discontinuation of the relationship.

Therefore, this study investigates the auditor-client relationship phenomenon and how to restore public confidence. Moreover, it intends to critically examine the key elements in enhancing the service quality and auditor performance and consequently build quality relationships between the auditors and their corporate clients.

The research methodology employed in this study combines a qualitative investigation (part one) and a quantitative approach (part two: survey questionnaire to clients of audit firms). The importance of the dyadic relationship suggested that both sides should be studied. This was done with four pairs (eight interviews) of dyads and the results helped to provide a clear understanding of the situation and as will be shown a framework of the relationship process emerged from this research. Although the process of relationships was clarified the degree of importance of different variables meant that it would be difficult to generalise results as predictor for auditor-client relationships. That is a key objective in this research. As a result a quantitative survey of a cross-section of clients from different industries in Scotland was undertaken.

This empirical study reveals that the identified constructs (elements) are important in the auditor-client relationships. Moreover, the quality in a relationship is vital to successful outcomes. This study intends to show the value of plausible outcomes, i.e., the study may claim to have achieved a contribution to the body of knowledge, to methodologies for qualitative research and some managerial implications such as how to build a positive image for the accountancy profession as well as how to restore the public confidence about the audit criticism.

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CHAPTER ONE
INTRODUCTION

1.0 AN OVERVIEW

This research project represents an attempt to explore the audit phenomenon. The purpose of this first chapter is to introduce the research problem, the study objectives, the background of audit where auditor-client relationships take place and the specific questions to be pursued within the context of the formulated theoretical framework. It also discusses the significance of the study and assesses the different theoretical approaches utilised in this study of exchange relationship behaviour. Finally, the chapter provides a description of the intended thesis structure.

1.1 THE RESEARCH PROBLEM

Accountants as auditors find themselves in a situation with conflicts. Therefore, the accounting profession faces a dilemma. On one hand, they have to remain independent and show their integrity: auditors are motivated to comply with the professional ethics and generally acceptable auditing standards. On the other hand, the pressure from competition and more demanding clients is forcing the profession to sell other services and to become client-cantered. This situation may lead to dilution of professional standards which the auditor wishes to avoid, but failure to comply with the client's (auditee) expectations may result in sanctions by him, including the possibility of discontinuation of the relationship.

Corporate failures and financial scandals are not a phenomenon of the 21st century. In the 1990s, the British economy witnessed the collapse of some well-known companies such as Polly Peck, Sock Shop, Coloroll, BCCI, Maxwell Group, etc. In the US, the problem has resulted in unprecedented financial scandals with Enron, WorldCom and others. Auditors for these firms gave a seal of approval to these companies. Later on the same companies faced liquidation and fraud. In this situation, which has brought the whole profession under scrutiny, the autonomy of auditing is being undermined. Hence, academics have raised the issue and called for government intervention and to make auditors responsible for detecting and reporting fraud. Advocates of government intervention argue that changes are highly necessary to bridge the 'expectation gap' created by what auditors believe to be the objectives of an audit and what the public understands. This gap can only be managed or reduced by embracing socially desirable audit objectives and reforming audit institutions according to accountancy academics reports (Sikka et al, 1992; Sikka et al, 1998; Amernic and Craig, 2004 and; Cooper, 2005 and 2005a). Meanwhile, the profession responds defensively to these attacks. It argues that the public expects more from an audit than it can deliver - the so-called expectation gap. The responsibility for drawing up a company's accounts rests with its directors. For example, the profession ICAS (The Institute of Chartered Accountants of Scotland) through its president, Allan Denholm (1992) argues that the survival of the accountancy profession is at risk and points out that:

> *"Over the last two or three years there has been a number of highly publicised scandals and the alleged financial irregularities have been blamed on the profession. The probity and integrity of the profession have been questioned and that is regrettable. It should be recommended that the accounts are not the auditor's accounts but those of the directors"* (p.10).

In this situation, which has brought the whole profession under scrutiny, and where the autonomy of auditing is being undermined, an investigation of the auditor client relationships is deemed necessary.

1.2. BACKGROUND AUDITOR-CLIENT RELATIONSHIPS

1.2.1 An Overview

Services' marketing has become a recognised area of the marketing discipline (Zeithaml et al., 1985; Zeithaml, 2000; Zeithaml et al., 2006). This has particularly been the case in consumer marketing where it has generally been acknowledged that the key distinguishing characteristics of services which separate them from tangible goods are: intangibility, heterogeneity, inseparability of production and consumption, and perishability. In industrial or business-to-business marketing however, the extent to which services are different from tangible products has not been well established (Morris and Fuller 1989). Yet, other writers saw the entire area of business services marketing still undefined or ill defined (Bingham and Rafield 1990; Smith, 2005). Others argue that the landscape for Business services markets has become blurred due to the deregulation, and information technology (Tyler, et al. 2007).

Further, little attention has been directed at gaining a better understanding of the similarities and differences of the two major types of business services proposed by Gronroos (1979), viz., "professional" services (e.g., management consultants) and "other" services (e.g., cleaning and maintenance, security). Dawes et al (1993) assert that 'professional services are distinguished by four factors: the service is often provided by professionally qualified personnel; these professionals have an identity such as a "lawyer" or "management consultant"; the services are advisory and focuses on problem solving; and they are generally commissioned on an assignment basis. In general, the delivery of a professional service involves a high degree of interaction with the client, together with a high degree of customisation. Because of their customised nature, most professional activities are organised on a project basis. The project nature of the work means that there are three major activities in the delivery of professional services: *client relations*, *project management*, and the *performance of the detailed professional tasks*. To understand the audit business, it is a perquisite to look at the definition of terms related to this service.

1.2.2 Defining the terms

Table 1.1 Explanation of audit terms

Client (Auditee):	This refers to the party that hires the auditor to perform the audit function. This is almost always the *management* or the *shareholders* of an audited company. In some cases *third parties* (Government, Banks, and others) hire the auditors. These parties can be termed as non-paying clients.
Auditors	They take their name from the function (audit) they perform. Auditors are required by law to be qualified accountants, i.e., chartered accountants or certified accountants. Auditors must be members of a body of accountants established in the UK and recognised by the Department of Trade and Industry, or authorised by the Department to be appointed. They are generally defined as "*independent experts who report to the shareholders of a company their opinion on the truth and fairness of published financial statement. Their remuneration (including expenses) must be disclosed in the published profit and loss account* (Parker, 1988, p.111). They are also referred to as "auditors or audit firm", i.e., the partners of a firm or a sole practitioner or a company or organisation providing audit services (Cosserat, 2004, p.664). They are also appointed each year by the shareholders at the company general meeting (Wood and Sangster, 2005). Auditors are usually accountants acting under another title. If they are appointed from outside the organisation they are sometimes referred to as the ***external auditors***. In the case of a limited liability company, they are appointed by the shareholders and not by the company's management. Their job is to protect the interests of the shareholders, and as such, they are answerable to the shareholders. This contrasts with ***internal auditors*** who are employees of the company, and therefore answerable to the management of the company. *Internal auditors* perform routine tasks and undertake detailed checking of the company's accounting and management procedures.
Audit:	It is a process (carried out by suitably qualified "auditors") whereby the accounts of business entities, including limited companies, trusts, professional firms, and non-profit organisation such as charities, are subjected to scrutiny in such detail as will enable the auditors to form an opinion as to their truth and fairness. This opinion is then embodied in an "audit report", addressed to those parties who commissioned the audit, or to whom the auditors are responsible under status (Woolf: 1990).
Statutory annual report:	A report made annually by the directors of a company to its shareholders. Its contents are largely determined by company law and statements of standard accounting practice.
Special audit investigation	This might be called from internal members of the company, i.e., employees, management or shareholders. From outside the company, third parties (non-paying clients) may call for a special audit investigation if a matter of concern is raised.

Source: Original

Maister (1982) argues that the professional service firm tends to sell to its clients the services of particular individuals (or a team of such individuals) more than the service of the firm and business success is thought to depend primarily on how well individual consultants can build social networks and keep loyal clients (Gronroos 1979; de Monthoux 1978; Turner 1969; Olkkonen et al. 2000 and Mouzas, 2007).

1.3 THE SIGNIFICANCE OF THE STUDY

To date, few empirical studies have examined the marketing of professional services in a *regulated environment*. This study has critically examined (cf. chapter three and four) - (i) buyer-seller models in general marketing (Dwyer et al., 1987) and consumer services (Gronroos, 1978; Copulsky and Wolf, 1990); (ii) industrial marketing (Ford, 1980), (iii) professional services in regulated environment (Yorke, 1990), (iv) accountancy services (Goldman and Barlev, 1974; Nicols and Price, 1976; DeAngelo, 1981). Most of the studies have focused on different issues from different perspectives. As a consequence of limited amount of empirical studies in regulated environment of professional services, little is known about elements and process of relationships. Furthermore, lacks of understanding of how professional services providers market their services such as an audit (statutory).

Despite the importance of the idea of exchange attributed to the buyer-seller relationship, there is still a lack of attention to elements and processes of interaction in a regulated environment. For example, the audit literature as an area of buyer-seller relationships reveals:

i. an absence of a conceptual relationship framework to evaluate auditor-client relationships. The existing models do not explain fully the elements involved in the development of relationships, nor the stages followed.

ii. audit relationships occur within a regulatory environment, where organisations affect and are affected by the environment (i.e., open system)

iii. audit relationships appear to have a strong emphasis on the human aspect, (i.e., interpersonal relationships)

iv. audit dilemma: the professional code of conduct of the accountancy profession stipulates that the profession has to maintain its integrity and independence. However, the relationship marketing concept advocates dependency through long-term relationships between the buyer and seller for a service. So the major question is how to maintain the *dependency* within the *independency*?

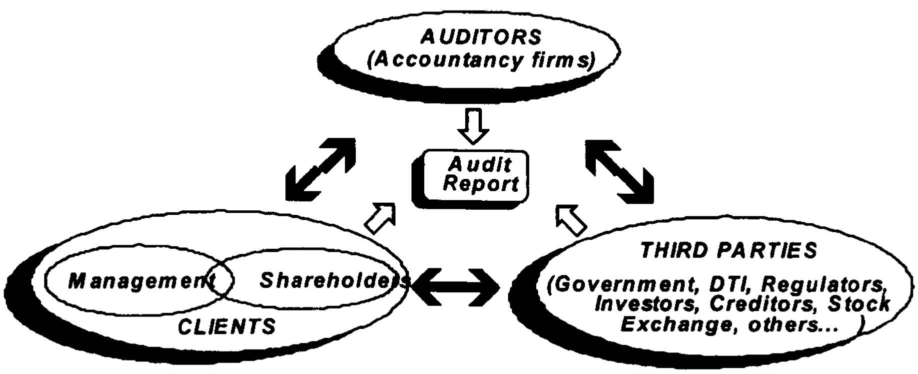
Viewing the audit function as means of communication between different parties in the business community suggests a need to look at the audit phenomenon from a relationship context. Therefore, the purpose of this study is to extend the research on professional services by focusing on statutory services within a regulated environment of an audit.

1.4 REPRESENTATION OF AUDIT RELATIONSHIPS

1.4.1 Macro environment relationships

As shown in figure 1.1, there are three major players in audit relationships at the macro environment level; auditors, clients and interested third parties.

Figure 1.1: The linkages between the different actors



Source: Original

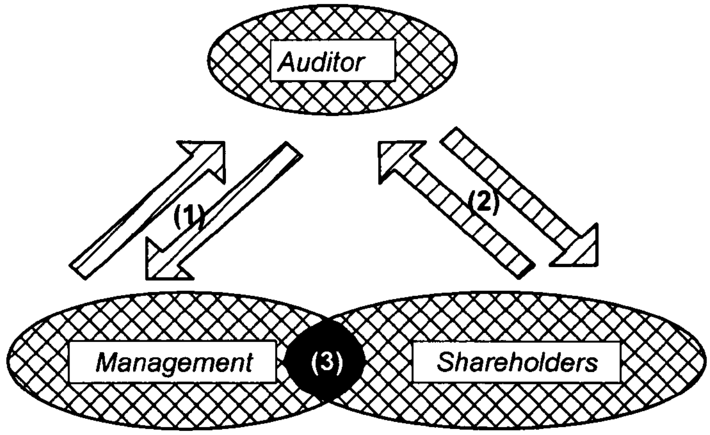
The role of each party involved in the relationship and the elements of their interactions are presented in table 1.2.

Table 1.2 Types of Auditors-clients relationships

1. Auditor-Management: Statutory & Working Relationship	▪ This relationship includes only individuals involved in the preparation of the accounts, planning the audit task and time. The major parties in this relationship are auditors and managements. ▪ All medium sized and large limited companies are required by law to have their accounts audited by qualified accountants, i.e. auditors. Accounts are presented annually to shareholders, investors and any other party interested in the company activities.
2. Auditor-Shareholders: Protectionist Relationship	▪ Auditors are played by the shareholders to check upon the management and protect them from wrongdoing and frauds.
3. Management-Shareholders: Stewardship Relationship	▪ Reflects whether the management is taking care of the money of the company's owners, i.e., the shareholders. A general relationship, which has a tendency to embrace all interactions, is the statutory relationships.

Source: Original

1.4.2 Micro Environment Relationships (figure 1.2)



Source: Original

As shown in the figure 1.2, there are three main sets of relationships at the micro firm level: *(1) Statutory & working relationship (*between auditors and their clients)*;* *(2) Protectionist relationship* (between auditors and shareholders) and *(3) Stewardship relationship* (between management and shareholders).

1.4.3 The dyadic members and their role in audit relationships

The role of each party involved in the relationship and the plausible elements affecting their interaction are summarised in table 1.3 and table 1.4.

Table 1.3 Description of participants' role in Auditor-Client relationships

Auditor	*Client (Management)*	*Third Parties*
▪ *Operates in the market of: audit services and non-audit services* ▪ *Resists any interference in the performance of his auditing duties* ▪ *Tries to sell other non-audit services*	▪ *Can choose the auditor he prefers from a large group of professionals.* ▪ *Determine his employment conditions* ▪ *Displaces him at will* ▪ *May demand a manipulation of regulations* ▪ *May try to impose his will upon the auditor to influence him for flexible accounting techniques* ▪ *Attempts to satisfy:* *(1) Shareholders' desires by employing an accommodating auditor.* *(2) Thus, reflecting a favourable image as a good steward of the shareholder's investment*	***Government:*** ▪ *May request auditor's report for:* *- investment,* *- litigation* ***Banks:*** • *Loans are granted according to the audited statements* ***Investors:*** • *Brokers and investment bankers insist that if a company "wants to go public" it should be audited by one of the large chartered accounted firms, designed as "reporting accountants"* ***Shareholders:*** • *Expect the management to select an auditor of quality*

Source: Orginal

Moreover, there are various sources of influence on the audit relationships. Some potential sources of factors (audit report, self-interest, regulations, accounting techniques, non-audit services and competition) affecting auditor-client relationships are summarised in the table 1.4

1.4.4 Types of relationships

Considering a "statutory and working relationship", one can argue that there are two further types of relationships (an ongoing / long-term relationship or a breakdown relationship). The second type of relationships has a tendency to appear in conflict situation. A situation of conflict between the auditor and the client (auditee) occurs when they do not agree on some aspect of the performance of the attest function. Under these circumstances, the client may attempt to influence the manner in which the attest function is conducted. The client pressurises the auditor to take an action that violates acceptable auditing standards, including the rendering of an inappropriate opinion. Since it is assumed that the auditor is motivated to comply with professional ethics and generally acceptable auditing standards, the auditor will be in a conflict situation with the client. Compliance with the client's demands may lead to violation of professional standards which the auditor wishes to avoid. Failure to comply with the demands may result in sanctions by the client (auditee), including the possibility of termination of the engagement.

Understanding the conflict of interest and its impact on changes of auditors requires an examination of the relationship between both parties (client and auditor) and their relationship to third parties. However, it is beyond the scope of this study to look at breakdown relationships, which might be due to other factors such as the client goes out business, or auditor image goes under scrutiny, i.e., a number of his clients go bankrupt or allegations of fraud (case of Stoy Hayward). The possible elements in the relationship which could trigger the conflicting situation are examined in chapter four.

1.5 RESEARCH OBJECTIVES & RESEARCH QUESTIONS

The main objective of the study is to examine the nature and quality of relationships between accountancy firms and their clients in the audit market by considering the elements in a relationship and the development of a relationtionship as a process through stages. There are two types of research objectives (qualitative and quantitative). The first objectives are of a qualitative nature and are set as follows:

1. To identify the elements of the auditor-client relationship
2. To explore and evaluate:
    a. The development of relationship elements through stages
    b. What makes auditor/ client relationship enduring?

   c. What are the external factors influencing the relationship?

3. To examine the implications of a close relationship
4. To critically examine how to restore public confidence.

Research questions - These research objectives have been expressed in the form of research questions as follows:

- *What are the elements describing the relationship development?*
- *What are the stages in relationship development?*
- *What actions do both sides take to building and maintaining relationships?*
- *What are the external factors influencing the relationship?*
- *What are the outcomes of the relationships?*

Consequently, a number of key determinants emerged from the qualitative investigation and contributed in building a conceptual framework (Fig 6.6, chapter 6). These determinants are tested in the second part of the study. Therefore, the specific research objectives relating to the quantitative survey are expressed as follows:

1. To critically assess how problem solving, trust, communication and commitment work as components in enhancing service quality and consequentially build a quality relationship between auditors and corporate clients.
2. To examine empirically how problem solving, trust, communication and commitment work as components in enhancing auditors' performance and consequentially build a quality relationship between auditors and corporate clients.

Table 1.4 Explanation of some potential sources of factors affecting the audit relationships

	Auditor	*Client*	*Third Parties*
Audit Report	• *expect to be produced on the basis of professional standards* *Auditor must:* • *qualify his opinion* • *or state he is not able to express it* • *(3) or express an adverse opinion*	*(1) Management:* • *is likely to try to influence the auditor to produce a more favourable report to impress the shareholders* • *wants as well the report to make good impression on third parties* *(2) Shareholders:* • *rely in part on the auditors' report in their evaluation of the management performance*	*(1) Investors:* ▪ *rely on the audit report (facts and evaluation) for their investment decision* *(2) Shareholders:* ▪ *use their report to see whether the company has taken care of their money* *(3) Banks:(Creditors)* ▪ *on the basis of the report they decide whether to grant loans to the audited company*
Self interests	• *may find himself in a situation where he can:* *- benefit by violating professional standards regulations* *- lose audit contract by not agreeing to the wishes of management* • *Try to sell other non-audit services* *N.B: Violating the professional standards and the code of ethics for their company benefits, can be viewed as internal conflict between the auditor's self-interest and his professional integrity*	• *Concomitant audit buys (i.e., buys other services if the audit is offered according to the wishes of management)* • *shop around for auditor who agrees to his demands* • *seeks for an accommodating auditor who helps to create the manager's image as a good steward* *Client reputation:* • *client does not approve that auditors reveal or disclose information that can damage company reputation (even if it complies with accountancy regulation)*	• *Investors* • *Banks (creditors)* • *Suppliers:* *any changes in auditors might cause the shareholders to be suspicious* *All the above parties want to protect their interests*

Regulations	*(1) Code of ethics:* • *should observe the code of conduct and maintain it* *(2) Standards:* • *Auditor should not be tempted to agree to the wishes of client even under the threat to be replaced*	• *By law company should produce an annual report (Company act 1947)* • *Misuse of accounting standards*	*(1) Government:* • *Labour Party tries to introduce new regulation;* • *tighter control on accountancy profession,* • *audit to be carried out by an independent body* *(2) Investors (shareholders):* • *Complain about accounting standards*
Accounting Techniques	• *If a new auditor were hired, the existing accounting policies might come under close scrutiny, and potential confrontation could arise with the new auditor*	• *May demand for the use of the most flexible techniques to cover the weakness in the audit report*	*Government:* • *ask for a severe control on the accountancy profession* • *ask the profession to improve the accounting techniques ion order to reduce the pressure from the clients* *Professional bodies* • *require their members to stick to the rules and uphold professional standards*
Non-audit Services	• *Provision of services to audit client*		*Professional Ethics:* • *care must be taken not to perform executive functions or to make executive decisions* • *Members should beware lest, in providing such services, they drift into situation in which they step across the border line of what is proper*
Competing Client	• *should select which client to advise but not both clients or not to advise any rival client*	• *wants advice and/or figures from the auditor related to rival company*	*Code of Conduct:* • *Auditor should avoid conflict of interests, i.e., not to get involved in advising a rival company tendering for the same contract*

Source: Original

same results. It does not expect the results to be different if they were different the study would have a problem with data collection or analysis.

1.7 ASSESSMENT OF THE THEORETICAL ORIENTATION

1.7.1 Theoretical Perspective: An Overview

An understanding of audit phenomenon requires, among other things, locating it within a conceptual framework. However, as the nature of the preliminary study is exploratory, the conceptual framework is expected to emerge during the course of the study. Miles and Huberman (1984) point out that:

> *"the conceptual framework should emerge empirically from the field in the course of the study; the most important research questions will become clear only later on; the most meaningful settings and actors cannot be predicted prior to the fieldwork; instrument, if any, should derive from the properties of the settings, and from the ways its actors construe them"* (p.27).

To this end, a number of models were generated from the analysis of relationships dyads. These findings were integrated and formed the basis for the quantitative survey. Adding to this, the researcher has examined existing theories / models from different sources, which constitutes the study's theoretical orientation. Therefore, the theoretical orientation (based on behavioural theory and systems theory) used for this study, provides a useful theoretical yardstick by which it is possible to check and identify relationship dimensions and the processes within it.

1.7.2 Theoretical Framework Development

Based on the constructs from qualitative investigations with auditors and their clients, practitioners, academics, i.e., fieldwork and review of the key relevant literature, this study has generated a conceptual framework (Fig.6.6 in chpter 6).

1.6 RESEARCH STRATEGY AND DATA COLLECTION

There are two stages for this study:

1.6.1 Stage 1: Qualitative Research

The first phase of the research represent a preliminary study and of exploratory nature. It is based on eight in-depth personal interviews with corporate clients and their auditors. This constitutes four business relationship marketing dyads. The purpose of this stage is to identify the elements and stages of the relationships. Carrying out a qualitative investigation as advocated by Miles and Huberman (1984) and Glasser and Strauss (1967) had not only shed the light on the elements influencing the relationships and what is happening in the business arena but it has also helped to draw four case studies based on qualitative inquiry. It is to note that the qualitative findings show the elements and stages of relationships. As it emerged from these findings, it is very difficult to measure each individual stage since the relationship between auditor and client is already existing (as one respondent put it: *the relationship existed before even I joined, I guess 100 years ago…*") and it is also for the respondents to be specific with any particular phase. This view reiterates what was found in another study of a related subject research area (Beloucif et al. 2004). This has helped, during the exploratory investigation, to focus this current study on identifying the elements of exchanges and stages.

1.6.2 Stage 2: Quantitative Approach

From the results of the approach used in phase 1 and enriching the literature review by examining agency theory, transaction cost theory and other behavioural theories; this stage is to improve on the models. Moreover, a set of hypotheses were formulated and tested through a mail survey (chapter 7). The sample of clients will be taken from FAME directory, which contains the names of all companies (listed and non-listed in the London Stock Exchange), registered in Scotland (and/ or mainly doing their business in Scotland). The Scottish firms across the industries are taken into consideration. The same directory gives the names of auditors of these selected firms. Therefore, the list of auditors will be drawn from the clients (firms) sample.

1.6.3 Reliability and Validity of the study.

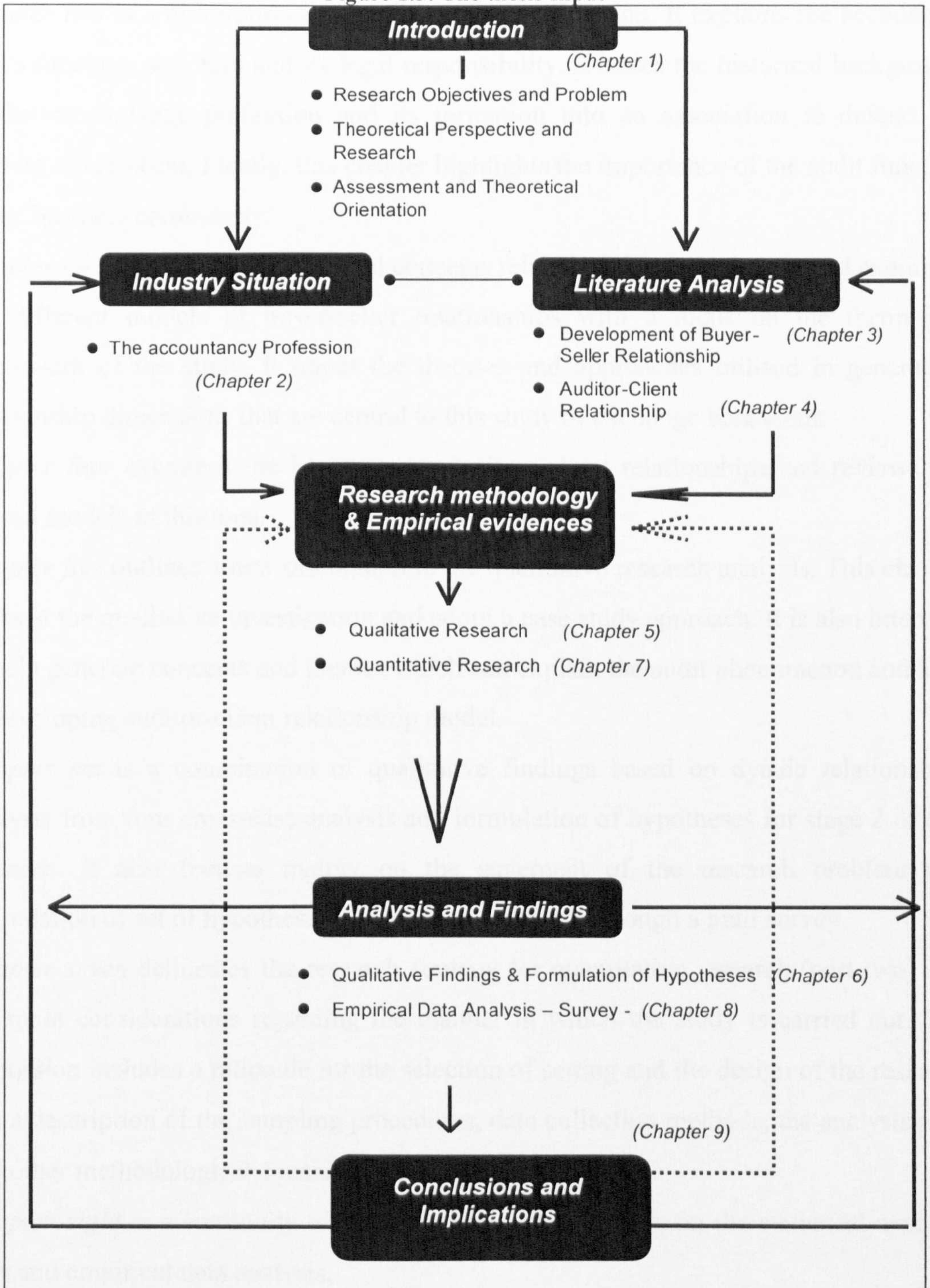
These two measures are very important in this study.

The validity of the study was tested to make sure the study actually answered the questions set to achieve the research objectives. Details of explanation are presented in methodology part one and two. This study is reliable because it can be repeated with the

1.8 THE STRUCTURE OF THE THESIS

The following diagram portrays a broader picture of the input of the study.

Figure 1.3: The thesis Input



Source: Original

The thesis contains nine chapters:

Chapter one provides an overview of the thesis and discusses the background and rational of the research. a discussion.

Chapter two is a description of the accountancy profession. It explains the accounting firm's function, structure and its legal responsibility. It traces the historical background of the accountancy profession and its formation into an association to defend the interest of members. Finally, this chapter highlights the importance of the audit function to the business community.

Chapter three reviews the theoretical concepts related to the area of study and examines the different models of buyer-seller relationships with a focus on the theoretical framework of the study. It traces the theories and approaches utilised in generating relationship dimensions that are central to this study of exchange behaviour.

Chapter four examines the literature on auditors-client relationships and reviews the related models in this area.

Chapter five outlines a new orientation to the qualitative research analysis. This chapter looks at the qualitative investigation and adopt a case study approach. It is also intended to help generate concepts and themes which can explain the audit phenomenon and help in developing auditor-client relationship model.

Chapter six is a combination of qualitative findings based on dyadic relationships analysis from four cross-case analysis and formulation of hypotheses for stage 2 of this research. It also focuses mainly on the statement of the research problem and formulation of set of hypotheses which are to be tested through a mail survey.

Chapter seven delineates the research strategy for quantitative research (part two) and the main considerations regarding the manner in which the study is carried out. The discussion includes a rationale for the selection of setting and the design of the research and a description of the sampling procedures, data collection methods, the analysis plan and other methodological considerations.

Chapter eight is a continuity of chapter seven but it focuses on the statistical analysis plan and empirical data analysis.

Chapter nine gives the main conclusions and implications that emerge from these findings.

CHAPTER TWO
THE ACCOUNTANCY PROFESSION[i]

2.0 INTRODUCTION

This chapter aims to describe and explain the nature of the accountancy profession, its activities and its historical development. It contains three sections. The first section deals with the structure and organisation of the accountancy firm, its activities and its legal responsibilities. Next, there is a need to examine professional standards. This leads to an examination of the professional codes of conduct of accountants, their education and training, as well as the discipline and self-regulation imposed by their professional bodies.

The structure of the industry deals with the market for accounting services. It looks at the audit market, it regulation and its criticism. Audit reforms formulated by Audit Standard Board (ASB) are described and the role of audit supervision is discussed. Finally, the formation of accountancy associations and their development is examined from a sociological perspective. Moreover, the accounting firms are formed on the basis of partnerships and operate within a self-regulated environment, have a special type of relationship. There is a need to understand the situation and its legal requirement. This leads to a review of the professional associations as political bodies.

2.1 ACCOUNTANCY FIRMS FUNCTION AND STRUCTURES

2.1.1 Functions

2.1.1.0 Accounting and auditing

The term ***accounting*** encompasses various tasks. It involves, for instance, book-keeping, which is a mechanical task involving the collection of basic information and entry of it in special records known as *books of accounts.* At the end of the financial year, the data are extracted and summarised in a form of statements known as a *profit and loss account,* and a statement of assets and liabilities, known as *a balance sheet.* Although accounting is a generic term, covering almost anything to do with the collection of information, it should be more properly applied to the use and conversion of that information once it has been extracted from the books of accounts. This activity is associated with auditing. It is clear that bigger accountancy firms do not handle book-keeping for medium-sized and large firms of their clients. However, accountancy firms advise them how they should go about it.

[i] In this chapter the term ***accountancy*** will be used to refer to the profession and ***accounting*** to the subject.

A primary function of an ***audit*** is to investigate the accounts supporting financial statements and to collect evidence of whether or not the financial statements give a true and fair view of the state of affairs of the company, its profit or loss and source and application of funds.

It is defined by Woolf (1997) as a process (carried out by suitable qualified *"auditors"*) whereby the accounts of business entities, including limited companies, charities, trusts and professional firms, are subjected to scrutiny in such detail as will enable the auditors to form an opinion as to their truth and fairness. This opinion is embodied in an "audit report", addressed to those parties who commissioned the audit, to whom the auditors are responsible under statute.

An auditor's judgement about critical audit areas is frequently based upon the individual auditor's experience and the combined experience of the profession- i.e., conventional audit wisdom (Johnson, 1987). As Wood and Sangster (2005) point out that:

> *"Contrary to most of the public think, auditors do not guarantee to discover any fraud that may have occurred. That is not what the audit is for. Following such financial scandals as Enron, the Maxwell affair, BCCI bank, Polly Peck and Barlow Clowes there has been pressure exerted upon the accounting profession to reconsider its position regarding the discovery of fraud when auditing the financial statements of a company"* (p.593).

Auditors in the US have been provided with a set of guideline questions to use when they are auditing their client. The checklist is presented in Table 2.1: Prospective Audit Client Site Visit Checklist.

Under UK Company law all enterprises incorporated under the Companies Acts are required to have their financial statements audited by *qualified accountants* who must report whether or not the statements show a true and fair view. Because of this privilege, the auditing activity has been viewed as reliable and accountable. However, criticisms concerning auditors have been making big headlines and their activity is now under scrutiny. This led some members of parliament and academics to ask for the introduction of an independent audit body. Consequently, an association for accountancy and business affair (AABA) was set up by this group and its trustees are:

- Professor Christine Cooper
- Professor Colin Haslam
- Professor Richard Laughlin
- Professor Prem Sikka
- Professor Hugh Willmott
- Mr Jim Cousins (MP)

- Dr Austin Mitchell (MP)

Source: http://visar.csustan.edu/aaba/aaba.htm (04-08-2003)

This association promotes itself as Britain's independent voice on accountancy and business affairs.

Table 2. 1: PROSPECTIVE AUDIT CLIENT SITE VISIT CHECKLIST

Accounting firms' proposal teams should visit the headquarters or production facilities of a prospective audit client during the mutual evaluation period. The teams should inquire about personnel changes, company goals, communication traditions and technical information as well as requesting the potential clients' auditor selection criteria and why they are changing auditors. Some potential questions include the co-operativeness of the internal audit staff and what changes are expected to impact the company in the next five years.

A site visit - a trip to a prospective audit client's headquarters or production facilities - is a good opportunity for the CPA firm and the client candidate to size each other up. Here are some questions that can be asked by the firm's proposal team.

1. To what extent and in what areas can we rely on your existing internal audit staff to support us?
2. What do you think are the most critical areas of risk in your business? How can you limit your exposure?
3. What information can you provide that will help us, in planning for the audit, to obtain a basic understanding of your operations and activities?
4 Are your internal reporting systems functioning as effectively as you think they could? What are their strengths and weaknesses?
5. Do you anticipate changes in the financial area in the next year? How could they affect the selection of a new auditor?
6. Do you use the last-in first-out, first-in first-out or weighted-average inventory method? Why is the one used the best for your operations?
7. Do you anticipate any manufacturing or systems changes in the near future? What kind of impact do you expect them to have on the organisation?
8. How are your overseas financial operations managed? Do you anticipate any problems or changes in the near future? Personnel-related Information.
9. What kinds of changes have you made in companywide staffing in the past year? Why? Do you anticipate more?
10. Do you anticipate any changes in your internal audit or tax staffing in the coming year? Issues, needs and goals.
11. What do you think will have the biggest impact on your industry and your company over the next five years? Why?
12. How have you prepared for this effect?
13. Is the transition to a new auditor a concern for you? Why? What could we do to lessen your concern?
14. Do you have a formal corporate goals or mission statement? Is it effective? Why or why not? Relationships and communications.
15. What kind of working relationship do you and your senior management prefer to have with your auditor? Have you had it in the past?
16. Would you like to meet periodically with our firm's top industry specialist? How often?
17. How frequently and in what forms do you prefer to receive communications from your auditor? Does your current auditor communicate in this manner?
18. How could we work best with your audit committee?
19. If you could change three things about your current audit or audit firm, what would they be? Selection criteria.
20. What do you think are the most important criteria your management should consider in selecting a CPA firm? Why?
21. Which members of your company do you expect to participate in the decision-selection process? Why were they chosen? (Even if you know the answer, you should ask it. You may be surprised.)
22. Why are you choosing a new auditor now?
23. Have you participated in the selection of a new auditor before? How was the process different from this one?
24. Which firm do you think has the leading edge? What would you it take for our firm to win?

Adapted from Winning Proposals –A Step-by-Step Guide to the Proposal Process by Kaye Vivian, in association with the American Institute of CPAs management of an accounting practice committee, 1993.

Source: AICPA. (1993), "Prospective audit client site visit checklist," ***Journal of Accountancy***, (US), July, Issue 175, No. 7, p.32

(i) Auditing of smaller firms

The financial Act 1994 stipulates that only medium-sized and large companies are to have this legal requirement, i.e. to have their accounts audited. However, it is worth examining briefly the issues of audit of smaller companies.

The profession has been debating the need for compulsory audit of certain smaller companies. There are fears, which have been expressed that the abolition of compulsory audit for small companies might have an unfavourable impact on the smaller practitioner.

(ii) Examination of some facts and issues involved in debate

There are two schools of thought. One advocates the use of audit for small companies, the other challenges it. Until May 1978, there has been an uneasy silence about the quality and scope of the audit of the smaller companies. At that time such small companies seldom received audit qualifications solely on account of the scope of audit work. Therefore, the exposure drafts of the new *"Auditing Standards and Guidelines"* were issued. These were finalised with one major modification and published in April 1980 (APC, 1980).

The *abolitionists*' arguments are essentially pragmatic-where there is a need, let those concerned make the appropriate decision. The arguments of the advocates of the status quo are more essentially theoretical and are enshrined in the concept of the price of "limited liability", as if the recipients of this public privilege must pay for it in the time-honoured way, an audit, whether or not such form of payment is relevant to Society's needs. The *advocates* of the status quo claim that there is no mandate for making any change. This attitude, however, does not take account of the main philosophical issue involved. In a free enterprise system, it must surely be argued that regulation is only justified if it passes a cost-benefit test; that is, the cost to be borne by those being regulated are outweighed by the benefits to society of imposing or, more particularly in this instance, retaining the regulation (Shirle-Beaven (1981). From sounding and straw polls made, there is no clear evidence of a strong majority either way, even, surprisingly, amongst the smaller practitioners themselves. It may, however, be noted that ICAEW has come out against abolishing the audit and against review as an alternative in the event of abolition. The arguments put forward ***in favour*** of compulsory audit and the contrary view are summarised in table 2.2.

The debate is well summarised by Shirle-Beaven (1981, p.234):

1) At this point, let it be clearly stated that the idea of exempting certain companies from the statutory audit requirement is not in any way bringing in dual standards. Many argue passionately that there can be only one standard of audit-one cannot impose a different standard of *audit* on smaller companies. Others have argued that one can. This must be wrong. The audit opinion is ultimately a matter of judgement. It is often hard enough to decide what is "true and fair". One cannot impose a lower judgmental level, an attainment of a "reasonable (or nearly) true and fair view". In this respect, it is all or nothing. For this reason, the review report does not pretend to express an opinion.
2) One can, however, define the various parameters that determine the need for audit. These parameters are capable of objective assessment and a decision can be made where to draw the line. This is not dual standards.
3) The small audit debate has drawn into focus the real issue - the existence of two sets of standards within the profession.

The key points of the debate are summarised in table 2.2.

Accountancy firm provide a number of services other than audit. These services are described next.

2.1.1.1 Taxation

Taxation is a highly complex and technical branch of accounting. Accountants involved in tax work are responsible for computing the amount of tax payable both by business entities and by individuals. Neither company nor individuals need pay more tax than is lawfully demanded, and so tax experts spend much of their time trying to reduce their clients' tax bills.

2.1.1.2 Insolvency

Insolvency comes under the term ***"bankruptcy"***. However, the term itself has no precise technical meaning. It may denote one of the three things:

(a) *insolvency*, i.e. a person's inability to pay his debts; (b)*"notour Bankruptcy"*, i.e. a state of insolvency which has become notorious in the sense of being public knowledge; or (c) *sequestration*, a court process by which the insolvent person's assets are gathered in and sold, the net proceeds (after payment of administration expenses) being then divided, as far as they will go, amongst the creditors, according to their various priorities, in payment or part-payment of the debts due to them (Marshall, 1983, p.477).

It is generally agreed that the term bankruptcy does not have any technical meaning in Scot's Law, despite the fact it appears in the title of Acts of Parliament, for example, the bankruptcy (Scotland) Act 1985. Cusine and Forte (1987) confirm that the term covers three distinct situations:

> *"A person may be bankrupt in the sense that his total liabilities exceed his total assets. He is sometimes described as being in a state of **practical insolvency**. A person, however, may be bankrupt in the sense that he is unable at a particular time to pay one or more of his debts. This often arises because of a **"cash flow"** problem. A manufacturer who has supplied goods to a retailer may require payment of these goods now but the retailer who has sold the goods has not yet received payment. The retailer is therefore unable to pay the manufacturer. It may be, however, that if he realised all his assets he could pay all of his creditors including the manufacturer. If a person is in that position, he is described as being in a state of **"apparent Insolvency"**. A person may be bankrupt in the sense that his estate has been sequestrated. **Sequestration** is a process by which a person's assets are transferred to trustee who is responsible for paying the creditors either in full or proportionately* (p.204).

Instead of resorting to sequestration, the insolvent and his creditors often in practice prefer to have recourse to a private arrangement, usually a trust deed for creditors. From the standpoint of the creditors such arrangements may save expense (with the result that there will be more funds available to meet the debts due to the creditors), and the debtor has the advantage of avoiding the greater publicity and the statuary disqualification and disabilities involved in the sequestration process. Private arrangements are described as "extra-judicial", because unlike sequestration, they are not conducted under "judicial" (i.e., court) authority (Marshall, 1983).

2.1.1.3 Corporate recovery

The insolvency experts-now known more often as *"corporate recovery specialists"*-work closely with the banks to save business in difficulties.

2.1.1.4 Management consultancy

Management consultants provide a wide range of services including corporate strategy, information technology, marketing, human resources and management developments. Many assignments- such as acquisition investigations- are multi-disciplinary, involving teams from general practice departments and one or more areas of the management consultancy practice.

This activity goes along with the insolvency situation. Most of the accountancy firms use them together. This activity appears to be not so well known to the public because of the lack of disclosure of information and safeguard of the companies rescued. However, it is with increasing frequency that partners and staff involved are called upon to provide assistance to halt the decline of ailing companies before they pass beyond help.

Restoring business to a sound financial footing and thereby preserving employment is certainly one of the most rewarding and satisfying aspects of this work.

Table 2.2: Audit for Small Companies: Abolitionists and Advocates Arguments

Interested parties	Argument in Favour of the compulsory audit	Argument against (Contrary view)
Shareholders	• need reassurance that their interests are being protected • need audited statements as a basis for lending decisions	• Let them decide. If even a significant minority want an audit, let them have one; but why impose it?
Banks and other lenders	• Need audited statements as a basis for lending decisions.	• Again, let them demand it when necessary. Why impose it on companies with no borrowing? • In any event banks rely as much on the way the account is conducted, on management accounts and other *"timely"* information, on cash flow projections, as they do on an out of date balance sheet.
Trade Creditors	• Seek assurance that the businesses they supply are financially sound.	• Statements are filed too late to be much use to creditors or for credit ratings.
Taxing authorities		• Have always been prepared to rely on unaudited statements and have stated that they would not hold out for an audit.
Employees	• Need reliable financial information for collective bargaining and to assess the prospective viability of an employer's business.	• In a small company employees are very unlikely to rely on audited statements, the profit shown by which is heavily dependent on director's remuneration, low interest loans from directors, etc.
Management	• Is helped by an independent check on a business's performance and on the company's procedures and staff.	• Again, let them decide. In any event, the whole debate stems as much as anything else from the concern that the statements frequently reflect only information supplied by management. Further, without an audit fee, management could afford to make better use of the accountant's other advisory services.

Source: Original

2.1.2 Structure

2.1.2.1 Partnerships

Accountancy firms are formed as "***partnerships***". In partnership there is a voluntary association of two or more persons for the acquisition of gain or profit, with a contribution, for that and, of stipulated shares of goods, money, skill and industry; accompanied by an unlimited mandate or power to each partner to bind the company in the line of its trade, and a guarantee to third parties of all the engagements undertaken in the social name (Bell's Commententaries II, 499 in Cusine and Fort 1987, p.302).

The Companies Act 1985 and amended by the Financial Services Act 1986, s 212 (2), sch 16, para 22, states that:

(1) No company, association or partnership consisting of more than 20 persons shall be formed for the purpose of carrying on any business that has for its object the acquisition of gain by the company, association or partnership, or by its individual members, unless it is registered as a company under this Act, or is formed in pursuance of some other Act of Parliament, or of letters patent. However, this does not prohibit the formation-(a) for the purpose of carrying on practice as solicitors, of a partnership consisting of persons each of whom is a solicitor; (b) for the purpose of carrying on practice as accountants, of a partnership consisting of persons either of whom falls within either paragraph (a) or (b) of section 389(1) (qualifications of company auditors); (c) for the purpose of carrying on business as members of a recognised stock exchange, of a partnership consisting of persons each whom is a member of that stock of exchange.

(2) The Secretary of State may by regulations in a statutory instrument provide that subsection (1) shall not apply to formation (otherwise than as permitted by subject (2), for a purpose specified in the regulations, of a partnership of a description so specified.

An upper limit on the number of partners in a partnership is imposed by the Company Act 1948 (s.434), as amended by the Companies Act 1967 (s.120): the maximum number of partners is 20, and the Department of Trade has the power to extend the exemption to partnerships formed for other specified purposes. Where the number of persons carrying on the business exceeds 20 and no exemption applies, a company must be formed, the usual procedure being registration under the Companies Acts.

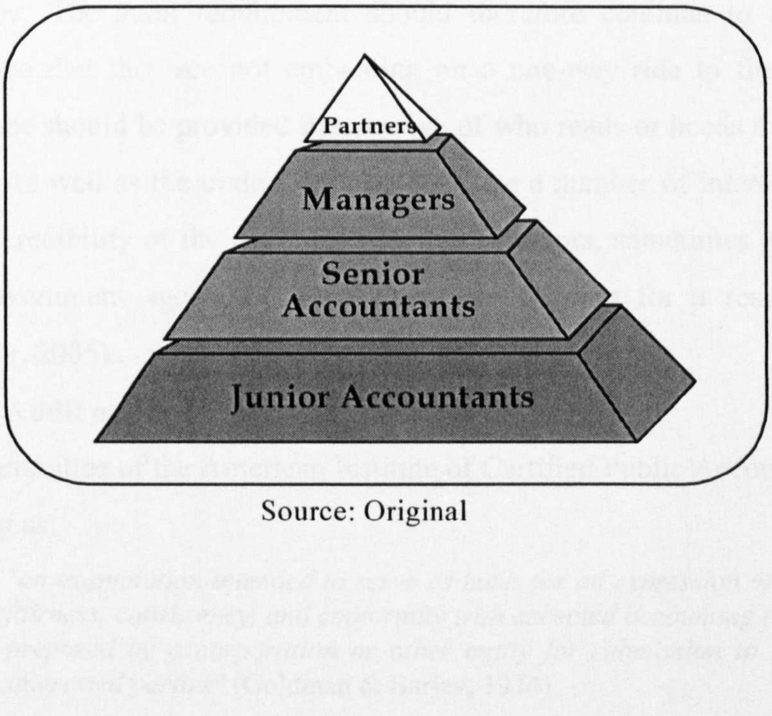
From the definition it is apparent that there must be at least two persons before there can be partnership. A sole trader, therefore, even though he may be trading under a name which suggests that he has business associates is not a partnership. Moreover, it appears that the profession can form incorporated practices where they can have shareholders but they must be practitioners (see section 2.6.4).

2.1.2.2 Organisational structure

Like any organisation, the accountancy firms have a structured management. The partners will generally delegate decisions of routine management to the managing partner, who reports to the full partnership at regularly convened meetings, usually monthly. The partnership secretary, reporting to the managing partner, takes responsibility for administration, including preparation for agenda papers and minutes of meetings, accounting and management records, time records, word processing, microfilming, printing, photocopying, binding, post, telex and communication generally. The salaries paid to those involved in the above activities form part of the firm's overheads. By contrast, the professional staff and partners maintain accurate time records to ensure that all time assigned to client affairs is properly billed at the appropriate hourly rates, determined in turn by reference to salaries. In this way the firm aims to obtain full recovery of the direct salary costs and the fees represents partnership profits, shared between equity partners in their profit-sharing ratios.

The professional staff are sub-divided both laterally (into departments) and vertically (into seniority grades) (cf. figure 2.1 and table 2.3). Usual departmental divisions might be audit, taxation, liquidation, accounts preparation services and any other assignment category undertaken by the firm on a regularly recurring basis. Partners take ultimate responsibility for the service given to those clients for which each of them is designated "assignment partner", but the detailed management of each assignment is the work of managers, who in turn take charge of the work teams of seniors and juniors within the broad departmental areas. The figure 2.1 and table 2.3 summarise the structure and organisation of the accountancy firm.

Figure 2.1: General Structure of Accountancy Firm



Source: Original

Table 2.3: Typical Departmental Structure (KPMG)

Staff Level	No. in Dept	Min. years with Firm	Job Specification
Partner	-	10	*In charge of client development. Responsible for satisfying client service requirements.*
Senior Manager	1	8-11	*Responsible for department. Manager in charge of a significant proportion of department's clients.*
Manager	3-5	5-11	*In charge of major client assignments, reporting directly to partner.*
Assistant Manager	3	4-7	*In charge of major client assignments, involving large teams of staff. Reporting to manager and partner.*
Senior Supervisor	3	3-6	*In charge of major client assignments, significant staff management responsibility.*
Senior	4	2-5	*In charge of various client assignments. Assisting on major client assignments. Responsible for 3-4 staff.*
Third Year Student	7	3	*In charge and assisting on various client assignments. Responsible for 2-3 staff.*
Second Year Student	9	2	*General assisting. Responsible for small and medium-sized client assignments. Certain staff management responsibilities.*
First Year Student	9	1	*Responsible for small assignment. General assisting.*
Secretaries	2-3	1	*General secretarial duties.*

Source: KPMG (2007)

2.1.3 Legal Responsibilities (constraints)

2.1.3.0 Audit report

Without an audit presence abuses would be greater, and failures would become common. The prime sufferers when a company collapses are the unsecured *trade creditors.* The audit requirement should therefore continue to afford a measure of assurance that they are not embarking on a one-way ride to financial loss and such assurance should be provided irrespective of who reads or heeds the audit report (Wolf, 1990). As well as the trade creditors, there are a number of interested parties who rely on the credibility of the auditors. They are investors, sometimes employees, customers and government agencies. All of them are looking for a reassurance (Wood and Sangster, 2005)..

2.1.3.1 Audit opinion

The Committee of the American Institute of Certified Public Accountants (CPA) defines auditing as:

> ***"an examination intended to serve as basis for an expression of opinion regarding the fairness, consistency, and conformity with accepted accounting principles of statements prepared by a corporation or other entity for submission to the public or to other interested parties"*** (Goldman & Barlev, 1974).

Two important issues are outlined by the above authors.

(i) Auditors submit opinions in the form of a written report. The report describes the nature and the scope of the examination (audit) made and includes a statement (opinion) as to whether the financial statements fairly represent the financial position of the audited firm in accordance with accepted accounting principles.

(ii) If the auditor feels unable to endorse a financial statement wholeheartedly, he must qualify his opinion, or state that he is unable to express an opinion, or express an adverse opinion.

Forming an opinion on the financial statement, in the UK the Auditing Practices Board (APB) sets out six types of opinion;

Table 2.4: Six types of opinion

1) ***Unqualified opinion.***	The accounts give a true and fair view.
2) ***Unqualified opinion-with emphasis.***	The accounting treatment and disclosures are sound but the accounts are affected by "fundamental uncertainties" about the financial situation.
3) ***Qualified opinion-partial disclaimer***	Not all the audit evidence could be obtained and assessed.
4) ***Qualified opinion-disclaimer***	Not all the evidence has been obtained and this is sufficiently material to make the accounts misleading.
5) ***Qualified opinion-disagreement.***	The statements have not been prepared in accordance with accepted accounting principles or do not give a true and fair view. But the disagreement does not make the statements as a whole misleading.
6) ***Qualified opinion-adverse opinion***	The financial statements do not give a true and fair view and are misleading.

Source: Original

The process of forming an opinion on financial statements is presented figure 2.2.

2.1.3.2 True and Fair view

The words *"true and fair"* represent the final objective of accounting. The Companies Act places upon the directors of every company the responsibility of ensuring that the balance sheet gives a true and fair view of the state of affairs of the company, and that the profit and loss account gives such as a view of its profit or loss for the financial year. While this duty remains exclusively that of the directors, the auditor, in his report to the members, is required to state whether, in his opinion, the accounts do in fact meet the above requirement (Woolf, 1990; Wood and Sangester, 2005).

There are some speculations that the concept does not reflect the reality of the accounts. Royce (1992) asks whether property accounts give a true and fair view. He argues that *"property firms pick policies to match the size of their pocket"* (p.27). Based on comments of the above writer, a summary of accounting techniques used in the construction industry to disguise the real health of the company is presented in table 2.5. The traditional view, of the profit and loss account representing the difference between two balance sheets, is rarely reflected in the property accounts. High gearing is common among property companies. In the 1980s, UK banks were so eager to lend to property companies and some contracted to receive a share of profits of various schemes. In America it is called 'equity-Kicker'.

Table 2.5: Accounting techniques used in construction sector

COMPANY	ACCOUNTING TECHNIQUE	PROBLEM/EXPLANATIONS
Olympia & York	*Revaluation of reserves*	• *Company showing profits, while shareholders' funds have fallen. More than half of shareholders' funds can consist of revaluation of reserve, i.e., the difference between the original cost of the building and its current open market value.*
Land Securities	*Revaluation of reserves*	• *Reported a retained profit of £55.9 m in 1991. This took no account of deficit on valuation of properties, which cut £12 billion from revaluation of reserves.*
Rosehaugh Stanhope Development	*Selling a property to a company outside the group and rebuy it again*	• *Its assets exceed those of its parent combined. An alternative method involves selling a property to "Shell" company outside the group. The "Shell" is a warehouse for property and loans. The developer can repurchase the property in future at predetermined price.*

Source: Original

The security for bank lending is primarily the property's value. Many companies have increased borrowings based on rising property valuations in the boom years. If the valuations fall, some companies will be in breach of loan covenants, making their borrowing repayable on demand. This may precipitate a company's administration, receivership or liquidation. Company that sought *refinancing* to avoid this situation. Such refinancing normally involves high interest rates and considerable fees to lenders and advisers.

Many high geared companies resorted to off-balance sheet financing. Joint-ventures, where companies take 50% or less, enable the investing firm to consolidate its share of profits and revaluation surplus, without needing to consolidate the accompanying borrowing within the joint-venture, subject to ownership equalling or exceeding 20% of the equity. Similar to Rosehaugh Stanhope Development, this alternative method is used also well by Distilleries.

Looking back at the property industry, *Cash Flow* is critical to property companies. The purchase of property is followed by its *development* or *redevelopment*. The cash *outflows* are then followed by rental income in a property trading company. In theory, the financial needs of investor companies should be more long-term than those of traders. In practice, some investors are selling property due to *illiquidity* and some traders are letting property originally intended for sale, due to the lack of buyers.

In 1987 and 1989 the Governor of the Bank of England signalled concern about the level of bank lending on property. In 1990, the banks reported by curtailing new property loans. Property companies had to turn to shareholders in a spite of rights issues in 1990 and 1991. Some issues were merely to survive rather than expand, though Sainsbury, Tosco and Argyll (Safeway) raised £1.5 billion from the shareholders to continue store-building. Property companies had difficulty raising money from banks. Recently, MPs blame watchdog with Northern Rock financial crisis and call for more power for Bank of England (Inman, 2007).

2.2 PROFESSIONAL STANDARDS

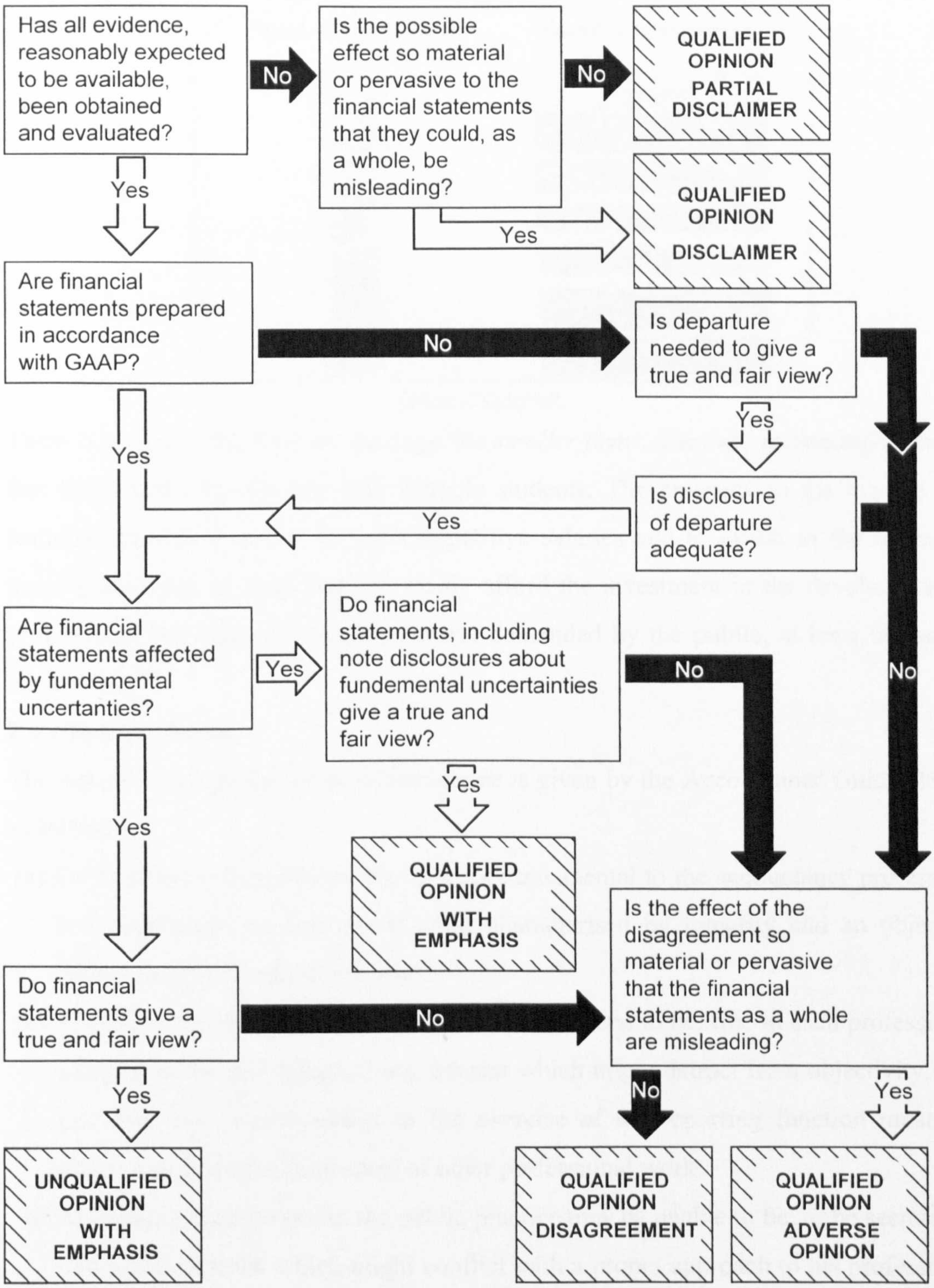
There are four important aspects of UK professional standards in which there have been important developments in the last few years:

- education and training,
- independence,
- professional discipline and self-regulation.
- ethical guidance

2.2.1 Education and Training

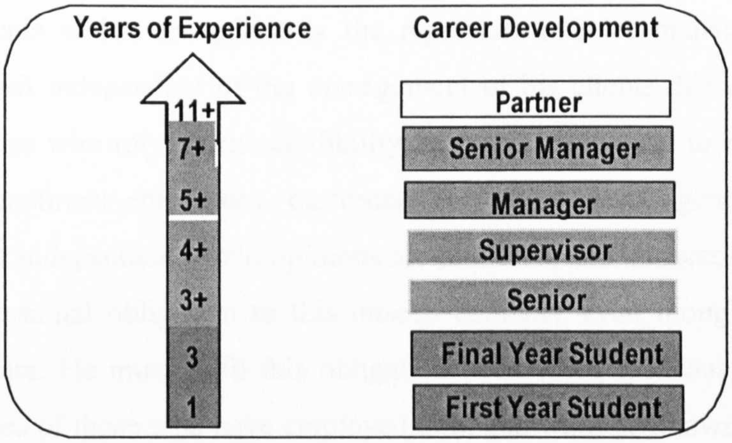
The career development from the first year student to a partner promotion follows the same steps in most of the accountancy firms. Figure 2.3 shows the experience acquired during the training and the educational progress;

Figure 2.2: Forming an opinion on financial statements



Source: Adopted with slight modification from The Auditing Practice Board in *The Times*, May 14, 1992, p.25

Figure 2.3: Accountant Career



Source: Original

There is a widespread concern amongst the *smaller firms*. They are increasingly finding that they cannot recruit and train suitable students. The pressure on fee income is a restraint upon their ability to pay competitive salaries and to invest in the necessary training facilities. Neither can they easily afford the investment in the development of professional standards and quality control demanded by the public, at least for public client work.

2.2.2 Independence

The statement on professional independence is given by the Accountants' Guide (1989) as follows:

(a) Professional independence is a concept fundamental to the accountancy profession. It is essentially an attitude of mind characterised by integrity and an objective approach to the professional work.

(b) A member in public practice should be, and be seen to be, free in each professional assignment he undertakes of any interest which might detract from objectivity. The fact that this is self-evident in the exercise of the reporting function must not obscure its relevance in respect of other professional work.

(c) Although a member not in the public practice may be unable to be, or be seen to be, free of any interest which might conflict with a proper approach to his professional work, this does not diminish his duty of objectivity in relation to that work.

This statement addresses all professional practitioners. However, the auditors are the centre of interest. Therefore, it is interesting to look at this concept from the auditing point of view.

As far as auditing is concerned, Mautz and Sharaf (1961) look at the concept of *"Independence"* as an essential auditing standard because of the opinion of the independent accountant is furnished for the purpose of adding justified credibility to the financial statements which are primarily the representations of management. If the accountant was not independent of the management of his clients, his opinion would add nothing. Those who rely on the credibility he furnishes are apt to be creditors or investors, or sometimes employees, customers, or government agencies. It is for assurance that the independent expert opinions are provided, and the accountant incurs a profoundly professional obligation to this unseen audience even though he does not know who they are. He must fulfil this obligation even when it means opposing and denying the wishes of those who have employed him, and who, he knows, may cease to do so.

Today, there is a greater demand for accountability in matters of public interest. Greater accountability brings with it a need for effective and independent monitoring and reporting.

Nowadays, the accounting profession is increasingly involved in matters of public concern and on ever widening front. At the same time it has come under greater scrutiny itself than ever before. Austin (1990) argued that the accounting firms are unduly influenced by their clients, and to make things fairer the *"profession needs backbone"*, in the form of an independent regulatory source of standards. Auditors should be rotated at regular intervals. Later on, AABA was set up to highlight these issues.

2.2.3 Discipline and Self-regulation

It has been argued that if a professional accountancy firm wishes to be considered to be in the top grade, it must submit itself to an acceptable standard of discipline and self-regulation. In this context, proposals have been submitted. Quoting The Greenside Report, which has been broadly adopted by three professional bodies (ICAEW, ICAS and CACA), in Shirley-Beaver 1981, a summary is presented as follows;

(a) The extension of disciplinary jurisdiction to include inefficiency and incompetence to such an extent or on such a number of occasions as to cause concern about its effect on the standing of the profession;

(b) the establishment of joint machinery to inquire into and make findings upon the professional conduct, efficiency and competence of members and of members firms in circumstances which give rise to ***public*** concern;

(c) The inclusion of a lay observer in the domestic (i.e. private) investigation process;

(d) The lay representation at all levels in the disciplinary process;

(e) The creation of Practice Advisory Services by each body;

(f) The need for stricter control over practising certificates;

(g) The need for development of a programme for continuing professional education;

(h) The need to recognise the separate responsibilities of members not in public practice.

On 17th February 1992, *Arthur Young* was fined £100,000 by its regulatory body for failing to highlight "seriously misleading figures" in 1984 published by *Millbury*, the collapsed house building group. The penalty was the largest yet imposed through ***the Joint Disciplinary Scheme, the Self-regulatory*** mechanism of the Institutes of Chartered Accountants in England, Wales and Scotland, and the Association of Certified Accountants. A Committee of inquiry set up by the disciplinary scheme said Arthur Young, which became part of Ernst & Young, the accounting firm; *"fell below the standard which should be displayed, and which may reasonably be expected of, a firm of chartered accountants serving as auditors of a public company."* The committee launched its inquiry after a critical report by the DTI on the company was published (Jack, 1992, FT 18.02.92).

2.2.4 Ethical guidance

In 1975, on the recommendation of a joint committee of the Institute of Chartered Accountants in England and Wales, Scotland, and Ireland each adopted an ***ethical guide*** setting out standards of professional conduct to be followed by members of these Institutes.

Statement one of the *Guides* requires practising members to be and to be seen to be independent. The *explanatory notes* to the statement give guidance as to the proper conduct in particular circumstances. Failure to follow the guidance does not itself constitute misconduct but means that the member concerned may have to justify departing from the guidance. The guidance given on important matters is as follows:

1. Members should not have either direct or indirect financial interests, in what including shareholdings in and loans to or from clients.

2. A member should make sure that the fees received from any one client or group of associated clients *do not exceed 15 per cent* of his total fee income.
3. The holding of a position as an officer of a company, not only currently but also at any time in the past two years, should debar a person from personally acting as auditor. Also, a person should not personally act as an auditor of his wife or husband of such child or brother or sister, is an officer.

The company Acts 1948, 1967 and 1989 contain a *provision* that the auditor is always appointed by the shareholders. In addition, they provide that none of the following persons shall be qualified for appointment as auditor of a company:

1. An officer or employee of the company,
2. A person who is a partner of, or in the employment of, an officer or employee of the company.

2.2.4.1 Professional code of conduct for accountants

The professional code of conduct can be summarised by the following points: integrity, independence and objectivity and confidentiality. The Accountants' Guide (1989) defines those concepts as follows;

(i) Integrity: Members, including ones working outside the areas normally associated with accountancy, must maintain a high standard of conduct. In keeping with this standard, members should not knowingly mislead or misrepresent facts to others and should use due care to avoid doing so unintentionally. At all times, member should be conscious that integrity must be an overriding principle.

(ii) Independence and objectivity: Members have a duty to be objective in carrying out professional work, and should maintain an independent approach to that work. Thus members performing professional work in commerce, industry or the public sector, should recognise the problems created by personal relationships or financial involvement's which by reason of their nature or degree may threaten their objectivity.

(iii) Confidentiality:

a) Disclosure of information

Confidentiality should be preserved both within and outside members' organisation. However, in the course of their work members may find themselves faced with conflicts between their loyalty to their employers or colleagues on the one hand and their duties as members of a profession or as citizens on the other hand. When faced with such conflict a member should make disclosure only with proper authority or where there is a professional obligation, a right, a legal requirement or a public duty to disclose.

b) Misuse of information

Information acquired by members in the course of their duties and to which they would not otherwise have access should not be used for personal advantage nor for the advantage for a third party. When members change their employment they must distinguish between experiences they have gained in their previous employment and confidential information acquired there.

2.2.4.2 Standards distinct from procedure

"Auditing" Is a profession designed to supply auditing services to publicly owned companies. "Non-audit" are others services provided by auditors, such as a management advisory services, tax consulting, data processing, handling of mergers, and the like, and are considered here as supplementary functions.

2.3 STRUCTURE OF THE INDUSTRY

2.3.0 Introduction

There are two sub-markets in the UK accounting services: auditing services and other services. Non-audit services cover a wide range of general and technical activities. The extent to which these services are offered varies from firm to firm. It is important to note that the supply of non-auditing services is hard to define. However, the supply of auditing services is easily identifiable. The Companies Act 1967 made this possible.

Following the collapse of Andersen in 2002, the audit and accountancy market underwent a period of substantial change relating to the fall of auditing standards and loss of public confidence. The regulatory environment took seriously the process of change in order bring back the audit independence and audit standards.

2.3.1 The Accounting services Market

The UK accounting services market can be seen as comprising two sub-markets, auditing services and other services. Non-audit services cover a wide range of general and technical activities. The extents to which these services are offered vary widely from firm to firm. They range from basic accounting services such as book-keeping, tax return preparation to more general management consultancy activities, financial planning, tax planning etc.

Key Note Report (2007) showed that accountancy firms cover four main disciplines:

- Management consultancy
- Audit and accounting
- Tax and legal services

- Corporate finance and business recovery

Audit, accounting and taxation services are the core activities for accountancy firms. ***Auditing*** is mainly confined to medium-sized and large accountancy firms. This reflects the need for a considerable number of specially trained staff. One has to remember that although audit, accounting and taxation are key activities, they rarely represent the major source of income for an accountancy firm. It has been noticed that the larger the firm the more likely it is that it will draw in the major portion of its income from other services, such as corporate finance, legal service and consultancy. Sole practitioners' accountants tend to focus on accounting and taxation services.

Table.2.6: The Total UK Market for Accountancy and Related Services by Sector by Value (£bn), 2002-2006

	2002	**2003**	**2004**	**2005**	**2006**
Audit and accounting	2,875	2,985	3,194	3,650	3,998
Taxation and legal services	2,344	2,334	2,661	2,834	3,117
Corporate finance and business recovery	1,318	1,485	1,685	2,033	2,338
Management consultancy†	6,940	7,634	8,474	9,211	10,132
Total	**13,477**	**14,438**	**16,014**	**17,728**	**19,585**
% change year-on-year	-	7.1	10.9	10.7	10.5

† — includes outsourcing

Source: Key Note 2007 page 11

Key Note (2007) estimated that: the total UK market for accountancy and related services as:

> *"Key Note estimates that, in 2006, the total UK market for accountancy and related services rose by 10.5%, to £19.59bn. This represents an increase of 45.3% on the 2002 figure of £13.48bn. Management consultancy, including outsourcing, is the single largest sector, representing 51.7% of the total market in 2006. Management consultancy is defined as including general business advice and outsourcing. As such, management consultancy represents a small proportion of revenue for most accountancy firms, but it is a growing part of their revenues. For the large accountancy firms, it is once again becoming an important source of revenue"* (p.11).

One has to bear in mind that, it still very difficult to identify the supply side, i.e., the audit firms, formed as partnerships, and are not required by law to publish their accounts. Since the collapse of energy giant and the financial scandals at WorldCom, a number of big firms changed their status into limited liabilities. Moreover, it is difficult to see how much they supply their clients with accountancy services. The auditing services market, however, can be identified on the supply side from clients' annual reports. In The UK, auditors' names and remuneration are required to be disclosed in all company accounts (1967 and 1989 Company Act).

Table. 2.7: The Forecast UK market for Accountancy and Related Services by Value (£bn and %, 2007-2011)

	2007	2008	2009	2010	2011
Audit and accounting	4,318	4,620	4,897	5,142	5,399
Taxation and legal services	3,335	3,535	3,747	3,972	4,210
Corporate finance and business recovery	2,572	2,829	3,112	3,423	3,765
Management consultancy†	11,044	12,038	13,121	14,302	15,446
Total	**21,269**	**23,022**	**24,877**	**26,839**	**28,820**
% change year-on-year	8.6	8.2	8.1	7.9	7.4

† — includes outsourcing

Source: Key Note 2007 page 56

2.3.2 The auditing services and the market place.

Moizer and Turley (1989) argue that one important characteristic of the audit services market is the degree of supplier concentration, i.e., the extent to which a relatively small number of audit firms account for a significant proportion of the total audit work carried out. This situation has been noted by Davies and Lyon (1982). The latter argue that in order to reduce uncertainty and improve profits, oligopolists will adopt some form of collusion. The most usual form will be an agreement to avoid price competition, although firms may continue to compete via product differentiation.

Commenting on the report published by the Accountancy Magazine (October, 1997), Kelly (1997) states that auditors profit from growing extra market. Fees paid to the audit firms that serve the UK's top companies rose 16 percent during the 1996 year, but the growth was led by charges for non-audit work, which jumped 26 percent compared with 4 percent for the audit itself. This author argues that these figures fuel the debate over whether auditors should be paid large sums for add-on services sold to the client. Some critics say it undermines their independence and ability to be objective in auditing. It is also argued that the figures help to explain why the merger between Price Waterhouse and Coopers and Lybrand was centred on winning market share in the rapidly growing consultancy market rather than the statutory audit

As far as the ***Insolvency*** market is concerned, the companies in bankruptcy are of smaller size. Hudson (1987) argues that the great majority of companies which go into liquidation are small companies partly because the great majority of registered companies are themselves small, even in many cases one-man business.

The industry is experiencing a very difficult time – the image of the profession has fallen dramatically since the beginning of 2001, competition is increasing and there are a growing number of new international accounting standards to be understood and mastered. Nevertheless, demand for accounting services continues to grow (Key Note Report, 2007).

The industry is highly concentrated. In 2006, the top four firms accounted for an estimated 32.4% of the UK market for accountancy and related services. Other accountancy firms and major management consultancies, including IT companies and specialist outsourcing companies share between them the rest of UK fee income.

Beyond the handful of major firms, the so-called mid-tier (medium sized?) are prospering. Mergers between these firms are enabling them to become a much stronger force in the market, which some believe is beginning to challenge the major firms. Meanwhile, the "Big Five" firms became the "Big Four" in the wake of the global disintegration of Andersen. These major firms dominate the auditing of the top 2000 companies in the UK. It remains to be seen how far the mid-tier firms will take market share away from them. The other major change being forced on the industry is that all the major firms have to sell their consultancy businesses, under pressure from the US Securities and Exchange Commission (SEC). It has been observed by the market analysts (KeyNote Report, 2007). A number of questions facing the profession have been raised:

- What sort of services should accountancy firms be allowed to provide?
- How can their auditing independence be assured?
- Should there be new codes of practice defining the relationships between accountants and their clients?

All these concerns have already been undertaken by Government and other regulatory bodies.

2.3.3 Accountancy professions and their monopoly power

Briston (1979) analyses the increasing concentration of power in the accountancy profession during a ten year period of time from 1968 till 1978. The evidence of his study suggests that the real dichotomy in the UK is between the large firms and the small firms and the medium-sized firm is rapidly disappearing. In 1979, there were 21 large firms, 57 medium-sized firms (defined as those with more than three and fewer than twenty listed clients) and 8,633 small firms. He predicted that by 1989 the medium-sized firm will almost certainly have disappeared, due partly to the loss of clients as result either of take-overs or of aggressive competition from the large firms and partly to mergers with the larger firms.

This is what the market witnessed in the 1980s. The big firms started merging together such as (Peat Marwick and KMG Thomson McIntosh in 1986; Arthur Young and Ernst Whinney in 1989; Coopers & Lybrand Deloitte and Ernst & Young in 1990; Touch Ross and Spicer Openheim). Moreover, a great number of small firms have been absorbed by medium-sized firms and other smaller firms are merging together as well. Following the collapse of Enron in the USA has resulted in a situation in which the "Big 5" accounting firms have become the "Big 4". In the UK, for example, Deloitte & Touche acquired the business of Andersen. This situation has been predicted by academic researchers such as Briston (1979), who raised several important issues;

- Do they want the auditing of major companies to be monopolised by a handful of accounting firms?
- Would such a monopoly lead to a restructuring of the profession into two tiers, or even its total division into two separate bodies?
- Would the government allow a monopoly which was created solely by the Companies Acts, to enjoy a very high monopoly income without any external regulation?
- Now that auditing has become a large-scale industry, is there any room for the traditional virtues of trust and the high standards of professional conduct which have for so long been the pride of the profession?

(Briston, 1979)

As a matter of concern, he recommended that it is essential that the professional bodies concerned address themselves immediately to these and to other major questions, if only to endeavour to bring their influence to bear on the future structure of the profession.

2.3.4 Audit Criticisms

However, twenty years after this article was published the profession has ignored the recommendation of one of their fellow chartered accountants members. Since 1990, the profession has been under strong criticisms;

(1) The accountancy firms have been accused of overcharging many of their corporate clients.

(2) Studies have found wild variation within the charges of each of the major accountancy firms. A variation that is hard to believe originates solely from the complexity of the work involved as the accounting firms claimed.

(3) In addition to what has been said above, accountancy firms have been criticised for using an audit to sell much more expensive specialist and consultancy services.

(4) Some critics say that auditors are biased by the conflicts of interest that the profession has brought upon itself, the fact the accountancy firms are trying to sell other services to the audit clients. This has prompted fears that the integrity of the auditors is now undermined by the desire to win business from audit clients.

(5) In November 2002, the Office of Fair Trading pointed out that "There is a public concern about the increased concentration in the supply of audit and accountancy services, and its implications for competition and choice. The OFT recognises that concern."

(6) A number of politicians are pushing the idea towards *regular and rotation of auditors* (A compulsory rotation of audit firms) with a rotation every 5 or 7 years, but the major accountancy firms are said to be unhappy about this reform. The main argument in favour of such a reform is that it prevents *too cosy a relationship* between client and auditor.

In response to the corporate collapse and financial scandals in the USA, The British government set up the Co-ordinating Group on Audit and Accountancy (CGAA) to ensure that there is a co-ordinated and comprehensive work programme by individual regulators to review the UK's current regulatory arrangements for audit and financial reporting. Their CGAA's interim report, published in July 2002, made comments and recommendations in a number of areas. Amongst them are:

- Auditor independence
- Corporate governance
- Regulatory oversight
- Financial reporting
- The reform of Company law
- Auditing standard

The CGAA report was interested in finding out through the OFT whether there are any competition implications of the high concentration in the market for audit and accountancy services. Moreover, The Treasury Select Committee launched an inquiry in

February 2002 to "examine, in the light of the collapse of Enron, the arrangements for financial regulation of public limited companies in the UK." Their report, published in July 2002, recommended that the government refer the operations of the "Big 4" accounting firms to the Competition Commission (CC).

2.3.5 Audit supervision

The Audit Registration provisions of the Company Act 1989 came into effect on 1st of October 1991. They apply to appointments or re-appointments as auditors on or after that date. The Secretary of State for Trade and Industry has granted supervisory body status to the three institutes of Chartered Accountants - ICAS, ICAEW and ICAI. Under the Company Act 1989 the Institutes will be responsible for the registration and supervision of firms of auditors. As supervisory bodies, the Institutes started monitoring firms' audit activities and checking compliance with detailed audit regulations. The three Institutes have worked closely together to develop the audit regime, the main purposes of which are spelt out in the Act:

> *"to ensure that only persons who are properly supervised and appropriately qualified are appointed company auditors, and carried out properly and with integrity and with a proper degree of independence".*

New Audit Regulations deal with eligibility for registration as company auditors and the conduct of audits. The regulations build on existing independence requirements and auditing standards and guidelines and reinforce the need for professional indemnity insurance. The Act requires the institutes to monitor registered auditors' compliance with the Audit Regulations, and the Joint Monitoring Unit's programme of routine visits to firms. The three institutes have also been approved as recognised qualifying bodies for company auditors under the Company Act 1989. With effect from 1st of October 1991, when Part II of the Act came into force, new arrangements were provided for;

- existing auditors to continue to qualify under the Act,
- those expecting to qualify as auditors between September 1991 and 1996 to continue under existing training and experience schemes,
- Those qualifying as auditors from January 1996 to meet the experience and other requirements laid down by the Act.

The practical effects were to change existing schemes very little, since the requirements of the Act are largely met already by those qualifying as chartered accountants. The requirements for work experience, which must be gained within authorised training offices under the supervision of qualified auditors, include a minimum of 12 months' audit work, of which at least six months must be on company audit. Moreover, a review of training and education in the accountancy profession has been examined by POBA Board (2004). However, since the collapse of Enron more changes were called for to reduce the audit expectation gap (Mitchell and Sikka, 2002 and Ojo, 2007).

2.4 HISTORICAL BACKGROUND OF ACCOUNTING ASSOCIATIONS

2.4.0 Introduction

Accounting is of social and economic significance. It plays a central role in the regulation of economic affairs in respect of the calculation of national and personal income, the costing of government expenditures, the administration of taxation and credit facilities and the appraisal of investments and corporate reporting to capital market (Willmott, 1986 and Gallhofer and Haslam, 2007).

At the very least, it can be said that accounting practices affect social and economic welfare and therefore that accounting is seen not only the concern of accountants but also of government and the general public. Anyone can practice in the UK as an accountant. Irrespective of training and experience, there is almost complete freedom to perform accounting work. Some work is, however, legally restricted, especially that relating to the audit of limited liability companies. Accountants are sometimes described as "qualified". A qualified accountant is generally regarded as someone who has been admitted to membership of one of the major accountancy bodies.

In the UK there are six major professional accountancy bodies. Together, they form the Consultative Committee of Accountancy Bodies, **(CCAB)**. Their list is given as below;

1. **ICAEW** The Institute of Chartered Accountants in England and Wales.
2. **CACA** The Chartered Association of Certified Accountants.
3. **CIPFA** The chartered Institute of Public Finance and Accountancy.
4. **ICAI** The Institute of Chartered Accountants in Ireland.
5. **ICAS** The Institute of Chartered Accountants of Scotland.
6. **CIMA** The Chartered Institute of Management Accountants.

Other UK Professional Bodies

- **APC** Auditing Practice Committee.
- **ASC** Accounting Standards Committee.
- **CCAB ltd** The Consultative Committee of Accountancy bodies ltd. It is an organisation through which the accountancy bodies act on matters of common interest.

2.4.1 Historical Background

Since 1970, the UK accountancy profession has started to make headlines. Before, it pursued its traditional role of invisible guide and mentor, the epitome of solidity and reliability. *"Although closely involved with the public, the accounting profession was nevertheless a relatively private one. It did not open itself to public scrutiny, nor in truth was such scrutiny much in demand"* (Shirely-Beavan, 1981, p.225). An analysis of the profession from sociological perspective and its formation as political body helps to have a descriptive picture of the profession as a whole.

2.4.2 The professions and their associations in sociological perspective

The sociology research of the professions incorporates a number of contrasting approaches. Before the early 1970's ***"functionalist"*** and ***"interactionism"*** perspectives were dominant (Macdonald, 1984). Since then a more ***"critical"*** approach, which draws heavily from the work of Weber and Marx, has emerged (Willmott, 1986). It is believed that the discussion of the above perspectives by Willmott (1986) makes an important contribution to the understanding of professions and their associations. Willmot argues that the *functionalist* approach usefully highlights the significance of the traits of professionalism in relationship to the production of complex social systems. The *interactionism* perspective helpfully recalls the constructed nature of these traits, setting them in the context of a negotiated interaction over the symbolic meaning and value of "professional" expertise. Finally, the *critical* approach deepens the insights of the interaction approach by placing them in the wider economic and political context.

The approach favoured by Willmott is to incorporate a number of insights of the functionalist and interactionism perspectives within an essentially critical framework. Taken from the *functionalist perspective* is an appreciation of the latent role played by professionals and their associations in maintaining social systems. Although this alone is not regarded as an adequate explanation of their existence, it is seen as significant in accounting for their acquisition of power and privileges relative to other groups within the liberal profession (Armstrong, 1986 and Woolf, 2004).

From the *interactionism approach* is drawn an understanding of the problematical, negotiated meaning of ***"profession"*** and a recognition of the segmented and interest-conditioned nature of the professional associations. Finally, from the *critical approach*, is taken an appreciation of the significance of the underlying structure of power relations in facilitating processes of professionalisation and, in particular, *enabling or constraining the formation and development of associations of **"professionals"***. Greenwood et al (2002) suggest that:

> *"associations can legitimise change by hosting a process of discourse through which change is debated and endorsed: first by negotiating and managing debate within the profession; and, second, by reframing professional identities as they are identities as they are presented to others outside the profession"* (p.59).

Evetts (2003) looks at the concept of professionalism in attempts to understand occupational and organisational change and the prominence of knowledge work in different social systems and global economy (p.395). By drawing selectively upon these approaches, the construction and organisation of professional work is positioned in relation to its contribution, analysed in terms of the identification, organisation, articulation and pursuit of interests within a dominant, capitalist structure of *power relations.*

2.4.3 Professional association as political bodies

Taking the explanations of the above mentioned author, professional associations are seen primarily as political bodies established and maintained to *define*, *defend* and *enhance* the symbolic and material value of their member's skills (Larkin, 1983 and Shackleton, 1995). Through the establishment and development of an association, an *image of the profession* can be projected that highlights and reinforces the *socially valued traits of trustworthiness, independence and dependability.* Moreover, the establishment of the professional body offers the *organisational means of regulation* both the quality and flow of "professional" services, thereby limiting labour supply and raising its market value. The preoccupation with the symbolic values of professionalism-expertise, altruism, and autonomy-is viewed in large measure as collective means of achieving higher remuneration and prestige for their labour (Evetts, 2002).

2.4.4 Phases of professional development in the UK

Three phases in the organisation of the profession are identified. These are explored with regard to influential members' strategies for securing and enhancing their *self-regulating powers* and *privileges* in relation to the institutions of the *market* and the *State.*

Phase.1: It covers the period 1854-1957 and includes the formation of associations of accountants that emerged to define, protect and advance the market position of those who were excluded from membership of other associations. This formative phase of organisation was dominated by unsuccessful attempts on the part of the less prestigious bodies to create a state register of accountants-the idea being that it would formally equalise the standing of all qualified accountants in a way comparable to that of the medical profession.

At the end of this period, in 1957, there was a merger between the two largest professional bodies, the English Institute and the Society of Incorporated Accountants-a merger that was prompted by intra and post-war changes in the market for accounting labour, together with their common interest in strengthening their influence over processes of public policy-making and administration.

Phase.2: 1957-1970 - This second phase involved the steady development in the size and dispersion of the membership of the accountancy profession. During this period, the profession became increasingly segmented. In turn, this segmentation stimulated renewed interest in unifying the profession. As in the past, debate over unification turned around the issues of market position, political influence, public prestige and the profession's powers of self-regulation. A proposal for unification developed principally by the Council of the English Institute was accepted by the membership of the other professional bodies, but it was rejected by its own members-an outcome that did nothing to inspire confidence in, or enhance the standing of, the accountancy profession.

Phase.3: 1970 to the present day. This third phase of organisation has been dominated by the establishment of a co-ordinating body (the C.C.A.B) formed to provide the profession with means of speaking with one voice when representing its interests to the market and the state. In particular, the work of sub-committees of this body has helped the six major bodies to present a more or less united front to the critics of the profession who have questioned its ability to consistently regulate and effectively discipline the publicly significant activities of its members. However, the size and financial dominance of the English Institute has been a source of tension and dissatisfaction among the smaller bodies, whose limited resources and proportional representation on C.C.A.B. subcommittees effectively constrain their contribution to its work.

Reviewing the formation of the accountancy profession from the sociological perspective and as political bodies, clarifies the role played by the profession. It appears that the role has been aimed to maintain their *social system*, enhanced by the significance of acquiring *power* and *privilege* (Carnegie, 2003). As an association, an image of the profession can be projected that highlights and reinforces the socially valued traits of trustworthiness, independence and dependability. By doing this, it defends the interests of its members. Moreover, the establishment of associations permits the profession to be a regulator body. One can argue that the establishment of the associations has a main purpose to defend the interest of their members and enhance its self-regulating powers and privileges in relation to the institutions of the market and the state. Sikka et al. (1992) say that:

> *"They may claim to represent the general public interest, but their conception is inevitably coloured by their business interests, education and background. Professional bodies were formed to promote the interest of their members and this remains their prime mission"* (p.27).

Others (Willmott et al., 1993 and Fogarty et al., 2006) raise the issue about the protection of public interest and profession profit making orientation and its role, which led to so called expectation gap. However, the accountancy profession believes that contrary to what most the public think, auditors do not guarantee to discover any fraud that may have occurred. That is not what the audit is for (Wood and Sangster, 2005).

2.5 ISSUES AND CONCERNS RELATED TO PUBLIC CONFIDENCE

2.5.0 Introduction

In the previous sections accounting firm function, structure, professional standards and historical background of accounting associations are reviewed. This section considers how to restore public confidence to the audit function after several criticisms.

2.5.1 The Object of the intense public scrutiny

Most criticism has risen from unexpected corporate failures in 1980s and 1990s, such as Polly Peck, The Bank of Credit and Commerce (BCCI), Maxwell group and others. Recently, the collapse of WorldCom and ENRON in USA has brought more attention to the accountancy profession. Many such firms received clean audit reports shortly before collapsing, which led shareholders, politicians and academics to ask where the auditors were. Then, there are more general complaints that the auditors have been neglecting their duties to the shareholders, and approving dubious accounts because they are too close to the managers. Grieved parties, including government regulators, have been suing accountants in unprecedented numbers. This situation worries the profession more than mere criticism does.

Companies' corporate failure & scandals

In 1980s, Stoy Hayward as an auditing firm to various clients, brought attention to the profession after a number of its clients went into bankruptcy. One of its most prominent clients that failed was ***Polly Peck***, the fruit, electronics and leisure group which went into administration in 1990 and which ***Stoy Hayward*** had audited from 1973, when the Group floated on the London stock-market. In the same year, other clients including

Sock Shop, went into receivership, *Citygrove*, the failed property developer, and *Astra-Holdings*, the munitions company was investigated by the Department of Trade and Industry (DTI).

Following this spate of failures, ***Stoy*** was criticised a great deal. Some of this has been fairly general- the first reaction of anyone associated with a company failure is often to blame the auditors.

In action, a number of larger firms such PwC, Arthur Anderson etc saw their medium-sized and larger firms going out of business. It has been observed in various cases of bankruptcy and fraud of well known companies such as Polly Peck, Maxwell, BCCI etc., that shareholders start the alarm and raise the following questions:

- *"Why weren't we warned? Where were the auditors?"*

The frequent answer of auditors is:

- *"That is not the purpose of our job"*

This answer has been always met with disbelief or incomprehension, which has provoked further debate.

It has been argued by the accountancy profession bodies that part of the difficulty in understanding the expectations gap resides within the fact that many users of accounts do not understand the contrasting responsibilities of directors and auditors and assume that the latter, as accountants, are responsible for the accounts and for ensuring that the company is free from fraud.

Corporate failures such as the ones mentioned above encourage the Government to make auditors responsible for detecting and reporting fraud, advocates accountancy academics in their report [cf. Sikka et al 1992 the expectation gap]. It is argued that changes are highly necessary to bridge ~expectation gap~ created by what auditors believe to be the objectives of an audit and what the public understands this to be. Such a gap, academics argue could only be managed or reduced by embracing *socially desirable audit objectives* and *reforming audit institutions*.

Meanwhile, the profession (ICAS) through its president, Allan Denholm (1992) argues that the survival of the accountancy profession is at risk.

> *"Over the last two or three years there has been a number of highly publicised scandals and the alleged financial irregularities have been blamed on the profession. The probity and integrity of the profession have been questioned and that is regrettable. It should be recommended that the accounts are not the auditor's accounts but those of the directors"* (p.10).

The profession explains that even the efforts of the most assiduous auditor are put at risk in uncovering deliberate and collusive fraud. Therefore, the blame is passed on to the directors because the auditor sees only a snapshot of the company at a particular time and that snapshot is provided by the directors. It may not be the full picture, with some important information left out - it could be something which is deliberately timed to happen after the end of the financial year. That is information should be drawn to the attention of the auditors, but what they see is what they get, and it worries that in some cases these directors who are perhaps not presenting the full picture are chartered accountants. Moreover, the scale of the accounting frauds in the US, plus the fear that similar cases could occur in the UK, has persuaded the Government that steps need to be taken now to prevent major corporate fraud or false and misleading accounting practices occurring in the UK (Key Note Report, 2007).

2.5.2 Expectation gap

Accountants respond defensively to these attacks. They say the public expects more from an audit than it can deliver- the so-called expectation gap. The responsibility for drawing up a company's accounts rests with its directors; it is, they claim, unrealistic to expect a one-off outside audit always to pick up a complex fraud or imminent collapse. Some auditors hope that educating the public about their limited role will bridge the expectation gap.

2.5.3 Auditor independence

The main concern raised by the public scrutiny concerning the expectation gap, competition between accountancy firms, collapse of companies etc. is related to the question which has been around from the beginning of the accountancy profession: how to ensure that the auditors are independent of the company they are auditing?

On the face of it, the arrangement for auditing in most capitalistic economics looks suspect. Though the *shareholders* formally appoint and pay a company's *auditors,* the decision is usually taken by *managers*. The auditors usually report back to the managers, even in cases where they suspect fraud. Among the analogies the following statement expresses clearly the point *"allowing criminals to pick their own police or setting foxes to guard the chicken crop*" (Haigh 1992).

2.5.4 Auditor defence of independent concept

Auditors naturally resent such criticism and complaint. They always argue that independence is *a state of mind, not a matter of structure* or rules. Others praise their *professional integrity* and the *partner ethics.*

In any case it rarely matters whether auditors consider themselves to be *independent* enough. The general public thinks they are not. The record of audit failures and financial scandals. Therefore, changes are needed to restore the investors' confidence.

2.5.5 Competition between accountancy firms

In 1980s competition between accountancy firms intensified. *Non-audit work*, especially management consultancy, flourished. The suspicion grew that at some firms auditing had become a *loss-leader* intended to pull in non-audit business. As the bigger firms compete for position, they were drawn into mergers. The traditional big eight became big six. In 1989, they nearly became the big five before Price Waterhouse (PW) and Arthur Andersen called off their merger talks. But, later on merger took place between PW and Coopers & Lybrand's, to become PwC.

Accountants were also caught up, in the decade's financial excess. It has been found that it is hard to resist accounting wheezes urged on companies by clever advisers keen to boost reported earnings per share. In Britain, it was alleged that it was possible because accounting standards were too flexible. Collings (2002) points out that the collapse of energy giant Enron and the problems at WorldCom have placed the accountancy profession under the spotlight as never before. He also says that there is a new buzz-word doing the rounds in the financial community – ***"Low-balling"-*** :

> *"If the large firms are themselves auditing all the large listed companies then it is not surprising every time there is a problem it is one of those firms that's involved".*

In this BBC News Report, it has been highlighted that:

- *Low-balling describes a practice which many commentators insist is becoming increasingly common in the accountancy profession.*
- *According to some observers, the Big Four have deliberately lowered their prices in order to keep smaller, middle ranking accountancy firms out of the audit market.*
- *The criticism is that smaller firms have been denied access to the more lucrative large scale consultancy roles.*

Peter Wyman from UK Institute of Chartered Accountants and a senior partner at PwC (representing the profession) answers that:

> *"Only the top four companies are capable of doing this work... the mid-size firms can not carry out the work because of the investment needed to be able to audit on a global basis. If the large firms are themselves auditing all the large listed companies then it is not surprising every time there is a problem it is one of those firm that is involved."*

Moreover, the profession dismisses suggestions that the audit work can be influenced by the prospect of lucrative consultancy contracts. More arguments are presented in defence for their stand:

- *The whole suggestion that somehow the audit is the* ***loss-leader*** *to get lucrative consulting work is completely unproven.*
- *We have looked very carefully at the independent reports of audit failure and in not one single case is there any connection between consulting work or any other non-audit work and some alleged cause of failure.*
- *So the whole notion that somewhat* ***audit quality*** *is affected by doing consulting work is completely without foundation.*

The accountancy profession has always fought its corner and defended the interests of its members. But, no doubt the investors will remain suspicious until the confidence is restored.

Competition in Professions

Restrictions relating to prohibitions on advertising fee comparisons, on seeking the business of potential clients by telephone, and on making and receiving payment for referring clients to accountancy professionals were identified in the OFT's report of March 2001. All these restrictions have been removed by the bodies concerned.

Given the recommendations of the CGAA and the Treasury Select Committee in relation to the public concerns about the level of competition in an increasingly concentrated market, OFT has carefully considered whether a full market investigation or making reference to the Competition Commission (CC) under the Fair Trading Act, should be launched into competition in the audit and accountancy market. To this end, OFT conducted a preliminary inquiry into whether, given the current market structure, there are competition problems in the accountancy market. OFT (2002) reports that:

> *"We have not found evidence to suggest that firms have acted to prevent, restrict or distort competition. Nor have we had complaints that they may be doing so... Our conclusion is that we should not, at this point, launch an OFT market investigation or refer the market to the Competition Commission".*

McMeeking (2007) examines the relationship between market structure, competition and pricing in the UK accounting services. He argues that the big firms changed their pricing strategies after the turn of the century. The audit fees increased significantly and non-audit service fees have fallen since 2002. He believes this change is consistent with the post-Enron restructuring of the major accounting firms and the increased reporting costs associated with the requirements of Sarbanes Oxley (Sarbox) legislation.

2.6 AN EVOLVING FRAMEWORK TO RESTORE PUBLIC CONFIDENCE

2.6.0 Introduction

A number of changes are required to restore public confidence. Figure 2.4 shows the logical sequence for change. It contains the goal, the strategy, the chain of consequences and potential problems. The model (figure 2.4) is explained in the following sections.

2.6.1 The Goal

There is a little disagreement that there is a need to restore public confidence in the audit system. Accountants, clients and the government are committed to changes in the system albeit some with more radical proposals than others.

2.6.2 The Strategic Options

The options for reform can be expressed in different ways with a key issue being the extent and form of government intervention.

2.6.2.1 Government Intervention – Government Audit Office

The most radical idea would be to set up a *government audit office* that takes over the power of the companies to choose their auditors. A *government body* could continue to appoint auditors from private firms. One can argue that that there would be no need to turn accountants into bureaucrats and using taxpayers' money as their remuneration. Some British Accountancy academics and associations such as AABA (Audit Association of British Accounts) argue that the expectation gap could only be managed or reduced by embracing socially desirable audit objectives and reforming the auditing institutions. Moreover, they challenge the self-regulation, i.e., the professional bodies cannot perform conflicting trade association and regulatory roles. In order to achieve this, they believe, the Company Act should be amended so that auditors are required to detect and report fraud, actively report on a company's ability to remain an ongoing concern, as well as owe a duty to all shareholders. In addition, they should not be allowed to sell non-auditing services to their clients. Others are suggesting an independent body. Lorsch (2002) argues that the cure for creative accounting is that audit firms need to have a strong, independent regulator if another Enron is to be avoided. He goes on by suggesting the creation of an independent, self-regulatory organisation to oversee accounting firms. Accounting firms would remain in the private sector, but the government would be involved, which is critical to restore public confidence.

2.6.2.2 Reforms of Existing Audit Practices

A number of reforms relating to the existing audit practices require changes. This embraces reforming the audit function, reforming the audit firm and reforms within client firms. It is to analysis of the options we now turn.

2.6.3 Reforming Audit Function

2.6.3.1 Auditor's role

The right place to start reform is by looking again at the auditor's role. Auditors check some but not all of the accounts drawn up by their clients for the previous year. Then, they declare that their accounts represent a *true and fair view* of the company's position. From the shareholders point of view, one can argue as well how good the company's management is and will the company remain as a going concern? Such questions are not easy to answer. Assessing the quality of management is very subjective. However, the *going concern concept* can be even more elusive.

2.6.3.2 Audit Protection

A priority is the need for clearer accounting standards. Even before these major scandals a book by Terry Smith (1992), formerly with UBS Phillips & Drew, a stock broking firm, listed 12 techniques used by companies to massage reported profits in 1980s. The list included off-balance-sheet financing, bizarre acquisition accounting and the abuse of extraordinary or exceptional items. Various techniques have been used by different companies in different industries. Terry Smith produced a list of the twelve accounting techniques used by the British firms. Their definition is explained in table 2.8.

Previously, the profession was allowed to define the conventions for presenting the company accounts *required by law.* In Britain, this used to be the job of the Accounting Standards Committee (ASC). In America it belongs to the Financial Accounting Standards (FASB). A stronger body laying down more rigid standards has replaced the ASC. The *Accounting Standards Board* (ASB) is headed by an academic, David Tweedie, who has set about redesigning British accounts. The next task will be to harmonise standards internationally which is another issue the profession will have to deal with.

Table 2.8 Accounting Techniques

Technique	Definition
(1) Pre-Acquisition Write Down	*Creation and use of provisions including those to cover fair value adjustments in respects of acquisitions*
(2) Disposals 1) Above the line, 2) Deconsolidation	*1) Disposal profits on sale of assets or businesses taken 'above the line'. 2) Deconsolidation of subsidiaries and treatment of associates as trade investments in anticipation of sale.*
(3) Deferred Consideration	*Earn-out commitments on acquisitions.*
(4)Extraordinary & Exceptional items	*As defined by SSAP6. Unfortunately no attempts can be easily made in a single table to rank the relative significance of these items.*
(5) Off balance sheet finance	*Use of a quasi-subsidiaries, sale and repurchase of assets and joint ventures.*
(6) Contingent liabilities	*Liabilities outside the 'normal course of business' e.g. bonds, guarantees of subsidiary overdrafts etc.*
(7) Capitalisation of costs	*Capitalisation of interest and other costs e.g. R&D*
(8) Brand Accounting	*Capitalisation of brands in the balance sheet*
(9) Changes in depreciation policy	*Changes in depreciation life or method.*
(10) Convertibles with puts & AMPS	*Outstanding issues of convertibles with premium put options or variable rate preferred stocks.*
(11) Pensions funds surplus	*A pension fund surplus which is used to reduce the regular annual charge or create a repayment asset.*
(12) Currency mismatching	*Mismatches between the currency of borrowing and deposits.*

Source: Smith, T. (1992). *Accounting for Growth*, Century Business, London, p.184.

2.6.3.3 Auditors' responsibility

The next change should be to auditors' responsibilities. Auditors say their duty is to existing *shareholders* as a whole and to *management.* This view has been supported by the House of Lords judgement in Caparo Industries vs. Dickman in 1990. Auditors are reluctant to accept a *wider duty of care* that might expose them to lawsuits, even though *creditors* and *potential investors* rely on audit accounts. Nor do they want an explicit duty to report fraud to public authorities. Their role should be broadened. Moreover, the *law should protect auditors* from the need to breach the *rules of client confidentiality* in reporting wrongdoing. Auditors for bans have always enjoyed this privilege in Britain. Thus, there are two main issues which should be addressed: 1) why companies or banks such as BCCI were not reported by their auditors earlier on, when signals were detected. Were there political influences? 2) How to use the protection by law with regard to client confidentiality in reporting of wrongdoing to public authorities; creditors; potential investors and media?

2.6.3.4 Standards enforcement

a) Regulators - Clearer standards need tougher *enforcement.* Once again this has been a greater concern in the accountancy profession. The *Financial Reporting Review Panel;* a sister body to ASB, has come up with some rules and procedures to deter creative finance directors. The panel can reprimand companies publicly when it thinks they have stretched accounting standards too far. It can even require companies to draw up new accounts at the directors' personal expense. Moreover, ICAEW (2003) published a report as guide for audit committees on how to review auditor independence.

b) Regulations & Trade Association - There are plenty of ideas for better ***regulation***. In both Britain and America, accountants, like other professionals, largely *regulate themselves through their professional associations*. In Britain the government has formally recognised the accounting institutes as *supervisory bodies* under the 1989 Companies Act. But some academics and even some leaders of the big four doubt whether the six bodies that combine the *function of trade association* and *regulator* can work effectively. The public is more sceptical still. What makes it more complex, the existence of *six separate bodies* and which have been talk about merging together but the fruits of these so-called mergers has not yet materialised.

On January 29th 2003, Patricia Hewitt the secretary of State for Trade and Industry, made a statement to the House of Commons on the final report of (CGAA, 2003) issues. This report covers 6 key areas: auditor independence, corporate governance, transparency of audit firms, financial reporting standards, enforcement and monitoring of audit firms.

c) Banning the sale of non-audit services to the same audit client - Accountants say there is no evidence that non-audit work by one side of a firm damages audit work by another. Some claim it can help. The overlap of clients is declining as most contracts are now awarded by competitive tender. A ban would also reduce competition for auditing work. A formal prohibition may not be necessary, but auditors should at least be required to disclose in their report on a company's accounts the non-audit fees that their firm is also receiving from that company.

d) Compulsory rotation – The time for compulsory rotation for audit firms rather than senior audit partners, will come. At this moment, it has been argued that in America most audit failures occur soon after an audit has changed hands. Some familiarity with a client can be a useful aid to book checking. But, too much contact can clearly compromise auditors by making their relationship with managers too cosy. Some academic have studied how auditors and management negotiate their financial reporting (Gibbins, et al. 2001 and Beattie et al. 2000 and 2000a). Critics have suggested a policy of mandatory rotation of auditors to improve the quality of audit service but no study has been conclusive. A good discussion and reasons for and against are presented by Arel et al. 2005.

2.6.4. Reforming Audit Firms - (From Partnerships to Unlimited Liabilities)

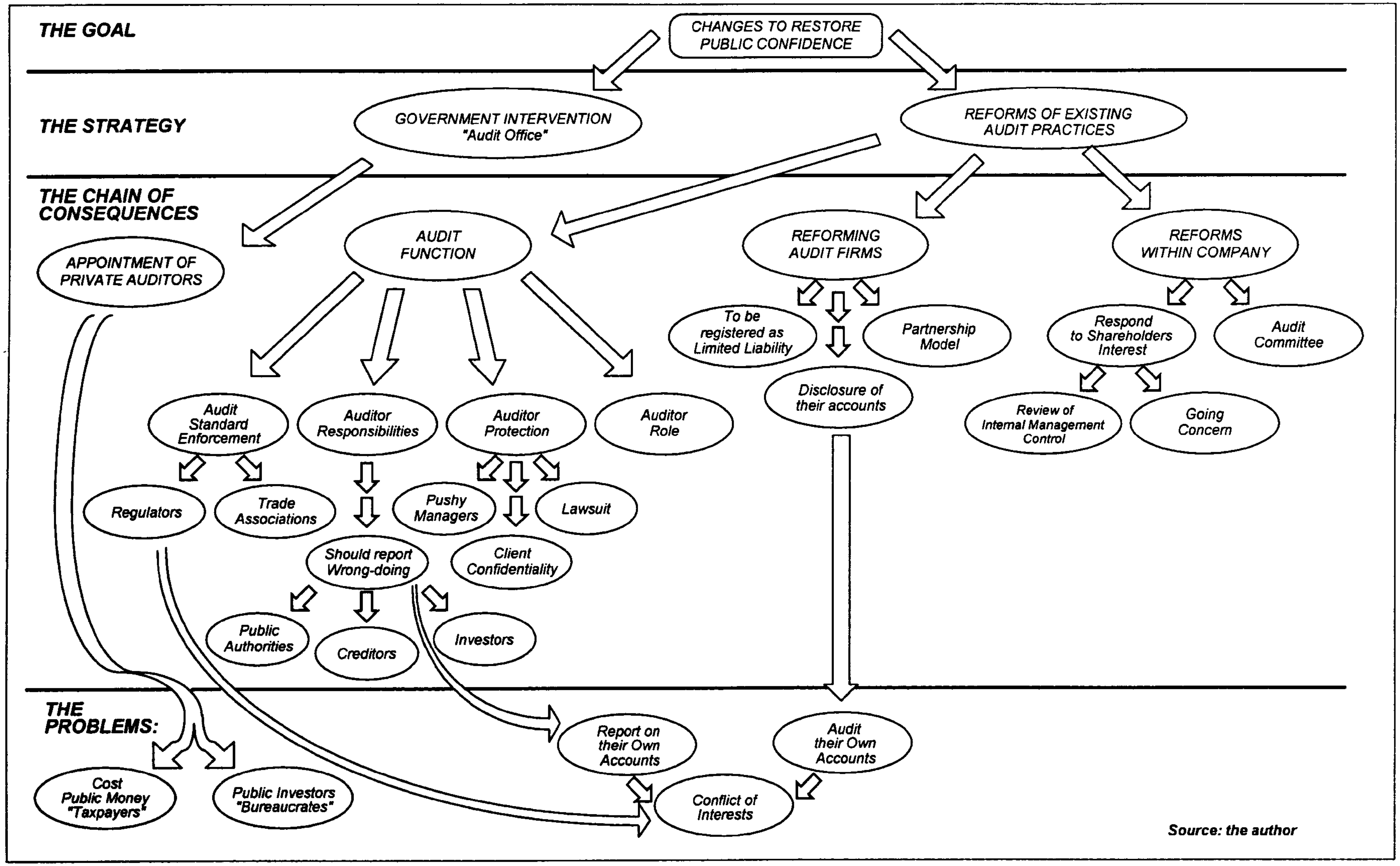
Changing the job that auditors do would require changes to the firms they work for as well. For most firms, *the partnership model* itself is no longer sensible, certainly not for big firms, with over 3,000 partners worldwide.

Incorporation has been intended to help accountants with their biggest worry: *professional liability*. Some American firms want to register as *limited liability* concerns under state laws, to draw the sting of *partners' unlimited personal liability*. That does not, though, protect the firms themselves. Laventhol's bankruptcy was bought on by lawsuits. One of the big firms could be next. And as predicted, it did happen to Enron in 2000. In Britain, the Big firms have taken this step forward (Cowe, 1995). Amongst all the firms, KPMG embraced plc status to avoid liability. The move has the support of several notable audit clients. Lord Alexander of Weedon, chairman of NatWest at the time, said: "*A public company has the right to know the financial position of its bankers, and I see no reason why this should not be the case for its auditors*" (Ashworth, 1995, p.25). Then, in the1996, KPMG was the first big firm to open its books to the general public. One wonders: why KPMG become the first to disclose so much what is still, legally a private business? KPMG says it is publishing the accounts as a part of wider vision of its future. Its decision to open all books was prompted by the desire to present a transparent business to clients and the general public (Kelly, 1996).

2.6.5 Reforming Client Firm - Audit Committees (Corporate governance)

One way to protect auditors, favoured by the Cadbury Committee on *Corporate* Governance, is the compulsory appointment of *audit committees*, composed of non-executive directors. These audit committees appoint auditors and fix their fees. They also offer a forum in which auditors may air concerns about a company's managers. It has been argued that Britain would, however, gain from adopting America's rule that if a company changes its auditor, both the firm and the outgoing auditor must publicly say why? The customer is not always right.

Figure 2.4: Changes to Restore Public Confidence



Source: the author

2.6.6 The problems

McMeeking (2007) argues that without some reform of government intervention, this situation (audit market concentration amongst big firms) is unlikely to improve in the near future. He explains because of the barriers to entry are huge and there is no evidence that the mid tier firms are catching up to the international firms. In order to improve competition in the UK audit market, McMeeking (2007) proposes that the government can play an interventionist role:

- By introducing a tax or other incentives to help mid tier auditors to grow.
- Radical reforms of market intervention would be to amend legislation to introduce other sources of audit to the market, such as Controller and Audit General. HM Revenue and Customs, National Audit Office of financial service groups.
- Compulsory rotation or mandatory joint audit engagements

Some critics might suggest radical reforms and call for government intervention to oversee the audit function. However, the challengers including the profession would argue that government interference and turning the auditors into *bureaucrats* paid by the *taxpayers*. This would not go down well with the general public. No doubt, it would be seen as another cost to the public money. Even, McMeeking agrees that compulsory rotation or mandatory joint audit engagements has a downside that costs would undoubtedly increase (p.212).

Government intervention is seen by the self-regulated profession as an extreme solution to this problem.

2.7 MARKETING RECOMMENDATIONS

The loss of public confidence is a marketing problem and a marketing approach is required to solve the problem. A poor image can occur in one of two ways. One way is where there is a fundamental problem with the 'product'. If this is the case then the product must be improved to meet the demand of the market and its customers or, alternatively, replaced by a better product. In this case the product is auditing services. The second way a poor image occurs is a failure to communicate the benefits of the service in the right way or to the right audience. If this is the problem then more transparency and better communication is required to the appropriate audience.

To redress the balance, it is recommended that those responsible for auditing services focus on the three main marketing issues; strategic vision, a marketing implementation plan and a focus on quality. These are discussed in chapter 9 as marketing recommendations.

2.8 POLITICIANS AND AUDITORS' RESPONSE

Having been shocked by the fraud and corruption among some of the largest companies in the US, it is argued that auditors have not lived up to what is expected of them and action is needed. The new recommendations, announced by the accountancy profession in May 2002 included the following:

- Auditors should document any potential risk or threats to their independence.
- Partners of auditing firms should not work for the same client for more than 7 years
- Accountancy firms should disclose their audit and non-audit fees.

Although the accountancy profession might not agree with all the emerging proposals, it is highly unlikely that it will be able to prevent the introduction of some new regulations, and its only influence is likely to be in terms of 'fine-tuning' the proposals (KeyNote Report, 2007).

2.9 ACCOUNTANCY PROFESSION RESPONSE

The accountancy profession does not seem too reactive negatively to recommendations by different committees and in particular the ones representing the government. It has already been observed in the ICAS response to the July 2003 Interim Report. The responses to issues raised by the Coordinating Group on audit and accounting in areas of: Non-audit services; rotation of auditors and re-tendering; auditor and client relationships; appointment of auditors; audit committees; non-executive directors; regulation of the accountancy profession; financial reporting; auditing standards; company law reform; improving accountability of audit firms; competition implications and impact on smaller companies.

2.10 CONCLUSION

This review of accountancy and audit services sets the context for the study of relationships between auditors and their clients. The chapter also explained the nature of the accountancy profession, its structure and organisation. It examined the audit market, its legal responsibility. The chapter revealed that the accountancy firms are formed in partnership and operate within a self-regulated environment. Moreover, the accountancy profession faced new criticisms which have brought the profession under public scrutiny and call for changes. Importantly, this chapter has produced an explanatory model (figure 2.4) relating to how to restore public confidence. Without a thorough understanding of the accountancy profession and the audit function, it would have been difficult to a Layman in appreciating the concept of buyer-seller development within this industry. Against this backdrop, the development of buyer-seller relationships and the literature review on auditor-client relationships will be examined in the next chapters (3 and 4).

CHAPTER THREE
DEVELOPMENT OF BUYER-SELLER RELATIONSHIPS

3.0 INTRODUCTION

In the previous chapter the nature of the accountancy profession, its activities, historical development were examined and also discussed the changes required to restore public confidence were discussed (figure 2.4). This chapter reviews the concepts, theories and model developments which are central to the study of buyer-seller relationships.

3.1 AN OVERVIEW OF THE RELATIONSHIP CONCEPT

There have been many articles and books written about the concept of relationship marketing. Moreover, some academics argue that the marketing discipline is undergoing a paradigm shift or at least a shift in its orientation from transaction based research to a relationship approach (Halinen 1995; Gronroos 1994; Paravatiyar and Sheth 1994; Webster 1992; Carson et al., 2004 and Palmer, 2007).

The relational paradigm points out the importance of the presence of enduring relationships between individuals and organisations and organisations themselves. In consumer markets, there has been an interest in the study of the development of long term relationships (Berry, 1983 and 1995; Gronroos, 1981, 1985, 1980; Copulsky and Wolf, 1990; Turnbull and Wilson, 1989; Christopher, Payne and Ballantyne, 1991; Stone and Woodcock, 1995; Stone, Woodcock and Wilson, 1996). Other writers argue that the relationship marketing concept is about consumer focus and consumer selectivity – i.e., consumers do not need to be served in the same way (Sheth and Parvatiyar, 1995a, Peppers and Rogers, 2004 and Lacey et al., 2007). In business markets, models of organisational interactions have tried to put emphasis on the relational aspects of buyer-seller relationships within a long term perspective. Models ranging from the development of buyer seller in industrial markets (Ford, 1980); developing an Interaction approach to marketing of professional services (Yorke, 1990) and developing buyer-seller relationships as a general model (Dwyer, Schurr and Oh, 1987).

Though these contributions are important in developing interorganisational exchange relationships in marketing, they do not seem to cover all aspects of business environment which take place within a regulated environment and in particular the auditor client relationships. However, there have been some limited attempts in audit market looking at: 1) the contractual relationship (DeAngelo, 1981), 2) auditor-client attachment (Levithal and Fichman, 1988) and 3) dissolution of interorganisational relationship (Seabright, Levithal and Fichman, 1992). These attempts are reviewed in the next chapter. This chapter reviews the existing relationship models by analysing the elements of relationship, their stages and the context where the interaction has taken place. First, it is to start with how academics have arrived at this concept of relational approach. Thus, a historical perspective of theory development is presented. Then, it is followed by an evaluation of selected theories and models related to the research area.

Table 3.1: Theory Development (Paradigm)
Discrete relationship (1970s)
Dyadic Approach (1980s)
Interaction Approach (1980s)
Relational Approach (1990s)

Source: Original

This chapter focuses mostly on relationship development in business markets. It is beyond the scope of this study to look in-depth at the relationship development in consumer markets. Although it is not tackled here, it has been referred to throughout the thesis.

3.2 HISTORICAL PERSPECTIVE OF RELATIONSHIP "PARADIGM"

3.2.1 Discrete transaction approach (1970s)

It is implicit in this approach that buyers are passive and only react to the stimuli of the seller by buying or not buying. The selling firm is the active partner in the buyer-seller relationship. A side effect of this approach to the study of marketing has been that the study of the buyers has developed along somewhat separate lines from the study of sellers. Some writers refer to this as "monadic paradigm" (Dant and Wilson 1988). Before talking about the monadic paradigm, let us define what is a paradigm. According to Ritzer (1975):

> *"A paradigm is a fundamental image of the subject matter within a science. It serves to define what should be studied, what questions should be asked, and what rules should be followed in interpreting the answers obtained. The paradigm is the broadest unit of consensus within a science"* (p.7).

In 1970s research in interorganizational exchange was dominated by a monadic paradigm which had some shortcomings. The monadic paradigm is the framework where there is a separation in the analysis of the buyer from the seller and both are not considered explicitly. Thus the monadic paradigm views the buyer and the seller as independent rather than dependent, emphasises their separate analysis rather appreciating the similarity of their task, and assumes that a single, a discrete purchase rather than purchases in the context of an ***ongoing relationship*** is representative of interorganisational exchange (Dant and Wilson, 1988). Similarly, Hakansson (1982) speculates the reason for this, is due to the application of traditional theories of consumer behaviour in the context of industrial and organisational markets.

Using this approach, studies have analysed factors, which affect both individuals and company buying processes, concentrated on a ***discrete transaction***. This is to say there is a manipulation of marketing variables by the seller to achieve a desired market response. On the other hand, there is a separate analysis of a single buying process and the factors, which affect that process, from which lessons can be drawn for marketing.

The second drawback is found in the study of one side of the exchange. It is the separation of the analysis of the buyer organisation from that of the seller organisation. This has lead to incomplete explanations of numerous models of *"buyer-behaviour"*, which claim to understand the behaviour of the buyer in isolation from that of the seller with whom they exchange and interact. Dant and Wilson (1988) summarise the critics of the models as follows:

> *"Such models stress the psychological processes of the individuals (involved in the decision making process) in their interaction within the organization rather than the processes involved in their interactions between organizations. An extreme form in which this caveat is often manifested is the stimulus-response paradigm according to which the buyer's action is assumed to depend on the symbolic stimulus that it is exposed to (Bonoma)* (p.90).

Looking at the reason why academic research in business-to-business marketing has not had much impact on marketing thought or practice, Johnston (1981) asserts that is because of the separation of the buyer's analysis from the seller. The studies fail to recognise the importance of the effects of their interactions with each other.

Dant and Wilson made it clear that most models of organisational buyer behaviour ranging from Organisational Buyer Behaviour Models, Industrial Buyer Behaviour Model to Industrial Response Models, Advocacy Behaviour Model and Reward Measurement Models suffer from either or both of these caveats, i.e., a discrete transaction and the separation of the analysis and; such can be thought as lying within the purview of the monadic paradigm. A slightly different genre of models which allegedly resolve the later caveat, and go by the name of the dyadic approach, continue to be plagued by the former caveat.

3.2.2 Dyadic approach (1980s)

This approach emerged with the interorganisation studies. The organisation is seen as part of a group of interacting units (IMP group, 1982). This approach admits the dependence between organisations and its environment. Evans (1963) was the pioneer, who identified the buyer and seller as dyad engaged in an interacting relationship. For him, a sale is a social situation involving two persons and should be looked at as a dyad between both parties and not individually.

The dyadic approach has been seen as ongoing relationships. However, ongoing buyer-seller relationships take many different forms and there is a tendency for organisational exchange to be bounded by long term associations, contractual relations and joint ownership. Thus, in some circumstances, Arndt (1979) argues that markets are becoming increasingly "domesticated" in that exchange occurs between organisations that are jointly owned or contracted for a period of time. He emphasises that within such ongoing relationships *"transaction are planned and administered instead of being conducted on **ad hoc basis**"* (p.70).

In the same line of reasoning, Wilson (1976) views **selling** as a process by which the buyers and the sellers exchange attributes that have both physical and psychological values. His *"Dyadic Process Model"*, focuses on the development of long term buyer seller relationships as being different from discrete one-time selling situation. There are two basic underlying assumptions to his model:

(i) The buyer is attempting to secure a group of attributes, both tangible and psychological, from the seller. These attributes may be product, company, or salesperson related.

(ii)The dyadic (buyer-seller) relationship develops over a period of time. While the model is explicitly directed at long-term relationships, Wilson asserts that it can, however, be adapted to a single contract (discrete purchase) situation as well. The sales process is conceptualised here in terms of five major stages crucial to the interaction. Assuming that the task situation is a new-buy situation, the interactions between the buyer and the seller are devoted to different activities like source legitimisation, information exchange, and attribute delineation, attribute value negotiation, and relationship maintenance. As the relationship develops over a period of time, their focus changes. Thus, whereas the initial interactions are more concerned with legitimisation of the supplier source, the later interactions are focused largely on the other activities such as *relationship maintenance.*

This model (dyadic) recognises the fact the buyer-seller interaction take place over a period and result in the development of relationships which are often stable and involve mutual trust. The focus of the marketing effort, thus, is not on understanding how the buyer makes his purchase decisions every time but on the *maintenance of these relationships.* Similarly Bonoma, Baggozi and Zaltman (1978) describe the industrial marketer as being *"embedded in an interdependent nexus of social relationships"* and advocate that consumer relationships should be viewed as entities to be ***interacted with*** and not ***acted upon*** has been postulated by the earlier models.

Dant and Wilson recognise the merit of the dyadic approach a significant development from the monadic paradigm, but it does not fully capture the complexity of interorganisational relationships. They argue also that

> *"dyadic models treat the exchange process as a one time discrete event rather than viewing it as one more "transaction" in an going relationship. As will become evident, the dyadic approach is only a special case of the more general relational approach, and the reason why the former has been adopted in spite of the fact that the latter offers a more accurate view of the marketing world, has been one of convenience and sociological influence"* (p.92).

3.2.3 Interaction approach (1980s)

This begins with the view that buyers and sellers are not separate entities but partners in an exchange process which may change over time. A number of authors have given a particular attention to the organisational exchange. Amongst them writers, Levine and White (1961) define organisational exchange as:

> *"Any voluntary activity between two organisations, which has consequences, actual or anticipated, for the realisation of their respective goals or objectives"*

They propose further four dimensions to the exchange process:

- the parties to the exchange for e.g. organisational size, prestige and structure),
- the kinds and the qualities of the exchange,
- the agreement underlying the exchange,
- The direction of the exchange.

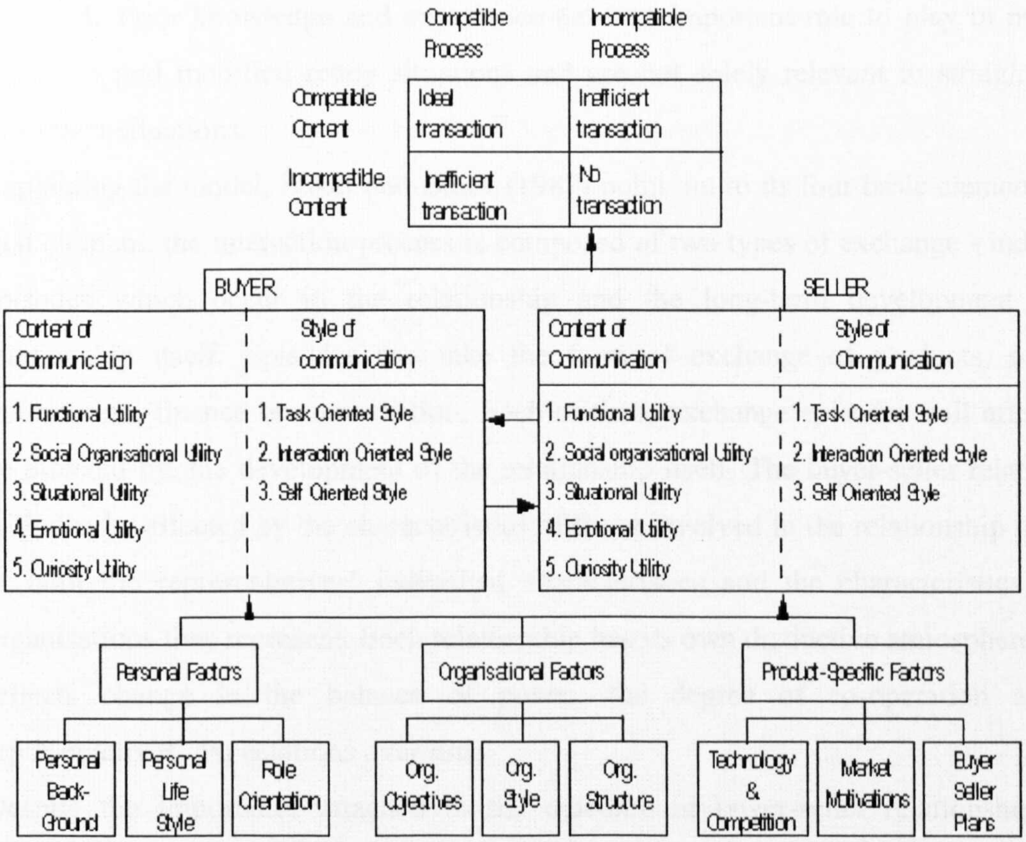
The direction of the exchange can take three different forms:

1. Unilateral, there is no return in this exchange.
2. Reciprocal, here there is a flow of elements in both directions.

3. Joint, two organisations work together in joint effort to interact with a third party.

Sheth (1976) provides a conceptual framework for Buyer / Seller Interaction Model (figure 3.1) below:

Figure 3.1 : A Conceptual Framework of Buyer-Seller Interaction



Source: Sheth, J.N. (1976) Buyer-Seller Interaction: A Conceptual Framework, Advances in Consumer Research, Six Annual Conference, edited by Beverlee B Anderson p383.

There has been an increasing amount of attention paid to the stability in organisational *relationships* over time. Mattsson (1986) has focused on the effect of stability in buyer/seller relations on innovation behaviour and states that new products are more likely are commercially successful when they are developed within the environment of stable buyer / seller relationship. Others highlight the importance of existence of *power-dependence* in relationship. Hakansson and Ostberg (1995) suggests that the balance of power will change according to the outcome of the meetings, negotiations, transactions and the degree to which both organisations adapt to solve mutual problems. Hankansson et al (1982) developed an interaction process model based on four assumptions:

1. Both buyer and seller are active participants in the market.

2. The relationship between buyer and seller is frequently long-term, close and involves complex pattern of interaction between and within each company.
3. The links between buyer and seller often become institutionalised into a set of roles that each party expects the other to perform which may require significant adaptations in organisation or operation and can involve both co-operation and conflict.
4. Prior knowledge and experience have an important role to play in new buy and modified rebuy situations and are not solely relevant to straight rebuy situations.

Explaining the model, Baker and Black (1987) point out to its four basic elements: The first element, the interaction process is composed of two types of exchange - individual episodes which occur in the relationship and the long-term development of the relationship itself. Episodes can take the form of exchange of products, services, information, finance or conversation. Each of these exchange episodes will affect, and be affected by, the development of the relationship itself. The buyer-seller relationship will also be affected by the characteristics of those involved in the relationship in terms of both the representatives' individual characteristics and the characteristics of the organisations they represent. Each relationship has its own distinctive atmosphere which reflects change in the balance of power, the degree of co-operation and the representatives' expectations over time.

Despite the importance attached to the outcome of buyer-seller relationships, i.e., purchases, these relationships are rarely planned or controlled by organisations (Cunnigham 1986). This author further argues that individual or groups of customers may be sufficiently different and important relationships are planned and handled in a unique manner.

In sum, from the above discussion, it is clear that organisational buying behaviour constitute a part of a dynamic long-term buyer-seller relationship. However, OBB sees the increased emphasis on the importance of the buying function. Although, this study acknowledges the contribution of this area to the buyer-seller relationship, it does not relate directly and add clarity to the key dimensions in the study of auditor-client relationship for a number of reasons:

1. It is to avoid any confusion or misunderstanding where consumer behaviour is involved, i.e., a number of writers (Webster and Wind, 1972; Baker, 1983 and Baker

and Black, 1987) believe that the area of OBB has its roots in consumer buying behaviour. Therefore, they do not differentiate between OBB and Consumer buying behaviour, in theoretical terms, as there are considerable areas of overlaps between the two fields. They argue further that it is up-to the individual researchers whether to prefer to look at organisational and consumer behaviour separately or in tandem.

2. Robinson, Faris and Wind (1967) recognised organisational buying as a process which occurs over a variable period of time. They define the buying process as *"the sequence of activities which must be performed in the resolution of a buying situation"*. The authors suggested a model which helps to explain the major themes of buying process. Amongst them, the "buygrid" which is probably the most widely used. Procedural or mechanistic model, giving an internal purchasing viewpoint of the buying process. Furthermore this model identifies eight (8) stages or "buypases" in their buying process and three (3) types of purchasing situation or degree of complexity, i.e., "buyclasses" (new task, modified rebuy and straight rebuy). This type of model has obviously great application to industrial markets but will face enormous difficulties if it is tried in audit market for the following reasons:
    - Audit service is a statutory function.
    - There is a modified rebuy. Auditors play the role of investigators. They cannot work to the client requirements.
    - Auditors are appointed by the shareholders but recruited by the management. Their remunerations are paid by the shareholders.
    - Unlike the industrial market, the buying process in audit market is complex and does not follow the stages recommended by the OBB model.
    - The buyers are well known to the sellers. Audit firms know their clients at a personal level, i.e., personal relationship (It happens they did their training together or worked together before or as a member of thee professional body). Therefore the questions such as who is involved in the buying process? Who makes the purchasing decisions? or what type of products is being purchased? etc. These questions do not seem to have a reason to be asked in the audit, market.
3. Moreover, the validity of the buygrid model has been questioned by Bellizzi and McVay (1983). They were not able to predict behaviour or industrial buying influence from the byclasses. They argue:

> *"buyclass may be useful to explain the general importance of a purchase but extending the role of the buyclass variable to other buyer behaviour concepts such purchase influence may be inappropriate".*

One should not refute the contribution of the process model to the area of marketing. It provides a frame of reference to help marketing managers identify common situations where organisational buying behaviour is consistent enough across several customers to form the basis of market segmentation. Moreover, the five classes of variables in the model such as (environmental, organisational, interpersonal, individual and informational) can also be found in other areas of studies of interorganisational relationships.

3.2.4 The relational Approach (1990s)

This paradigm takes place within the context of a market, which consists of complex interactions of business unit. It is characterised by an aggregation of individual, interpersonal and organisational dyads, each showing a high degree of interaction, interdependence, and interconnectedness.

It is obvious that this concept of the market as a network is in contrast to either the monadic or dyadic approach as explained earlier. This paradigm points out the importance of the presence of enduring relationships between organisations. There has been an increasing interest in the study of the development of long term relationships in consumer markets, business markets and industrial markets. A detailed literature review for models and frameworks of relationship development in industrial sectors has been summarised by Halinen (1995) in table 3.2.

Though their contribution is important in developing interorganisational exchange relationships in marketing, they do not cover an understanding of all aspects of interoroganisational relationships which take place within a regulated environment adding to this list, a number of articles have been written. However, these models do not clearly tackle the issue of relationship in a regulated environment like auditing. Nevertheless, their key components and the stages of their development cannot be ignored (see table 3.3).

Table 3.2: Models and frameworks of relationship development in industrial sectors

Author and Model	Distinguished phases, states or elements of developments	Focus, conception of development and empirical basis
Guillet de Monthoux 1975: *Model of the mating process of industrial organisations*	Phase 1: Romance Phase 2: Affair, Marriage Phase 3: Divorce Phase 4: New romance New affair, New marriage	Analyses the development of relationships e.g. with respect to exchange volumes, complexity. formalisation and interdependence. Change perspective. Cross-sectional interview data.
Gummesson 1979: *Buyer-seller interaction model*	Pre-stage Decision process Decision to select a particular professional Operation of the assignment Post-stage	Describes the stages of buyer-seller interaction in a professional service context. Identifies stages from the stage before the service need is recognised to the stage where the assignment has been carried out. Emphasises the decision process that leads to the selection of a professional firm. Input-output perspective. Conceptual presentation.
Grönroos 1980, 1982: *The customer relation life-cycle a three stage model*	Stage 1: Initial stage Stage 2: Purchasing process Stage 3: Consumption process	Views the life cycle from the marketing planning point of view. builds a corresponding three-stage model for services marketing. Input-output perspective. Conceptual presentation.
Ford 1982: *Development of buyer-seller relationships*	The prerelationship stage The early stage The development stage The long term stage The final stage	Analyses the development of relationships by considering the variables of experience, uncertainty, distance, commitment, and adaptations in the five stages. Change perspective. Cross-sectional interview and survey data.
Ford and Rosson 1982, Rosson 1986: *A model of manufacturer-overseas distributor relationships*	New Growing Troubled Static Inert	Considers relationships to be in one of five possible "states" of development, which are determined by three factors: stake, experience and uncertainty, and characterised by the level of commitment, adaptation and conflict. Change perspective. Longitudinal interview and survey data.
McGiven, C 1983 *Some facets of the relationship between consultants and client organisations*		
Frazier 1983: *A framework of interorganisational exchange behaviour in marketing channels*	Initiation process Implementation process Review process	Describes ongoing channel relationships in terms of three interactive processes and their outcomes, paying special attention to the review and evaluation of rewards and losses from exchange. Processual perspective. Conceptual presentation.
Edvinsson 1985: *Service export sales life cycle:*	Contact phase Negotiation phase Trial order and delivery phase Maintenance and repeat phase	Applies and extends the model of Grönroos to export marketing. Input-output perspective. Case studies from professional and other business services.
Wilson and Mummalaneni 1986: *Framework of relationship development*	Need complementarily Interactions Outcomes Satisfaction Investments Commitment	Views relationship development as a process where satisfaction, investments and commitment develop between the buyer and the seller in repeated successful interactions. processual perspective. Conceptual presentation.
Dwyer, Schurr and Oh 1987: *The relationship development process*	Phase 1: Awareness Phase 2: Exploration Phase 3: Expansion Phase 4: Commitment Phase 5: Dissolution	Considers relationship development as a process of deepening dependence evolved in five subprocesses: attraction, communication & bargaining, power & justice, norm development, and expectations development. Processual perspective. conceptual presentation.
Liljegren 1988: *A cynical model of relationship development*	Establishment phase Build-up phase Development phase Maintenance phase Uncertainty phase Break-up phase Settlement phase	Considers relationship development as a cyclical process focusing on adaptations, uncertainty and conflicts, the surrounding inter-firm network and critical events. Processual perspective. Longitudinal case study.
Frazier, Spekman and O'Neal 1988: *Just-in-time exchange relationships*	Interest Stage Initiation-Rejection Stage Implementation Stage Review Stage	Analyses why and when JIT-exchange relationships and initiated and which factors influence the success and failure of initiated relationships. Input-output perspective. Conceptual presentation.
Yorke 1990: *The changing nature of professional service supplier-client relationship*	Ignorance Interest Initiation Involvement Integration	Examines perceived benefits, range of services offered/purchased, strengths and weaknesses of a supplier and fulfilment of specific client needs in "young" and "Old" relationships. Change perspective. Cross-sectional survey data from professionals and their clients.
Halinen 1994: *Process model of the development of advertising agency-client relationship*	Pre-relationship phase Initial phase Growth phase Decline phase Constant phase Troubled phase Termination phase	Builds a process model of relationship development by identifying six conceptual categories and specifying the temporal and logical relationships between them. Defines the nature of each developmental phase by using the concepts of the model. Processual perspective. Longitudinal case study.
Heide, J. B. (1994) Interorganisational Governance in Marketing Channels	1. Relationship Initiation 2. Relationship Maintenance 3. Relationship Termination	Market governance and nonmarket governance

Adopted from Halinen, A.(1995). Development of buyer- seller relationships: suggestions for future research, ***IMP, 11th International Conference, Manchester, September 7-9, vol.1, pp537-565.***

Table 3.3: Selected model of buyer-seller relationships

	Stage.1:	Stage.2	Stage.3	Stage.4	Stage.5: Final Stage
FORD, Y (1982) Industrial Marketing 5 stages model	**Stage.1: Pre-relationship Stage** *Evaluation* of new potential suppliers by the buyer. Evaluation initiated by: particular episode in existing relationship general evaluation of existing supplier performance efforts of non-supplier other information sources Evaluation conditioned by: *Experience* with previous suppliers *Uncertainty* about potential relationship *Distance* from potential supplier *Commitment*	**Stage.2: Early stage** Characterised by negotiation of sample delivery *Experience* between 2 parties is low High *uncertainty* High *distance* *Commitment* Actual: low Perceived: low *Adaptation* High investment of management time. Few cost savings.	**Stage.3: Development Stage** Characterised by contract signed or delivery build up.	**Stage.4: Long-term Relationship** It is reached after several major or large scale deliveries. *Experience* between 2 parties is high *Uncertainty*: minimum development of institutionalisationn *Distance*: minimum *Commitment* Actual: maximum Perceived: reduced *Adaptation* Extensive adaptations, cost-savings reduced by institutionalisation.	Characterised by: • In long-established stable markets. • Extensive institutionalisation Business based on industry codes of practice.
DWYER et al. (1987) General Marketing 4 stages model	**Stage.1: Awareness** *Awareness* refers to party A's recognition that party B is a feasible exchange partner.	**Stage.2: Exploration** It refers to search and trial phase in relational exchange. *Exploration* phase is 5 subprocesses (cf.Scanzoni 1979) 1. attraction 2. communication & bargaining 3. development & exercise of power 4. norm development 5. expectation development P.S: *Trust & joint satisfaction* will lead to increase risk taking within the dyadic in the following stage.	**Stage.3: Expansion** *Expansion* refers to the continual increase in benefits obtained by exchange partners and to their increasing interdependence. P.S: The five subprocesses introduced in the previous phase (exploratory) also operate in this phase (expansion). The range and depth of mutual dependence.	**Stage.4: Commitment**	**Stage.5: Dissolution** The possibility of *withdrawal* or *disengagement* has been implicit throughout the relationship development framework. i.e., not every dyadic linkage of which the buyer or seller is aware enters the exploration phase, and not every relation probed and tested in exploration enters expansion or becomes soldered by commitment.
YORKE, D (1990) Professional services 5 stages model	**Stage.1: Ignorance** *Ignorance* is defined as a lack of knowledge (and possible awareness) of each other and each other's activities. Use of 3 dimensions to compare *perceptions* of suppliers and clients: 1) the *benefit* which the client is buying (as perceived by both supplier and client) 2) the *strengths & weaknesses* of the supplier firm (as perceived by the client) *specific qualities desired* by the client of the supplier (as perceived by the client)	**Stage.2: Interest** This phase goes along with the next phase *"Initiate"*. Potential clients will develop and *interest* in and *initiate* a relationship with a professional service supplier if: 1. the benefits of specific advice can be demonstrated 2. specific services can be developed 3. The supplier firm can convey a degree of flexibility to changing clients' needs. 4. The partner/employee is easily available for construction.	**Stage.3: Initiation** It has the same characteristics as the previous stage (interest). 1. the benefits of specific advice can be demonstrated 2. specific services can be developed 3. The supplier firm can convey a degree of flexibility to changing clients' needs. The partner/employee is easily available and can offer a speedy service.	**Stage.4: Involvement** The relationship is likely to generate greater *involvement* and, ultimately *integration*. Involvement phase: 1. The benefits of *"peace of mind"* or *"confidence"* can be developed and sustained. 2. A full range of services can be provided to meet clients' growing needs. 3. the supplier firm can create a perception in clients' mind of giving *"individual treatment"* The partner/employee is easily available and can offer a speedy service.	**Stage.5: Integration** This phase is joint to the involvement phase and both of them characterised by: 1. peace of mind / confidence 2. full range of services 3. individual treatment availability and speedy services

Source: Original

The selected models presented in table 3.2 and 3.3 show clearly the different stages of relationship development. To better understand relationships requires a theoretical examination. This may explain / contribute to our understanding of relationships in general and auditor-client relationships in particular. Relationship theory and systems theory appear to be the most appropriate and plausible theories in this context.

3.3 Relationship Theory

3.4 Systems Theory

3.3 RELATIONSHIP THEORY

Generally speaking there are two approaches in defining marketing. A traditional view based on the applicability of the elements of marketing mix has been criticised as being too limited. A new approach to marketing is seen from relationship aspects either in consumer market or industrial market. Let us look at these two approaches.

3.3.1 Defining Marketing: The Marketing Mix Approach

The marketing concept has been defined in different ways by different authors. In most of these definitions, the core of marketing is *marketing mix.* The origin of this thinking is neatly summarised by Gronroos (1990:134):

> *The marketer is viewed as a "mixer of ingredients" (an expression originally used by James Culliton in a study of marketing costs in 1948; see Borden 1964) who plans various means of competition and blends them into a "marketing mix" (this concept was introduced by Neil Borden; see, for example, Borden 1964), so that a profit function is optimized, or rather satisfied. Pedagogically, the marketing mix of different means of competition as been labelled the 4 P's* (McCarthy 1960).

Traditionally, marketing is seen as the application of mix ingredients referred to as the "four P's", i.e., *product, place, price,* and *promotion.* Some writers see the concept as too limited. In service marketing researchers have found as many as seven P's (Booms & Bitner 1982). In his article, Judd (1987) argues for *people* as a fifth P. In industrial marketing, research approaches to marketing such as the interaction approach and the network approach have been always arguing that defining marketing on the basis of marketing mix elements is not valid (see IMP Group, Hakansson,1982; and the *Nordic School approach* to services marketing,.Gronroos,1983a and 1987c; Gronroos 1985a, Gummesson 1985a, and Gummesson 1987c and 1987d).

The marketing mix approach is considered too limited, although it includes activities that are important and often central components of marketing. Dixon and Blois (1983b) have gone further in their criticism of the 4 P's. They state that the marketing mix approach is badly fitted to fulfil the requirements of the marketing concept. And they conclude that "*...indeed it would not be unfair to suggest that far from being concerned with customer's interests (i.e., somebody for whom something is done) the views implicit in the 4 P's is that the customer is somebody to whom something is done!*" (p.4). In line with this argument it has been suggested that the marketing mix and its 4 P's constitute a production-oriented definition of marketing, and not a market-oriented one (Gronroos 1989a).

Defining marketing according to the marketing mix approach is like using a list of objects as a definition. Such way of defining a phenomenon can never be considered the most valid one. A list never includes all relevant elements, it does not fit all situations, and it becomes obsolete. The extension of the number of P's does not offer a fundamental improvement in the definition. The need during 1980's to add new categories, marketing variables to P's is a symbol of the weakness of the marketing mix approach, demonstrates as well as anything that, as a general marketing model, the marketing mix approach has failed, although it may very well be valid and helpful in some contexts, such as for consumer packaged goods (Gronroos,1990).

It is interesting to note that Borden's original marketing mix was a list of twelve elements and that it was not intended to be a definition at all (Gronroos,1990). Also, Borden considered these twelve elements of the marketing mix approach as a guideline only, which probably would need to be reconsidered in any given situation. This is a fact that advocates of the 4 P's and of today's marketing mix approach seem to have totally forgotten. The 4 P's represent a significant oversimplification of Borden's original concept (compare Cowell 1984).

Unfortunately, the 4 P's of the marketing mix have become an undisputable paradigm, the validity of which is taken for granted (Kent,1986 and Gronroos 1989a). Kent (1986) referred to them as:

> *"the holy quadruple... of the marketing faith... written in tablets of stone" (p.146), states that the "mnemonic of the four P's, by offering a seductive sense of simplicity to students, teachers and practitioners of marketing, has become an article of faith. Among the consequences of this have been a lack of empirical study into what are the key marketing variables and how they are perceived and used by marketing managers, a neglect of process in favour of structure and a neglect of product range considerations"* (p.145).

Particularly in services marketing and industrial marketing, the marketing mix approach frequently does not cover all resources and activities and the processes that appear in the customer relationships at various stages of the customer relationship life cycle. There are especially during the consumption process, a range of contacts between the service firm and its customer which are outside the traditional marketing function as defined by the 4 P's of the marketing mix. Managing and operating these contacts (for example, the conference facilities, the cabin services, the restaurants, and managing the employees onboard) are the responsibility of operations and other non-marketing departments. Nevertheless, these contact interactions have an impact on the future buying behaviour of the customers as well as on word-of-mouth; *that is, they have marketing implications,* and should therefore be considered marketing resources and activities and managed as such.

In conclusion, the marketing mix and its 4 P's as described in the textbooks represent a significant oversimplification of Borden's original notion of the marketing mix. In fact, it is almost unbelievable how the world of consumer packaged goods of the 1950's and the 1960's, is still today widely considered the marketing model for the 1990's (Gronroos, 1990).

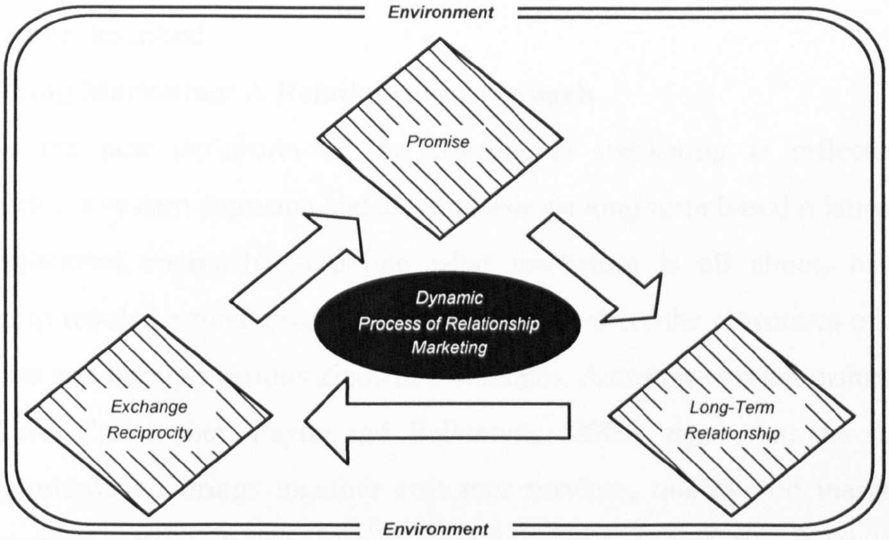
3.3.2 Exchange of promises

The concept of *promises* as an integral part of marketing vocabulary has been stressed by the Finnish researcher Calonius (1986 and 1988). This concept is by no means new, not even in the marketing literature, but his way of emphasizing it and including it in a buying behaviour and marketing framework is unique. In establishing and maintaining customer relationships the seller gives a set of promises concerning, for example, goods, services or systems of goods and services, financial solutions, materials administration, transfer of information, social contacts and a range of future commitments. On the other hand, the buyer gives another set of promises concerning his or her commitments in the relationship. The promises have to be kept on both sides if the relationship is to be maintained and further developed for the mutual benefit of the parties involved.

Gronroos (1990:138) puts the promise concept and the exchange concept as equally important elements of customer relationships. He says, *"in fact, promises about the exchanges that are to take place are mutually given in the relationship, and these promises are fulfilled by the various kinds of exchanges that take place."* The main points of the discussion can be summarised in the figure 3.2.

Figure 3.2 shows the components of the relationship marketing concept from a systemic approach. Its components are reciprocal interaction, promise and long-term relationship. These components interact with the environment through a dynamic process

Figure 3.2 Dynamic Process of Relationship Marketing



Source: Original

The research in interorganisational exchange was dominated by the monadic paradigm in 1970s. The dyadic approach has raised the alarm and put emphasis on studying on-going relationships. The interaction approach which is no more different from the dyadic approach enhanced the belief of the dyadic approach. Then, the relational approach asserts the importance of making exchange at two levels (interorganisational and individuals). In terms of methodological consideration, the current study used a "matching" relationship, where the buyer is known to the seller not only at the firm level but at the individual level as well. Therefore, their behavioural analysis is one rather than two separate analysis (see chapter five).

3.3.3 Marketing as Relationship

It has been argued that in consumer goods or services, there might be a certain reluctance of service provider employees towards establishing positive relationships with customers due to the nature of the product delivery, i.e. the interaction process is short. Moreover, one might see that the attitudes and behaviour are just part of working life and the relationships are not. But, the relationships are not distinct from an attitude or set of behavioural traits towards customers. The relationship has four specific characteristics:

- Reciprocal interaction, i.e. a two way interaction.
- dynamic process
- exchange of promise
- long-term based relationship

So on the basis of these four qualities, a relationship between a service provider and a buyer might be described.

3.3.4 Defining Marketing: A Relationship Approach

It appears the new definition of the concept of marketing is reflected in two characteristics, a system approach and an emphasis on long-term based relationships. From a relational approach, to define what marketing is all about, marketing is considered to revolve around *customer relationships*, where the objectives of the parties involved are met through various kinds of exchanges. A customer relationship is the key concept here. Christopher, Payne and Ballantyne (2002) argue that the relationship marketing orientation brings together customer services, quality and marketing. The linkages between these three areas must be exploited to achieve total customer satisfaction and long-term relationship. The challenge facing the organisation is to bring these three areas into closer alignment. They also argue *that:*

> *"Relationship marketing has as its concern the dual focus of getting and keeping customers rather than 'keeping customers. Traditionally, much of the emphasis of marketing has been directed towards the 'getting' of customers rather than 'keeping' of them. Relationship marketing aims to close the loop"*(p.4).

Various authors have attempted to define relationship marketing in different business areas. In consumer markets, Stone, Woodcok and Wilson (1996) define relationship marketing as *"the use of a wide range of marketing, sales, communication, service and customer care approaches to:*

- *identify a company's named individual customers;*
- *create a relationship between the company and its customers that stretches over many transactions;*
- *Manage that relationship to the benefit of the customers and the company.* (p.675)

The above study is based on an IBM-sponsored programme to develop a model to help companies to plan the use of IT to manage their customers. The authors recognise themselves that while this definition is technically a good one, is a little lacking in feeling. So they go further trying to improve their definition: *"a company could describe relationship marketing to its customers like this: Relationship marketing is how we:*

- *find you;*
- *get to know you*
- *keep in touch with you;*

- *try to ensure that you get what you want from us in every aspect of our dealings with you; and*
- *Check that you are getting what we promised you ... subject of course to it being worthwhile to us as well"* (p.676).

3.3.5 Relationship Development Models in consumer markets

For stages of relationship development, Stone, Woodcock and Wilson (1996) look at eight phases: 1) recruitment; 2) welcoming; 3) getting to know; 4) account management; 5) intensive care; 6) potential divorce; 7) divorce and 8) win-back. These authors conclude their article by suggesting to companies which consider using a strong relationship marketing approach, perhaps via deployment of IT, needs to develop an integrated customer relationship management proposition, rather than conducting a series of disparate experiments. They reckon that this will be achieved by observing the following points:

- Branding needs to be controlled.
- The customer focus needs to be maintained.
- Technology is only one part of the customer relationship.
- Material in digital form will need to be used cost effectively.
- Customers can be encouraged to use the transparent marketing approach.

3.4 SYSTEMS THEORY AND ITS APPLICATION TO RELATIONSHIP MARKETING

3.4.0 Introduction

The previous sections looked at relationship theory. This section focuses on the systems theory and its application to marketing domain. According to Gronroos (1990), the relationship approach to marketing is based on the systems approach, introduced into marketing literature by Alderson in 1950 (p.136). A systems-oriented approach to marketing is not a new phenomenon. At the beginning, it was the concern of various authors (Alderson, 1957 and 1965; Fisk, 1967, Fix and Dixon, 1967). Later on, the view of a systemic approach in marketing becomes evident. Organisations are clearly dependent on some elements of their task environment, and both channels and buyer-seller literature stress the importance of the ***open system approach***, i.e., the interaction of the organisation with the environment and the lack of clear boundaries between the two (Thompson, 1967; Stern and Reve, 1980; Dwyer and Welsh, 1985; Achnol, Reve and Stern, 1983; Anchol and Stern, 1988; Naumann and Lincoln, 1989). As a result there are a variety of opinions on the important characteristics and constituents of system theory as well as how it should be defined. Although the difference in essence, these ST flavours do, of course, have much in common and the following serves as a list of the main concepts around which it may be useful to base system theory (Bronte-Stewart, 1997, pp.174-175).

A notion system can be taken to have:

- a purpose - it does, or can be perceived to do, something
- an environment that affects it
- a namer - someone who is interested in it
- a boundary distinguishing it from the environment and identified by the system namer
- inputs and outputs
- transformational process that convert the inputs to outputs
- parts (subsystems) that interact, a pattern of relationships
- hierarchy - each part is itself a system and can be treated as such
- dependency - addition, alteration or removal of a part changes both the part and the system
- communication and feedback amongst the systems
- control, both within the system and through the hierarchy
- emergence - the whole system exhibits properties and outcomes, sometimes unpredictable, which derive from its parts and structure but cannot be reduced to them
- Dynamism - it is subject to change including growth, adaptation and decay.

Bronte-Stewart goes further by saying that:

> *"one of the dangers with such a list however is that its length and jargon might make Systems Theory (ST) seem complicated and difficult to comprehend, when the essential concepts of ST are in some ways familiar to anyone who has reflected upon the interdependency of things. We recognise the underlying principals of ST. Indeed it could be argued that it is this axiomatic quality, cross-disciplinary nature and intrinsic familiarity that make ST so attractive to so many"* (p.175)

Gronroos (1990) strongly comments:

> *"Eventually, however, the marketing mix overran the systems-based texts, apparently because of the pedagogical virtues of the 4 P's and the ease with which the marketing mix can be used in classroom and practical marketing*

> *planning. However, these advantages do not make the marketing mix theoretically more sound"* (pp.136-137).

In 1995, Ballantyne examined the relationship marketing from a systemic view. He comments that:

> *"Relationship Marketing, as an emerging discipline and practice needs to stay alert to this great and difficult divide. For this reason systems theory is (re) affirmed, as a meta-theoretical framework for marketing, explicitly for the socio-economic insights it can offer to relationship marketing"* (p.98).

3.4.1 Long-term relationships

Based on the system approach, Alderson (1957) defined marketing as the *"matching of segments of supply and demand"* (p.199). Implicit in this definition is mutual relationships between parties. *Long-term relationships* with customers are important (Gummesson, 1987d). In the long run, short-term relationships, where the customers come and go, are normally more expensive to develop. As Berry (1983) observes, *"clearly, marketing to protect the customer base is becoming exceedingly important to a variety of service industries"*(p.25). Jackson (1985a) adds that, in many situations, long-term relationships are profitable in industrial marketing as well (also compare the perspective of the IMP Group; see for example Hankinson 1982). This is not to say new customers are undesirable. Of course, even those who perhaps make one purchase only, are still desirable; however, in most long-term customer relationships are more profitable (Gronroos, 1990).

The long-term perspective has become more and more recognised in services marketing (Gronroos 1980 and Berry 1983) as well as industrial marketing (Hakansson 1982 and Jakson 1985a). If a close and long-term relationship can be achieved, the possibility that this will lead to continued exchanges at a profit is high. The same goes for both consumer markets and industrial markets (Gronroos 1980, p.137). Furthermore, in many situations there are several parties in a relationship. The buyer and seller act in a ***network***, consisting of, for example, suppliers, subcontractors, other customers, financial organisations, and political decision makers. Especially in a business-to-business relationship context the whole network may become part of the customer relationship and may have an impact on the development of the relationship (Hakansson, 1982).

3.4.2 Factor influencing auditor-client relationships

This describes the context in which interaction between auditors and clients takes place. It also includes two dimensions, internal environmental conditions and external environmental conditions. The intervening variables in the internal environment include: audit opinion, audit work, self-interest, accounting techniques, opinion shopping, going concern, expectation gap, dependency and ethical guidance. For instance, dependency can be seen as exchange between "audit opinion" and audit fees. The client (management) needs to show that they are taking care of the money of their shareholders. The management works towards maintaining the shareholders' confidence. This can be shown through the audit opinion expressed by the auditors. In the same time, auditors need work to remain in business. Therefore, auditors audit the company accounts and receive in return an audit fee from the management. This interaction shows the dependency of both of them. It is to note that the internal variables have an influence on the structure and the process of audit-client relationships (protectionist relationship, stewardship and, statutory and working relationship).

The intervening variables in the external environment are: audit regulations, competition, self-regulation and the third parties (banks, creditors, investors, stock exchange, politicians, academics, analysts etc.)

3.4.3 Structural and process analysis

The two sets of situational dimensions (internal and external environments) combine to influence the ways auditors, shareholders, management and third parties (government, DTI, Stock Exchange, regulators, investors, creditors, banks, stockbroking firms, analysts, etc.) interact. The structure and process dimensions of interactions can be divided into:

(i) Protectionist Relationship: (Auditor - Shareholders)

(ii) Stewardship Relationship: (Management - Shareholders)

(iii) Statutory and Working Relationship: (Auditor - Client)

In this chapter the concept of relationship, theories and models development which are central to the study of buyer-seller relationships were examined. Moreover, three relationships are identified and are subject of discussion in the next chapter four.

CHAPTER FOUR
AUDITOR-CLIENT RELATIONSHIPS

4.0 INTRODUCTION

This chapter draws on the researcher's early interest and in particular on the analysis of business relationship marketing examined in the previous chapter three. The author espouses that there are three relationship types in auditor-client relationships:

(i) The stewardship relationship

(ii) The statutory and working relationship

(iii) The protectionist relationship

Theoretically, a framework of relationship marketing or dissolution analysis can provide an understanding of business relationship from a systems perspective and its importance cannot be underestimated (Beloucif et al, 2006). Moreover, this chapter examines the auditor selection, the conflicts between auditors and their clients. Finally, the literature on auditor changes is reviewed.

4.1 THE STEWARDSHIP RELATIONSHIPS

Despite its limitation, as explained in chapter three, the *agency theory* literature is still popular amongst some researchers (Jensen and Meckling, 1976; Ng, 1978) explain the demand for auditing as arising from *conflicting interests* between managers (agents) and shareholders (principals) and other entities that contract with a client (e.g. creditors, other labour unions). In an agency setting, a moral hazard problem arises because of an informational asymmetry. Information asymmetry occurs when the manager has access to superior information to maximize the manager's self interest at the expense of shareholders. This view is also shared by Goldman and Barlev (1974). However, this moral hazard can be solved by designing, for the manager, *incentive contract* which are more closely aligned with the interests of the shareholders (e.g., bonus plans to net income). Another option to alleviation of the moral hazard problem is to provide complete *public disclosures* of the firm's information in order to remove the superior information position of the manager (Beaver, 1981). In the UK, Lamb (1994) reporting on a Scottish study carried out by ICAS, points out to two ways in dealing with this issue. There is a general agreement that all relevant financial information will be made available and be easily accessed through the Stock Exchange and the Internet. However, there have been no studies or suggestions on how to make auditors communicate with the shareholders and investors apart from the audit annual report or the audit interim report. Companies faced a difficult task in steering a balanced course between *compliance* with the complex rules and meeting the legitimate demands of analysts for information. A study carried out by ICAS and reported by Lamb (1996), showed that companies believed the meetings were the most valuable *form of communication* with *investors* at which a wide range of topics and future prospects could be discussed. There are two types of meetings:

1. General meetings held for a wider audience from a range of stockbroking firms and institutional investors;
2. Special meetings held for an individual or small group from one organisation.

Both options require complete and accurate financial information. Both also create a demand for auditing services since the shareholders require independent monitors to assure the 'fairness' of the financial statement disclosures.

Auditor selection (Theory of Auditor Choice) - Under the stewardship concept, a manager would seek an auditor who satisfies the shareholder's need for assurance. It is assumed that the manager will engage the auditor to satisfy his interests but with the interests of the shareholder in mind. The shareholders would require that the auditor be competent in conducting audits in conformity with generally accepted auditing standards, detecting material misstatements and providing sound business advice to the agents. In short, the shareholders expect the managers to select an auditor of quality.

It is obvious a selection of auditor comes after exiting auditors have changed. When a company acquires another company, merge with another one or taken over by another company, it is likely to see itself changing auditors. For example, Fleming (1996) wrote a case study on Praxair Inc., industrial gas company, who changed auditors when it was spun off from Union Carbide in 1992. This company went through two phase selection process.

First, the company evaluated the candidates' qualifications on a global basis. The company operates in 44 countries. It asked for statements of qualifications from around the world, starting at the top with the proposed engagement partner and the team that would work with the company at the corporate level. The company looked at match of the firm offices. At this stage there were no fees discussions.

In the second phase, Praxair asked the remaining candidates to dig deeper into the company's operations and provide a price quote on what the audit would cost on a global basis. The candidates made a formal presentation to senior management on their services and synergies. They did a presentation at the headquarters and were ranked on seven criteria, including creative approaches and ideas in conducting the audit, value-added services and transition approaches. With this change the company ended up with a substantial saving over what it had paid before but added the actual fee ultimately did not have an impact on the selection. More over, the company claims that by going through the process of selection, it managed to find out that audit firms do have different philosophies and ways of getting to the same result.

However, contrary to the above case, there has been a different reason to change auditors. In the second case it is believed that the primary factor driving the company to consider a change was that while the company had a good relationship with its long-standing auditors, it learned the lead engagement partner was moving up in the firm and would not be able to perform the audit. The partner's critical importance in determining the nature of relationship between the two parties and the perceived quality of service, along with cost dynamics in the market, convinced management it might be a good time to look at what other audit firms had to offer.

4.2 THE STATUTORY & WORKING RELATIONSHIPS

This is a legal requirement. Under UK company law all limited companies are required to have their financial statements audited by qualified accountants who must report whether or not the statements show a true and fair view. Then, the owners of the company, investors and other interested parties will draw their own conclusions and act accordingly.

The relationship between auditor and client involves formal and informal working rules in preparing the accounts, agreeing about the accounting techniques and the influence of one member on the other. Moreover, it deals with the conflict resolution mechanisms when formal rules or informal influence fails. This study focuses on statutory and working relationships.

4.3 THE PROTECTIONIST RELATIONSHIPS

This relationship derives from the fact the auditors are theoretically appointed by the shareholders to protect their interests in the company, i.e., Auditors are paid by the shareholders to check upon the management and protect them from wrongdoing and frauds. In practice, the shareholders are less involved with auditors than the management. The *protectionist relationship*, i.e., the interaction between auditors and shareholders has not yet been debated in the financial institutions and markets. But, in the City of London there is a general agreement that all relevant financial information will be made available and be easily accessed through the Stock Exchange and the Internet. However, there have been no studies or suggestions on how to make auditors communicate with the shareholders and investors apart from the audit annual report or the audit interim report. Companies faced a difficult task in steering a balanced course between *compliance* with the complex rules and meeting the legitimate demands of analysts for information. A study carried out by ICAS and reported by Lamb (1996), showed that companies believed the meetings were the most valuable *form of communication* with *investors* at which a wide range of topics and future prospects could be discussed. There are two types of meetings: a) general meetings held for a wider audience from a range of stock broking firms and institutional investors and; b) special meetings held for an individual or small group from one organisation.

Although special meetings are viewed as being more important and more valuable to the companies, they are also more risky for a regulatory standpoint. The less formal, friendlier atmosphere which often surrounds such meetings can lead easily to the unintentional release of price sensitive information. To achieve equal access to information for all users, it has been suggested that detailed records of all meetings held between investments analysts and directors of quoted companies should be disseminated to market as soon as possible after the meeting using the Stock Exchange's Regulatory News Service and the Internet. Moreover, a greater use of the Operating and Financial Review should be encouraged to increase the available published information. Other writers (Linsley and Lawrence, 2007) have called for more transparency. They went even to examine the risk disclosures by UK companies and to assess whether directors are deliberately obscuring bad risk news. They concluded that the level of readability (information) of the risk disclosures is difficult or very difficult in annual reports. They also highlight that there are no evidence to suggest that directors are deliberately concealing bad risk news through their writing style. However, there have been calls for improved risk disclosures to enable stakeholders to better company's information and its risk's position.

4.4 AUDITOR-CLIENT CONFLICT

4.4.1 Goldman and Barlev's Behavioural Model of Independence

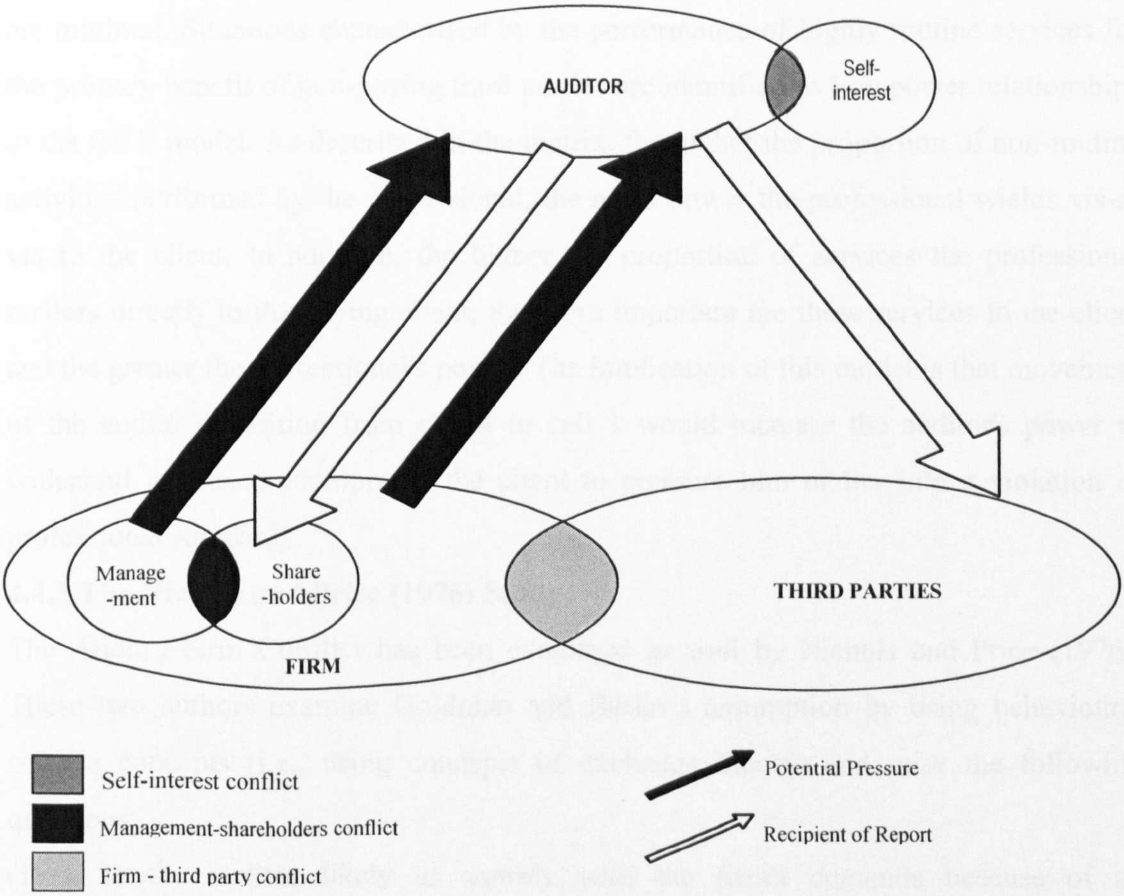
Goldman and Barlev (1974) argue that the auditor is potentially involved in three conflicts of interests. These represent different sources of pressures on the auditors to produce a report not according to professional standards and represent potential threat to his independence. These conflicts are:

1. The auditor - firm conflict of interest;
2. The shareholders-management conflict of interests;
3. The self- interest - professional standards conflict.

These authors point out that conflict of interest has important implications on the auditors' independence. They suggest three solutions to the auditor-client conflict of interest: (1) decreasing the potential power management *vis-à-vis* the auditors by limiting management freedom of action, (2) reducing auditors' flexibility of action, and (3) changing the structure of the auditing role.

The potential effects of the solutions on auditors' independence and on the organisation of the profession varied. Goldman and Barlev (1974) argue further that the attempts to influence the auditor to take an action that is not in conformity with professional standards may be successful because of an asymmetrical power relationship in favour of the firm in a conflict situation. Therefore, they produce the following model

Figure 4.1: Goldman and Barlev's Behavioural Model of Independence)



Source: Goldman, A and Barlev, B. (1974), "The Auditor-Firm Conflict of Interests: Its Implications for Independence," *The Accounting Review*, October, pp. 707-718.

Table 4 1: The amount of power wielded by professionals vs. paying clients

Beneficiary	Problem solved	
	Non-routine	Routine
Paying Clients	(1) Highest	(2) Medium
Others	(3) Low	(4) Lowest

Source: Adapted from Goldman, A and Barlev, B. (1974), "The Auditor-Firm Conflict of Interests: Its Implications for Independence," *The Accounting Review*, October, pp. 707-718.

According to the G&B model, the power of a professional vis-à-vis a client may be described by the matrix above, and the auditing profession is characterised by cell 4. The auditor is so qualified because the auditor is providing a service not for the paying client, the firm, but primarily for the benefit of a third party, such as the stockholders or creditors. In addition, the auditor's service is considered basically routine since many standardised procedures are utilized and discretionary judgements of the professionals are minimal. Situations characterised by the performance of highly routine services for the primary benefit of non-paying third parties are identified as low power relationships in the G&B model. As described in the matrix, the higher the proportion of non-routine activities performed by the professional, the more power the professional wields vis-à-vis to the client. In addition, the higher the proportion of services the professional renders directly to the paying client, the more important are these services to the client and the greater the professional's power. The implication of this model is that movement of the auditor's position from cell 4 to cell 1 would increase the auditor's power to withstand influence attempts by the client to pressure him or her into a violation of professional standards.

4.4.2 The Nichols and Price (1976) Study

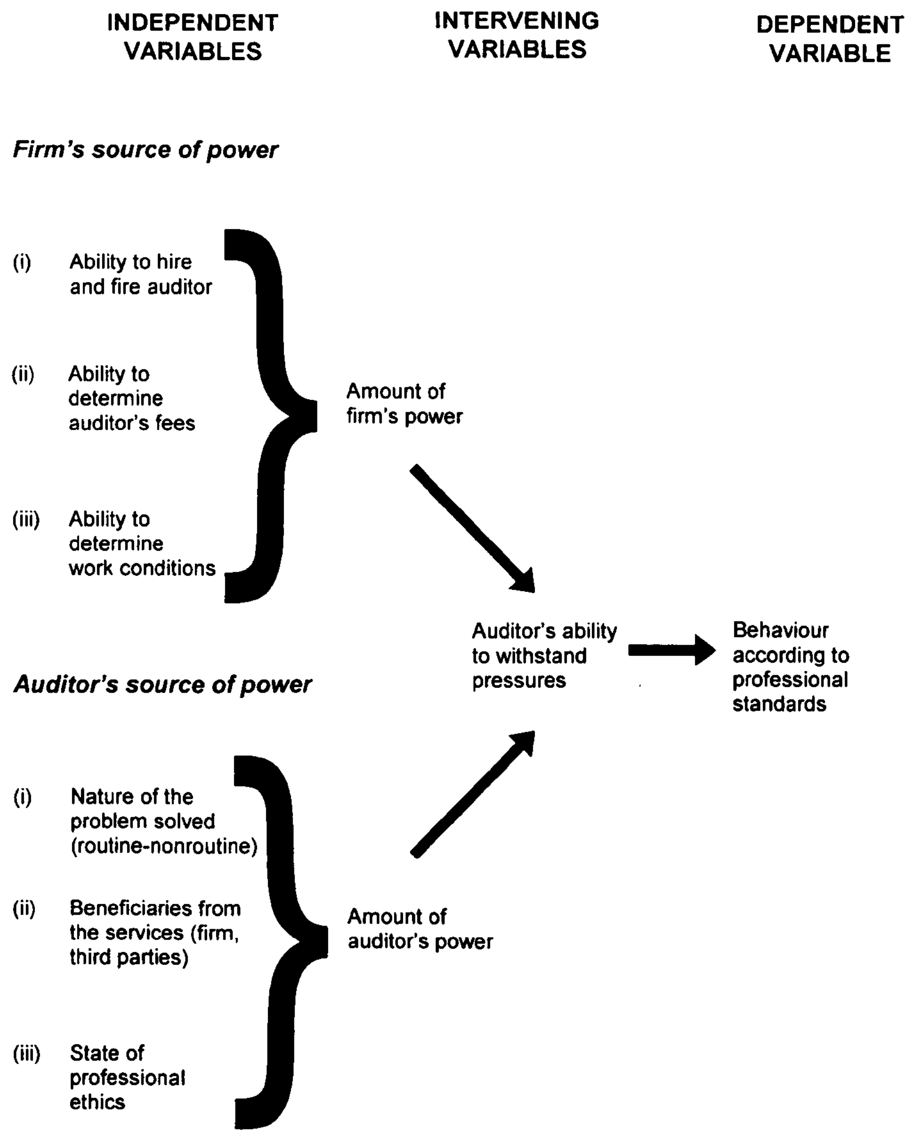
The Auditor-Firm Conflict has been examined as well by Nichols and Price (1976). These two authors examine Goldman and Barlev's assumption by using behavioural science concepts (i.e., using concepts of exchange theory) and raise the following questions;

(1) Is the auditor likely to comply with the firm's demands because of an asymmetrical power structure favouring the firm?

(2) If any asymmetrical structure does exist, what are the factors causing the imbalance?

(3) What changes in the structure of the auditor-firm relationship would reduce the probability of the firm's attempting to influence the auditor and also decrease the likelihood of auditor compliance when such attempts are made?

Figure 4.2 Behavioural Model of Independence



Source: Goldman, A and Barlev, B. (1974), "The Auditor-Firm Conflict of Interests: Its Implications for Independence," *The Accounting Review*, October, pp. 707-718.

4.5 THE AUDITOR-CLIENT CONTRACTUAL RELATIONSHIP (Deangelo, 1981)

Deangelo (1981) wrote a book in an attempt to produce an audit theory. She sought to explain the equilibrium pricing of audit services and the length of the auditor-client relationship in response to differences in the regulatory environment. This author analyzes the nature of audit services and argues that self-interested individuals have incentives to capture the benefits from auditing by devising arrangements which internalize any externalities. To the extent that the costs and benefits of audited financial statements are internalized by current owners, the decision to purchase audit services is conceptually identical to any other firm investment decision. One possible surrogate for audit output is auditor brand name. She also points out that all market forces which enable the brand name mechanism to signal audit quality, where direct observation of quality is costly. The theory presented in her book is that "low-balling" is a competitive response to the existing client-specific learning-by-doing advantages, positive transaction costs of changing auditors, and competition in the market for audit services. She also points out to the potential benefits of auditor-client independence. The existence of potential benefits to auditor independence provides auditors and clients with the incentive to contract in a manner which enables both parties to capture these benefits. There are, however, certain exogenous factors in the exchange of audit services which inherently impair auditor independence by creating a material financial interest in clients. These factors are: 1)-the presence of significant learning-by-doing advantages (high start-up costs) in the provision of audit services, and 2)-The presence of positive transaction costs of changing auditors.

4.6 AUDITORS-CLIENT ATTACHEMENTS

4.6.1 Attachments (Levithal and Fichman, 1988)

Levithal and Fichman, (1988) explore the dynamics of interorganisatrional relations and consider time dependence in these relationships. They based their research on data collected from secondary resources over a two-year periods, i.e., annual reports, Moodys Financial Manuals (US), etc. Their results reveal that these attachments were found to have positive duration dependence but decrease with time. They refer to the early stage of the attachment as a "honeymoon "period. Moreover, they were unable to determine exact time of stages of development. Later on, with the contribution of another colleague, they have attempted the end of honeymoon, i.e., relationship dissolution

4.6.2 The dissolution of interorganisational relationships.

Seabright et al. (1992) explain that attachments are based on the auditor-client relationships (personal and organisational levels):

> "*Attachments in an exchange relationship may emerge as the result of individual or organisational level ties. Sources of individual attachments include personal skills, knowledge, and interpersonal relationships; specific to organisational members constitute the repository of such assets. Sources of organisational attachment include the formalisation and standardisation of exchange arrangements, such as the establishment of policies and procedures for managing interorganisational transactions. The collectivity, rather than specific individuals, is the repository of these assets*" (pp126-127).

It is believed that these interpersonal and interorganisational attachments are expected to provide tangible benefits to both parties and creating barriers to change.

Seabright et al. (1992) argue that changes into the resources have an impact on the auditor-client relationships and lead to the dissolution of their relationships. However, they claim that the individual and structural attachments developed with exchange partners over time will counter this pressure for changes. They explain that "change in clients' resources needs increased the likelihood of their switching auditors, but attachment of individuals primarily responsible for the exchange relationship decreased the likelihood of switching.

4.7 THE LITERATURE ON AUDITOR CHANGES

The previous sections looked at the auditor - client relationships. The aim of this section and the next section is to deal with the relationship breakdowns which are entitled in the accountancy literature as auditors' changes and auditors' switches as well as the auditors' independence.

It emerges from the accountancy literature that a number of research on auditor changes concentrated primarily on isolating variables associated with impaired auditor independence (e.g., audit fees, accounting disputes and audit opinions). Auditor-related variables were also explored (e.g., technical qualifications and industry expertise). Amongst these studies are Burton and Roberts, 1967; Bedingfield and Loeb, 1974; Linbeck and Rogow, 1978; Coe and Palmon, 1979; Chow and Rice, 1982; Eichenseher and Shields, 1983; Crasweed, 1988 and Williams, 1988). Moreover, some authors were interested in comparing auditor change rate across a number of countries. Beattie and Fearnley (1994) looked at the changing structure of the market audit services in the UK. There is a general belief that the common significant variables relating to an auditor change were audit fees and qualified audit opinions. Additional audit services and client- auditor relationships also appeared to be significant. These findings represent an initial list of factors for inclusion into a model for the determinants of auditor changes. However, other authors are not fully satisfied with the previous studies and have been looking for a model for the determinants of auditor changes (Williams 1988).

4.8 THE DETERMINANTS OF AUDITORS CHANGES

There are a number of determinants of auditors' changes. One most recognised determinant is the client preference for a big audit firm size. For example Pannel Kerr Foster lost the audit of its largest client, Williams Holdings, was put under pressure by the City to appoint one of the big six, Coopers & Lybrand, in its place. From the qualitative analysis this determinant has been reinforced (Accountancy, July 1996, p.17). DeAngelo (1981) suggests a model of the *auditor's choice* of the number of clients in his "portfolio." Within this framework she analysed the auditor's incentives lower audit quality by attesting falsely to the financial statement of a given client. It is intended to show that auditor opportunism of this type is constrained by the threat of withdrawal of future business from the auditor's other clients. Another important contribution of her study is to provide a theory that potentially explains the frequency with which firms change auditors. The study criticises previous studies of auditor switching. For this author, none of these studies has supplied a rigorous formalisation of the incentives which drive a client's change of auditors. The formulated theory which predicts that the firm's decision to change auditors is a trade-off between

1. the cost saving of retaining the incumbent auditor for future audits, and
2. The negative impact on client firm value of maintaining a relationship with an auditor who possess "future economic interest" in the client.

One wonders how an analyst can come to a conclusion of this type as, one well known; the information is so sensitive and not accessible to the general public. A prescriptive model does not seem sound. However, another researcher (Williams, 1988) attempts to determine a more precise answer to the question of auditor changes: to develop a rationale for auditor changes and to identify some of the factors contributing to auditors switches. Contrasted to prior studies on auditor changes, he develops and employs a theoretical model to explain auditor switches. He uses the stewardship hypothesis, as reflected in the agency theory literature, to explain the demand for auditing. Then, a theory of auditor choice and auditor changes is drawn from this hypothesis. Williams arguments were strong in the sense the previous studies showed a number of weaknesses. Among these weaknesses, (1) two studies utilised questionnaires and had relatively small sample sizes: one study achieved such a low response rate that non-response bias limited its findings. (2) The time periods examined in two earliest papers were so extended that concerns over changes in economic or industrial conditions could influence the results. (3) Another potential limitation concerns sample definitions. The two early studies define population as only the Fortune 500 which represents a very small subset of the total number of audit clients, and makes the findings difficult to generalise to a larger population. The remaining four studies define the population as all firms registered with the SEC. Prior research by McConnell (1985) notes a significant difference in the descriptions of disagreements cited in the form 8-K reports filed with the SEC for an auditor change when the subjects were listed on the New York Stock Exchange (NYSE) and the American Stock Exchange (AMEX) as compared to the over-the-counter (OTC) exchange. Also, Carpenter and Stawser (1971) discovered that when firms are initially listed on a national exchange (primarily the OTC), they tend to change auditors, usually switching to the big (eight) six. These findings imply that the reasons motivating an auditor switch are different for firms on the major exchanges (NYSE and AMEX) as opposed to all SEC registrants. (4) The definition of qualified opinions issued in these studies was somewhat oversimplified: first-year qualifications were not distinguished from continuing qualifications. It could be argued (e.g., DeAngelo, 1982) that first-year qualifications are more relevant to auditor change research than continuing qualifications in the sense that a client would be more upset about the initial qualification.

What differentiate Williams and the prior studies is that Williams believes that

> *"These studies sought to isolate these variables that yielded a statistically significant result. While not without virtue, these studies do not fit into an overall theoretical framework of auditing and, hence, fail to produce findings of more general importance"* (p.244).

Williams' study is based on the assumption that understanding the general demand for auditing and the related reasons for selecting and retaining auditors are necessary for conducting a meaningful auditor change study. ***Agency theory*** literature explains the demand for auditing with respect to the ***stewardship*** hypothesis. Based on the stewardship hypothesis, a theory of auditor choice and auditor change was derived.

Williams's model includes three concepts concerning the theory of auditor change *(Change in Client Contracting Environment, Auditor Effectiveness*, and *Client Reputation)* represent the theoretical basis for selecting variables to include in a model explaining auditor changes.

Williams (1988) has isolated three variables which aid in classifying clients who change auditors. Two auditor-related variables deal with the auditor's industry specialisation and the longevity of the auditor on the engagement, and a client-related variable dealing with negative media publicity. The model correctly classified 66 percent of the clients in the sample of 1986 matched-pair firms. None of the three determinants of auditor change identified in his study appeared in any prior research. Several significant variables were not found to be statistically significant in this study, but in all cases, the data on the related variables had the same directional signs as observed in the prior studies. This common directional influence tends to support the effect of certain events on clients' attitudes toward their auditors.

The rationale is that auditors with industry specialisation and engagement of longevity may provide improved services by capitalising on economies of scale. The client's reputation also tends to influence auditor changes. Clients that received a tarnished reputation appear to seek new auditors in an attempt to renew the managers' faith in the monitoring of financial statements. These findings support the contention that auditor changes are not triggered by firms "shopping around" for a lenient auditor. Firms that change auditors appear to be either dissatisfied with the quality of the predecessor firm or perceive that the successor firm can exhibit audit efficiencies. Also, firms which seek to improve their monitoring system have a higher tendency to change auditors. This evidence refutes the criticisms of the auditing profession that clients seek auditor changes in order to manipulate their monitors.

In the case of auditors' changes, predecessor auditor working papers are likely to be used for evaluating beginning balances and the consistent application of accounting principles, as well as identifying potential problem areas for planning purposes. Successor auditors appeared to routinely request permission to review the predecessor's audit working papers either before accepting a new engagement or after.

In the US professional standards specify that when a company changes auditors, the successor and predecessor auditors must follow certain procedures, i.e., communications between predecessor and successor auditors. A survey carried out by Glezen et al (1996) showed that it was rare in practice for a predecessor to deny a successor access to the papers except in the case of valid business reasons, such as potential litigation.

4.9 THE ASSOCIATION BETWEEN QUALIFIED OPINIONS AND AUDITORS CHANGES

Stricharchuk (1983) points to the fact that companies fire auditors in hopes of keeping bad news from the public. This author refers to a number of anecdotal evidences where *accounting disagreements* or *personality conflicts* are the reasons given behind the qualified companies' reports. *"Once you give a qualified report you have a cloud over you," an accounting executive says. Two years later it may happen that you are fired, but ostensibly for some other reason"* (p.35).

However, auditors take a number of measures before pulling the alarm on the company's going concerns. When a company's finances are in especially bad shape, auditors are encouraged to negotiate with its officials. Auditors are urged to be careful in giving "going concern" qualification by the Audit Standards Boards. There are a number of reasons. First, as cited in Stricharchuck (1983), the word "qualification" is such as an emotional word. It brings an emotional reaction that causes investors to stampede; you can't whistle the thundering herd back and say: `hey, we can explain this'. The second reason for the caution is when auditors state that a company might die its chances for survival drop. For these reasons, auditors look first whether the client has viable plans to "get out of the jam." Finally, as a conclusion to this, *"I show them the various opinions possible so there are not any surprises. If it is a surprise, then there is something wrong with the management."* -borrowing a favourite phrase from Robert J. Ball of Peat Marwick's Chicago office (cited in Stricharchuk, 1983).

Krishnan, et al (1996) argues that previous studies examining the relationship between auditors' opinion and auditor switching assume a one-way causation, with the insurance of a qualified opinion triggering a switch. However, analytical studies dealing with auditor independence issues (e.g., Magee and Tseng, 1990; Dye, 1991; Teoh, 1992) suggest an opposite causation, in which the auditor is less likely to qualify the opinion for a client who may switch auditors. Some evidence of an opposite causation is provided by Krishnan (1994), who finds that auditors treat switchers more conservatively (relative to non-switchers) in issuing the audit opinion. The causation between switching and the audit opinion is clearly important for policy decisions regarding both opinion shopping and auditor independence. The simultaneity-adjusted estimates confirm previous findings of a positive effect of a qualified opinion on switching (Chow and Rice, 1982; Craswell, 1988; Citron and Taffler, 1992). However, it finds in addition that auditors are more likely to issue qualified opinions to switchers. This finding does not support the analytical studies cited earlier.

4.10 THE DIFFERENT EFFECTS OF AUDITORS CHANGES

4.10.1 Auditor changes and reporting lags

A study by Schwartz and Soo (1996) investigated whether audit report and earnings announcement lags are associated with the timing of auditor changes in relation to firm's fiscal year-ends. It hypothesised that companies which replace auditor early (late) in the fiscal year do so for positive (negative) reasons and experience shorter (longer) reporting lags. Conflicts over reporting issues can be difficult to resolve and consequently lead to reporting delays. In other cases, clients may be more concerned about adhering to customary reporting practices or improving timeliness. These are likely to be considerations in auditor realignment decisions are predictably reflected in the timing of auditor change.

4.10.2 Effects on audit fees and audit quality

Deis and Giroux (1996) investigate the relationship of independent audit fees, hours and quality, with particular emphasis on initial audits. Their study reveals low balling relationships. Moreover, first year independent audits had statistically significant lower audit fees. Despite the lower fees, quality was higher and more audit hours were utilised. However, previous studies have investigated the relationships between initial audit fees and auditors changes (Simon and Francis, 1988; Pong and Whittigton, 1994). Other researchers have examined the audit time as a proxy of audit quality (Palmmrose, 1986 and, Leventis and Caramanis, 2005). These authors believe that big audit firms exhibited both higher audit fees and audit hours. These big audit firms charged higher audit fees not because of their monopoly power because they conducted higher quality audit.

Moreover, Gregory and Collier's (1996) study suggests that the audit fees reduction are the reason behind changing auditors. They have looked at the impact of auditor change on cross-sectional UK data for 1991 with the aim of discovering whether there is any evidence of price cutting and subsequent price recovery in a European, rather than a US, context. It is found there is evidence of such a phenomenon. The largest reduction is experienced by firm changing to big six firms (now big four). Involuntary changes are associated with positive increases in fees, whereas voluntary changes are associated with negative fee reductions. These effects are shown to be robust with respect to model specification. This suggests that fee reductions cannot be ascribed to economies of scale or scope, but is consistent.

4.11 AUDITOR'S INDEPENDENCE

This section examines the type of relationships that could impair auditors' independence. There are two types of influences on the independence of auditors;

(a) Inside influences, related to ethical guide and criteria of establishing independence,

(b) Outside influences, on the independence of the auditor.

4.11.1 Inside effects, related to ethical guides and criteria for establishing independence.

In considering the position of an auditor with respect to the expression of an opinion on financial statements, certain relationships or situations may exist which could pose a threat to the integrity and objectivity of the auditor, in fact or in appearance. These fall into the following general categories:

i. Certain financial relationships with clients.

ii. Relationships in which an auditor is part of management or an employee under management's control.

iii. Certain business, personal, or family relationships or occupations engaged in concurrently with public accounting that are incompatible with the need to retain the appearance of independence.

iv. The rendering to an audit client of other professional services such as those related to taxation, management consulting and executive research.

Source: The International Study Group of Independence of Auditor (1976:11).

One has to wonder whether individuals' goals do not go against the organisation's goals. Firstly, would getting to know the client at personal level and involved with him in social life have influence on the objectives of the organisation which are based on integrity and independence? Secondly, where should the line be drawn between individuals' goal and their organisation goals?

According to Handy (1976), groups:

> *"Can be too cohesive; they can become so important to each member that the goals of the group... these ultra-cohesive groups can be dangerous because in the organizational context the group must serve the organization, not itself. In its absorption with itself, its own members and its own priorities, it can blind itself to what is going on around it"* (p. 157).

4.11.2 Outside effects on the independence of the auditors.

The involvement and function of the third parties may enhance the auditors' independence from the management (i.e. management influences and pressure). These involvements are expressed in the following points;

(1) In Britain, attendance by the auditor at the meeting of shareholders provides them with opportunities to report directly to the owners of the company, respond to their questions, and demonstrate their independence. However, in reality, auditors are too close to the management than the audience of shareholders. Moreover, regulations do not reflect the interpersonal relationship between auditors and their clients.

(2) The formation of an audit committee of the board of directors. Such a committee, whose members are usually composed of a majority of the "outside" directors (that is, those not also a part of management), enhance the auditor's independence from management since they may be used to resolve adjustments and problems that have come to the auditor's attention and to resolve matters where the auditor and management are in disagreement.

4.11.3 Criteria for establishing standards relating associate to independence

In establishing professional standards in the three nations, the Accountants International Study Group of Independence of Auditors (1976) raises the following factors for consideration:

1. Auditors will normally be exposed to situations that involve the possibility of pressures being exerted on them. The pressures may work to impair their integrity and objectivity and, therefore, their independence.
2. It is impracticable to define and prescribe all such situation where there possible threats may exist.
3. The rule of reason must prevail in establishing standards for identifying relationships that are likely to, or appear to, impair the auditor's integrity and objectivity

It is important that consideration should be given to both magnitude of the threat posed by a relationship and the existence of countervailing pressures (such as professional discipline, loss of reputation, and the resistance of a professional to any infringement upon his integrity and objectivity and legal liability. Relationships must be avoided which actually make it difficult, or appear to the reasonable observer to make it difficult, for the auditor to be impartial or unbiased in expressing his opinion.

4.12 BUYER-SELLER RELATIONSHIPS AND AUDITOR-CLIENT RELATIONSHIPS

In an audit context, the relationship has a meaning which is mainly derived from a company's legal requirement. It is seen as a protection of the shareholders interests. Adding to this, audit relationship is based on the integrity and partiality of the auditors.

It is important to note that the analysis of relationship marketing in the audit field is a complex one. On one hand, accountancy profession have to remain independent and show its integrity through their auditors, i.e., auditors are motivated to comply with professional ethics and acceptable auditing standards, while on the other hand, the pressure from the competitive environment and more demanding clients are forcing the profession to sell other services (non-audit services). Thus, it shows the complexity of the interactions in the audit context. Therefore, this study concentrates on matching dyadic relationships.

From the IMP group and their research interest, one can see certain similarities. The auditor-client operate within the context of relationship, and can be built on the history of the organizations 'dealings with each other, as well as it might be described having certain similarities such as commitment, trust and conflict. But, the major difference found in audit relationship, is the nature of the audit service, the role of interpersonal relationship and the legal requirement imposed on one of the dyad member.

As far as the environmental pressure is concerned, various factors such as legal, political, and economic conditions can affect the auditor-client relationships. For example, some would argue that the setting up of the Cadbury Committee is to portray the regulatory body, which is the profession itself, as doing something about the recent criticisms and hoping to restore the public confidence. Consequently, a code of best practice of how to run the companies has been recommended to the companies. Challengers (academics and politicians) are not still convinced that the code will have major impact.

After examining the research background in chapter 2 to the accountancy profession, the theoretical foundation in chapter 3 to the development of buyer-seller relationships and the auditor-client relationships in chapter 4, it is important to examine in depth the research problem and empirical evidence. Therefore, a qualitative research investigation follows in chapter 5 and the qualitative research findings and formulation of hypotheses are discussed in chapter 6.

CHAPTER FIVE: RESEARCH METHODOLOGY
~ QUALITATIVE RESEARCH ~

5.0 INTRODUCTION

The research methodology employed in this study combines a qualitative investigation (part one) and a quantitative approach (part two: mail questionnaire to clients of audit firms). The importance of the dyadic relationship suggested that both sides should be studied. This was done with four pairs (eight interviews) of dyads and the results are presented in chapter six. As will be shown a framework of the relationship process emerged from this research but three problems arose:

1. While respondents were happy to discuss the relationship process and their own objective and expectation there was reluctance from clients to discuss the auditors to a third party in an open and instructed way.
2. In other cases, auditors refused access to the researcher even after interview with their clients. The relative importance of key dimensions leading to a quality relationship could not be assessed adequately. Therefore, the qualitative investigation was limited to four dyads.
3. Although the process of relationships was clarified the degree of importance of different variables meant that it would be difficult to generalise results as predictor for auditor-client relationships. That is a key objective in this research.

As a result a quantitative survey of a cross-section of clients from different industries was undertaken. This is described and justified in chapter seven.

This chapter critically examines in detail the nature of the qualitative research design used, the selection of respondents, the data collection methods and the analysis procedure used in this first part of research. Bearing this in mind, studying customer relationship marketing is not an easy task. Researchers have to resort to different ways to achieve their research objectives. Stone et al (1996) point out the use of qualitative approach because:

> *"The matters we are probing are commercially sensitive and reaching quantitative conclusions would be difficult, due to very selective sampling often we can gain co-operation only because we are known and trusted by the respondents or recommended to them by one of their trusted suppliers of systems or marketing services"* (p.675).

Others suggest the use of a qualitative approach as a valuable tool for discovering descriptive information and identifying certain norms that are present in channel relationships (Weitz and Lap, 1995). This idea has been expanded on by Nevin (1995) to propose that research that focuses on examining the structure of channel relationships and the relationship development process would be especially beneficial to understanding relationships in the channel context. Furthermore, qualitative research can be used to develop a conceptual model for building and maintaing relationships (McQuiston, 2001).

5.1 RESEARCH PROBLEM, OBJECTIVES AND RESEARCH QUESTIONS

5.1.1 Research problem

As mentioned in chapter one (introduction), the accountancy profession has come under a lot of criticism, particularly after the collapse of some well-known public companies. These companies were given a seal of approval by auditors. Later on the same companies faced bankruptcy and their managers accused of fraud. Due to this situation the accountants as auditors find themselves in a conflicting situation. The accounting profession faces a dilemma. On the one hand, they have to remain independent and show their integrity motivated by professional ethics and generally acceptable auditing standards. On the other hand, the pressure from competition and more demanding clients is forcing the profession to sell other services and to become client-centred by not applying the auditing standards very strictly. This situation seems to have many implications for the client-auditor relationship.

5.1.2 Qualitative Research objectives

The main objective of the study is to examine the nature of client-accountancy firm relationships in the audit market by considering the determinants of relationship quality in auditor – client relationships. There are four research objectives:

1. To identify the elements of auditors client relationship
2. To explore and evaluate:
    a. The development of relationship elements through stages
    b. What makes auditor/ client relationship enduring?
    c. What are the external factors influencing the relationship?
3. To examine the implications of a close relationship
4. To critically examine how to restore public confidence.

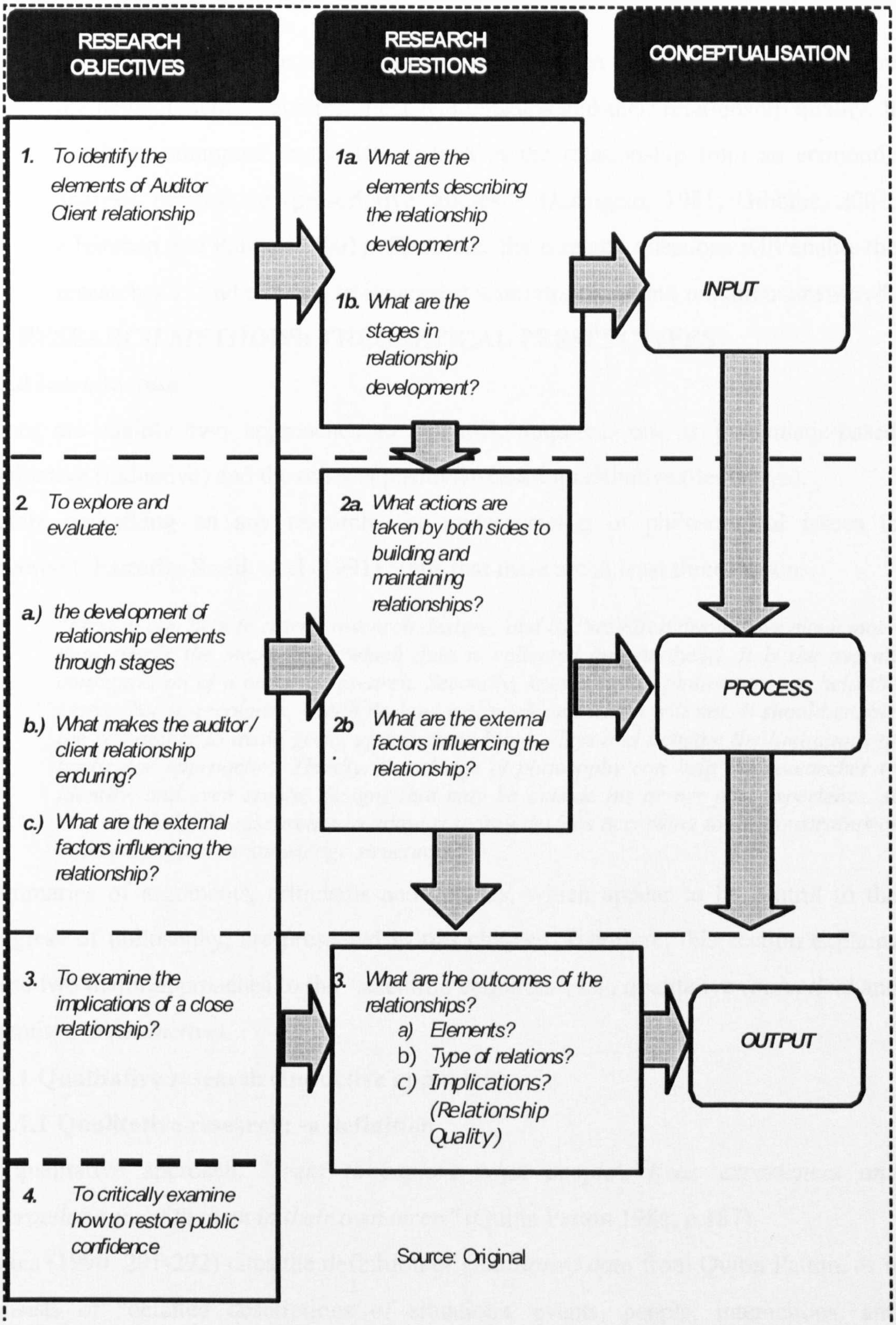
5.1.3 Research questions

The research objectives identified in table 5.1 have been expressed in form of research questions as follows:

- What are the elements describing the relationship development?
- What are the stages in relationship development?
- What actions do both sides take to building and maintaining relationships?
- What are the external factors influencing the relationship?

- What are the outcomes of the relationships?

Table 5.1 Research Direction for Qualitative Research (Preliminary Study)



Source: Original

In this first part of the investigation, the study was set in a way to give the research the flexibility and freedom to explore the relationship phenomenon in-depth by using a qualitative approach because:

(a) Most of the elements pertaining to the nature of auditor client relationship phenomenon have not yet been clearly identified, understood and conceptually developed.

(b) As far as is known, no studies in the UK have taken up the challenge to explore the development of auditor-client relationships and their relationship quality. It has been attempted in the US to look at the relationship from an economic analysis perspective (prescriptive studies – DeAngelo, 1981; Gibbins, 2001; Kleinman and Palmon, 2001). Therefore, the research questions will enable the researcher to find answers to issues that seem important but remain unanswered.

5.2 RESEARCH METHODS: THEORETICAL PERSPECTIVES

5.2.0 Introduction

There are mainly two approaches to scientific inquires, one is humanistic-based qualitative (inductive) and the other is positivist-based quantitative (deductive).

Before embarking on any research, the understanding of philosophical issues is important. Easterby-Smith et al (1991) argue that there are at least three reasons.

> *"First, it can help to clarify research designs, and by "research design" we mean more than simply the methods by which data is collected and analysed. It is the overall configuration of a piece of research. Secondly, knowledge of philosophy can help the researcher to recognise, which designs will work and which will not. It should enable the researcher to avoid going up too many blind alleys and indicate the limitations of particular approaches. Thirdly, knowledge of philosophy can help the researcher to identify, and even create, designs that may be outside his or her past experience. It may also help the researcher to adapt research designs according to the constraints of different subject or knowledge structures".*

Summaries of arguments, criticisms and debates, which appear to be central to the progress of philosophy, are presented in this chapter. Therefore, this section explains these two major approaches to the "scientific enquiries", i.e., qualitative *(inductive)* and quantitative *(deductive)*.

5.2.1 Qualitative research (Inductive approach)

5.2.1.1 Qualitative research: -a definition

A qualitative approach, *"seeks to capture what people's lives, experiences and interactions mean to them in their own terms"* (Quinn Patton 1986, p.187).

Sykes (1990, 291-292) cites the definition of *Qualitative data* from Quinn Patton, as it consists of "detailed descriptions of situations, events, people, interactions, and observed behaviours; direct quotations from people about their experience, attitudes, beliefs and thoughts; and excerpts or entire passages from documents, correspondence records, and case histories... the data are collected... without attempting to fit institutional activities or people's experiences into pre-determined, standardised categories such as the response choices that comprise typical questionnaire or tests" (Quinn Patton 1986, p.187).

5.2.1.2 Qualitative research as humanistic approach

Qualitative research is associated with *"**humanists** who believe that there is no 'real' world to discover. Science aims to make sense of the world for us in terms, which are relative to our place and time in history. You can do science in many ways; the important thing is to find the right way for doing what you want to do. Data do not provide an objective test of a theory because data are created, at least in part, by theory"* (Gabriel 1990, p.509). Gabriel goes further indicating that Humanists are relativists; in this context it is people who believe that objective knowledge does not exist and that all knowledge is relative to the knower. Relativists are open to the criticism that all of their knowledge is arbitrary and without anything beyond personal validity.

5.2.1.3 Qualitative research -an inductive approach

Mintzberg (1983:108-109) sees two steps in inductive research. The first step is *detective work* the tracking down the patterns, consistencies. One searches through a phenomenon looking for order, following one lead to another. But the process itself is not neat.

> *Even in the nineteenth century, celebrated discoveries were often achieved enigmatically. Kekuly tortuously arrived at his theory of the benzene molecule; Davy blundered onto the anesthetic properties of nitrous oxide; Perkin's failure to produce synthetic quinine circuitously revealed aniline dyes; and Ehrlich tried 606 times before he succeeded in compounding salvarsan in 1910 (Dalton: 1959:273)"*

The second step in induction is the *creative leap*. The fact is that there would be no interesting hypothesis to test if no one ever generalised beyond his or her data. Every theory requires that creative leap, however small, that breaking away from the expected to describe something new. There is no one-to-one correspondence between data and theory. The data do not generate the theory -only researchers do that- any more than the theory can be *proved* true in terms of the data. All the theories are false, because all abstract from the data and simplify the world they purport to describe. The choice, then, is not between more and less useful theories. The usefulness, to repeat, stems from detective work well done, followed by creative leaps in relevant directions.

Swan (1985:348) describes the general inductive method as *"research then theory"*. This method consists of four main steps:

1. Select a phenomenon and list as many characteristics of the phenomenon as possible;
2. Measure the characteristics in as many situations as possible;
3. Analyse the data to see if any systematic patterns can be identified;
4. The systematic patterns found are formalised as theoretical statement, Zaltman, LeMasters, and Heffring (1982, p.98-103).

Hunt goes on by stating the advantage and disadvantage of this approach;

> *"A main advantage of the inductive approach is the exploration of the phenomenon that is not covered by current theory and the discovery of the new theory. A major limitation of the inductive research is that the investigator may feel lost since the process is so unstructured. The researcher must choose among an almost unlimited set of possible phenomenon, characteristics of the phenomenon and patterns in the data,* Hunt 1983 (pp.24-25).

Qualitative research offers a systematic and fruitful way to choose among diverse characteristics of phenomenon and data paterns in order to develop theory from the data.

The qualitative investigation offers a systematic and fruitful way to choose among diverse characteristics of phenomenon and data patterns in order to develop theory from the data.

5.2.1.4 Inductive research: qualitative inquiry

Qualitative inquiry is about explanation and discovery and in some cases developing new theory from data systematically. Glaser & Strauss (1967:6) explain that generating a theory from data means most hypotheses and concepts not only come from the data, but are systematically worked out in relation to the data during the course of the research. *Generating a theory involves a process of research.* By contrast, the *source* of certain ideas, or even ~models, ~ can come from sources other than the data. The biographies of scientists are replete with stories of occasional flashes of insight, of seminal ideas, garnered from sources outside the data. But the generation of theory from such insights must then be brought into relation to the data, or there is great danger that theory and empirical world will mismatch.

These authors suggest that researchers select a general topic of interest and start observation on a very small sample. A small sample makes it feasible to cast to a wide net in making initial observations. Patterns found in the data begin to provide the researcher with some guidance as to what is relevant or irrelevant, since a fundamental goal of science is to discover regularities in nature. As the research process continues, the focus can be sharpened using qualitative research procedures. In summary, qualitative research makes minimal demands on prior knowledge, so the research is free to discover new concepts and theory. In addition, the procedures of qualitative investigation provide a focus and structure for the research process.

5.2.1.5 Qualitative research as the chosen research method for stage one.

The fascination of exploratory research in discovering theory from data has been stimulating for the researcher to use his creativity and enthusiasm in contributing to greater understanding of the issues of auditor-client relationships. These elements have encouraged facing the difficulties of research by developing his own research methods. Various authors have pointed to this line of argument. Turner (1981) argues that qualitative research methodologies direct the researcher immediately to the creative core of the research process, and facilitates the direct application of both intellect and the imagination to the demanding process of interpreting data. This is shown by the development of model "respondent access as a sampling process" (p.25).

Part one of this study, is first of all explorative as it aims at discovering what dimensional aspects (constructs) are relevant in exploring the development of auditor-client relationships. The emphasis of this part (Research Methodology – Part I) is to provide an in-depth understanding and help in generalising and formulating hypotheses rather than on testing theory. Previous established theories and empirical reality will be used as equally important sources for this exploratory endeavour.

In this part one, the description of relationship development as well as the resulting hypotheses will be constructed as a result of a continuous dialogue between the theoretical framework development and the empirical findings.

The data collection was based mainly on the interviews and discussions. The data was collected from the two parties (the auditors and their clients). However, other sources (other than the interviews) were used to complement the internal data such as company documents, articles in the press, video recording and interviews with non-member of the company. It was expected to help triangulate the data.

It was to focus on understanding the elements of interaction and the business environment. In this early phase the researcher had to rely on different sources of data (literature, interviews and discussions). In-depth interviews were carried out in a small pilot sample of the clients and the accountants. This not only shed light on the elements influencing the relationships and what was happening in this business area, but also helped the study to develop the sampling process model and improve the research process direction. Later on, the researcher concentrated on particular issues raised during the research process, i.e. issues, which needed to be investigated further, as outlined in Swan's qualitative investigation steps.

5.2.2 Validity & reliability in research methods

(a) Validity of qualitative research

The term ***`validity'*** is used in a variety of senses in discussions about qualitative research. The most important distinction is between its use in referring to the *kind* and *accuracy* of the information obtained from individual sample units (people, groups and so on)- its `goodness' and its use in debates about the *status* of qualitative findings (their `hardness', `generalisability', `scientificness' and so on). The first of these meanings concerns the extent to which a particular methodology produces not only *relevant* information from individual sample units but also information which is `plentiful', `accurate', `honest', `illuminating' or whatever are the specific criteria of `goodness' (Sykes 1990, p 392).

(b) Reliability of qualitative research

The concept of reliability as it is applied to quantitative methods is inappropriate in qualitative research context. Sykes (1990) cites Robson who points out that the complexity of the interaction between problem analysis, data generation and interpretation makes it difficult to disentangle `researcher effects' from `method effects'. Any reliability measures will necessarily cover the effects of researcher input in both the conceptualisation of the problem and the interpretation of the data. The point here is that differences between replicated studies using different researchers are to be expected- and not in pejorative way. *"Given the dynamic and inductive way (qualitative research) operates, it is true that replicability is impossible to prove theoretically. Indeed, I would not want to, since regarding the researcher as a valuable bias in the whole process, I prefer to believe that while the base data may be replicable from one study to another, the interpretation (and consequence action) may differ"* (Robson 1989, p.8)

Table 5.2Validity and Reliability

Research Approach	Validity	Reliability
Qualitative	• kind and accuracy of the information • its goodness • plentiful, illuminates, accurate, honest, goodness (Sykes, 1990)	• inappropriate • Replication of the studies using different researchers due to be expected but not in pejorative way.

Source: Original

However, the advocates of qualitative approach have taken appropriate measures in defending it. Kirk and Miller (1986) propose a definition, which takes account of the particular relationship in qualitative research between the researcher's orientations, the generation of the data and its interpretation. They claim:

> *"For reliability to be calculated, it is incumbent on the scientific investigator to document his or her procedure. This must be accomplished at such a level of abstraction that the loci of decisions internal to the research project are made apparent. The curious public (or peer reviewer or funding source) deserves to know exactly how the qualitative researcher prepares him or herself for the endeavour, and how the data is collected and analysed. But the researcher also needs to be able to isolate the conditions under which he or she best 'goes to risk' -the time at which he or she is organised to learn something"* (p.72).

5.2.3 Participants in the study

Mintzberg (1983) points out that the size of the sample is not as important as the richness of the data collected

> *"... Given that we have one hundred people each prepared to do a year of research, we should ask ourselves whether we are better off to have each study 100 organisations, giving us superficial data on ten thousand, or each study one, giving us in-depth data on one hundred. The choice obviously depends on what is to be studied. But it should not preclude the small sample, which has often proved superior"* (p.107).

Glaser and Strauss (1967) point out the difference between theoretical and statistical sampling. *Theoretical sampling* is done in order to discover categories and their properties, and to suggest the interrelationships into a theory. *Statistical sampling* is done to obtain accurate evidence on distributions of people among categories to be used in descriptions or verifications. Thus, in each type of research the *"adequate sample" that we should look for (as researchers and readers or research) is very different"* (p.62). From Glaser and Strauss one can summarise adequacies and inadequacies of sampling in research management (table 5.3).

Table 5.3 Theoretical Sampling

	Sampling	
	Adequacy	***Inadequacy***
Theoretical	*is judged on the basis of how widely and diversely the analyst chose his/her groups for saturating categories accordingly to the type of the theory they wish to develop.*	*is easily spotted, once the theory associated with it usually thin and not well investigated and has too many obvious unexplained exceptions.*
Statistical	*is judged on the basis of techniques of random and stratified sampling to the social structure of the theory they wished to develop.*	*is often more difficult to spot; usually it must be pointed out by specialists in methodology since other researchers tend to accept technical sophistication uncritically.*

Source: Adapted by the author

5.2.4 Why studying relationship marketing from a client perspective in part two?

There are two reasons which are presented below:

1. As the subject is very sensitive and from qualitative inquiry and research access negotiation, one has learned how difficult it is to organise a matching relationship between audit firms and their clients in a very large scale survey from both perspectives.
2. Using a questionnaire to study relationship marketing, it will be very hard for auditors to give some insight to their experience about a particular company client. Auditors work on different assignments and use different teams, to have a match relationship, we need to identify the client firm and its auditors and send them both the questionnaire. However, different audit teams work in different relationships with different clients. Therefore, is it feasible to use a match relationship? Moreover, from the access negotiation and qualitative findings, it was found unlikely that an auditor would talk about a particular relationship of his client without a prior agreement from the company. As a result a client perspective is adopted for the quantitative survey.

5.2.5 Concluding remarks for this section

It is important to summarise the two approaches. The deductive method can be characterized as a linear process that starts with the logical derivation of hypotheses from the literature, a study is designed to test the hypotheses, the study is conducted, and the results are focused on whether or not the data support the hypotheses. The general inductive method can also be characterised as a linear process that starts with the choice of a topic moves to measurement, then analysis and ends with a suggested theory. The qualitative research approach is an iterative process that starts with a general problem. Joint data collection, coding and analysis on a small sample starts theory development which determines who to sample next and what information to obtain in order to press the theory along until it is developed.

This part one ot the current study shares the belief of Gabriel (1990) that the concepts of validity in humanist-based qualitative and positive-based quantitative market research are compared. It is argued, within the context of science as rhetoric, that whether we regard a piece of research as valid comes down to the use of critical judgement in both cases. Neither approach to research is intrinsically more valid than the other. A proper understanding of the issue of validity is an important component in claims of researchers to be professional.

From a theoretical point of view, the concept of reliability applied to quantitative methods is inappropriate in qualitative research context. The replicability is impossible to prove theoretically. However, it seems important to express the view that critical relativism is more `hard-headed' than positivism which often assumes the things which critical relativists take care to discuss. Robson (1988) asserts that:

> *"Everyone involved, not just qualitative researchers is using themselves as a data source. At least qualitative researchers recognise this potential bias and try and deal with it. Are others always so enlightened? I doubt it"* (p.11).

5.3 PRELIMINARY QUALITATIVE INVESTIGATION

This study aims to contribute to a better understanding of the elements affecting the development of long-term relationships between two organisations, how to build a positive and lasting relationship and its implications on auditor independence. A thorough understanding of audit phenomenon requires, among other things, locating it within a conceptual framework. However, as the nature of the study is exploratory, the conceptual framework is expected to emerge during the course of this preliminary qualitative study. Miles and Huberman (1984) point out that:

> *"the conceptual framework should emerge empirically from the field in the course of the study; the most important research questions will become clear only later on; the most meaningful settings and actors cannot be predicted prior to the fieldwork; instrument, if any, should derive from the properties of the settings, and from the ways its actors construe them"* (p.27).

To this end, this study has been designed to include the literature review and the analysis of fieldwork together. The fascination of exploratory research in discovering theory from data has been stimulating for the researcher to use his creativity and enthusiasm in contributing to greater understanding of the emerging issues raised earlier. This research focuses on the creative core of the research process, and facilitates the direct application of both intellect and imagination to the demanding process of interpreting data. This study is first of all explorative as it aims at discovering what dimensional aspects are relevant in exploring the development of auditor-client relationships. At this stage, the emphasis of the study is in generating and formulating hypotheses rather than on testing theory. Previous established theories and empirical reality will be used as equally important sources for this exploratory endeavour. The main aim of the preliminary study is to examine the nature of relationships between accountancy firms and their clients in the audit market by considering their elements and their development as a process.

5.4 RESEARCH PROCESS AND CONCEPTUAL FRAMEWORK DEVELOPMENT

Based on the advice of the R&D subcommittee on Qualitative Research (1979, pp.115-121) the best results will only be obtained when care, attention, experience and skill are bought to bear in the following areas:

1. Initial problem definition
2. Choice of research approach and methodology
3. Sample selection
4. Recruitment
5. The location
6. The skills and the qualities of the researcher
7. Analysis and interpretation of data
8. Conclusions and recommendations
9. Verbal reporting
10. Written reporting.

Carrying out a qualitative investigation, the research process adopted in part one of this study, as well as the sampling process, grew out of the researcher's confusions. As the research area is barely explored the researcher did not start with preconceived set of questions and then went out testing them. He relied on formulating general questions to get a feel of the accountancy situation and a general understanding. This is explained in detail in conducting a situation analysis.

5.4.1 STAGES OF THE RESEARCH PROCESS FOR THE QUALITATIVE INVESTIGATION

There are nine stages; (1) conducting situation analysis, (2) topic guide, (3) select informants, (4) access/reaccess negotiation, (5) qualitative fieldwork, (6) data analysis, (7) findings, (8) revision of plan and (9) conceptual framework development. These stages are explained as follows:

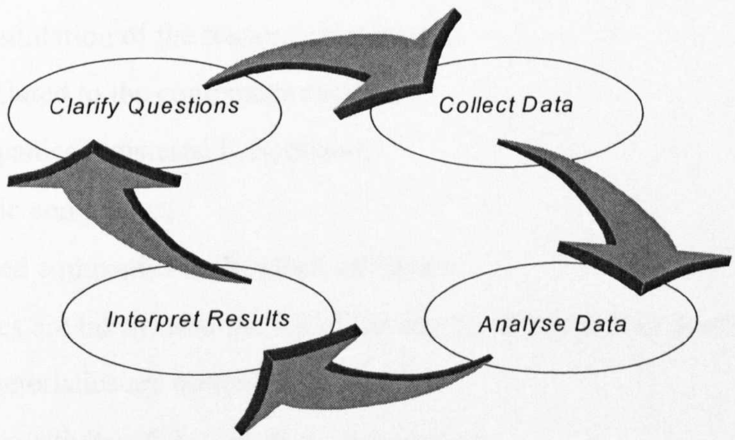
Stage (1) Conducting situation analysis:

From the start, there was a suspicion whether this research can be carried out when a number of companies were facing collapse and fraud. Moreover, the whole accountancy profession and in particular the auditors came under public scrutiny. This first stage started with a review of relevant literature (classification of technical literature on accounting services, professional services and industrial marketing). The non-technical literature is based on: a group discussion with three people (one lecturer in accounting and finance, one lecturer in marketing and the researcher). As a result, individual interviews were judged to be the most appropriate move to have an insight as well as a tool for providing the type of guidance needed for the next move. Due to the nature of the research problem and the research situation, the investigation took the form of cyclical steps rather a linear approach. A model describing the research cycle is presented in figure 5.1.

During this stage, the use of technical and non-technical literature enhanced understanding of the research problem and the context of where to place the auditor-client relationship problem within the following study areas: medium and large companies, sole traders and others.

Bearing in mind the difficulty of gaining access to the clients and their auditors during the recent situation dominated by the financial scandals, fraud and collapse of big companies such as BCCI in the UK and ENRON and WorldCom in the USA, where the whole audit profession come under scrutiny, and anticipation of changes were perquisite in this study.

Figure 5.1: Cyclical nature of the research process



Source: Original

Stage (2) Topic guide:

Though the researcher has been interested in a highly inductive approach, he started with some general research questions, set up in topic areas. By doing so, he has found the freedom to move in any direction from a base. The topic guide has helped to have a clear vision about what to investigate in general terms and what is of most interest to the researcher. As far as the research questions are concerned, they emerged from the objectives and the early interviews and group discussions during the situation analysis. Later on, the researcher started having a clear picture on the phenomenon to concentrate on.

In formulating the general questions, the researcher tried to raise about 30 questions spread over the chosen areas at the earlier stage. A copy of an early topic guide is attached in appendix 1. While the interviews were taking place, the number of questions were reduced in order to avoid an overload of information that cause difficulties to see emergent links across different part of the data-base and to achieve successful integration of findings.

Stage (3) Selecting informants (theoretical sampling for qualitative research):

The details of the selecting process are expressed through the theoretical sampling framework for qualitative research represented in figure 5.2.

This stage deals with the procedures used in sampling. These range from the characteristics of the sample, the determination of the sample size through contacting and persuading respondents (auditors and clients) to take part in the study, to efforts made to reduce self-selection bias resulting from the failure in gaining access to these organisations.

a) Respondents' characteristics

The characteristics of the sample are two-fold and expressed from step 1 to step 5 (cf graphical representation of the respondent access);

(a) Some are related to the companies such as

- companies registered in Scotland,
- public companies,
- quoted companies in the stock exchange,
- names are taken from the list of the top 50 companies in Scotland.

(b) Other characteristics are related to:

- the sensitivity of the problem investigated,
- the exploratory nature of the study,
- The feasibility of the study.

b) Sample size

Through the sample size is expressed the representativeness of the quantitative study. Unlike the quantitative studies, however, there are various reasons for not talking about representativeness in the qualitative study. Some are related to a general argument of qualitative research discussed earlier, other are related to the nature of the study such as the practicalities of the studies.

c) Explanation of participants' selection process

Unlike the quantitative approach, the sampling process takes place within the access negotiation with the respondents. Figure 5.2 shows the steps taken in the sampling process.

Stage (4) Access/ Reaccess negotiation:

In order to carry out this study successfully and maintain the follow up required, a negotiation approach for access and for re-access was formulated. This approach stems from a mixture of sampling process and fieldwork techniques. However, during the fieldwork the researcher had to consider contingency plans for anticipation of key problems such as access denial, partial access, conditional access and others. These issues are explained in chapter 10 (figure 10.2).

Testing the accessibility was very important to see the feasibility of the study. As a pilot sample, a selection of a very small sample to test the accessibility was considered and results were successful.

Due to the exploratory nature of the study, its practicality in carrying out the investigation with the dyadic members of relationships, and through the theoretical sampling, the sample size reached a manageable size. The study considered ***four*** *"matching relationships"*. This number appeared very suitable to this type of study considering its exploratory nature and practicalities.

It has been argued that in qualitative research, the number of case studies is not a problem. Mintzberg (1983, p.107) sees the possibility to use a sample of one. He goes by saying:

> *"What, for example, is wrong with the samples of one? Why should researchers have to apologise for them? Should Piaget apologise for studying his own children, a physicist for splitting one atom?"*

Gummesson (1988, p.79) advocates that:

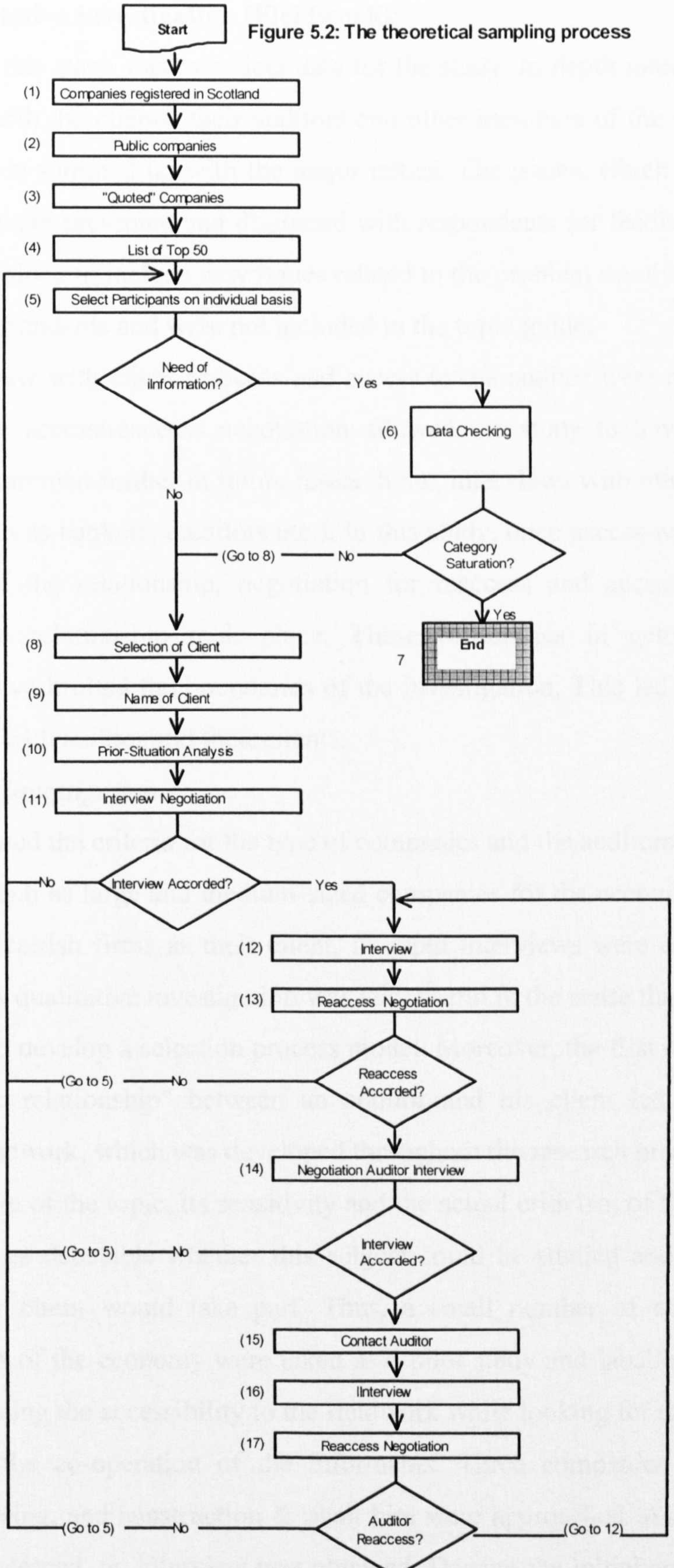
> *"... The possibilities to generalise from one single case are founded in the comprehensiveness of the measurements which makes it possible to reach a fundamental understanding of the structure, process and driving forces rather than a superficial establishment of correlation or cause-effect relationships".*

The qualitative sample of clients was taken from The Survey of the Top Listed Companies in Scotland in Chartered Accountant Magazine. The list of auditors was drawn from the clients (firms) sample, i.e. from the annual reports.

The question of how many companies should be involved in qualitative research has been a different matter of opinion as expressed by the qualitative practitioners.

As far as this study is concerned, it has not been possible to carry out interviews with a big number of firms and their auditors. The exploratory nature of the research and the difficulties facing getting access to the companies made the investigations to concentrate on a limited number of cases.

Figure 5.2: The theoretical sampling process



Source: Original

The study has deliberately chosen a number of cases of top Scottish firms from different industries to have a wider view.

Stage (5) Qualitative investigation (Fieldwork):

The purpose of this stage was to collect data for the study. In-depth interviews were to be carried out with the clients, their auditors and other members of the network. Each client interview is summed up with the major issues. The issues, which emerged from the interviews, were presented and discussed with respondents for feedback. It is to be noted that this helped to include new issues related to the problem involved which were raised by the respondents and were not included in the topic guide.

At every interview with client reaccess and access to the auditor were negotiated (see figure 5.2). The access/reaccess negotiation allowed the study to have a boundary, which can be examined further in future research i.e., interviews with other members of the network such as bankers, creditors etc.). In this study, once access was gained with one member of the relationship, negotiation for reaccess and access to the other member of the relationship took place. These difficulties in getting access to organisations have limited the boundaries of the investigation. This led to concentrate interviews only with auditor and their clients.

The qualitative investigation –

Having determined the criteria for the type of companies and the auditors to be included in the sample such as large and medium-sized companies for the accounting firms and the top listed Scottish firms as their client, in-depth interviews were carried out in a pilot study. This qualitative investigation was very useful in the sense that it encouraged the researcher to develop a selection process model. Moreover, the first obtained results from a "dyadic relationship" between an auditor and his client led to a tentative conceptual framework, which was developed throughout the research process.

Due to the nature of the topic, its sensitivity and the actual criticism of the accountancy profession, it was debatable whether this subject could be studied and whether audit firms and their client would take part. Thus, a small number of companies from different sectors of the economy were taken as a pilot study and labelled a *"sacrificed sample"*, i.e. testing the accessibility to the fieldwork while looking for the feasibility of study through the co-operation of the informants. Three companies from hotel & leisure, engineering, and construction & plant hire were approached. As far as the first company is concerned, an interview was obtained. Despite the initial agreement to see their auditor in three month time, a difficulty raised that the researcher had to negotiate with their auditor separately and not mentioning that he was given the approval by the client to avoid cost charges by the auditors. The second, an engineering company, offered limited access, i.e., an interview with the financial director who objected to even mentioning the name of their auditors. Finally, a company from construction and plant hire granted an interview and access to their auditor.

This situation, experienced within the pilot study, indicated the difficulties likely to be encountered and out of this the sampling process model emerged. Details are explained in the section of the sampling process. The data collected emerged from different sources;

- Companies annual reports of clients; promotion material from the accountancy firms;. tape recorded interviews with individual informants (one auditor and three different clients as mentioned earlier).
- A tape-recorded individual interview with a chartered accountant and a group discussion with two chartered accountants, and one from management accountant, not representing any particular company.
- Videotape of the programmes related to the research area and in particular the collapse and scandal of well-known companies such as Maxwell group, BCCI, Polly Peck, ENRON and Worldcom.
- A fieldnote from a discussion with the general secretary of ICAS for Glasgow region.
- Adding to this, discussion notes with academics in the auditing area.

Gaining Access

(a) Prior-contacts

Information was collected to facilitate accessibility. Having in mind to gather information concerning the name of chairman, chief executive and the company address including their phone numbers were checked through various directories (Jordan, ICC, phone-books and data base FAME). In checking their phones and addresses, recent phone directories or contacting the general inquires (telephone) helps to see whether the company does still exist and have the same phone number and whether their offices are in the same addresses or moved to a new place. Some companies disappeared from the market very quickly although their names still appear in the phone-book and other directories. Some of them have gone through merger, acquisition or simply ceased to exist. In one case a construction company office has been moved to a Scottish Bank headquarters.

This practical situation made it necessary to concentrate on the companies whose whereabouts are confirmed by the process explained above.

(b) Personalisation of contacts

The researcher‘s personal experience showed that a personalised letter to the chairman of a company has a better chance to attain the objective than an impersonalised one. Before addressing a letter, prior contact was made to establish where the company is and who runs it. By taking interest in asking and talking to them, the informants are already expecting a request (a letter) to take part in a study. This unconventional way seems to be more appreciated by the managers.

(c) Letter content & style

The letter was rephrased when the researcher had his colleagues look at it. After the first interviews and getting to know the "culture of respondents", i.e. accountants who are known for their grey suits, reserved as described by one accountant, the researcher felt relieved for not using his intended `jokey' style. Instead a serious and professional approach was adopted.

(d) Follow up

After sending a request letter to the chairman or chief executive inviting them to take part in the study, in most of the cases the letter was passed to an appropriate department to deal with the request. It appears that approval from the chairman or chief executive facilitates access to the company.

It has been argued by some writers (Buchanan and his colleagues, 1988) that contacts should not be addressed to the top management to obtain an interview. However, in this study, the experience has shown that there have been fewer rejections from the top than from the management. It appears that once the approval is given or the request is passed from the top management to the lower level in the organisation, it might be considered as an order as it put the management in the sharing responsibility for information.

Carrying out successful interviews

(a) Who are the respondents?

As part of the interview it is necessary to look at the "organisational culture". Although, the study of organisational culture is beyond the scope of this research it was considered necessary to have an understanding of the individuals' perceptions. Conducting a situation analysis shed some light on the characteristics of the respondents and it needed to be assessed whether the auditor and the financial director of client's company have a similar culture. In fact, most of the financial directors are qualified accountants and have worked in accountancy firms before joining in the client companies.

(b) Who to contact in first place?

Various authors have pointed out to the difficulties in the field research. Buchanan et al. (1988) advocate an `opportunistic' approach to fieldwork organisation. They argue that:

> *"Whatever carefully constructed views the researcher has of the nature of social science research, of the process of theory development, of data collection methods, or of the status of different types of data, those views are constantly compromised by the practical realities, opportunities and constraints presented by organisational research"* (p. 54).

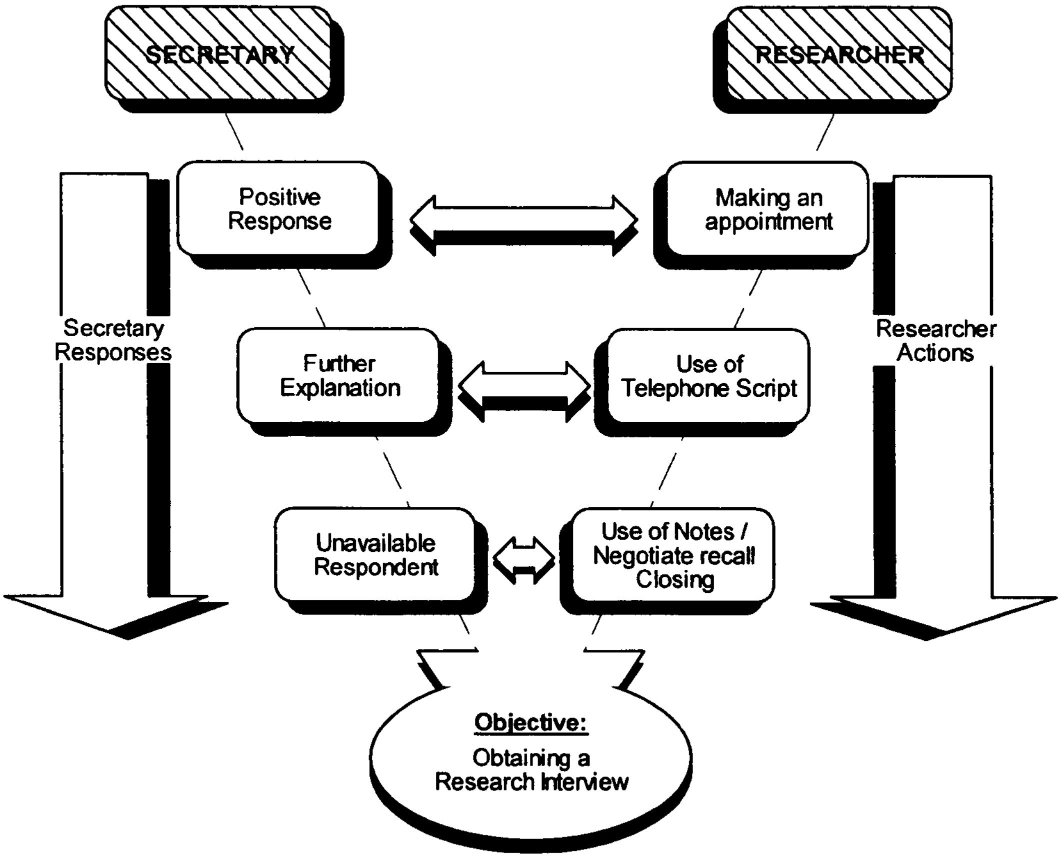
There is a lot of controversy. Some practitioners of qualitative researcher have argued that it is not necessary to approach top management to get access to organisation. However, in this study, chairmen and chief executives who responded positively to participate were contacted. This approach seemed to reveal the seriousness of the study. Nevertheless, it was necessary to go through the *"gatekeepers"*, i.e., the secretaries or PAs who appeared as the main barriers to have access to organisations. Negotiations were carried out by telephone. Negotiating for a research interview can be seen as selling a product or service by telephone and requires skills and techniques of negotiation. Generally speaking there are three type of response while negotiating for access; a positive response, further explanation required to the secretary of respondent; and prior access denial under different pretexts. In this current study of auditor-client relationships, similar situations have occurred and are presented in figure 5.3. The telephone negotiation has three types of responses from the secretary and followed by three alternative researcher actions. These are expressed in the figure 5.3.

(c) Preparation for the interview

Being properly dressed as an interviewer has positive effects on establishing rapport. At least it creates an easy atmosphere for the interview process. This impression emerged just after an interview with an auditor in Edinburgh, and particularly with a visit to the ICAS (Institute of Chartered Accountants of Scotland) building in Edinburgh to collect information related to accountancy firms. In this place, the researcher was warmly welcomed and got some photocopies done without being asked whether he was a member, a trainee or just an outsider. The researcher believed that his appearance was identified with the "accountant culture". This is believed because a couple of months ago, following a published survey of Scottish auditing firms, the researcher contacted the author for further information. The later suggested that a contact through the University would secure the access to the ICAS library.

As a result of this experience, a negotiation process for research access model (figure 5.3) and explanatory models (figure 10.1 and 10.2) are produced and presented in chapter 10.

Figure 5.3 Negotiation process for research access



Source: Original

(d)Topic guide

It is very useful to memorise the questions and rehearse before the interview. An open interview creates a discussion atmosphere rather than being asked question and receiving closed answer Yes or No. In every interview carried out, it was noticed respondents brought the contact letter, (which contains the information about the study, the researcher, his topic and the major issues he wants to discuss). Therefore, this shows respondents were already prepared for answering the areas mentioned in the letter. Moreover, in most of cases, it was noted that the letter was marked by "coloured pen".

(e) The interviews

In-depth interviews were carried out using a tape-recorder. *"In in-depth interview of forty-five to ninety minutes, respondents can be probed to reveal their real motivations, feelings, behaviours, and aspirations"* (Sokolow, 1983, p.26).

The interview started by reminding the respondent of the letter content. This helped give the interviewee guidance of the discussion. So, a reference to the introductory letter tells the respondent to follow or at least remember what is supposed to be discussed, i.e., and a sort of topic guide for the respondent. This has proven to be useful as in one interview the respondent was commenting point by point to the areas mentioned in the letter.

Questioning - starting the questions by asking general information leading to particular ones. It has been experienced that going straight to painful question will face some resentment. The nitty-gritty is left within the flow of information and once the respondent has already got into the swing of flowing information. Letting the respondent talk about themselves and their organisation and follow it up with question generated more detail. In order to avoid barriers to answer research questions, a sort of *"projective technique"* such as *"I have been told by a financial director of a Scottish PLC that..."* was used. It is to say someone else has said this, experienced that or believe this why do think is happening. This is to put the respondent in the other person's shoes and gives their own answer to that particular situation. This technique, as advocated by qualitative researchers, is based on the theory that *"When people are presented with ambiguous stimuli, where there are no clear clues, no right no wrong answers, it will encourage a freedom and diversity of response and allow respondents to project themselves into the situation creating their own definitions, seeking their own clues, drawing on their own experiences. They will thus reveal their own true feelings, attitudes and motive"* (Mostyne, 1978, p 4) quoted in Sykes (1990, p 301).

In most cases, general questions were used, phrased in a way to make the interviewee respond positively to the question such as: "I appreciate if you tell me from your own experience concerning.... In order to have an account." As most people like to talk about themselves, this appeared to be very useful way to break down barriers and establish rapport. Some interviewees made clear to the researcher in their contacts before the interview that they were not prepared to talk about any particular relationships. Despite this attitude before the interview, however, during the interview respondents found themselves talking about their company and their clients.

(f) Reaccess and access to other dyadic party negotiation

This was left to the end of the interview. At that stage the researcher would have established rapport and could judge the way to abort the negotiation process or to leave it to the next visit. A detailed explanation is given in section sampling process. A transactional analysis technique was used by turning a `No' answer to a `Yes' answer.

(g) Sharing the experience with other people

Discussions with colleagues and fellow research students as how to move from the present situation to the next one took place after every fieldwork. Telling the experience to the supervisor, friends and colleagues helped to generate ideas and advice to keep the research moving and avoiding barriers.

Stage (6 and 7) - DATA ANALYSIS AND CASE STUDY REPORTS

A combination of the Corbin & Strauss (1990) coding system and Swan's (1985) analysis steps, was used for the purpose of the analysis of this stage of the study. Further explanation now follows:

5.4.2 Data analysis structure and procedure

The analysis used the following data:

- Tape recorded interviews
- Matching Auditor/Client
- Non-Matching relationships
- Videotapes (BBC – special reports)
- Promotion material

5.4.3 Analysis procedure

5.4.3.1 Coding Procedure

Strauss and Corbin (1990:57) define *"coding represents the operations by which data are broken down, conceptualised, and put back together in new ways. It is the central process by which theories are built from data."* They summarise the analytical procedures of qualitative inquiry are designed to:

1. Build rather than only test the theory.
2. Give the research process the rigor necessary to make the theory "good" science.
3. Help the analyst to break through the biases and assumptions brought to, and that can develop during the research process.
4. Provide the grounding, build the density, and develop the sensitivity and integration

5. Needed to generate a rich, tightly woven, explanatory theory that closely approximates the reality it represents.

Analysis in qualitative research is composed of three major types of coding. There are; (a) open coding, (b) axial coding and (c) selective coding.

(i) Open Coding

Strauss and Corbin (1990) define this as *"the part of the analysis that pertains specifically to the naming and categorizing of phenomena through close examination of data... During open coding the data are broken down into discrete parts, closely examined, compared for similarities and differences, and questions are asked about the phenomena as reflecting in data"* (p.62).

During the analysis of the data, the researcher asks questions such as what is this? What does it represent? To what phenomenon does it relate? What is this data referring to? What is the action/ interaction all about? By doing this it helps to label the phenomenon. By phenomenon is meant the central idea, event, happening, about which a set of actions and interactions is directed at managing or handling, or to which the set is related.

In this part of analysis, the researcher has used different ways in naming a category.

1. Important word or phrases used by respondents during in-depth interviews such as *"Beauty Parade"* referring to accountancy firms doing a presentation of the client as a selection process for audit buy.
2. Names chosen by the researcher and which seem most logically related to the data they represent.
3. Some names are drawn from the review of technical literature such as academic articles, books and professional journals (accountancy) and non-technical literature (newspapers, manuscripts, reports, videotapes and other related materials).

There are important points to mention here:

1. The process of open coding stimulates the discovery not only of categories but also for their *properties* and *dimensions.*
2. Properties and dimensions are important to recognise and systematically develop because they form the basis for making relationships between categories and subcategorises and later between major categories.

3. Therefore, to understand the nature of properties and dimensions and their relationships is a requisite task for understanding, in turn, all of the analytical procedures required for a qualitative investigation.
4. As defined above, properties are attributes or characteristics of a phenomenon (category).

In summary, through the analytical process, these concepts (constructs) are identified and developed in terms of their properties and dimensions. Asking questions about the data and making systematic comparisons of events, incidents and other situations does this. Then, similar events and incidents are named and brought together to form categories.

(ii) Axial Coding

Corbin and Strauss (1990:96) define axial coding as:

> *"A set of procedures whereby data are put back together in new ways after open coding, by making connections between categories.*

Axial coding is simply the process of relating sub-categories to a category. It uses inductive and deductive reasoning. This is to say, it proposes statements of relationships or suggests possible properties and their dimensions when working with the data, then actually attempts to verify what it has deduced against data so as to compare incident with incident.

(iii) Selective coding

It is defined by Corbin and Strauss (1990:116) as:

> *"The process of selecting the core category, systematically relating it to other categories, validating those relationships, and filling in categories that need further refinement and development".*

After collecting and analysing the data, the researcher embarks on the task of integrating the identified categories. This task appears to be the most difficult in the analysis process. As Paul Atkinson, quoted in Corbin and Strauss, writes:

> *"This aspect--making it all come together--is one of the most difficult things of all, is it not? Quite apart from actually achieving it, it is hard to inject the right mix of (a) faith that it can and will be achieved; (b) recognition that it has to be worked at, and is not based on romantic inspiration; (c) that it is not like a solution to a puzzle or a maths problem, but it has to be created, (d) that you cannot always pack everything into one version, and that any one project could yield several different ways of bringing it together".*

Through the analysis three types of analytical relations have been used; (1) similarity, (2) opposition and (3) influence.

Similarity and opposition were necessarily to investigate in order to define each category as clear as possible. Influence was necessary to code in order to establish causal chains of these conceptual categories.

All data, i.e., notes from interviews conducted with clients and their auditors were transcribed and divided into conceptual categories on a fairly level of "abstraction". These so called C codes for clients and A codes for auditors. These categories could be described as recurrent themes. A total of 120 codes for clients and 109 codes for auditors.

Each category's relations to other categories were also coded (axial coding). These relations were formed by comparing all categories two by two. The next step in ths category was to research cluster related to categories from auditors and clients that described important empirical phenomenon (in the cases) or theoretical issues, i.e., treated in the literature. In practice, it means a careful and playful combinatory research from one category (A or C) to the next, translating labels and relations between categories into meaningful fragment of theory.

In the case study reports open and axial coding will be presented. However, for more practical reasons selective coding will be presented in the section-analysis of qualitative findings.

The general technique, which is central to all coding procedures, is the *asking of questions*. This is to say asking questions all along the research project. Moreover, there is no single route to discovery of knowledge. As Diesing (1971:14) says:

> *"Actually scientific knowledge is in part an invention or development rather than an imitation; concepts, hypotheses, and theories are not found ready-made in reality but must be constructed... The procedures are not mechanical or automatic, nor they do constitute an algorithm guaranteed to give results. They are rather to be applied flexibly according to circumstances; their order may vary, and alternatives are available at every step.* (Quote from Corbin and Strauss:1990:59)

5.4.3.2 The Ethnograph

(i) What is the Ethnograph?

Ethnograph is defined by its pioneers, Seidel, Kjolseth and Seymour, as:

> *"A set of interactive, menu driven computer programs designed to assist the ethnographic/qualitative researcher in some of the mechanics of data analysis. These programs present an efficient alternative to the often-cumbersome tasks of managing field notes, transcripts, documents and other types of text data collected and analysed in ethnographic/qualitative research. By turning over the mechanical aspects of the work to the computer, the researcher is free to devote more time and attention to the critical interpretive aspects of qualitative data analysis"* (1988:1-2).

(ii) Managing and Analysing Text Data

Traditionally this involved a substantial amount of photocopying, cutting and pasting and sorting of coded segments of data into analytically useful and meaningful piles of cards and sheets of paper.

The Ethnograph allows the qualitative researcher to use a PC to accomplish many of these tedious, time consuming, and frequently messy tasks. Further, the Ethnograph permits researchers to "cut and paste" and cross reference data in ways that would have been difficult, if not impossible, using traditional manual data management practice, i.e., mechanical cutting and pasting and using some combinations of scissors, tape, glue, and many photocopies of raw data. As they make sense of their data, qualitative researchers literally cut and paste their materials. However, studies using this approach, can easily generate hundred of pages of interview transcripts, fieldnotes, diaries, company documents, etc.

At the start, this study adopted this approach and the researcher faced enormous difficulties in remembering the codes and text segments. This situation has been highlighted as well by Seidel et al (1988). Due to the cyclical nature and iterative process of categorising, the qualitative investigator faces the problem of keeping track of all the proliferating pieces.

(iii) Researcher and data relationships

The analytical process begins when the researcher comes into contact with some data, starts noticing certain features and patterns in the data and then begins to identify and label those features and patterns for later retrieval and more intensive analysis. In the Ethnograph language this is referred to as "code mapping."

Seidal et al (1988) explain the interaction between the qualitative researcher and his data by saying that:

> *"You begin to progressively develop a relationship with the data. You are "listening" to your data and at the same time bringing your ideas and thoughts to bear on the data in an effort to understand and make sense of them. Your ideas are influenced both by the concrete materials that make up your data, and by the analytic and theoretical baggage that you bring to your task"* (p.7).

One can say, as the researcher identifies and marks segments of texts, he is mapping out the relationship that is evolving between himself and his data.

(iv) Making sense of the data

At best, code mapping appears a useful process of making sense of the data. One possible limitation is that the eventual analytic and conceptual categories developed by the researcher, may or may not have obvious and explicit connections with the code-mapping scheme. Therefore, to an external observer they might appear unclear until he or she is shown how to see the data as the researcher has come to see it.

Seidal et al (1988) argue that:

> *"If you try to deal with your data on its terms rather than in the terms of some pre-established conceptual or analytic framework, you are more likely to discover unexpected features again and gain new insights"* (p.7-9).

(v) Facilitating the thinking tasks

The Ethnograph does not replace the researcher in his thinking or analysis. Rather it allows him to overlay analytic schemes on the data. The true capabilities of the Ethnograph are realised after the researcher has initiated the thinking part of data analysis.The interpretive part of data analysis has been discussed in several qualitative papers and research method books (Glaser and Strauss, 1967; Strauss and Corbib, 1990; Spradley, 1979; Lofland and Lofland, 1984; Hammersley and Atkinson, 1983; Emerson, 1983; Dey, 1993; Silverman,1994 and others. As the study chose to use grouded approach advocated by Glaser and Strauss, 1967 and Corbin and Strauss, 1990, definitions and interpretive process are discussed in detail in the coming sections.

(vi) The analytical process

With the help of computer assisted package, the Ethnograph, is demonstrated through this section.

Stages (6 &7) Data analysis and findings

Details of the analysis are presented in the next sections of this chapter. The early findings reflected the original topic guide areas of the study. They constituted the elements describing the auditor client relationships, the stages of their development, the process and their outcomes. Therefore, a revision of plan for further investigation of new issues to emerge took place.

Stage (8) Revision of plan:

Revision of plan followed the findings of the fieldwork, case boundaries and follow up and access methods were considered to further the investigation. Although the researcher managed to obtain 4 matching relationship and 6 non-matching relationships, the study presented only 4 matching relationships in form of case studies due to the richness of the data and the *"category saturation"* as advocated by Glaser and Strauss (1967).

Stage (9) Conceptual framework

The conceptual framework may be seen as the current version of the researcher's map of the territory being investigated in auditor-client relationships. More and more exploratory fieldwork was carried out in a cyclical process, the researcher gained terrain and the map became differentiated and integrated. Thus, qualitative research has the merit to give the researcher the freedom to change direction easily and to focus data collection for the next field trip in this stage one.

In summary, this chapter five has critically examined in detail the nature of the qualitative research design used, the selection of respondents and negotiation process for research access, the data collection methods and the analysis procedure used in this first part of research. In order to address the qualitative research objectives of this study, chapter six is set to examine the qualitative findings, clarifying the statement of research problem and formulating hypotheses.

CHAPTER SIX
QUALITATIVE RESEARCH FINDINGS, STATEMENT OF THE RESEARCH PROBLEM AND FORMULATION OF HYPOTHESES

6.0 INTRODUCTION

The purpose of this chapter is to present the qualitative research findings, explain the statement of the research problem and show how, from the empirical data generated, the study hypotheses are formulated. In an attempt to carry out these tasks, the emphasis is placed on identifying the elements of relationships, stages and emerging issues. In order to identify the elements, stages and issues from the qualitative data analysis, the study research questions and objectives were used. The research objectives, identified in table 5.1, have been expressed in the form of research questions as follows:

- What are the elements describing the relationship development?
- What are the stages in relationship development?
- What actions do both sides take to building and maintaining relationships?
- What are the external factors influencing the relationship?
- What are the outcomes of the relationships?

This chapter is structured in three sections:

- Section 6.1 gives an indication on how the analysis of the findings is carried out and presented.
- Section 6.2 shows the cross-case study analysis and findings. It focuses on the elements, process and stages of relationships and highlighting any emerging issues.
- Section 6.3 reviews the concepts related to the area of study, i.e., emerging concepts from the qualitative investigation and the ones covered in the previous studies. Moreover, these concepts will be used as captured constructs to measure the extent of the relationship quality. Thus, hypotheses are formulated.

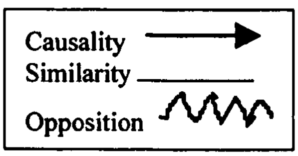
6.1 QUALITATIVE RESEARCH FINDINGS AND ANALYSIS

This section gives an indication on how the findings and analysis on matching relationships between the audit firm and the client company. For the research four dyadic relationships were studied and eight in-depth interviews were undertaken. Contact was first established with the client firm then agreement was obtained from the audit (Figure 5.2, chapter 5). In each case the senior executive/manager in the client firm then the principal auditor was interviewed. The eight in-depth interviews forming the dyads and from the literature studies (technical and non-technical literature as advocated by Strauss and Corbin 1990), can be regarded as an integrated way to produce a conceptual framework for auditor-client relationship (figure 6.6). The intention is not only to link the case studies to the literature analysis but also to use them as an integral part of developing auditor-client relationship framework. This stage can be referred to as an integrative process. One can also start thinking about how all of this fits into the larger phenomenon of dyadic relationships. For each case the approach taken is to present the data in the following manner and integrated together to form a cross-case analysis:

1) A description and analysis of the elements, stages and processes involved in the auditor-client relationship.
2) An analysis of the environmental conditions, which help to see the relationship from a holistic view
3) The outcomes of the analysis, the benefits of a long term relationship, the type and implication of relationship, breakdowns and the emerging issues are analysed.

As outlined in the previous methodology chapter five, the cases were not analysed in isolation and the process was informed by reference to the other cases under study. Auditor coded information has the designation letter A followed by a number. Client information is coded C followed by a number. The full coding process, also explained under methodology, has a code-list attached as appendix 2.

All cases are analysed and figures presented in a similar way, although many of the smaller/intermediary diagrams are omitted due to space. The following legend has been used in all cases:



6.2 ANALYSIS OF THE ELEMENTS, PROCESS AND STAGES OF RELATIONSHIP

Recognising the importance of the key elements, process and stages of auditor-client relationships, this section attempts to give a coherent and in-depth analysis of empirical data description of the auditor-client relationship stages and outlines the key determinants of these relationships.

6.2.1 Theme 1 - Establishing relationship

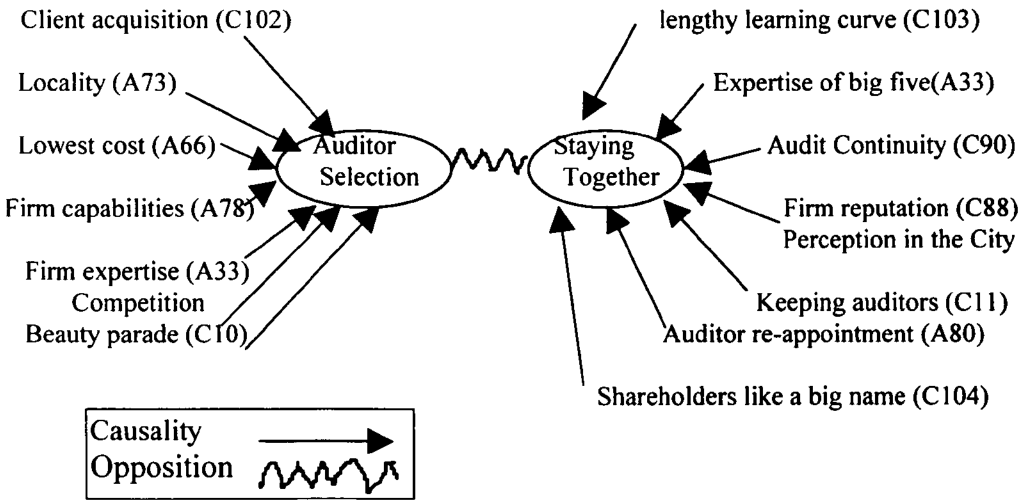
Establishing a relationship is not only with an audit firm but with a number of professional services providers such as banks, lawyers etc. As far as the audit function is concerned, it begins with the needs of an organisation to satisfy the legal requirement imposed by the Company Act and reassurance of the shareholders by the management as stewards. The *personal* and *business familiarities* appear to be the main features of selecting the audit firm in all four of our cases. It emerges that the personal and professional familiarities (friends, trainees or work colleagues), feeling comfortable with each other and confidentiality, constitute the ingredients of their *rapport.* From here, it is apparent that knowing people in the business community is part of the business activity. Friends, colleagues from previous training firms or even work colleagues still pop in to see each other in their business circle. So the relationship has already existed between people from the audit firm and management in the client company. It is matter of establishing it, i.e., obtain the contract and starting developing the relationship. At this stage, the level of adherence for the relationship is based only on the *rapport* established between the chairman, financial director or other top decision makers at the early stage. The *audit firm capabilities* were expressed in terms of making themselves available to the client, i.e. a point of contact, having a good knowledge of client business and the industry as a whole. The audit firm tries to sell the client other services to show that the firm is capable to help and solve client problems through direct involvement or by referral. Moreover, the firm used its experience gained from client businesses to sell their expertise to other clients in the same industry. Establishing relationship pre-existed (case 1) when the chairman was a partner in the firm which he appointed as auditor for his own business. Moreover, the analysis shows that establishing relationship between auditors and their clients is made at the top level. It is also an on-going process for the accountancy firms. *Regular contacts* and *courtship* are used frequently by the accountancy firms to gain new clients and keep the existing ones.

> *"I am just thinking, I was at lunch in PriceWaterhouseCoopers last week, I have no relationship with PWC at all. They phoned up and asked me to come for lunch. I had lunch there. I have had lunch with PWC this year; I have had lunch with Ernst & Young"* (case 1).

However, most respondents (clients) believe if their company grows and gets involved in international operations and the auditors cannot cope with the expansion then, it will be time to raise the question of changing auditors. One emerging issue is that some auditors change side and take new post as financial director with the client company, i.e., resign from the audit firm and go on secondment to the client firm. Others are very close to be appointed auditors. Thus, in one case the audit partner formed a new company and appointed his friend as auditor (case 1). The accountancy professional circle expressed here demonstrates that *professional familiarity* and *personal familiarity* are interrelated concepts. Moreover, the firm used its experience gained from client businesses to sell their expertise to other clients in the same industry. These personal and business familiarities appear to be key elements in a *working audit relationships* are important in the sense where both company's staff (auditors and clients) interact. Like-minded personalities help to speed the audit work as communication is much easier. Moreover, *problem solving* appears to be more to do with auditors and the company's board rather than the whole stakeholder. If the company is in financial difficulties it would not want to alarm its shareholders due to the risk attached to the information provided to the public. As argued by Linsley and Lawrence (2007) that directors might conceal bad news from their shareholders. Therefore, an audit firm which is in a position to take a justified minimum risk will put them in a favourable position. *Commitment* will be expressed by showing concern and enthusiasm to the client. *Regular contact* will increase at this stage to develop a good rapport and to show the possibility of full commitment.

There is a pressure from the banks, institutional investors and other users of the accounts on the company. They are always looking for business confidence. Therefore, client wants audit firm *(Auditor selection)* with a good reputation and international capabilities. This leads to the way management are assessed on their performance.

Figure 6.1: Selecting a new audit firm & Staying with the same firm



Another element taken into account in the selection of auditors is the "innovative approach" proclaimed by the auditors. Innovative approach is described as the firm having a quality of audit manager, experience in the client business sector, accessible and a speed of response. Adding to this, auditors praise themselves as providing a service plus, i.e., at the end of the audit exercise, they take time and efforts to sit down with the clients and asking them what they did well and what they did wrong and what they like the auditors to do. This is part of an open dialogue aimed to have a total understanding of what each other expects.

At this stage of establishing relationship and in terms of marketing, accountancy firms are promoting themselves as more than auditors. They sell non-audit services and promote themselves as *specialists* in certain areas.

> *"Auditing does not any longer feature as being the business they are in. It is still the business that is seen to be done. But, they are out there flogging the other services as fast as they can go"* (case 1).

6.2.2 Theme 2 - Developing relationship

Within an existing relationship, auditors and clients (especially top management) will try to develop the relationship after changes have taken place in one of the two parties. Both will go through a *learning process* where the effort of developing an understanding is the first priority. There is a strong belief in the client that *buying non-audit services* is a way to develop closeness and an *understanding* which cannot be developed through an audit job (i.e., audit relationship). *Relationship development* is reflected as well through the efforts put by both (auditors and client) upon working at the relationship which lead to a better understanding of the needs and *expectations* of each other. It is worth noting that auditors find themselves at the different stages with different clients. It sometimes happens with even an existing relationship. Some efforts are produced to develop the relationship because a change has taken place within the client's organisation, i.e., such as appointment of a new chief executive or chairman.

> *"You need to develop the relationship- that is we are trying to do -we are trying to cement the relationship and trying to enhance it - try to expand it"* (case 4).

The auditor describes the relationship as it might start off doing the basic audit and expand the service offerings to the client, i.e., consultancy work. This situation leads the analysis to the term used as *"Hold on to it" strategy* discussed in the model of marketing strategy for auditors (see chapter 9, discussion). Auditors recognise that in order to move through the stages of a relationship, it might take longer and depend on the needs of the clients. For instance, the client might want just an audit service as cheaply as possible. So, to be able to sell other advisory services might take longer for an accountancy firm to do so. Internal auditors and external auditors are involved in the preparation for the audit plan. Approval is generally obtained from chief executive and the chairman of the audit commission. This shows that the structure of the different parties involved is such that it will not cause any disagreement or set back in audit work. Another factor expressed by one respondent (the client) is that developing a relationship is to have some expectation, i.e., feeling comfortable with auditors because it is a *people business.*

Other interesting factor in developing a relationship is having client's business knowledge. Understanding the client's business might take a longer period depending on the client size. Auditors are aware that it could take several months or several years to fully understand the client business. Therefore, it is a lengthy learning curve. Moreover, a client operates within a dynamic environment where changes take place regularly. Auditors find themselves continuously re-assessing their understanding of the client's business. As part of developing their relationship with clients, auditors look at the changes in the marketplace and keep their clients informed of what is happening and what they can do for them. What they have in terms of service offerings. This is expressed as *keeping auditors in the client mind* and having *regular contact.* So the clients know where to turn for help if needed. Moreover, this reinforces the audit firm credibility.

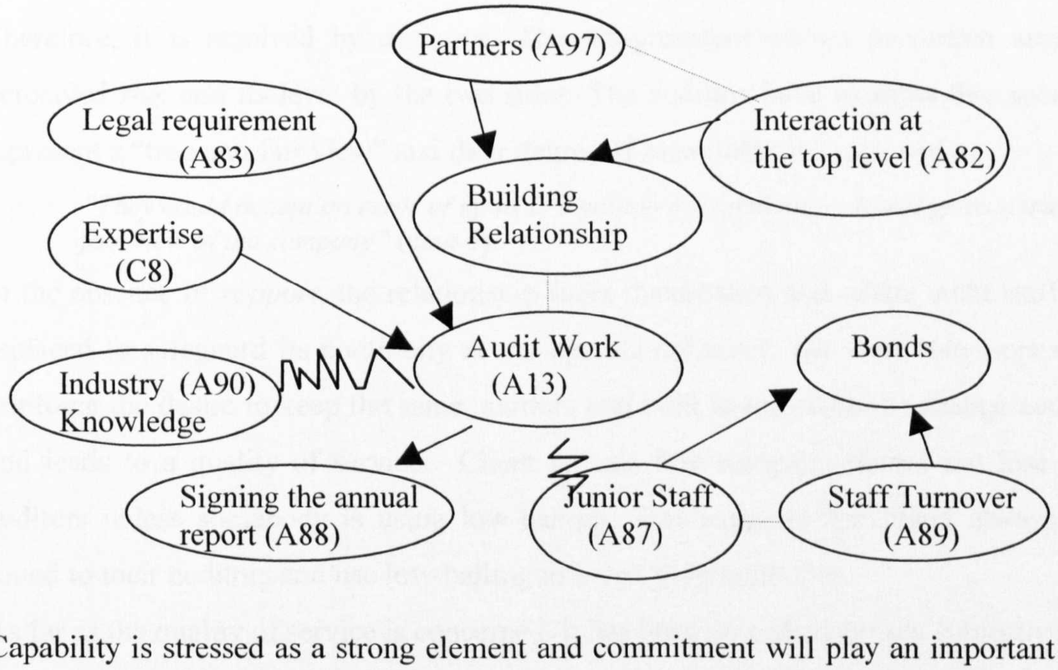
6.2.3 Theme 3 - Building on Relationship

Building a relationship is described as the ability to manage it. There is a belief that the client perceives auditors as technically proficient. The extras are on that ability to be proactive in perceiving client's problems and helping in resolving them. Adding to this, using personality the partner in charge manages the relationship with the client.

> *"It is actually acknowledged the personalities- and very much of those types of issues which cannot be measured. To take a simple principle this is not all of it in accountancy terms - but personality terms. They will look at the company which is a client at the outset and may be match individuals"* (case 4).

The interaction includes the *exchange of formal information*, getting to know the business of the client and feeling more comfortable to discuss with the auditors about the business and transactions and how to avoid problems.

Figure 6.2: Building Relationship



Capability is stressed as a strong element and commitment will play an important role. The working relationship dimension will be as a learning process and emphasis will be put on *mutual exchange understanding*, business and way of working together. Commitment is the result of early interest in a mutual satisfying exchange at the early stage of selection (buying the service) and its degree will increase as a result of close interaction (working relationship). The emphasis in this stage is about building on relationships, which lead to establish stability between both organisations as well as individuals involved in the audit work.

There is a need for a co-operation effort and trust. Thus, it will project not only the client business image, but a stability of interactions conveying a favourable picture to the stakeholder and the City. *Continuity* between auditors and their clients can enhance relationships between individuals and both organisations. This is reflected in staff continuity. In audit services, both auditor and client like to keep the continuity at the senior level. But, continuity at the lower level of the organisation is desirable. This will result in terms of perceiving themselves as partners. This may lead to better efficiency and problem solving as they occur. The concept of *continuity* has been singled out in case one and equally given importance in the other three cases. It is believed that all big firms have knowledge of their clients and they need to maintain that continuity of audit work. *Continuity* is desired by both parties (client and management). The client know their auditors and does not want to go through period of disturbance, i.e., knowing people and company business helps to keep client satisfied and reduce its *disruption.* However, *disagreement* between management and external auditors sometimes occurs.. Therefore, it is resolved by *dialogue.* The disagreement occurs in certain areas of perceived risk and its level by the two sides. The auditors have to show that accounts represent a "true and fair view" and their degree of materiality is much wider.

> *"They could accept an error of up to £10 million or something... It still gives a true and fair view of the company"* (case 4).

In the absence of *rapport*, the relationship faces disturbance and where audit staffs are replaced to safeguard its continuity at the operational level. *The continuity* appears to reinforce the desire to keep the same auditors and built in reluctance to change auditors and leads to a quality of service. Client reveals that company should not lose their auditors unless somebody is using low-balling. This suggests that client always turn round to their auditors and use low-balling to lower their audit fees.

As far as the quality of service is concerned, it has been described as very subjective and difficult to determine because it is about perception of decision-makers that are not necessarily accountants. Moreover, the quality of service is checked somehow by the audit committee, which is formed of non-executive directors.

Building up relationship is through *learning process* and while giving auditors opportunities to develop *knowledge about the company* and *industry,* both parties increase their *mutual trust.* Maintaining *Continuity* at the top level (partner and audit manager) is seen as an important factor in building relationship. Changes of staff at the lower level of the relationship does not cause any harm to on-going relationship. It is more important to keep the smooth running of relationship at the top level (decision making level).

As one client expressed it his company does not see any problem of auditors doing an inspection job. The inspection concept of an audit is acceptable to the client as a part of internal control. It appears when the client does not have an internal audit they rely on the feedback from the external auditors and when problems happen or expected to happen, they call upon the auditors to help to solve them through an inspection. This suggests that there is a strong belief that external auditors have the resources and since they do the audit work for the different divisions and have knowledge of individual businesses, they are better equipped to do it than having internal auditors. However, it appears that *sharing audit* job is cost reduction, especially for small operations i.e., the size of the subsidiaries and their foreign location.

Building relationship is related to the continuity of the audit and the interface with the external auditors. Client believe that the auditors must satisfy themselves that their client have an adequate internal control system. External auditors do examine the reports on internal control and place reliance on the end results. This shows that there is a *built trust* between two parties.

Audit working relationship is described as a very good one when both of them have knowledge of each other. Moreover, the relationship is seen as consistent due to the continuity of the partners. Although junior staff are important, this has less impact on the relationship compared with the relationship at the top level. However, despite the junior staff changing a lot, some of them remain working with the same client and move upward in the level of hierarchy and become an audit manager or partner. During this period, i.e., from junior level to managerial level, personal relationship is developed and bonds are established (chapter 2, figure 2.3).

Continuity is seen as a *continuous dialogue* between the auditor and its client, not as a number of years they spent together. The reasons behind it, it is important to know people you work with in order to do the audit work. For instance, auditors presume the systems have not changed. If there is no dialogue then they would not know if the systems have been changed until they arrive next year. That will cause a problem because they do not expect changes in the client system. If it is the case, they have to go and redesign their test. So this shows that the continuity is not working. But if they had a dialogue in between, i.e., meeting and discussing client business. Therefore, auditors know what is happening and they can react to it. So it is more than continuity, it *continuity plus*.

Both building and *maintaining relationships,* is not left only to the top people to take care of it but it is lowered down the hierarchy. Everybody will be involved whether they are students, supervisors, manager or senior partner. It has been recognised that the relationship should be maintained at the top level. However, efforts should also be produced by all the audit team at their different levels.

Composition of *audit team* is very important and where personality character takes over the skill. Audit supervisor watch closely their audit team in order to avoid any clash of personality or disruption. If a member of the audit team does not get on with the client staff will be singled out at the end of the audit work and will be assigned to another team to a different client. *Clash of personality* does happen but not so often and are dealt with as quickly as possible. Precaution is generally taken to avoid any misunderstanding which can be developed into a clash of personality. Supervisors are there to guide junior staff so they will not be asking the same questions or seen to be learning audit work at the expense of the client time.

6.2.4 Theme 4-Maintaining relationship

Audit relationship is there to stay. It is for the interest of clients to keep auditors for a longer period. A regular change of auditors will attract outside attention and might put the company under scrutiny. Both individuals and organisations continue to interact, familiarity, personnel involvement and expressing trust will take place. The client sees the relationship with auditors is there to stay i.e., a long-term relationship. However, it is quite different from other advisory services as is shown in this quotation:

> *"... now many other people are having a four year of five year beauty parade. Now funny enough we have not done it with our auditors, but if you are to think like our insurance brokers they have got a step forwards every four or five years and they go through the book"* (case 1).

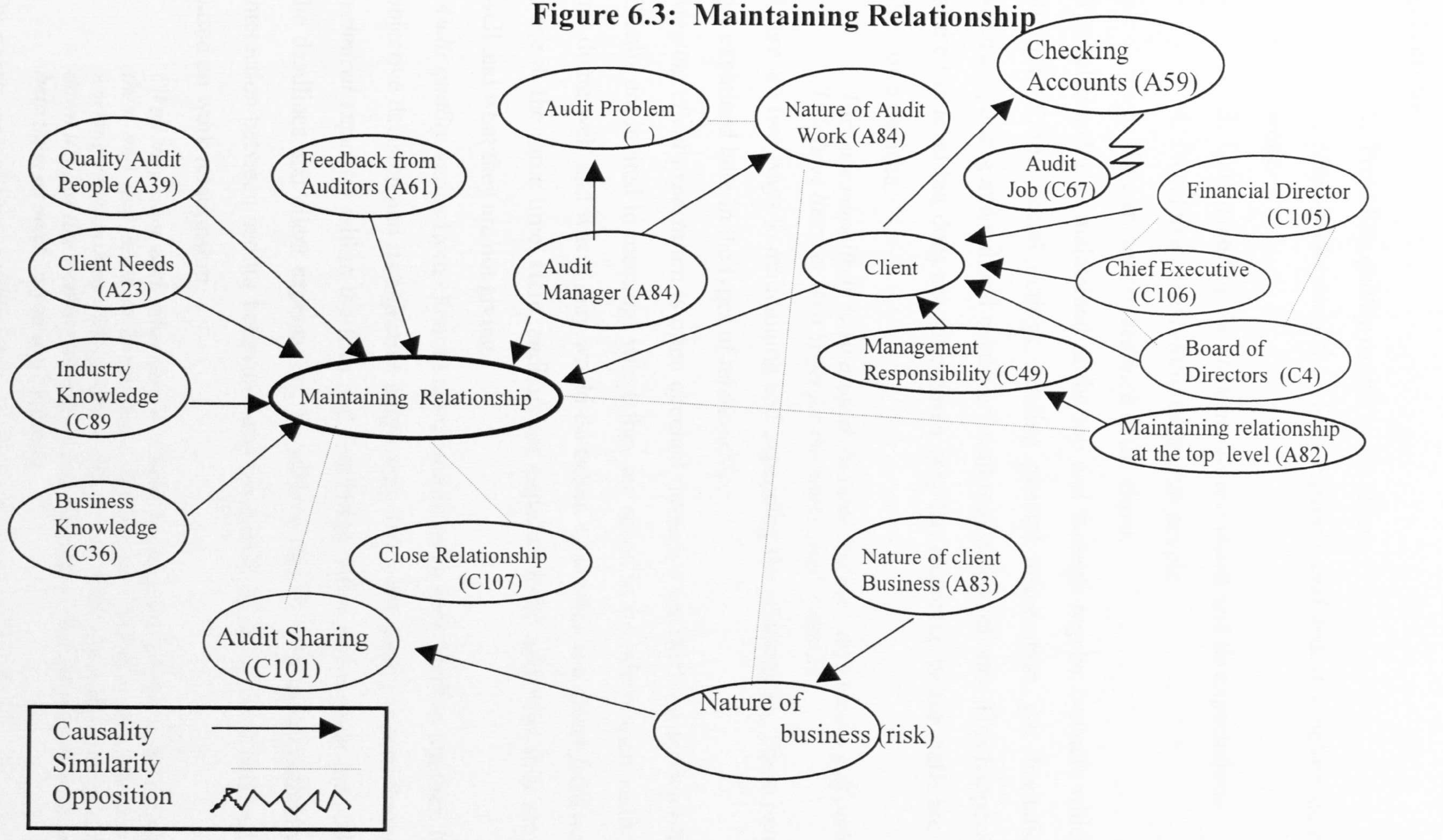
One client argues that the auditors have never done anything wrong to worry about it. Therefore, the relationship is maintained and long-lasting. For the client, auditors have managed to produce and work with a large number of staff and not upsetting them (i.e., no relationship disturbance). They have showed a *mutual understanding in* working with them and delivering the audit on time. On the whole, the client believes that *"auditors have delivered in their interests"*. One can say there is a sense of *partnership* in the relationship, which is expressed by the freedom of movement of auditors within the client company, i.e., they have been given the authority by the management to go anywhere and to any subsidiaries and give a *feedback* to the management. This demonstrates the existence of an *open dialogue* between auditors and the management.

> *"They have got the total freedom they can go anywhere... and when they want. They can speak to senior managements. And they are absolutely no restriction imposed on them at all. I think that is the correct way. People would say the auditor sit in that room. He (management) does not allow people to go and see him - forget it - The auditor has no chance to do his job"* (case 1).

Maintaining the relationship is generally related to the nature of the audit. Audit manager does not believe that the firm has a problematic relationship with their client. Clients do not look at audit job (role) as checking the accounts, because bank directors understand that it is not simply a checking exercise to go away and pay the fees. They are not looking for a situation where they can minimise the cost and minimise the burdens of its overheads because it is a bank business and banks are very risk concerns. If things go wrong and if the systems are not correct then a bank will fall flat and it will very quickly perceive the situation as that (Case 2).

When it comes to *maintaining a relationship*, emphasis is put on making sure and a clear understanding and appreciation of the concern and expectations of the *chief executive*, the top man in the company, not just the financial people because he is the man who decides. But, views of the directors are taken into account as well. This is to say, audit firm target and find out who is the decision maker. Auditors try to be closer to their clients in order to recognise who the key players are on any board of directors of any company.

Figure 6.3: Maintaining Relationship



The main points of *maintaining the relationship* summarised by one respondent (client) are:

1. Providing *quality people* to the client.
2. Must *understand* the client *business and industry* before doing any work.
3. Understanding the *client needs* and *wants* and its expectations
4. Develop a *close relationship* with people.
5. Give an *honest feedback* to the client.

The relationship is maintained at the top and through regular contacts which take different forms, social outings, sending general information, etc. Invitations to various sporting and cultural events are sent regularly to clients. This happens often at the top level but does not filter down very far. However, junior staffs are left to their own devices.

> *"They are more likely to sit around the table and say "let's have a golf outing" or "let's have lunch or do a buffet for the junior staff"* (case 2).

There are two ways to maintaining and expanding the relationship. These two ways are explained later in the types of relationship.

Meeting client expectation is often checked through a feedback on service offering. Clients are invited to meetings where they are asked to say where their auditors are not doing well and where they would do better. *Courtship* and *client feedback* take place in the same time. Here, auditors are expected to be told what they are doing well and what they are not giving.

Audit quality varies from client to client and from an individual to another. It is an objective decision and its objective judgement. The audit quality is seen through the *technical expertise* within the firm and Edinburgh office to conclude the audit and the deadlines and client expectation. To achieve this, it is to have continuity. The interaction between auditor behaviour and the quality of the audit is believed to be based on work relationship.

> *"Well they know each other very well now. We have one or two social outings with them and that helps to break down any barriers and it is just like any other working relationships with anyone works for the bank. Once this barrier is broken down it's just like working with any other colleague. They have a job to do and you help them as much as you can"* (case 2).

On-going *socialising relationship* is expressed in other forms. Auditors use "defensive measure", as described by the client. The defensive measure is used when audit firms try to record personal interests of their corporate clients and store them in their database. Clients receive from time to time and according to their personal interests invitations to social activities. This defensive measure is trigged by the fact business relationship is based on *social relationship*. This is to say, business relationship is tied up to the fact of losing a client but also losing a social relationship and its closeness. *Closeness* was more pronounced in this case, and took the form of almost a utopian state of outcome. This category (construct) receives influences from working at relationship expressed through the business interactions which contain audit and non-audit services. The non-audit relationship provides a set of opportunities to develop, build and maintain an on-going audit relationship. While on-going socialising relationship has similarities with closeness, it leads to personal familiarity development.

Audit work start early with a pretext of an *audit review* or *an audit interim*. This is to check whether if there is any problem or foreseen problem to the main audit. It appears that auditors adopt the following a strategy - preparing the client for the audit, i.e., (1) preparation or preliminary work for audit, (2) feedback to the management, discussion and audit planning, (3) audit the company. This activity has been reported somewhere else as conflict of interest by (Goldman and Barlev, 1974). These audit review and audit interim are requested by management. They want a feedback on the situation before the main audit work starts. At this stage, it is believed that negotiation will take place and prediction can be made and what should be expressed through management letter. This leads to what it has been raised as a concern in relation to auditors' independence (Hand, 1976 and DeAngelo, 1981).

From a client perspective, it shows that auditors and management work as partners within a continuous dialogue and negotiation. This leads to trust building. Both gain from this dialogue. Auditors would add advice services to their audit fee and management will be happy to be seen performing well by the shareholders. However, critics (Gates et al., 2007) argue that relationships that were 'too close' have led to the auditors' inability to scrutinise transactions and contributed to recent dramatic audit failures of well known companies (e.g. Enron, WorldCom, Xerox, etc.)

Management of an External Audit is very low due to the fact audit review or interim reviews are there to find important problems. It is meant to prepare terrain to avoid any foreseeable problem while doing the external audit. Nevertheless, management try to resolve their problems, in particular accounting techniques before external auditors point out to them. This has been refereed to by critics as creative accounting (Smith, 1992). This is seen as a good working relationship.

Maintaining Relationship - One factor, which emerged within maintaining the relationship, is when the audit firm tries to support its audit activities by providing accountancy training to the client staff. Moreover, maintaining the relationship might go back to the selection factor, i.e., selecting auditors for the job. Asking the client about what constitute a good relationship, a number of factors emerged:

- happy relationship
- friendly auditors
- professional in their attitude and behaviour
- respect of different opinion
- maintaining a regular contact
- helping each other.

However, the analysis reveals in the selection process of auditors, a number of influential factors are used and expressed in this citation of the client:

> *"... auditing is particularly difficult because in the law, client is really the shareholders and it is slightly different. It is often things like deciding why influential people... and who has the influence. It varies from company to company... who would have liked to have been auditors of Robert Maxwell? - what kind of auditors does he want? Do you go for the most competent one that you can find, or look for someone who can easily bully? - I think this company's directors are very conscious of their role as stewards of assets which are held by a range of shareholders and take it very seriously"* (case 1).

This citation reveals how the selection of auditors is part of *power relationship* and *influences* between clients and their auditors. One has to ask whether relationship is only based on *personal relationship* and *familiarity* or on the power - negotiation and influences. This has been echoed in previous studies (see chapter four).

Communication has been expressed as an important factor in maintaining the relationship. Client needs to have a main point of contact in order to maintain that *continuity*. In case of change of staff, the main point of contact informs and discusses with the client the future replacement. It is about *matching personalities*. The audit manager believes that a breakdown of communication might be very damaging for the audit firm. *Communication* is expressed through not only providing the services, and keeping the client informed but also ensuring that he perceives that he is getting the best service. To communicate is to find about the client needs and wants to satisfy them through the innovative approach defined earlier. It is also to obtain feedback from the client how he perceives audit services.

It is to note that maintaining relationship at the top has been the concern of the auditors.

> *"So that communication is important... I mean we maintain our lead partner on the relationship. He would meet with the chief executive or the chairman, maybe every month, certainly every two months to discuss the key businesses.... used to discuss what we are doing. To find out from the clients what they are doing and how they perceived us. So that is relationship building"* (case 4).

The above quotation shows that there are different stages of relationships with different clients. It might be an existing relationship with a change at the top. So communication factor is important at all the stages of the relationships whether establishing, developing, building or maintaining it.

Recruiting auditors and offering them new post within the client's organisation has taken place within on-going relationship. This has been encouraged by both sides of the relationship. Junior staff that finish their training with the firm and establish a good *rapport* with the client might be offered a new post if there is a vacancy. This happens not only at a junior staff level but also at the audit manager level as expressed in case 2.

Business familiarity and *personal familiarity* are used to gain new clients. The firm keeps in touch with its newly qualified trainees, who moved to a client or to a non-client. It constitutes an important link for the firm to have and obtain businesses.

Problem solving is expressed through as helping the client to run his business. In the management letter, recommendations are put in to improve client performance through accounting records or accounting systems etc. Problem solving is seen also as identifying issues and demonstrating that these issues are well understood by auditors and can help to do something about them. Trying to solve client's problem and understanding his expectation lead to have a close working relationship as a form of a *partnership*. Therefore, advice is provided through the sale of other services as expressed in the quotations below from case 4:

> *"...We see ourselves as being not just auditors but business advisers and we have a relationship. Our whole firm has a relationship with the client. So it is a bit like what I was saying earlier the developing of the relationship".*

> *"... I would say that value is by helping the clients to achieve their business objectives. So we are really acting along side them almost as a partner to advise them to get to their goals as quickly and efficiently as possible."*

Commitment is determined by the existence of long-term relationship. The degree of commitment is that an auditor feels toward a relationship will be a strong organisational condition. Commitment is not particular to the last stage of relationship development.

However, it takes place from the early stage. Later on, a number of years, auditors are not expected to change because the cost of terminating the relationship will have impact on the image of the client and on the price of its shares. It is believed that commitment will continue despite the conditional changes in the environment. However, auditors are more careful and do all that they can to preserve their integrity without exposing their clients to risks. If the risks are greater and clients willingness to improve or act on the auditors advice and follow the third parties (watchdog, DTI, stock exchange etc.) guidelines, interactions between auditors and their clients may decline and perhaps even cease.

This stage can be characterised by even recruiting ex-auditors for the post of financial director in the client firm and even training their staff.

Important factors in maintaining long-term relationship might be expressed as follows:

- client became more involved in buying other non-audit services
- recruiting auditors to work for them as financial directors
- training their staff.

6.2.5 Theme 5 - Outcomes of relationships

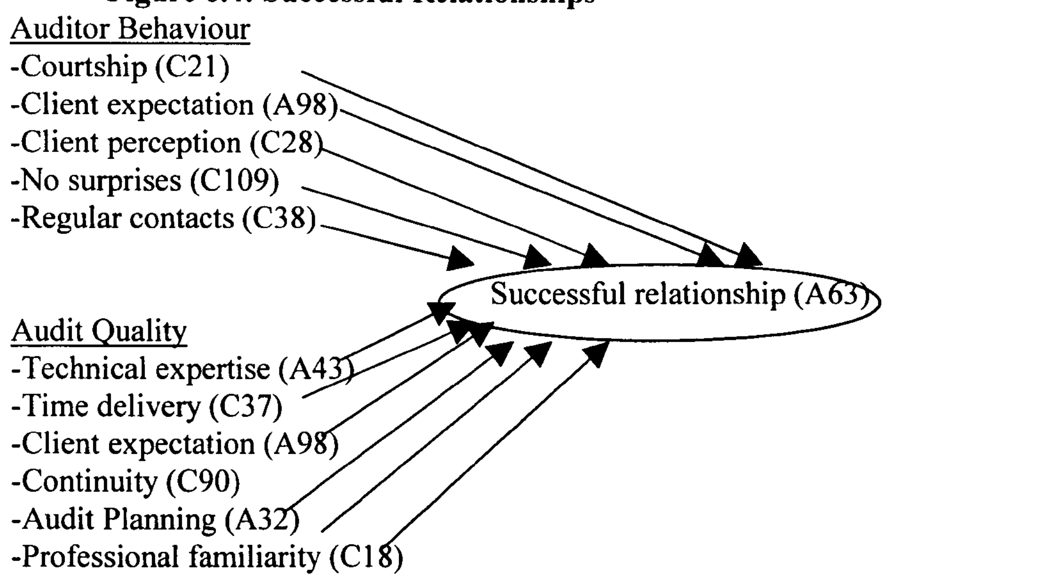
There are a number of factors related to the benefits of long-term relationships and what makes the relationships last longer.

(i) The benefits factors are as follows:

- Controls are thoroughly examined
- Continuity of audit and staff
- A good dialogue
- Knowing people and trusting them
- Auditors understanding of client business
- Business and company knowledge
- Understanding management expectation
- Help to solve major problem
- Partnership in work and problem solving
- Ideas for profit improvement from auditors
- Apply ideas from other businesses
- Personal relations
- Openness and mutual understanding

(ii) In case2, it emerges that a successful relationship is closely linked to two major categories: (1) how auditors behave towards the management, (2) whether auditors will deliver what client expects. These two categories are represented in the figure 6.4.

Figure 6.4: Successful Relationships



(iii) Commitment is expressed at two levels. At the working level, management do not see the commitment as important at the lower level due to the staff turnover but it is highly expected at the top level. Commitment is shown through personal relations and rapport established with the client staff. There are scenes where commitment is lacking at the lower level within junior staff who are less able and ardent during the period of their training. De Ruyter and Wetzels (1999) argue that commitment plays a central role in auditor-client relationships.

6.2.5.1 Types of relationship

The analysis reveals two types of relationships - *existing relationship* and *targeting relationship.* If the audit firm is expanding or developing its business. It has two ways to expand its business services. Either it increases the level of its services and fees to its exiting clients or to obtain work from new clients. These relationships are closely linked to the marketing strategy (see chapter 9 discussion of findings). By putting emphasis on the first, audit firm tends to establish its credibility and be more helpful to the client. For new client, it comes down to people and when the firm cannot just rely on referral. The firm has to have the presence and the contacts as well. The second type of relationship is *gaining a new client.* Contacts with non-client, i.e. (client other than theirs) help the audit firm in increasing its profile. This also leads to enhance the firm's credibility. On the whole, there are two types of relationships between accountancy firm and its clients. Long term relationship is based on the audit work and the short term relationships are related to one off work, i.e., non-audit services.

6.2.5.2 Implications of Auditor-Client Relationships

A close relationship can be *disruptive.*

> *"How we are able to assist our clients in meeting their operational and financial problems and how we actually do our audit?... The answer is whether we interrupt the client and annoy them or we try to minimise the disruption that - because an audit is disruptive, everyone is disruptive".*

Keeping in touch works both ways. Auditors try to have regular meeting with their clients throughout the year. This is imposed upon them by the nature of the banking business.

> *"The nature of the business is that there is so much happening now both on regularity front as well as compliance with the accounting standards you find that you have to see them more often".*

To the client, auditors perform various roles in the bank (case2) and not just as auditor reporting to the shareholders. They hold the reporting accounting role to the Bank of England and also required to sign off returns to the securities and exchange commissions in Washington. If the bank is doing loan capital issues or share capital issues and it has done few of these in the past five years. Then, auditors are involved in looking at the figures and are part of the team that eventually put solid documentation for these issues together. So, the client believes that it has been a very close working relationship that they have had with them. In the case 2, *the implication of a close relationship* is expressed through the auditor involvement in preparing a "solid documentation" for a loan capital issue or share capital issue. They are part of a team. This lead to see the relationship developed to a "*partnership*".

Partnership is seen as working as a part of a team; *it is very much a joint effort. It has got to work that way. The complexity of the documents that are produced, it has to be that way." Commitment* is about perception of what the client makes of their auditors, such as whether they take their role very seriously. They take interest what is happening within the company and talk to the right people in the company. So, being informed and knowing what is happening it helps avoid asking the same questions again and again by the audit team. *Co-operation* is part of doing business and getting the audit work done. It is about meeting and discussing the various aspect of business.

The implication of close relationship - Auditors are not seen as *inspectors* to check accounts but rather helpers. However, client believes that auditors have to satisfy themselves that *proper controls* were in place.

> *"Obviously a good few of their meetings this time around focused on the levels of bad debt provisions. That has been the main focus of a lot of meetings"* (case 2).

6.2.5.3 Other emerging issues

There are three important dimensions emerged in these analysis i) understanding client business and industry, ii) having a good communication and iii) ability to negotiate and use ones influence.

(i)Understanding client business and industry makes auditors a better backstop to check client activities.

(ii) Developing a special communication language

> *".. I think the key one is what I referred earlier is we understand what they say and what it means because one person saying something does not matter or saying something that is very important and significant is not necessarily the same as another"*(case 3).

Both management (financial director) and auditors have the same training and a good understanding of accounting system and techniques. One wonders what type of language they need to develop over the years to communicate to each other. It emerges from this analysis that establishing or developing a communication system whereby they express their concerns and worries about certain issues and their degrees and come to a compromise. Understanding an auditor and its communication patterns are the key element to maintaining relationship. However, difficulties appear from time to time in the communication process between auditors and client. This leads to a breakdown of communication. Generally it is due to a misunderstanding and disagreement. These misunderstanding and disagreement happen but very rarely. It happened not with the main auditors but with the acquisition service, i.e., people from the same audit firm but not the usual auditors the client has been dealing with. They were skilled people in the industry and though they will give the client a better service, management expectation is completely different. Management prefers to deal with the same people. This shows that management by dealing with the same auditors as external auditors and advisers for acquisition, it puts them in a better position for future negotiations.

The analysis shows that management prefer to use the same auditors (people) known to them in order to occupy a stronger bargaining position later on when it comes to audit fees determination. This might lead to a conflict of interest.

> *"I would rather have somebody I know whatever their skills background at given level of an audit"* (case 3).

(iii) Power - Negotiation

These two concepts emerged as an important issue within auditor-client dialogue and depending on how important the relationship was.

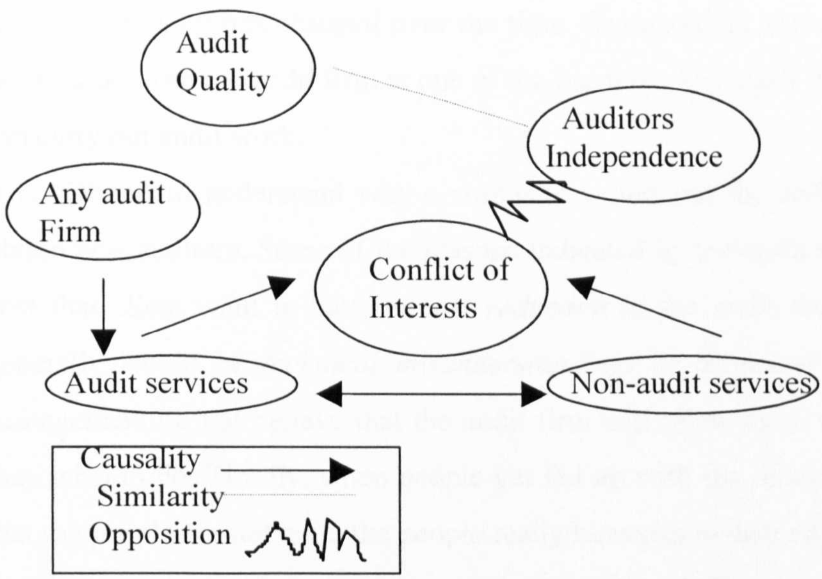
> *" I think it vary and a lot will depend on whether fundamentally the auditors see it as black and white issue or not. A lot of things are very grey... it is technically correct obviously our auditors would recognise it. The debate is then only over how much it is and yes you would expect then~ level of give and take~ review and argue about the number would be"* case 3).

> *"... but if they say you cannot do something I would ask them to try and accept something or come to a compromise or something that was not compromisable if you like"* (case 3).

From the case, it emerges that *Commitment* and *partnership* lead to a compromising situation, which the client describe as auditors should be innovative i.e., in case of disagreement related to the accounting system or accounting techniques used by the client, auditors should suggest other techniques which lead to the same results wanted by the clients. This shows, there is a compromise from auditors who are not only involved in agreeing that technique is correct but also suggesting other methods. This leads to a *conflict of interest* and *auditors independence* will be questioned. Here, the shareholders would not be aware of it and their protection is not as such described by the Company Act.

The *auditor independence concept* receives many influences. There is a general belief that clients who buy most of non-audit services from their principal auditors raise a serious concern. It is simply to show that the auditors are not independent from their clients. This picture is portrait across all cases.

Figure 6.5: Conflict of Interests



This cross-cases analysis reveals that audit review, interim audit, using the same auditors for non-audit services (acquisition) and asking auditors or even using techniques approved by auditors but which are not too obvious to the *general public* and *shareholders*. The negotiation process takes place and conflict of interest and auditor independence emerged as the two categories which contribute as well to a long standing relationship.

One would ask how far these auditors can go doing these things. One has to look at the collapse of well known companies and the techniques used before their collapse. These have been explained by Smith (1992) and reported in chapter two of this thesis.

6.2.6 Theme 6-Relationship Breakdown

Auditor switching is not seen necessarily for the client. Management feels comfortable and happy with the audit service. Moreover, it believes that changing auditors does not change anything in way the business is run since the company is not expanding abroad and becoming an international company.

> *"As long as our business remains as relatively simple as it is just now, I do not find that is necessary"* (case 1).

International operation and *size* of the client will be the two major factors in deciding whether to stay with the same auditors or change them. One factor emerging from the analysis is that the client might keep the same auditors but not as **principal ones**, i.e., they will remain auditing the client in Scotland and become **auxiliary auditors**. As far as *changing auditors* because of their size i.e., the question whether clients prefer to be audited by one of the big five because they are well known in the City. This does not bother the client in case one who sees the attitude to the size of audit firm and their image in the City has changed over the time. Shareholders are not interested in paying big fees because the audit firm is one of the big five. Any audit firm given the resources can carry out audit work.

It is difficult to understand why a company would put the audit out for tender or to obtain new auditors. Some of the reasons indicated by the audit manager as popular are *cost* that client want to have, a *cost reduction* in the audit fee. Other reasons given generally would be *technical misunderstandings* or *technical grievances* where the management do not believe that the audit firm will allow them to do something which they wish to do. Thirdly, when people get fed up with the relationship it is when think that the people are not quite the people really he wants to deal with on annual basis. The fourth reason is the size of the firm or its international dimensions, for example a small audit firm which could not cope with perhaps international needs of its client. There is a tendency to believe that companies tend not to change auditors, and certainly that has been the historical experience in the UK. They tend to stay with the same auditors. This suggests that conflict of persons is linked to understanding each other expectation.

> *"If the firm does not understand what the directors are expecting and what they want and if they are giving the wrong messages then that could jeopardise the relationship"* (case 2).

Expectation gap - Auditors try hard to communicate with their clients. However, they feel that some of their messages delivered to their clients are not well received due to the message delivery or not to be accepted by the board of directors. This is defined as *"expectation gap"*

> *"You have a non-financial director who expects different things from an annual audit report and perhaps he does not understand the scope of the work that is undertaken. What you are obliged to do under the Companies Act and what we actually do under technical guidance in the firm"* (case 2).

> *"It is common to just about every audit you will come across. If the senior management is knowledgeable about the shortcomings of an annual audit then that is fine. It is where certain directors believe that an audit is a complete review of everything in the company. This is a method by which management can maintain dozens of helpful points to run their business better and hopeful points which will help management to run the business better. But the focus of the work is to the figures not to the way the business is run all the time because if we did that we would be charging a higher audit fee"* (case 2).

Conflict of interest - When an auditor is working with another client because he specialises in one industry would jeopardise the relationship with another client with the same industry and it depends on how much control exist within the audit firm to investigate those conflicts between rival companies. This audit firm does not have this problem because they have different work teams working on different assignments and allocated to different clients within the same industry, i.e,

> *"In banking sector that is not such a problem because first of all we have the Chinese wall imprint between the teams who have to work for that. But also because we have a central pool of expertise coming together and experience. That actually enhances the quality of services too..."* (case 2)

Conflict between people - The conflict is general between people not about audit. The conflict is resolved through discussion and argument.

> *"If a professional advisor is not testing the customer then he is not a good professional advisor. Everything is always hunky dory and going on fine - it means it is too cosy. - and the professional advisor is not suggesting alternative ways of doing things which may be better for the customer. If that conflict on people is on personal relationship and is apparent - say there is a lot of conflict of people - not just the suggestions or technical side then I think there are dangers"* (case 2).

This suggests that conflict of persons is linked to understanding each other expectation.

> *"If the firm does not understand what the directors are expecting and what they want and if they are giving the wrong messages then that could jeopardise the relationship"* (case 2).

Auditor independence - It touches the image of the quality of the audit they are doing for the client, if they cannot be seen as being independent.

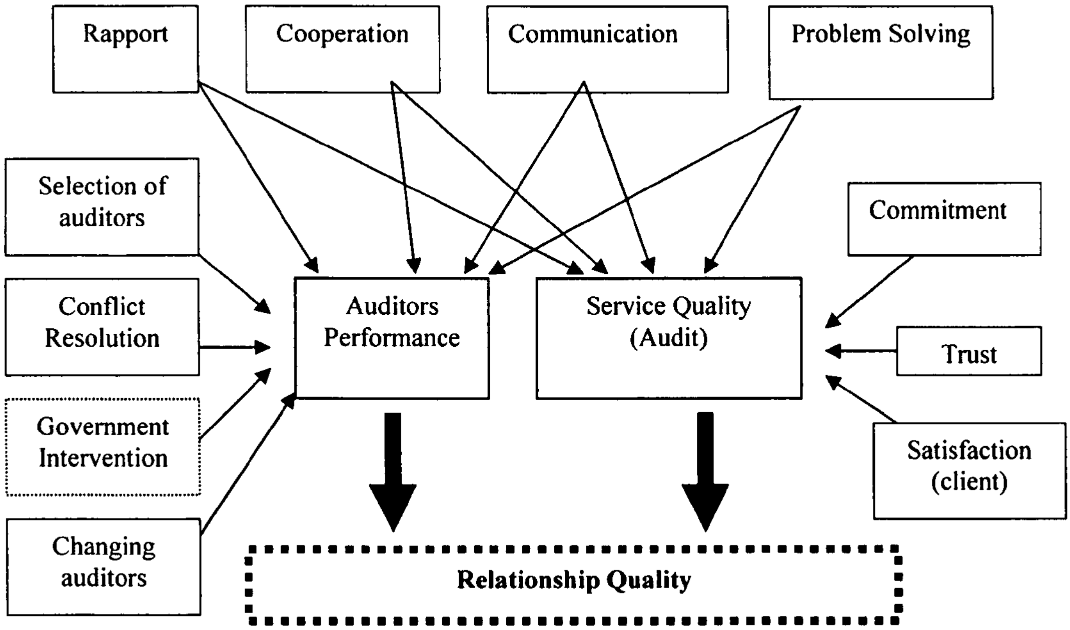
6.2.7 Theme 7 - Marketing strategy for auditors

There are two identical models emerged from the integrative process which will be revisited in the discussion chapter (9). The initial integrative model emphasises the two types of strategies and their target markets. The first strategy "getting it strategy" is aimed at clients who are not audited by the firm yet. The second marketing strategy "hold on to it" is aimed at the existing clients who are already audited by the audit firm. From the analysis, it emerges that accountancy firm's objective is to have a secure income by providing a portfolio of services. In accountancy market, audit service appears to be the "bread and butter", due to its statutory function. However, the accountancy firm has to work hard and compete to have it. If the accountancy firm is not appointed as auditors for a potential client, it works towards obtaining it. This point is expressed through all cases.

6.2.8 Emerging conceptual framework from the qualitative findings

This qualitative analysis, in its integrative findings, has shown that there are at least 14 dimensions (categories) describing auditor-client relationships, see figure 6.6 (Auditor-client relationship framework).

Figure 6.6 Emerging Conceptual Framework



Source: Original

Further, there are three types of relationships at the micro firm level (statutory & working relationships; protectionist relationship and stewardship relationship). A number of factors affecting auditor client interactions have been explained and a model of the marketing strategy used by auditors has been generated (see chapter 9). Future research needs to develop this systems approach. As such it needs to encompass:

1. Elements of exchange (rapport, capabilities, problem solving, communication, trust, audit quality, working relationship and commitment).
2. The nature of exchange (internal and external environmental condition, structure and process dimensions); outcomes (dimensional outcomes and relationship types).
3. Consequences (auditor integrity, firm interdependence, public scrutiny and audit reforms).

To sum up, from the qualitative investigation the following key constructs (elements) emerged as influential factor in relationship quality between auditors-clients:

Rapport	Selection of auditors	Auditors' performance
Cooperation	Conflict resolution	Service quality
Communication	Government intervention	Commitment
Problem solving	Changing auditors	Trust
Satisfaction		

Moreover, from seven themes, the stages of relationships have been highlighted as establishing, developing, building, and maintaining and breakdown relationship. Due to the nature and complexity of the audit business, it is very difficult to put a time scale between the different stages. Thus, the study focuses mainly on the key determinants of relationship quality between auditors and their clients. Therefore, the new quantitative research objectives are twofold:

- To critically assess how problem solving, trust, communication and commitment work as components in enhancing service quality and consequentially build a quality relationship between auditors and corporate clients.
- To examine empirically how problem solving, trust, communication work as components in enhancing auditors' performance and consequentially build a quality relationship between auditors and corporate clients.

Against this backdrop, this study aims to at building and testing an exploratory model that predicts auditor-client relationship quality outcomes, it was decided to use predictors and enter them in the mathematical models through SPSS. Thus, a multiple regression analysis – stepwise approach (chapter 8, p.213) was used. First, all constructs from the conceptual framework (figure 6.6) were given equal importance and their correlations examined. It is worth noting that a number of models evolved from conceptual framework to a final model of auditor-client relationship quality.

6.3 REVIEW OF KEY CONSTRUCTS IN THE CONCEPTUAL FRAMEWORK

Having clearly identified the key concepts (constructs) from the qualitative findings, it is worth revisiting them in order to generate hypotheses. These constructs and their contribution to the interaction with relationship quality will be expressed as hypotheses for testing in the next section. Their measurements and the degree to which the constructs affect relationship quality were examined in details in chapter 7 and 8. A justification now follows to generate hypotheses.

It has been argued that obtaining a competitive edge is to have a strong relationship with your customers. This quality relationship itself dictates whether or not the relationship will continue in the future (Kempeners, 1995 and Crosby et al. 1990). High relationship quality means that customer can rely on the organisation's integrity and have confidence in them because the level of past performance has been consistently satisfactory. Relationship marketing theory proposes that relational factors are principal antecedents to positive relationship outcomes (Ganesan, 1998 and Morgan and Hunt, 1994).

Assessing the quality of any relationship has remained a problematic issue in spite of the recognised importance of relationships within business-to-business marketing (Naude' and Buttle, 2000). In order to redress these shortcomings, these authors have identified five dimensions of high quality business-to-business relationships: *trust; needs fulfilment; supply chain integration; power; and profit.* They went further by arguing that within the rapidly expanding literature of business-to-business marketing, supply-chain management, relationship marketing and customer relationship management, there is a little attention paid to the issue of relationship quality. Important issues remain poorly addressed:

- What are the features that distinguish successful relationships from unsuccessful ones?
- What is it that makes a relationship highly valued by those within it?
- Why do actors in a relationship wish and act to pursue and protect that relationship?

Their work focuses on the *benefit* rather than *the cost element of value* and, develops an understanding of what the characteristic attributes of a good relationship are, and how they might vary in importance. This current research goes on the same line as Naude' and Buttle (2000). Moreover, there has been an interest amongst practitioners and scholars in studying the relationship quality and its antecedents in business relationships (Ford, 1980; Dwyer et al., 1987; Yorke, 1990; Crosby et al. 1990; Ganesan, 1994 Kempeners, 1995; Morgan and Huntly, 1994; Donaldson and O'Toole, 2007). Based on these studies, one can conclude that the relationship quality is made of relational constructs – rapport, cooperation, commitment, trust, problem solving, communication and client satisfaction – which are developed with the existence of service quality (audit) and service provider performance (auditors).

From this work, a number of hypotheses are formulated and are shown below:

H1 *Higher involvement in client problem solving leads to higher service quality*

H2. *The greater the trust in the audit firm, the higher the service quality provided by an audit firm.*

H3. *The stronger the communication effectiveness in the relationship, the greater the service quality perceived by the clients*

H4. *High commitment to the relationship by the client leads to high service quality of audit.*

H5 *Higher involvement in client problem solving leads to higher performance of auditors*

H6. *The greater the trust in the audit firm, the higher the audit firm performance is.*

H7. *The stronger the communication effectiveness in the relationship, the greater auditors' performance will be.*

H8. *High commitment to the relationship by the client leads to high performance by auditors.*

H9. Higher service quality leads to higher relationship quality.

H10. The greater auditors' performance, the higher the relationship quality between audit firm and its client

Now, the justification follows.

6.3.1 Problem Solving

Professional services studies are based on the assumption professional services differ from other services in some important aspects which carry implications for the marketing and, management of professional services (Wilson, 1972; Gummeson, 1978; Yorke, 1990; Gronroos, 1979; Ettenson and Turner, 1997; Verma, 2000; and Jakkola and Halinen, 2006). Problem solving is influenced by factors embedded in the related organisational, market and institutional environment (Jaakola and Halinen, 2006). Moreover, accountancy firms as professional services providers are characterised by specialist knowledge, autonomy, self-regulation and high interaction with their clients (Hill and Neeley, 1988 and; Hausman, 2003). Other writers see problem solving as part of negotiation process and an attempt to reach an agreement as well as reconcile conflicting self-interests (Goldman and Barlev, 1974; Nickols and Price, 1976 and; Thompson, 1990). Therefore two hypotheses are drawn:

H1 Higher involvement in client problem solving leads to higher service quality

H5 Higher involvement in client problem solving leads to higher performance of auditors

6.3.2 Trust

There have been various attempts to define relationship marketing and its relationship with the concept of trust. Moreover, trust has been viewed as an increasingly important factor in dyadic relationship and has been widely studied in the social exchange and the business marketing literature (Mooreman et al.,, 1993; Morgan and Hunt, 1994; Fox, 1994; Garbarino and Johnson, 1999). Looking at the convergence in the different definitions used to conceptualise trust, it is commonly defined as a belief, attitude or expectation that a service provider can be relied on to behave in a certain manner and where the interests of the buyer are well served (Crosby et al., 1990). Other researchers have warned against the use of one-dimensional evaluation of trust, without taking into account the key components and behavioural outcomes (Smith and Barclay, 1997 and Tzokas and Donaldson, 2000). It has been argued by McKechnie (1992) that if the relationships are to be developed and maintained for long-term, they have to be built on mutual trust and commitment. Moreover, Schurr and Ozanne, 1985 and Sharma and

Patterson, 1999 argue that when uncertainty and risk are present and warranties absent – as is the case with many professional services. Trust is decisive for continuity of a relationship, especially when uncertainty and risk are present and warranties absent as it is the case for accountancy profession. In audit market, relationship marketing has *reason d'être* as both auditors and client go through the process of exchanging information in order to prepare the annual audit report. The process of exchanges is also used for establishing a lasting relationship. Relationship marketing has been defined by Svensson (2001) as: *"establishing, developing and maintaining successful relational exchange."* (p.431). Svensson (2001) recognises that: *"Marketers have begun to emphasise the concept of trust because of the increasing significance of the relationship marketing perspective"* (p.431). Morgan and Hunt (1994) describe, "Trust" as the confidence that one partner has in the other's reliability and integrity. Confidence is associated with the partner's *consistency, competence, honesty, fairness, and willingness to make sacrifice, responsibility, helpfulness* and *benevolence*. These authors argue that trust is the cornerstone of relationship commitment. In business markets, a collaborative relationship between buyer and seller relies on relational forms of exchange characterised by high level of trust (Dwyer, Schurr, and Oh 1997; Morgan and Hunt 1994; and Doney and Cannon, 1997). Doney and Canon, 1997 found that the trust does not influence the current supplier selection decision. Others have attempted to examine trust in relation to conflict, satisfaction and other components. Trust brings about a feeling of security, reduces uncertainty and creates a supportive climate (Geyskens and Steenkamp (1995). Trust in a supplier also reduces conflict and enhances channel member satisfaction (Anderson and Narus, 1990). Morgan and Hunt (1994) provide empirical data, which support the role of commitment and trust in relationship marketing success:

1. First, acquiescence and propensity to leave directly flow from relationship commitment.
2. Secondly, functional conflict and uncertainty are the direct results of [lack of] trust.
3. Third, and most importantly cooperation arises directly from both relationship commitment and trust (p.25).

Moreover, they claim that co-operative behaviours are necessary for relationship marketing success whatever the context. Based on the review of previous work relating to trust in buyer-seller relationship, the following hypothesises are drawn.

H2. The greater the trust in the audit firm, the higher the service quality provided by an audit firm.

H6. The greater the trust in the audit firm, the higher the audit firm performance is.

6.3.3 Communication

One important characteristic of strong relationships is an easy flow of communication between the service providers and their client and a high degree of interaction and interpersonal communication is essential for successful service delivery (Morgan and Hunt, 1994; Sharma N. and Patterson, 1999). Moreover, Clark (1992) argues that clear communication plays a powerful role in improving customers' views about service quality. The amount, accuracy, timeliness and relevance of information shared between the exchange partners form the key components of communication effectiveness (Krapfel et al., 1991 and Moorman et al., 1993). Therefore, accuracy of the information, delivery time, perception and expectation of exchange partners yield to trust building. Thus, this lead to the following hypotheses:

H3. The stronger the communication effectiveness in the relationship, the greater the service quality perceived by the clients

H7. The stronger the communication effectiveness in the relationship, the greater auditors' performance will be.

6.3.4 Commitment

Various studies of relationship marketing have examined the factors, which lead to commitment between buyer-seller (Anderson and Weitz, 1989; Wilson and Mummalaneni, 1990; Mummalaneni and Wilson, 1991). This concept of commitment has been widely used within the interaction approach (IMP group) of industrial marketing and refers to adaptation processes and positives attitudes of the parties involved in the exchange process. The commitment is the result of relationship development through stages and the continuity of interaction between buyer and sellers (Ford, 1980; Dwyer et al, 1987 and Szmigin 1993). However, the key dimensions such as trust, satisfaction, social bonds and relational investments are signalled to have impact on the development of "commitment". Morgan and Hunt (1994) argue that:

"Commitment and trust are 'key' because they encourage marketers to (1) work at preserving relationship investments by cooperating with exchange partners, (2) resist attractive short-term alternatives in favour of the expected long-term benefits of staying with existing partners, and (3) view potentially high risk actions as being prudent because of belief that their partners will not act opportunistically. When commitment and trust – not just one or the other – are

present they produce outcomes that promote efficiency, productivity and effectiveness" (p.22).

Looking at the above quotation one can conclude that commitment is an enduring desire to maintain a relationship. Moreover, together with trust, it is the core element of relationship quality. Their presence lead directly to cooperative behaviour that is conducive to relationship management success. Therefore, the following hypothesises are drawn:

H4. High commitment to the relationship by the client leads to high service quality of audit.

H8. High commitment to the relationship by the client leads to high performance by auditors.

6.3.5 Service Quality *(Audit)*

Gronroos (1978) has identified two key components of service quality – technical quality (the core service or `what' is delivered) and functional quality (`how' the service is delivered). He goes further by asserting that functional quality is the result of service provider and client interaction and assessed in highly subjective manner. Others researchers link the service quality concept to other key relationship components such as trust. Trust occurs when the customer has *"confidence in the quality and reliability of the service offered by the organisation"* (Garbarino and Johnson, 1999). Morgan and Hunt (1994) define as a perception of "confidence in the exchange partner's reliability and integrity". The functional quality can be characterised as time response, delivery of service, understanding the need and client business as well as service provider behaviour and attitudes towards his clients. As far as the audit service is concerned, the service is delivered as a result of both parties interactions, therefore the quality of service output very much depends on the information (materiality) provided and personal interaction of the client. By their nature, audit services are bought annually as a legal requirement. This constitutes regular incomes for the accountancy firms and it is referred to as "bread and butter". The result is that there is a clear need for accountancy firms to establish initial relationships with prospects (for non-audit services) while at the same time maintaining long-term relationships with the existing clients. Therefore, studying business-to-business relationship within the context of professional financial services should take into account the long-term perspective and a quality relationship between service provider and the clients the long term perspective and an understanding of the relationship quality (Normman, 1991; Gronroos et al., 1994 and; Naude and Buttle, 2000). From these discussions, the following hypotheses have been drawn:

H9. Higher service quality leads to higher relationship quality

6.3.6 Performance

Groves and Valsakis (1998) argue that "a company may develop closer relationship and mutually beneficial relationships only with its major suppliers or only with its major customers" (p.52).

H10. The greater auditors' performance, the higher the relationship quality between audit firm and its client

To sum up, qualitative research findings in stage one has already given us an insight into the issues investigated. A cross-case dyadic relationship analysis has been carried out, i.e., a matching relationship between the auditors and their clients. Moreover, fourteen constructs were drawn from the case study analysis as well as literature review. Based on the preliminary findings of qualitative research (phase1) and prescriptive findings of the literature, it is believed that the relationship quality conceptual framework (figure 6.6), if supported by empirical research, may provide a background for improvement, which rationalizes the crucial importance and existence of relationship quality. Therefore, a research direction and hypotheses testing are presented in table 6.1 and 6.2.

For practical reasons, only key constructs appearing in the final model (figure 8.4) are presented in table 6.1 and 6.2.

2. To examine empirically how problem solving, trust, communication work as components in enhancing auditors' performance and consequentially build a quality relationship between auditors and corporate clients.	***H5*** *Higher involvement in client problem solving leads to higher performance of auditors*	The underpinning constructs of problem solving and auditors' performance within relationships	**Independent Variable:** Problem solving **Dependent Variable:** Auditors' Performance
	H6*. The greater the trust in the audit firm, the higher the audit firm performance is.*	The underpinning constructs of trust and audit firm performance within auditors-client relationships	**Independent Variable:** Trust **Dependent Variable:** Auditors' Performance
	H7*. The stronger the communication effectiveness in the relationship, the greater auditors' performance will be.*	The underpinning constructs of communication and audit firm performance within auditors-client relationships	**Independent Variable:** Communication **Dependent Variable:** Auditors' Performance
	H8*. High commitment to the relationship by the client leads to high performance by auditors.*	The underpinning constructs of commitment and audit firm performance within auditors client relationships	**Independent Variable:** Commitment **Dependent Variable:** Auditors' Performance
	H10. The greater auditors' performance, the higher the relationship quality between audit firm and its client	The underpinning constructs of auditors' performance and relationship quality within auditors-client relationships	**Independent Variable:** Auditors performance **Dependent Variable:** Quality relationship

CHAPTER SEVEN: RESEARCH METHODOLOGY ~QUANTITATIVE RESEARCH~

7.0 INTRODUCTION

In this study, the research methodology employed, encompasses a qualitative investigation (Part One) and a mailed survey (Part Two). The purpose of this part two is to describe the nature of the research design, the sampling plan, and the data collection methods and analysis procedure. Also, through the research design, the researcher conceptualises an operational plan based on Churchill's 1979 paradigm to undertake the various procedures and tasks required for the study; and ensures that these procedures are adequate to obtain valid, objective and accurate answers to the research questions.

7.1 RESEARCH OBJECTIVES AND HYPOHYSESES

7.1.1 Research Objectives

There are two research objectives which are listed as follows:

1. To critically assess how problem solving, trust, communication and commitment work as components in enhancing service quality and consequentially build a quality relationship between auditors and corporate clients.
2. To examine empirically how problem solving, trust, communication work as components in enhancing auditors' performance and consequentially build a quality relationship between auditors and corporate clients.

7.1.2 Research Hypotheses

Edwards and Talbot, (1994) refer to hypotheses as:

> *"Hypotheses are propositions or statements about reality which you wish to test in your research... Hypotheses are used in deductive research models. They are turned into negative predictions or null hypotheses which have to be disproved in order to verify the predictions evident in the hypotheses"* (p.157).

The study's hypotheses are generated from the literature review and qualitative research findings (chapters 2, 3, 4 and 6). The operational variables are also derived from the key constructs (concepts) discussed in the literature review of concepts relating to accountancy profession, buyer-seller relationship development and auditor-clients relationship covered in these chapters. These hypotheses, as well as distinction between *dependent* and *independent* variables are presented in table 6.1 and 6.2. - Hypotheses Development.

7.2 CONCEPTUALISATION OF THE RESEARCH DESIGN

Having decided what this study wants to achieve (see table 6.1), the next questions are: i) how is it going to be conducted? ii) What procedures will the researcher adopt to obtain answers to research questions? And iii) how the researcher carries out the task needed to complete the different components of the research process? These are the questions which have been raised and constitute the core of a research design of the stage two. For the purpose of this study, the following definition has been adopted:

> *"A research design is a plan, structure and strategy of investigation so conceived as to obtain answers to research questions or problems. The plan is the complete scheme or program of the research. It includes an outline of what the investigator will do from writing the hypotheses and their operational implications to the final analysis of data"* (Kerling 1986, p.279).

The nature of investigation is *non-experimental.* This type of investigation consists of the researcher observing a phenomenon and attempting to establish what causes it. In this instance the researcher starts from the effect (s) or outcome(s) and attempts to determine causation (Kumar, 1999, p.88). As it has been clearly mentioned in chapter two, the financial scandals and corporate collapse have brought the audit function under scrutiny. Therefore, this study attempts to explore and understand this phenomenon relating to auditor-client relationships.

7.2.1 Quantitative research as positivist approach

Quantitative research is associated with the doctrine of positivism (August Comte, 1798-1857). ***Positivist*** believe that science is (or it is only useful to construe it as) a set of specific methods for trying to discover facts about real world. Science is an objective procedure, which builds up a picture of how things work from a relatively secure base, and taking the broad view, its efforts are cumulative. If you have a theory about how things work, then data can provide an objective test of that theory (Gabriel 1990, p.509).

7.2.2 Quantitative research as a deductive approach

Quantitative research concentrates on testing theory rather than the discovery of new theory. Swan (1985:348) argues that deductive research is a "*theory then research*" approach, which consists of eight key steps:

1. the researcher selects a *topic or problem of interest;*
2. the *literature on the topic(s) is reviewed;*
3. "theory" that is a set of variables and their relationships is *developed from the literature*;
4. Logical *deductions from the theory are developed* which specify as a minimum that two variables are related. Commonly the deductions are referred to as hypotheses;

Table 6.1: Hypotheses Development

Specific Research Objectives	Hypotheses	Information Required	Identification of Required Variables
1. To critically assess how problem solving, trust, communication and commitment work as components in enhancing service quality and consequentially build a quality relationship between auditors and corporate clients.	*H1 Higher involvement in client problem solving leads to higher service quality*	The underpinning constructs of problem solving and service quality within auditors client relationships	**Independent Variable:** Problem solving **Dependent Variable:** Service Quality
	H2*. The greater the trust in the audit firm, the higher the service quality provided by an audit firm.*	The underpinning constructs of trust and service quality within auditors client relationships	**Independent Variable:** Trust **Dependent Variable:** Service Quality
	H3. The stronger the communication effectiveness in the relationship, the greater the service quality perceived by the clients	The underpinning constructs of communication effectiveness and service quality within auditors client relationships	**Independent Variable** Communication **Dependent Variable:** Service Quality
	H4. High commitment to the relationship by the client leads to high service quality of audit.	The underpinning constructs of commitment effectiveness and service quality within auditors client relationships	Independent Variables: Commitment Dependent Variable: Service Quality
	H9*. Higher service quality leads to higher relationship quality between an audit firm and a client.*	The underpinning constructs of service quality and quality relationship within auditors-client relationships	**Independent Variable:** Service Quality **Dependent Variable:** Quality relationship

5. *measures of the variables* are either developed or borrowed/adapted from the literature;
6. *a sample is taken* and the measures are used *to derive a set of observations*;
7. the observations are used to see if predictions contained in the hypotheses are supported;
8. The major *purpose* of the research is *verification;* do the results support the hypotheses? The original theory may be modified if unexpected results are found."

7.2.3 Validity of quantitative research

A measure is *valid* when the differences in observed scores reflect true difference on the characteristics one is attempting to measure and nothing else (Churchill, 1979, p.65). The positivist view of validity is often illustrated by a physical example. A measuring instrument is said to be *reliable* if you get the same answer when using it on different occasions. The measuring instrument is said to be *valid* if it is measuring what you think it is measuring.

7.2.4 Reliability of quantitative research

Reliability can be looked at through the question whether two researchers will arrive at the same conclusion. Collins (1989) argues that it is the background which plays a crucial role in determining whether the two quantitative researchers arrive at the same conclusions as one another where there are marked differences in orientations, not only of the problem as a whole, but even of identical data sets.

The term *'reliability'* is used to refer to the degree of variable error in a measurement. Tull and Hawkins (1987) define reliability as *"the extent to which a measurement is free from a variable error"*(p.222). Reliability: a measure is reliable to the extent that independent but comparable measures of the same trait or construct of a given object agree. Reliability depends on how much of the variation in scores is attributable to random or chance error (Churchill, 1979, p.65). It has been argued that if a measure is valid, it is reliable, but that converse is not necessarily true, i.e., the reliability is a necessary but not a sufficient condition for validity (Churchill, 1979).

7.3 DEVELOPING MEASURES OF RELATIONSHIP CONSTRUCTS

7.3.1 The development of study research instruments (measures)

This section describes the development of the research instruments. Bearing in mind that because the study's findings are based on the data collected and the data is entirely dependent on the research instruments. Therefore, the construction of a research instrument or tool appears to be one of the most important elements in the study design. Despite its immense importance in the research management, there are no specific guidelines for beginners on how to construct a research tool. The underlying principle is to ensure the validity of the research instrument by ensuring that the objectives of the study are achieved (Kumar, 1999, p.121). For this particular reason, detailed lists of the measures are presented in (table 7.1 Measures Used to Capture Constructs). Therefore, this section intends to explain and provide a framework where procedure and stages are identified in order to help developing research constructs. The emphasis of this section is on developing measures with the desired reliability and valid properties. Churchill's approach (1979) has been adopted in this study and to have a clear picture of Churchill's model of developing measures for marketing constructs is presented in figure 7.1.

There has been an interest by academic research to examine how to develop measures of marketing constructs. Jacoby (1978) argued that the poor quality of some marketing literature is because of the measures marketers use to assess their variables of interest (p.91):

> *"In point of fact, most of our measures are only measures because someone says that they are, not because they have been shown to satisfy standard measurement criteria (validity, reliability, and sensitivity)"* (p.91).

This author goes further asking that:

> *"What does it mean if a finding is significant or that the ultimate in statistical analytical techniques have been applied, if the data collection instrument generated invalid data at the outset?"* (1978, p.90)

Examining these issues in marketing measures, Churchill (1979) attempts to provide a framework, i.e., suggesting a procedure by which measures of constructs of interests to marketers can develop. This framework puts an emphasis on developing measures, which have desirable reliability and validity properties.

7.3.2 The process of measurement or operationalisation of constructs

7.3.2.1 Assigning numbers to objects

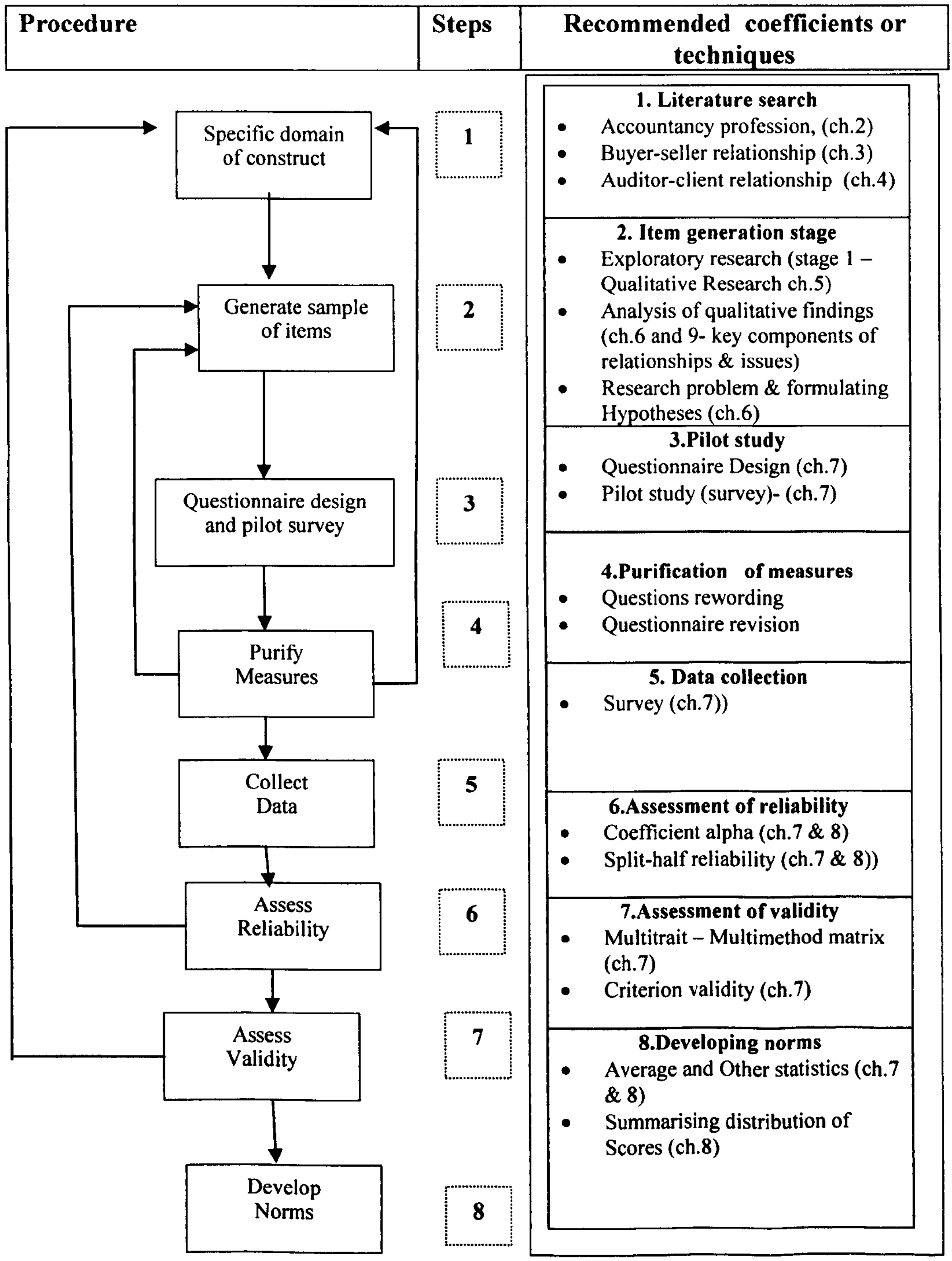
From a technical point of view, this process involves *"rules for assigning numbers to objects to represent quantities of attributes"* (Nunnally, 1967, p.2, quoted in Churchill, 1979, p.65). There are two important notions relating to this definition:

a) *Attributes of objects - It is the attributes of objects that are measured not the objects themselves.*
b) *Assigning numbers - No specified rules by which numbers are assigned. But, the rigor with which the rules are specified and the skill with which they are applied*

determine whether the construct has been captured by the measure. (Churchill, 1979, p.65)

Based on Churchill's 1979 model, the following figure 7.1 is produced to highlight the procedures used to develop better measures for the study of auditor-client relationship.

Figure 7.1 Procedure for Developing Measures for Auditor-Client Relationship Constructs



Source: Adapted with modification from Churchill, 1979.

One criticism of Churchill's framework is that - although, it is logical and well thought of as a process, it has no reference to the two stages of research for any exploratory study, i.e., initial qualitative research to have a feel of the situation and create an opportunity to let constructs emerge (generate a sample of items) and the quantitative stage (survey). The model only refers to "pilot study" to a quantitative survey. For the purpose of this current study, the researcher demonstrates the inclusion of items generated from the qualitative findings of dyadic relationship between auditors and their clients (see also research methodology contribution). Now, let us explain the sequence of steps and the calculation involved which lead to developing better measures for auditor-client relationship study. Churchill (1999) has suggested a framework of 8 steps for developing marketing constructs. In the following sections, these steps are explained and applied for this current study.

7.3.3 - Specify domain of construct (Step 1)

This first step here is to specify the *domain of construct.* The researcher has to decide what exactly is to be included in the definition of the construct. In order to do this the researcher has to critically review the literature of concepts, models of buyer-seller relationship (chapters two, three, four and five), as well as checking the qualitative findings (chapter 6). Expressions and definitions from interviewees in the early **exploratory study** were also used. Considering for example, the construct of auditor selection as defined by one client:

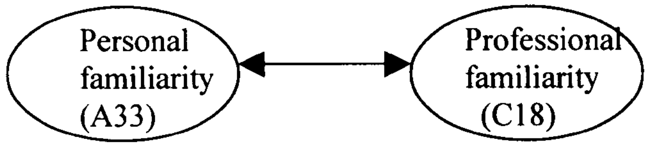
> *"... now many other people are having a four or five year beauty parade. Now funny enough we have not done it with our auditors, but if you are to think like our insurance brokers they have got a step forwards every four or five years and they go through the book."*

One has to say, the jargon "beauty parade" refers to auditors are selected through the process of tender and presentation to the clients. This expression is only used by the accountancy profession and practitioners in the audit area.

Within *rapport* as one of the major construct in audit relationship, there are elements (items) such as *personal factors,* which help to develop the relationship. Moreover, the audit, it is seen not just as a piece of paper signed by auditors but as the *whole relationship*. This leads to developing rapport based on personal relationship. As one client expressed:

> *"When it comes to our ordinary relationship with clients we believe there is no substitute for getting to know people at the highest level, i.e., the decision makers. If you have to go elsewhere to get that information then you are have not got that relationship".*

Figure 7.2 Rapport - Accountancy Profession Circle



"...indeed I think it is inevitable in city of the size of Glasgow somebody in my position or my chairman position, Sir Martin Gallagher, is also a chartered accountant, it is inevitable we know a lot of partners, a lot of the leading partners in the big firms. It is our business that was our trade before we come into the industry. And therefore, I think that will be very difficult for us in Glasgow to have an auditor who is entirely unknown to us. In the circles we move in we meet the people who are in charge of the accounting firms. And therefore, Martin and I, between us, almost certainly know of each of senior partners of the big five and six and ten or twelve leading accountancy firms in Glasgow on more than just a casual basis. So any suggestion that the auditor has got to be unknown to you it is very difficult."

As to the appointment of auditors one respondent expressed that:

"... He arranged that the firm he was partner in and the firm his friend was partner... were appointed our auditors in 1968 when we went public. Now, that may sound terribly cosy but we have made sure that they are capable of supplying services and the expertise we need over the years."

It emerges from qualitative findings that establishing relationship is found within two categories (items): personal familiarity and professional familiarity. As in their position of qualified chartered accountant, auditors and top management know each other and are familiar with the audit business. Another interviewee refers to "rapport" as:

"Completely. I mean all of us... Graham used to be a partner in the firm, he was an audit partner, and he worked on this job. The bank was one of his clients."

7.3.4 Qualitative data analysis and item Generations (Step 2)

Having shown how constructs were expressed in the words of qualitative research participants, it is now to turn to examination of the item generation for these constructs. Brace (2004) argues that:

"No matter which scale is used, one crucial factor to get right is the wording of the items against which the attitude to be measured. As with all questionnaire research, if the item is not measured it cannot be analysed, and if important attributes are not included then the analysis could be totally misleading... If there is no existing set of attitude or attribute dimensions that have been proven to represent the issues in the market under consideration, then they will need to be developed" (Brace, 2004, p.99).

Brace (2004) states that ideally the dimensions should be developed throughout a preliminary stage of qualitative research and if it is not possible to carry out a preliminary stage, the dimensions must be collated from elsewhere, i.e., previous studies in the same area. He also argues that:

"The principal purpose of the preliminary study is to provide the attitude dimensions that are to be measured for strength of agreement in the quantitative survey" (Brace, 2004, p.99).

To generate items that capture the domain of relationship marketing construct, a number of techniques have been used in this study. The grounded theory used in the early exploratory study (4 dyadic cases of auditor-client relationships), have helped to generate items (categories) which capture the domain construct. As part of the theoretical foundation for this study, chapter 6 was reserved to review the key concepts (constructs) and demonstrates how the hypotheses were drawn.

> *"The literature should indicate how the variable has been defined previously and how many dimensions or components it has."* (Churchill, 1979, p.67)

During the qualitative fieldwork, one audit manager pointed out that establishing a relationship is to identify the key people within the client' organisation. People targeted are usually financial directors, chief executive and the chairman of the company. These individuals have obvious role and functions and the one to develop relationship with:

> *"I would probably put it as the priority items of who are the key people within the client. Because you don't develop relationship with the client – being a company – you develop relationship with people within the client company".*

Through the qualitative data analysis process a sample of items (categories) is generated. Adding to the technical literature review, the researcher used a qualitative enquiry. Categories (constructs) were developed from the qualitative analysis as advocated by Strauss and Corbin (1990). By using an exploratory qualitative study with 4 matching relationships cases, this helped to synchronise the definition of constructs as well as generating items of interest.

The search for ways how to measure constructs such as rapport, communication, cooperation, technical literature analysis (literature, leaflets from accountancy forms, interviews, TV programme such as money programme) were used to generate items as well as develop their measures.

For this current study of auditor-client relationships, although a number of sources have been used, the emphasis on qualitative research findings has played an important role in early stage as item generation and lead to development of the dimensions of the constructs as issues of auditor-client relationships. *"By incorporating slightly different nuances of meaning in statements in the item pool, the researcher provides a better foundation for the eventual measure."* Churchill, 1979, p.68). He furthers explains that *"Near the end of statement development stage, the focus would shift to item editing. Each statement would be reviewed so that its wording would be as precise as possible"* (p.68).

As far as the auditor-client relationship study is concerned, this issue has been well dealt with in the exploratory stage by using a qualitative approach. As advocated by a number of researchers, the qualitative approach, *"seeks to capture what people's lives, experiences and interactions mean to them in their own terms"* (Quinn Patton 1986, p.187). Moreover, inductive research through grounded theory was used. Strauss and Corbin (1990) define this as:

> *"the part of the analysis that pertains specifically to the naming and categorizing of phenomena through close examination of data... During open coding the data are broken down into discrete parts, closely examined, compared for similarities and differences, and questions are asked about the phenomena as reflecting in data"* (p.62).

A detailed explanation of grounded theory as an inductive research approach and its contribution to item generation has already been dealt with in the previous chapter of the thesis. Later on during the questionnaire design, the researcher has taken care to define individual objectives for each question used in the questionnaire. By doing this, the research intends to make sure the wording for each item is used to measure what it intends to measure. Therefore, a number of amendments to the questionnaire has been introduced and summarised in table 7.4 Modification -Questionnaire Amendments.

7.3.5 Questionnaire design process and pilot survey (Step 3)

7.3.5.1 The questionnaire

A questionnaire has been as:

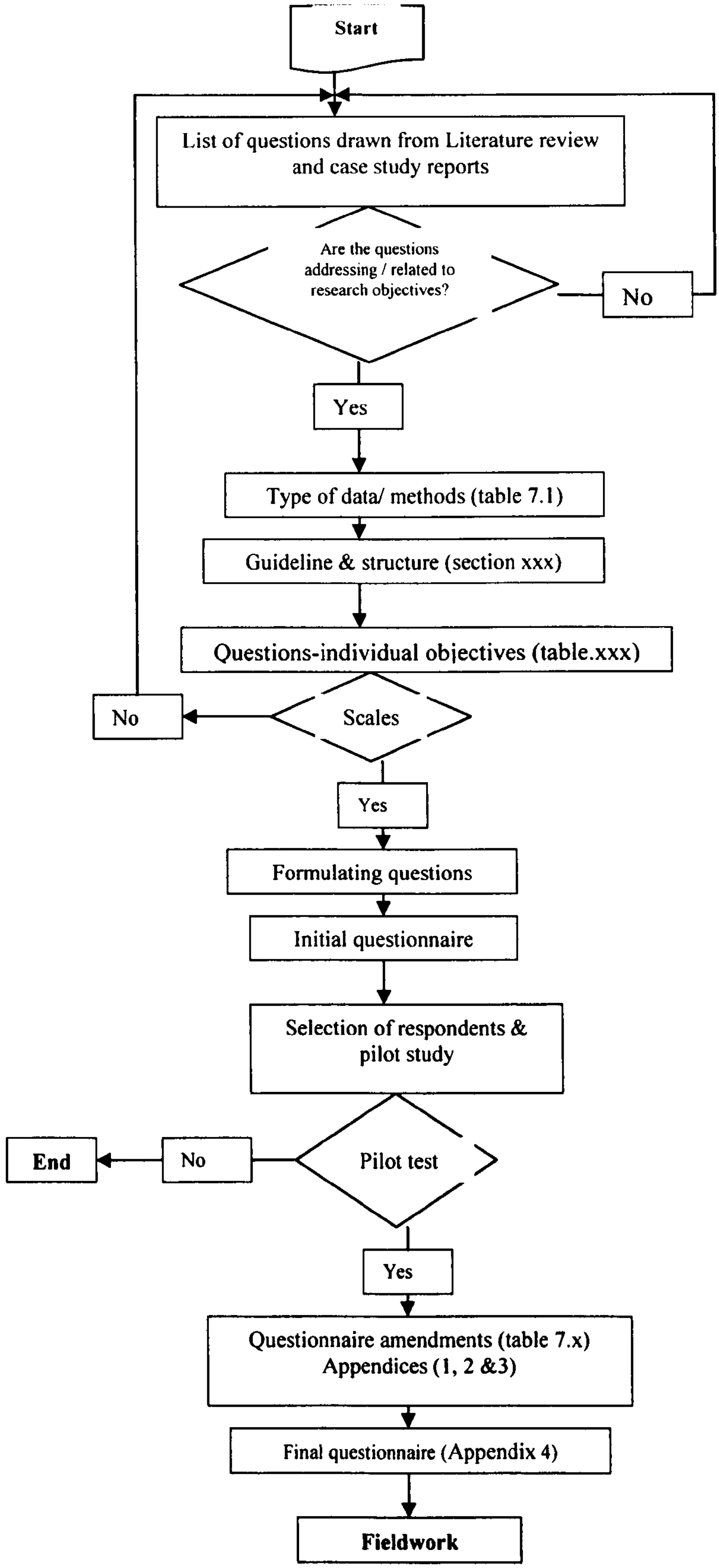
> *"A document containing a series of questions designed to discover the information required to meet a firm's research objectives"* (Lines et al, 1996).

The following principles were used in order to ensure the greatest degree of accurate response, i.e., each question asks only on one issue. Moreover, it was the intention to keep the questionnaire simple, the questions short and unambiguous in order to help the respondent to understand the questions and respond quickly. Closed questions were pre-coded to allow for easy answering and to facilitate entry into the SPSS computer package.

7.3.5.2 Guidelines and Questionnaire Structure

Guidelines to the questionnaire are used to explain to the respondents the nature of the different sections of the questionnaire, how to answer the questions and reassuring the respondent about the confidentiality of the information collected.

Figure 7.3 Questionnaire Design Process



Source: Original

At the beginning the questionnaire was rather lengthy and contained a number of sections. After a first review and discussion with research colleagues, the questionnaire was revised and given a clear focus concentrating on the interactions between auditors and their clients, i.e., process.

Questions are grouped in four sections. The first section deals with information, which enables classification of companies according to selected characteristics. Section two relates to the extent the factors contribute to the effectiveness of working relationship with your auditors. Section three is to assess the importance of commitment, trust and quality of services in the auditor-client relationship. Finally, section four deals with the auditor's performance, conflict and changes. The objective of each individual question and reasons behind collecting the information is explained in the following sections of the questionnaire.

7.3.5.3 Type of measures used in the questionnaire

Table 7. 0: Types of measure

Lkt	**Likert scale**	with anchors of *"strongly agree"* and *"strongly disagree."*
SD	**Semantic differential**	with anchors of *"very satisfied"* and *"very dissatisfied."*
RS	**Rating Scale**	with anchors of *"excellent"* and *"very poor."*

Likert Scale - The scale known as agree-disagree was developed by the psychologist Renis Likert in 1932. The technique presents respondents with a series of attitude dimensions, for each of which they are asked whether, and how strongly, they agree or disagree using one of a number of positions on a five-point scale. Generally, respondents are given scores for each statement, from 1 to 5, negative to positive, or –2 to+2. As these are interval data, means and standard deviation can be calculated for each statement positive to negative and asked to cast their opinion

> « *The full application of the likert scale is then to sum the scores for each respondent to provide an overall attitudinal score for each individual. Likert's intension was that the statement would represent different aspects of the same attitude. The overall score, though, is rarely calculated in commercial research (Albaum, 1997), where the statements usually cover a range of attitudes. The responses to individual statements are of more interest in determining the specific aspects of attitude that drive behaviour and choice in a market place, or summations are made over small groups of items.* (p.86/87)

Brace (2004) points out that there are four interrelated issues relating to the questionnaire design when using Likert scales:

(i) Order effect

(ii) Acquiescence

(iii) Central tendency

(iv) Pattern answering

(i) The *order effect* arises from the order in which the response codes are presented. It has been shown (Artingstall, 1978) that there is a bias to the left on a self-completion scale.

One can argue that the list of questions and statements presented to the respondents on the auditor-client relationship questionnaire may lead to the same effect, i.e., order bias and prompts to the left. To remedy these issues, the researcher has included both positive and negative statements. In fact, some completed answers were scored out and corrected.

(ii) *Acquiescence* is the tendency for respondents to agree rather than disagree with the statements (Kalton and Schuman, 1982), also known as 'yea saying'. To remedy this, the researcher has attributed the scale 1 to 7 and strongly agrees to strongly disagree.

(iii) *Central tendency* – is the reluctance of respondent to use extreme positions. It has been shown (Albaum, 1997) that a **two-stage question** elicit a higher proportion of extreme responses. For e.g. each of the statement listed below indicate first the extent of your agreement and second how strongly you feel about your agreement.

(a) `A product's price will usually reflect its level to quality'.

Agree______neither agree nor disagree______disagree_______

(b) How strongly do you feel about your response?

Very strong______not very strong _______

In our questionnaire, these types of questions were not used. With a large number of dimensions to be evaluated, this approach may be too time-consuming for most studies (Brace, 2004, p.88). It is appropriate for telephone interview but not in our current study.

It is very difficult to take into account all the issues relating to questionnaire design. However, this study has taken precautions in reducing bias. But some are beyond any researcher's control. For example, it is a common practice that people have a tendency to walk into shops and follow the left side. The researcher does not know exactly why people walk clock-wise.

(iv) *Pattern answering* – occurs when a respondent falls into a routine of ticking boxes in a pattern, which might be straight down the page or diagonally across it. It is often a symptom of fatigue or boredom. The researcher thought the best way to avoid it is to keep the questions interesting and related to the audit area for respondent. Moreover, negative statements have been included to `waken up' the respondents see for e.g. questions Q9-9; Q9-1; Q9-26; Q13-8; Q15-5; Q19-1; Q19-3 and Q19-4.

Reversed questions are also used in the questionnaire for example Q12-3 *`Auditors advise on accounting techniques'* This statement is affirmative but auditors should not get involved in suggesting to the client the accounting techniques that lead to a positive picture of the company.

Semantic Differential Scale

The semantic differential scale is a bipolar rating scale. It differs from the Likert scales, in that opposite statements of the dimension are placed at the two ends of the scale and respondents are asked to indicate which they most agree with by placing a mark along the scale. This has the advantage that there is then no need for the scale points to be semantically identified. Any bias towards agreeing with a statement is avoided, at both ends of the scale have to be considered.

This scale was originally developed by Osgood, Suci and Tannenbaum in 1957. They also recommended using seven points on the response scale. This scale has been favoured by most researchers (McDaniel and Gates, 1993).

In our study, care was taken to ensure:

- The statements are kept as short and precise as possible to make the respondent read and understand fully both ends of the scale.
- As attitudes are difficult to express concisely and in particular finding the opposite pole for e.g., `sweet' vs. `sour', or `bitter'. This has made the research to re-examine what the dimension is that to be measured.
- The main reason for using semantic differential scales is it is more suited to descriptive dimensions.
- Use of Anchor strength

With all semantic scales, the wording of the `anchor statement' is crucial to the distribution of data that is likely to be achieved. It has been argued by Bruce, 2004 that

> *"A five-point bipolar scale that goes from **`extremely** satisfied' to **`extremely** dissatisfy' is likely to discourage respondents from using the end points and concentrate the distribution on the middle three points. If the end points were `Very satisfied' to `Very dissatisfied', the end points would be used by more respondents and the data would be more widely distributed across the scale. This can make the data more discriminatory between items"(*Brace, 2004, p.96).

This author argues that as a general rule, the stronger the anchors, the more points are required on the scale to obtain discrimination. Therefore, our study has used both, i.e., stronger anchors and 7 point scales. Moreover, the use of 7 point scale for both Likert and semantic differential scale in this study and care has been taken:

- Dimensions of similar meaning should be given with reversed polarity in order to minimise pattern answering and to check internal consistency of responses.

Rating Scales in client satisfaction with auditors' performance

The rating scales appear to be the most plausible scale for auditor-client relationships for the following reasons:

- Rating scales are commonly used in customer satisfaction research.
- They provide a relatively easy way in which a customer can assess the service on a number of different items in a way that allows comparisons to be made between the items.
- The interval nature of the data makes it appropriate for the production of mean scores, and for carrying out correlation or regression analysis using other data such as overall satisfaction or behavioural data.

After pilot test and all amendments have been carried out, it was reasonable to assume that all respondents who the questionnaire was intended for are familiar with the subject area, i.e., company auditors. Furthermore, all the points of scale are cited to make it easier for the respondents to look up and check the point in the scale, for example:

1	2	3	4	5	6	7
Excellent	Very good	Good	Satisfactory	Quite poor	Poor	Very poor

7.3.5.4 Questionnaire Content

Table 7.1 shows the structure of the questionnaire as well as the different constructs. Moreover, the type of scale, anchors, questionnaire number and the individual objective of each question are summarised in table 7.1.

Table 7.1 Measures Used To Capture Constructs

Constructs	Scale & Type	Anchors	Question Number & Coding	Question's Objective (Items)
Section 1. Company Background & Characteristics of relationship				
Company Background (1/1)		N/A	Q1	To identify the key business activity/industry of the client firm
		N/A	Q2	To determine whether the client is listed company in the stock exchange.
		N/A	Q3	To identify the origin of the client firm.
		N/A	Q4	To determine the size of the client firm
Characteristics of Relationship (1/2)		N/A	Q5	To identify whether the client uses one of the "Big Four" auditing firms. Medium-sized or a small audit firm.
		N/A	Q6	To establish the time length of the auditor client relationship

		N/A	Q7	To illustrate whether the client firm uses different accounting firms for different divisions or limited company within the same group
		N/A	Q8	To establish the reasons behind using two audit firms at the same time
Section 2. The Elements (components) of Working Relationships				
Rapport (2/1)	**1-7 Lkt**	**Strongly agree to strongly disagree**	Q9	To examine the extent to which the factors (Rapport, Cooperation, Communication, Problem Solving, and Relationship Quality) contribute to the effectiveness of working relationship with the auditors.
			9-1	To ascertain whether "Good Personal Rapport" is criteria to all staff.
			9-2	To show whether personal relationships are key elements in the rapport construct.
			9-3	To find out whether feeling comfortable with auditors is an important criterion to the success of the audit
			9-4	To verify whether the "audit function is a People Business"
			9-5	To ascertain if knowledge of client business and its environment are important factors in establishing a rapport.
			9-6	To relate the size of audit team to the audit work to be carried out.
			9-7	To find out whether the audit firm resources reinforce the long-term working relationship **(resources)**
			9-8	To find out whether the audit firm technical expertise reinforce the long-term working relationship
Cooperation (2/2)	**1-7 Lkt**	**Strongly agree to strongly disagree**	9-9	To find out whether the personal familiarity plays an important role
			9-10	To recognise "problem solving" as a part of an effective working relationship with auditors
			9-11	To show that surprise has no place in the auditor-client relationship, i.e., client firm are expected to know every single move of their auditors in terms of audit work involved.
			9-12	To ascertain that problem solving is not a one off, but a continuous process.
			9-13	To show that continuity of senior audit staff helps to reduce uncertainty.
			9-14	To state that a mutual understanding between auditors and client encourages a satisfactory delivery of audit report.
Communication (2/3)	**1-7 Lkt**	**Strongly agree to strongly disagree**	9-15	To demonstrate the existence of open dialogue is a key success factor in the working relationship.
			9-16	To state that the "continuity" concept is defined in terms of continuous dialogue (personal interactions) not in terms of years spent with the same audit firm.
			9-17	To recognise the fact that junior staffs are important in terms of audit preparation but the interaction at the top is the key factor.
			9-18	To find out how effective auditors are at communicating.
			9-19	To find out how effective the auditors are at communicating with their clients
			9-20	To find out whether the client firm believe in true & fair view concepts, i.e., truthful reporting by auditors
Problem Solving (2/4)	**1-7 Lkt**	**Strongly Agree to strongly disagree**	9-21	To determine whether auditors are effective in providing/delivering management solutions to problems.
			9-22	To find out whether the auditors use referral when they are unable to resolve their clients' problems
			9-23	To recognise that problem solving is a continuous process within the audit function, i.e., finding an answer to any accounting transaction through applying the appropriate accounting techniques.
			9-24	To explain the extent of the auditors' efforts to solve accounting problems for their clients.
Quality Relationship (2/5)	**1-7 Lkt**	**Strongly agree to strongly disagree**	9-25	To clarify whether the clients want to keep their auditors for ever.
			9-26	To recognise that audit is not just a signed annual report but refers/reflects to the whole business relationship.
			9-27	To find out whether the client makes an effort to keep and maintain a relationship with their auditors

			9-28	To clarify whether there has been an intention to change their auditors
			9-29	To ascertain whether the relationship is developed and maintained at a personal level between the senior auditors and the top management in the client firm.
			9-30	To explain whether a consistent relationship is due to a continuity of audit partners (senior auditors with the top management)
			9-31	To determine whether a social relationship between the audit team and staff in the client accounting department is an important factor in developing and maintaining long-term relationship
	1-7 Lkt	Strongly agree to strongly disagree	9-32	To determine the extent of the effectiveness of client auditor relationship
			9-32a	a) To what extent do auditors understand the client business and its environment?
			9-32b	b) To what extent are auditors involved in the problem solving for the client?
			9-32c	c) To what extent are auditors effective in providing management solution?
			9-32d	d) To what extent does the audit team carry out its commitment to the client?
Communication (2/6) see also (2/3) communication	**1-7 Lkt**	**Very important to not all important**	10-1	To find out the extent of the work in relationship between auditors and accounting staff in client firm in terms of:
			10-1a	a) To receive information (materiality)
			10-1b	b) To answer questions raised by auditors
			10-1c	c) To provide help
			10-1d	d) To provide a statement to the shareholders, audit committee and creditors.
			10-2	To ascertain whether courtship is an important element in building quality relationship
			10-3	To show that regular contacts are used with existing clients not only for audit work but also for the sale of non-audit services and also as part of a strategy to maintain an effective working relationship.
			10-4	To ascertain availability of auditors to clients for enquiries
			10-5	To find out whether the availability to non-clients, as a strategy, is an important one.
Client Satisfaction (2/7)	**1-7 Lkt**	**Very satisfied to very dissatisfied**	11	How would you rate your company satisfaction in terms of:
			11-1	To assess the quality of the audit service provided by the auditors
			11-2	To assess the auditors communication skills
			11-3	To evaluate the socialising between audit teams and client staff
			11-4	To assess the level of satisfaction in relation to technical expertise
			11-5	To see whether auditors meet client expectation
			11-6	To assess whether the client are satisfied with auditors response to queries or problem solving
			11-7	To ascertain the auditors 's ability to meet client deadlines
Section 3. Commitment, Trust, Service Quality and Quality Relationship				
Commitment (3/1)	**1-7 Lkt**	**Strongly agree to strongly disagree**	12	To identify and assess the key factors in commitment and trust in relationship
			12-1	To find out whether the auditors are committed to the client business.
			12-2	To determine whether the auditors devote time and effort to develop and maintain relationship with their clients.
			12-3	To determine whether auditors provide advices on accounting techniques
			12-4	To ascertain whether the client sees their auditors as partners.
			12-5	To find out the extent that the auditors assist their clients in identifying problems and their resolution
			12-6	To establish whether "continuous dialogue" concept is a key

				factor for commitment to the client.
Trust (3/2)	**1-7 Lkt**	**Strongly agree to strongly disagree**	12-7	To ascertain whether personal familiarity is an important factor in building trust between auditor and client.
			12-8	To find out how trust is perceived by the client, i.e., understanding client circumstances and being flexible.
			12-9	To show the extent that trust is an essential ingredient in establishing, developing and maintaining successful relationship with auditors
			12-10	To ascertain whether there is a link between trust and the breakdown in a relationship
			12-11	To find out whether trust is when auditors deliver the interests, i.e. how independent the auditors are!
			12-12	To ascertain whether trusting auditors means freedom to check and speak to anybody in the company.
			12-13	To see whether auditors can be trusted
			12-14	To find out whether auditors have a great deal of integrity and impartiality
Audit Service Quality (3/3)	**1-7 Lkt**	**Strongly agree to strongly disagree**	13	To identify the key factors and their influence on the quality of service in auditor-client relationship.
			13-1	To demonstrate that the audit quality service depends also on the auditors' flexible attitude towards its client, i.e., the auditors understand the company's circumstances.
			13-2	To find out whether auditors' behaviour is part of quality service
			13-3	To ascertain whether quick response to the client request is an important part of quality of service
			13-4	To determine if the agreed audit schedule and delivery time constitute important elements in the audit quality service.
			13-5	To ascertain whether the role of auditor is to find irregularities and wrong doing through asking the appropriate questions addressed to the accounting staff of client firm.
			13-6	To state whether there is a serious belief that a client firm being audit by a big audit firm provides confidence in the City (Financial market).
			13-7	To find out whether personal relationship influence the quality of service
			13-8	To determine whether an audit firm without previous experience in a new industry can produce a quality report.
			13-9	To ascertain if flexibility and accessibility to advice provided by auditors improve the audit quality of service, i.e., the biggest concern by auditors is to keep management happy.
			13-10	To ascertain whether flexibility shown by auditors helps to produce a quality audit service
			13-11	To find out whether the image of an audit firm is reflected in the quality of audit report.
			13-12	To show that there is a quality service if the management are happy with the audit report.
			13-13	To determine whether the expectation set by the client (a signed annual report) is delivered by the auditors.
			13-14	To find out if the management believe that audit tendering will increase the quality of audit service
			13-15	To recognise that the quality of audit report is related to the creative accounting techniques used by the management.
Section 4. Auditor Performance, Conflict Resolution & Auditors' Changes				
Auditor Performance (4/1)	**1-7 Lkt**	**Excellent to very poor**	14	To measure the performance relative to overall relationship with the auditors.
			14-1	a) Value for money
			14-2	b) Ability to deliver
			14-3	c) Quality of the audit
			14-4	d) Knowledge of client business
			14-5	e) Knowledge of client industry
			14-6	f) Continuity of personnel
			14-7	g) Good rapport
			14-8	h) Good working relationship
			14-9	i) Problem solving
			14-10	j) Commitment
			14-11	k) Quality of advice
			14-12	l) Local business experience

			14-13	m) Technical capabilities
			14-14	n) Innovative approach
			14-15	o) Other, please specify
Conflict Resolution (4/2)	**1-7 Lkt**	**Almost always to almost never**	15	To measure the influence of various factors on conflict resolution between client firm and their auditors
			15-1	To determine the ways and the frequency that disagreements and disputes were handled
			15-1a	a) By changing some staff in the audit team
			15-1b	b) By avoiding the issues
			15-1c	c) By smoothing over issues?
			15-1d	d) By letting senior management and senior partners sorting them out
			15-1e	e) By getting the parties involved in discussion?
			15-2	To determine how much involvement is between the client firm and its auditors
			15-2a	a) To receive information (materiality)
			15-2b	b) Answer questions
			15-2c	c) Provide help
			15-2d	d) Prepare a statement to the shareholders, audit committee and creditors.
Compromise (4/3)	**1-7 Lkt**	**Almost always to almost never**	15-3	To find out the amount of information required to prepare an audit report
			15-4	To find out whether the auditors agree with the accounting techniques provided by the client (i.e., the client creative accounting)
			15-5	To determine whether the client firm is in favour of buying non-audit services from the same accountancy firm which audit their accounts.
			15-6	To find out if integrity and independence of auditors is compromised when there is a business interest
D.M.U (4/4)	**1-7 Lkt**	**Strongly agree to strongly disagree**	16	To identify the decision makers in the client firm
			16-1a	a) Chief Executive
			16-1b	b) Managing Director
			16-1c	c) Group/ Financial director
			16-1d	d) Board of Directors
			16-1e	e) Non-executive Directors
			16-1f	f) Sub Committee of Board
Auditors 'Switch (4/5)	**1-7 Lkt**	**Strongly agree to strongly disagree**	17	To identify the reasons associated with the client firm changing its auditors, i.e., breakdown of relationship.
			17-1	a) Auditors charging high fees
			17-2	b) Group/ Company policy
			17-3	c) Company take-over
			17-4	d) Merger with another firm
			17-5	e) Company size
			17-6	f) Need of a firm with international operation
			17-7	g) Litigation
			17-8	h) Changes in Management
			17-9	i) Dispute over Principles
			17-10	j) Qualified Opinions
			17-11	k) Rotation Policy
			17-12	l) Clash of Personality
			17-13	m) Difficult Working Relationships
			17-14	n) Poor Commitment
			17-15	o) Poor Communication
			17-16	p) Lack of Co-operation
			17-17	q) Other reasons, please write in
Auditors Selection (4/6)	**1-7 Lkt**	**Strongly agree to strongly disagree**	18	To underline the key reasons in selecting the auditors
			18-1	a) Competitive fees
			18-2	b) Management and auditors have already a good personal relationship
			18-3	c) Audit firm's reputation in the City

			18-4	d) Investors / Shareholders prefer "Big Four"
			18-5	e) Good working relationship
			18-6	f) Local presence
			18-7	g) international presence/ capabilities
			18-8	h) Problem solving
			18-9	i) Accessibility
			18-10	j) Wide range of services
			18-11	k) Referral
			18-12	l) Industry/ client business knowledge
			18-13	m) Firm technical expertise
			15-14	n) Other reasons, please write in
Government Intervention (4/7)	**1-7 Lkt**	**Strongly agree to strongly disagree**	19	To find out the attitudes of client firm towards a government office overseeing the audit function and to assess the perception of the audit function and its benefits to the company.
			19-1	To question the supervision of audit quality by the accountancy profession (watch dog).
			19-2	To examine how to restore public confidence and whether there is a belief the auditors are up to the challenge from the investing community.
			19-3	To see to what extent the client firm is prepared to buy advisory services from consultancy firms other than their auditors.
			19-4	To ascertain whether the profit making business of audit has an influence on audit function.
			19-5	To assess the reaction of client firm towards audit regulation by government office.
			19-6	To find out whether audit fee determined by government will lower the cost of audit.
			19-7	To find out whether the management are in favour of the government intervention.

7.3.5.5 Selecting a sample

This study is based on clients of audit firms in Scotland (UK). Given the finite population, judgemental sampling has been used. This is very important particularly for the selection of the persons that the questionnaires would have been sent to because the nature of the research demanded that respondents are directly or indirectly involved in dealing with the company auditors. 265 companies in Scotland were tracked together with their corresponding addresses, annual turnovers, number of employees and phone numbers using the University's FAME CD business directory database. However, 10 companies were found to be subsidiaries of other companies and therefore eliminated from the sample. Three components were used to identify the sample characteristics annual turnover, number of employees and location. The company's size has been determined by the Company Act of 1985:

Table 7.2 Determination of company size

	Sales Turnover	Number of Employees
Small firm	£5.6 million or less	50 employees or less
Medium firm	Greater than £5.7 million and less than £22.8 million	51-249 employees
Large firm	£22.9 million or more	250 employees or more

The respondents from the different companies were: Chief executive, Company secretary, Group accountant, Accountant and others (internal auditors, etc.).

The questionnaire sought to find out about the current audit market, how the audit function is perceived by the client firms and an understanding of how clients interact with their auditors. It also sought to identify the reasons of the breakdown (switching) of client-auditors.

Questions were developed from a study of literature in relationship marketing, inter-firm relationships, inter-organisational relationship and findings from the qualitative study (in-depth interviews with clients and their clients); a case study approach described in chapter 6.

7.3.5.6 Pilot study

The pilot study has taken three stages. The initial list of questions was produced as intended to become a questionnaire. A very limited number of academic staff at Aberdeen Business School were approached and asked their views on the questionnaire design. These academics were chosen from different disciplines such as professors in Marketing (1), Accounting (1), Finance (1) and Economics (1); lecturers in accountancy (2) and auditing (1); management (3). Consequently a number of changes to the questionnaire were made and presented in details in table 7.3. At the start, the initial questionnaire contained two parts: one relating to the elements of relationships and the second part pertaining to the stages appeared to be length and confusing and the respondents raised concern whether they can really remember the elements through the stages. The feedback confirmed the researcher's belief that it is still difficult for the respondents to determine which stages of the relationship the company has gone through. Moreover, it appeared so complex with so many details. This had led to focus only on the elements and relationship quality which took the form of questionnaire 1 (Appendix 1). At this first stage, 10 academics (professors, readers and researchers) were approached and given the first version of the questionnaire and asked about the wording of questions and the grammar. This time relationship quality between auditors and their clients emerged as an important issue to be examined.

In the second pilot stage, the researcher has taken care to include in the sample 10 managers who were Part-Time MBA students. The researcher has taken time and care to design a questionnaire and using the three stages in order not to spoil the final stage. As a lecturer, he wants to present a professional questionnaire to a network of companies in Aberdeen where he has contacts through industrial students' placement. In this stage, scale measurement was looked at closely and a number of changes were introduced (see Table 7.3: Modifications - questionnaire improvement).

The third pilot stage focused on obtaining data through a self-administrated approach to all companies. Fifteen companies were already familiar to the researcher where he has regular contact through his student industrial placements. This took place between February-April 2006. It is worth noting that the researcher, as a lecturer and supervisor, has managed to advise his students on how to approach companies and reach a higher response rate for questionnaire return. Now, he feels it is time to do what he has been preaching for a while. Using an opportunistic approach, the research started from the researcher's place of work, Aberdeen Business School has over 200 students placed in different companies and 190 companies have current students. As lecturer, the researcher has 10 placement students. These companies were approached through his placement students to complete and return the questionnaire. 3 were dropped, mainly because they did not fit in with the sample criteria, i.e. (law firm, charity organisation and local authority). The remaining 7 were contacted through placement students and their industrial placement supervisors by telephone. Personal visits to these students have also taken place in order to collect or distribute the self-administrated questionnaires. On the covering letter, the receiver was asked to complete the questionnaire or directed it to the person most closely involved with the audit function. 7 usable responses were obtained.

7.3.6 Purification of measures – Step 4 -

As advocated by Churchill, 1979, p.68),

> *"The calculations one performs in purifying a measure depend somewhat on the measurement model one embraces. The most logically defensible model is the domain sampling model which holds that the purpose of any particular measurement is to estimate the score that would be obtained if **all** the items in the domain were used* (Churchill, 1979, p.68 quoting Nunnally, 1967, pp.175-81).

At this stage, the purification has taken the form of ***questionnaire revision***. Based on the pilot test of the questionnaires version1&2 (February-April 2006), the following table 6.3 summarises the key modifications to the initial questionnaire after pilot testing with academics, students and practitioners.

Table 7.3: Modifications (Questionnaire improvement)

General	The original size font was changed and made larger for clarity and easy to read. In guidelines to the questionnaire "10 minutes" was changed to "no more than 15 minutes" and later on removed entirely. In order to ask the respondents to express their personal view rather than the organisation view, "**your** working relationship with **your** auditors" was changed to "the client" and "its auditors." The expression "all replies are treated with confidentiality" was changed to "will

be treated "with confidentiality.

Consistency of words used throughout the questionnaire such as "auditor" singular was changed to plural "auditors" and expression such as "Other, please "specify" rather than "write in"

Too many questions

Some questions are repeated or appeared to be or have the same words or concepts.

For pilot testing purpose a space was created to give the respondents an opportunity to comment on the questions and questionnaire in general. This was moved to the opposite side of the page rather than at the end of section.

Empty space was only used for feedback purpose of question design/wording. Once taken out the length of questionnaire was reduced further.

The scale should be more explicit to the respondents rather than just using the anchors in the two poles., "Excellent" and "very poor"

Typo were checked and corrected. The "font" size was made consistent by using "Times New Roman".

It was brought to the attention of researcher respondents' names and positions should be identified for re-access in the future. This information was added at the end of questionnaire.

Section 1: Company Background

Q2 The service sector seems under represented with one category, therefore "please specify" was added.

Q3 The sub-categories of this question were changed into: a listed public company (PLC); a private limited company (ltd); a state owned company; an unlisted public company and a company limited by guarantee.

Q3 The nationalities were identified in the following categories: American, Japanese, European, please specify and others, please specify.

Q5 For the size of the company, i.e., sales turn over was corrected accordingly to the Company Act definition.

Q6 Who are your principal auditors? (questionnaire1) was removed. This information can be obtained from a secondary source, i.e., Fame.

Q7 The word "same" was replaced by "current" and less than a year was inserted (questionnaire1).

Q8 The question "Do you use another audit firm as a joint audit?" (questionnaire1) was not understood by non-finance people. Therefore, the expression was changed to: *"another audit firm to join the audit work"*.

Section 2: Elements of working relationship

The section 2 title "The elements of relationship." was changed into "Your Views of Client - Auditors' Relationships."

Since Q6 was removed, section two starts with Q9 in the Final Questionnaire.

Rapport

Q9 In order to measure this construct, the scale "Strongly agree; agree, Neutral, disagree and Strongly disagree" was used.

Q9-2 and Q9-3 might be seen as the same question for some respondents. Their individual objectives were checked again. Moreover, Q9-2 "familiarity" was replaced by: "personal relationships".

Q9-3 the expression "success of the audit" was more relevant than "to do audit" in (questionnaire1).

Q9-4 the size of audit team was raised. It refers to a team from a trainee to audit manger. It is not intended to measure different categories of teams, i.e., small, medium or large. No changes for this question.

Cooperation

In questionnaire2, the first two questions relating to cooperation item was not understood by a layman respondent during the pilot questionnaire. This has been taken into consideration and checked again with people involved in the audit process. The decision was made to keep it because the future respondents have a clear idea what the question refers to.

Client Satisfaction

The pilot questionnaire2 has highlighted the importance of client satisfaction as an important factor to be included in the assessment of auditor-client relationship.

Therefore, it has been added into the questionnaire.

Commitment In Q12, the instruction given to respondents has been changed from *"By ticking once for each statement"* to a simple version *"by ticking one box for each statement"*.

"The audit team carries out its commitment to the client". This statement has been questioned by a respondent in a sense that "if not, would the company use auditors?" The researcher decided to keep it in order to see whether respondents express the same views.

Trust In questionnaire2, the word "a deep" was suggested and introduced into the question b for emphasise purpose. Question c) and Question d) appear to be the same. Therefore Question d) *"Trust is an important factor in a working relationship with auditors"* was removed.

In questionnaire1, the question *"Our auditors understand well our personal circumstances"* was rephrased *"The auditors understand the personal circumstances of their clients"*.

In the final questionnaire, four questions were deemed necessary to measure trust were introduced (Q12-11 to Q12-14).

Service Quality (audit) From Questionnaire1-the question "To have a quality of audit service, auditors should ask the correct questions and look for what are supposed to look at. "was rephrased for clarity and it reads: *"To have a quality of audit service, auditors should ask the correct questions and look at agreed areas of assignment only."*

In Questionnaire2:

"Courtship and feeling comfortable with the audit team..." appeared ambiguous and repeat of the same thing. Therefore, courtship was removed and Q13-7 becomes "Feeling comfortable with audit team..."

For clarity this question – *"Auditors view flexibility and accessibility to their services by the client as important criteria to produce a quality audit service"*, was split into two questions Q13-9 and Q13-10. Moreover, the verb *"see"* was changed to *"view"* to reflect the opinion of respondents.

Q13-12 The expressions *"happy"* has been removed from the following question: *"Management should feel comfortable and happy with the audit service"*, now Q13-12.

*"Auditors are expected to deliver the **interests**"* appears to be not understood by some pilot respondents (non-accountants) was rephrased and used as Q13-13 *"Auditors are expected to deliver to the client's **expectations**"*.

Communication In questionnaire2, "Continuity is seen as continuous dialogue not as a number of years auditors spent with same client" has been rephrased and became Q9-16 "Continuity is seen as a continuous dialogue not as the number of years that auditors have had contractual relations with the same client." Now, it is Q9-16.

In Questionnaire2, the question related to the junior staff was reworded to read: *"The junior staffs are also important but have less impact on the audit relationship than top management."* Later on in the final questionnaire, it was split into further two questions Q9-17 and Q9-18.

In the final questionnaire, Q10 was rephrased.

Q9-19 and Q9-20 were added to reflect attitudes towards how effective auditors are in communicating with clients and as well their belief towards the concept of " *true & fair view"*

Problem Solving The Question 9-21 has seen two changes, in questionnaire2 was reworded as *"Problem solving is to assist the client to prepare his account and solve his*

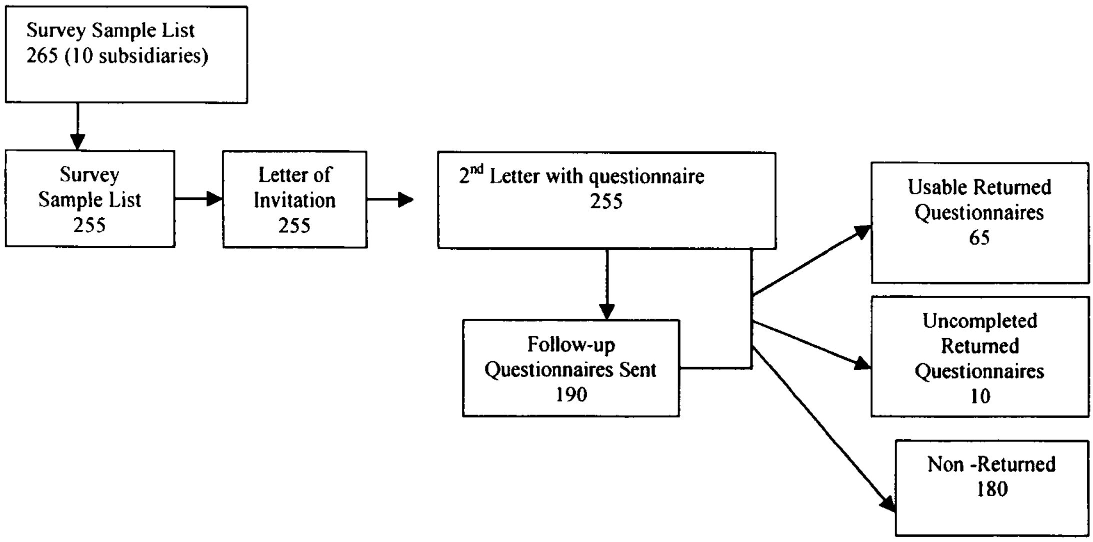
	financial operations. Then, later it was rephrased again as: *"Problem solving assists the client to prepare the final account"*.
Relationships Quality	In questionnaire2, Questions starting with: *"We intend to keep the audit firm indefinitely"* was change to the *"The client intends.."* in Q9-25 In questionnaire1 -the question "The audit is not just a piece paper signed by auditors but as the whole relationship becomes "The audit is not just a piece paper signed by the auditors but a complete extended business relationship." *"We do put a lot of effort in keeping..."* becomes *"The client should..."* in Q9-27. Q9-30 the concepts consistency and continuity raised the issues whether they mean the same thing, i.e., consistency=continuity. Again, these comments are from pilot respondents from a different background. Q9-31 in this question the term "contacts" was changed to "relationship", i.e., *"Social contact is an important factor..."*
Auditor Performance	No comments
Conflict Resolution Mechanism	No comments
Compromise	No comments
D.M.U	No comments
Auditors' Switch	Too many items
Auditors' Selection	Too many items (whether to combine both), i.e., can one question answer both objectives set for changes and selection.
Government Intervention	The following statement constituted in itself a question and was introduced as Q19-7 *"Auditors have been under a lot of criticism recently. Please state whether you agree with the introduction of a government intervention"* was rephrased as *"Auditors have been under a lot of criticism recently. A government intervention will increase the quality of audit service"*

Source: Original

7.3.7 Data collection (Step 5)

In the fist stage the data was obtained from in-depth interviews with clients and their auditors (part.1- qualitative research, chapter four). This second stage ***(quantitative research)*** focused on obtaining data through a postal questionnaire. The figure 7.6 below shows the data collection for survey questionnaire and the response rate. The study questionnaire was mailed to **255** appropriate informants from the original list taken from FAME. Even so only 65 usable questionnaires were returned, representing a response rate of 25%.

Figure 7.4: Questionnaire Response Rate



Source: Original

7.3.8 Assessment of reliability and validity in measurement (Step 6 and 7)

After the pilot tests of questionnaire, the researcher started to wonder what type of results the study is going to generate, what type of issues are likely to emerge etc. The researcher started thinking about the type of data analysis and correlations. One could not help to notice that checking again and going back to the characteristics of companies, their balance sheets in FAME. It emerged then, the categories for classification needed to be amended. Moreover, the UK Trade and Investment website information **(www.uktradeinvest.gov.uk)** was used for the different characteristics/ legal status of these companies.

As far as the statistical tests are concerned, this can be also part of purification of measures as explained in Step 4. let us define first the terms of reliability and validity.

In general terms, it refers to "consistency" or "repeatability" of our measures, i.e., the reliability has to do with the quality of measurement. Some definitions are as follows:

Definition 1 –

> *"In research, the term reliability means 'repeatability' or 'consistency'. A measure is considered reliable if it would give us the same result over and over again (assuming that what we are measuring is not changing!)"* (Trochim, 2006).

Definition 2-

> *"In short, it is the repeatability of the measurement. A measurement is considered reliable if a person's score on the same test given twice is similar. It is important to remember that the reliability is not measured, it is estimated"* (Colosi, 2006).

For this study, the reliability can be defined as *"the consistency of the measurement used in the questionnaire, i.e., examining the degree to which an instrument measures the same way each item it used under the same condition with same subjects."* There are two ways that the reliability is usually estimated: test/retest and internal consistency.

Internal consistency - *"Internal consistency estimates reliability by grouping questions in a questionnaire that measures the same concept."*

For this study, for e.g., the questions q9-1 to q9-8 are written to measure the concept "rapport" in the relationship between auditors and their clients. After collecting data from N=22 respondents, the researcher runs a correlation test between all these questions to determine if the instrument is reliably measuring the relationship marketing constructs. Running this test, the study used Cornbach's Alpha as a way of computing correlation values among the questions on the instrument. Here, this study has used SPSS 13.0 reliability statistical test.

Internal consistency and Test/retest -

Definition – Validity is seen to be the strength of your conclusions, inferences or propositions. Cook and Campbell (1979) define it as *"best available approximation to the truth or falsity of a given inference, proposition or conclusion"*. For this study, a number of exercises were used to purify the measures. A detailed explanation is presented in the next section when dealing with coefficient alpha.

(i) Coefficient Alpha

Testing the measurement scale for marketing constructs, this study uses Cronbach's alpha. In another words, it is to determine the internal consistency of items in auditor-client relationship constructs. Cronbach's alpha is a generalisation of a coefficient introduced by Kuder and Richardson (1973) to estimate the reliability of scales composed of dichotomously –scored items (Lewis-Beck, 1994).

> *"The recommended measure of the internal consistency of a set of items is provided by coefficient alpha which results directly from the assumptions of the domain sampling model. Coefficient alpha absolutely should be the first measure one calculates to assess the quality of the instrument"* (Churchill, 1979, p.68).

Application of reliability test to the construct "Rapport"

By examining the internal consistency of the construct "Rapport", one can see that the "item correlation in Matrix 7.4" shows that q9-7 and q9-8 are closely related but have poor correlation with the other items. Churchill refers to this as:

> *"Thus, a low coefficient alpha indicates the sample of items performs poorly in capturing the construct which motivated the measure. Conversely, a large alpha*

indicates that the k-item test correlates well with true score." (Churchill, 1979, p.68),

Therefore, these two questions are removed from the bank or kept for other tests to see they might have been measuring another construct such as cooperation. Moreover, it shows clearly in Item-Total Statistic table that q9-7 has scored **.**176 and q9-9 scored **.**266 (see table 7.4a). Once these two questions were removed (q9-7 & q9-8), Cronbach's Alpha increases **α>0.7** (see table 7.5).

Table 7.4 Inter-Item Correlation Matrix

	q9_1	q9_2	q9_3	q9_4	q9_5	q9_6	q9_7	q9_8
q9_1	1.000	.299	.295	.226	.149	.290	.244	.167
q9_2	.299	1.000	.621	.713	.447	.264	-.004	.038
q9_3	.295	.621	1.000	.596	.481	.124	-.359	-.344
q9_4	.226	.713	.596	1.000	.449	.503	-.151	-.045
q9_5	.149	.447	.481	.449	1.000	.133	.013	.120
q9_6	.290	.264	.124	.503	.133	1.000	.384	.237
q9_7	.244	-.004	-.359	-.151	.013	.384	1.000	.873
q9_8	.167	.038	-.344	-.045	.120	.237	.873	1.000

The covariance matrix is calculated and used in the analysis.

One has to bear in mind, by removing both items (q9-7 & q9-8), Cronbach's Alpha increases **α>0.7.** Now, looking back at reliability test with Item-Total Statistic Matrix. All correlations items are >**0.35** (see table 7.4c).

Table 7.4a Item-Total Statistics Matrix

	Scale Mean if Item Deleted	Scale Variance if Item Deleted	Corrected Item-Total Correlation	Squared Multiple Correlation	Cronbach's Alpha if Item Deleted
q9_1	18.68	21.942	.415	.244	.679
q9_2	18.36	17.100	.596	.643	.627
q9_3	18.50	21.310	.333	.643	.695
q9_4	18.14	19.076	.585	.777	.637
q9_5	19.55	22.641	.449	.361	.679
q9_6	18.23	20.470	.489	.624	.661
q9_7	17.77	22.184	.176	.874	.739
q9_8	18.73	23.160	.266	.836	.705

Conclusion: the q9-1 to q9-6 are the items to measure "Rapport". The other two items (q9-7 & q9-8) having a correlation of 0.873 are very close and removed from this test.

Table 7.4b - Inter-Item Correlation Matrix

	Q9_1	q9_2	q9_3	q9_4	q9_5	q9_6
q9_1	1.000	.299	.295	.226	.149	.290
q9_2	.299	1.000	.621	.713	.447	.264
q9_3	.295	.621	1.000	.596	.481	.124
q9_4	.226	.713	.596	1.000	.449	.503
q9_5	.149	.447	.481	.449	1.000	.133
q9_6	.290	.264	.124	.503	.133	1.000

The covariance matrix is calculated and used in the analysis.

Table 7.4c - Item-Total Statistics Matrix

	Scale Mean if Item Deleted	Scale Variance if Item Deleted	Corrected Item-Total Correlation	Squared Multiple Correlation	Cronbach's Alpha if Item Deleted
q9_1	12.91	17.706	.346	.184	.792
q9_2	12.59	12.063	.702	.588	.709
q9_3	12.73	14.303	.619	.511	.732
q9_4	12.36	13.385	.766	.676	.692
q9_5	13.77	17.708	.477	.283	.772
q9_6	12.45	16.926	.358	.364	.794

Now, the reliability is fine and all correlated Item-Total Correlation are greater than **.**358 **Corbach's Alpha** is greater than 0.7 (see table 7.5).

Table 7.5 Reliability Statistics

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
.786	.710	6

Application of reliability test to the construct "Cooperation"

First reliability test of cooperation for the items q9-9 to q9-14 shows a poor correlation, i.e., **α<0.7.** From the matrix of correlated items, q9-9 appears the poorest in terms of correlation with other items (-.185, .031, -.157, -.133). Hence, Churchill argues that:

> *"Basic to the domain sampling model is the concept of an infinity large correlation matrix showing all correlations among the items in the domain. No single item is likely to provide a perfect representation of the concept, just as no single word can be used to test for differences in subjects' spelling abilities and no single question can measure a person's intelligence. Rather, each item can be expected to have a certain amount of distinctiveness or specificity even though it relates to the concept."* (Churchill, 1979, p.68)

Again, in the Item-Total Statistics q9-9 emerges as the poorest with a correlation of -.050. By removing item q9-9 from the bank, **α** has improved slightly but still low. Item q9-14 appears to have a very low correlation with item q9-14 and scored only .093 and -.173 with q9-12. It is to note that by removing q9-9 and q9-14, reliability statistic **α** is .566, closer to 6. In conclusion, due to a lack in consistency amongst some items, both items q9-10 and q9-14, the study faces the challenge either to remove them from the bank or settle for **α ≥ 0.6** and **Correlated Item-Total >0.3.**

Overall Conclusion - After all statistical tests for relationship marketing constructs, it appears that the study will settle for: **α≥0.6** and **Correlated Item-Total >0.3** as presented in table 7.6.

Table 7. 6 Constructs Statistical Tests

Constructs	Cornbach's Alpha	Item Reliability Range (Correlated Item-Total Correlation)
Rapport	0.781	0.346 to 0.766
Cooperation	0.687	0.306 to 0.523
Communication	0.742	0.339 to 0.578
Problem Solving	0.736	0. 401 to 0.622
Relationship Quality	0.796	0.393 to 768
Client Satisfaction	0.915	0.723 to 0.888
Commitment	0.819	0.392 to 0.706
Trust	0.683	0.291 to 0.472
Audit Service Quality	0.677	0.299 to 0.690
Auditor Performance	0.935	0.341 to 0.853
Conflict Resolution	0.671	0.307 to 0.590
Compromise	0.603	0.298 to 0.491
DMU	n/a	n/a
Auditors' Switching	0.859	0.312 to 0.708
Auditors' Selection	0.858	0.316 to 0.793
Government Intervention	0.750	0.350 to 0.700

By examining the above table, one can notice that there is a variety of item reliability range. This is what Churchill. 1979 advocates:

> *"In practice, though, one does not use all of the items that could be used, but only a sample of them. To the extent that the sample of items correlates with true scores, it is good. According to the domain sampling model, then, a primary source of measurement error is the inadequate sampling of the domain of relevant items"* Churchill, 1979, p.68).

Therefore, the researcher has decided on **$\alpha \geq$ 0.6** and **Correlated Item-Total >0.3.** Therefore purification of items (adjustments should be made to the items, highlighted in the table above, relating to the following constructs: communication, relationship quality, audit service quality, conflict resolution, compromise, auditors switching, auditors selection and government intervention) as recommended by Churchill 1979.

Moreover, the researcher is to decide whether to use two stages of analysis: analysis with all the items including the "outliers" and analysis without "outliers" i.e., odd numbers.

7.3.9 Developing norms (Step 8)

This study intends to use the most plausible statistical calculations leading to the true results. In the next section, the different type of scales and their measures are explained and the reasons for using them in this study have already been discussed in questionnaire design section (see type of measures).

7.4 SURVEY AND RESPONSE RATE

This study has used FAME database. Selection of respondents has been thought through in such way to target the key respondents who are involved in the relationship with auditors and maximise the response rate in a very protected and sensitive area of research, i.e., the audit function. Letters to potential participants were addressed to Chairmen, Chief Executive, Head of Finance, Company Secretary, Accountant and others. It emerged that a company secretary is there to make sure all the right documents are available and information sent to "Company House". A quick examination of financial data in FAME, will reveal that in a number of cases, letters addressed to company secretaries have been passed on to the appropriate respondents e.g. see extract from the letter a company secretary:

Another letter from a Chief Executive

> *"Dear Ahmed*
> *Some time ago you requested we complete a questionnaire to help with your studies. I passed this on to the person internally I thought best able to complete it, but unfortunately the paperwork has now been lost.*
> *I realise that it may now be too late, but if you still need some input, please forward it to me again (by email if possible) and I will try to get it completed.*
> *Kind regards (and apologies for the delay),*
> *Anne Richards.*
> *Aberdeen Asset Management, Plc "*
> *25-07-2006*

> *"Dear Mr Beloucif,*
> *Thank you for your letter dated 22 August 2006. As Company Secretary I don't get involved with the audit aspects of the Company and have therefore passed your letter on to the Company Account, Mr Simon Long, who may wish to participate in your survey to assist you with your studies.*
> *I wish you well with your doctoral research.*
> *Yours sincerely"*

The researcher has identified the target as well as making it easy to be contacted by having his email contact on the questionnaire and using headed letter have helped to track down the researcher address.

Fame Database and refinement of respondents' list

Using FAME database, the researcher has to overcome a number of limitations. Some companies are listed but no address given. The researcher tried to use the office register for the company but not found. An online research through "Google" provided the missed information. Amongst these limitations are:

- Missing information address, telephone number, names of directors etc.
- Limited companies as part of a parent company or a group.
- Head of Finance acting for a number of limited companies within the same group and while a different person is in charge of another Ltd company.
- Different nationalities under the same group

- Companies ceased activities or taken over
- Change of trading address
- Change of personnel, i.e., chairman, FD etc.
- Company 5 Nunn Group Plc, address found but no telephone number or directors' names. Moreover, a number of limited companies are under the umbrella of one parent or group, for e.g.:
- Companies 54, 55, & 56 have same address but only company 54 has a different Head of Finance. 55 & 56 is represented by Mr C Winchester.
- Another company - Baillie Gifford for e.g. manages the following:
    - Scottish Mortgage
    - Monks
    - Edinburgh Worldwide
    - Mid Wynd
    - Japan Trust
    - Shin Nippon
    - Pacific Horizon
- Blue Planet Group have one European, one American Investment and 10 locals. Since the FD is the same for all of these companies – The European Company, based in Edinburgh has been selected, i.e. used in the sample. Moreover, it is the only company which has a working website. www.blueplanet.eu.com
- Company 169 - BCW Group PLC not found in Fame but found under AVANCE Group Limited with contact address www.bcwgroup.com
- Company 172 (Sogomana Group Plc) in Glasgow is under receivership of Ernst & Young. No contact no trading address. This has been dropped from the sample.
- Close Second Aim VCT Plc (200) is part of a group, i.e. 187, 186, 185. Moreover, it has been found that under "Close Venture management" 9 VCT subsidiaries.

Companies within same group – Number of questionnaires to be sent

- When companies are under the same group, the researcher has to check whether these companies have different auditors. If they have, questionnaires are sent to them. If not, one single questionnaire is sent to Head of Finance/Group Finance Director or Chief executive/chairman. This is to find out whether companies use joint audits. However, it appears that companies have different audits at acquisition and takeovers. Later on, they are put under the same auditors, i.e., principal auditors. For example Terrace Hill Group Plc and Serah properties and PCG Presidential PLC – 173, 174, 1975 and 1976

- Company 176 Britannic Global Income Trust is under different Chairman (Gavin Stewart) and audited By Ernest & Young, not BDO Stoy Hayward.
- Glasgow Income Trust Plc (183) and Shires Smaller Companies Plc (184) have different chairman as well as auditors. But, both companies have the same finance director (Mr Michael Balfour). Moreover, both companies have the same primary trading address. Therefore, to have diverse views one questionnaire was sent to the chairman and another one to the Finance Director.
- Company 188 questionnaire sent to Chief Executive Mr L Arnold and another sent to Head of Finance for company 189 (Abbey national Life Plc). The head of finance (David Wallis) is acting as director for Scottish Mutual Assurance (188).
- Abbey National Group has 50 companies which are mostly operating in Scotland. It is not possible to send questionnaire to all their companies. This will raise suspicion and jeopardise any attempt to take part in the survey. It has been decided to send only a limited number of questionnaires (target areas: Aberdeen, Glasgow and Edinburgh).
- 188, 189 and 190 Abbey national. Two only company were targeted in Glasgow since they have the same trading address.
- British Caledonian Group Plc (247) acquired by BA awhile ago. It is part of BA group but not fixed address except an office at the airport.

Registered vs. trading address

- By checking on Fame, companies' updated addresses are found online for e.g. just before contacting the company SMG (180) their initial address was: 200 Renfield Street, Glasgow, Strathclyde, G2 3PR. 2months later, the company moved to a new premise Pacific Quay Glasgow. Generally, the research prefers to use the "primary trading address". If it does not exist, then "registered address" is used instead.
- It is very difficult to trace back company when "Fame" does not provide trading address. Checking through Google, it is found that a number of small companies are scattered around Scotland and operated by just managers. The researcher decided to select one director and checking his personal address against the company address where the questionnaire is to be sent for example company 223 (Lanarkshire Ice Rink Public Limited Company)

- Aberdeen Asset Management PLC, Company Number: SC82015, and having its Registered Office at 10 Queen's Terrace, Aberdeen AB10 1YG Scotland, is the parent company for the Aberdeen Asset Management Group of companies. Since the Chief Executive, Mrs Anne Richards has emailed the researcher, it was decided that one questionnaire for the whole group will be sufficient. Therefore, the remaining companies under the same group were not sent a follow up questionnaire, i.e., companies 37, 38, 39, 40, 41, 42 and 43.

Using Company Directories, Fame and websites

- Name and companies contacts are not quickly updated for some companies for example Weir group plc announced in their website the appointed a new Group Financial Director on 21st of March 2006. But, the information has not been updated in "Fame" on 25 July 2006.
- Not all information exists in Fame. For example address and contact names have to searched and completed through Google (214).

Table 7.7 UK Standard Industrial Classification of Economic Activities 2003

1992 SIC Codes - Main Classification Headings	
1.	A - Agriculture, hunting and forestry
2.	B – Fishing
3.	C - Mining and Quarrying
4.	D – Manufacturing
5.	E - Electricity, gas and water supply
6.	F – Construction
7.	G - Wholesale and Retail Trade including Repairs
8.	H - Hotels and restaurants
9.	I - Transport, storage and distribution
10.	J - Financial intermediation
11.	K - Real estate, renting and business activities
12.	L - Public administration and defence, social security
13.	M – Education
14.	N - Health and social work
15.	O - Other community, social and personal service activities
16.	P - Private households with employed persons
17.	Q - Extra-territorial organisations and bodies (e.g. UN, EC, OPEC, etc)

Analysis of Non-responses

Some questionnaires were returned uncompleted with a note, or a letter. Examples are below: - Clyde Radio – no signature or name:

> *"It is with regret that there will be no one suitable at present to complete your survey. We wish you every success for the future and apologise for any inconvenience".*
> *Radio Clyde – no signature*

7.5 STATISTICAL ANALYSIS

7.5.1 Parametric and non-parametric data and tests in the study

> *"The distinction between types of scale is important, as the type of scale determines which types of statistical analysis is appropriate. In order to use the parametric statistical tests, one should have used an interval or ratio scale of measurement. If the data is measured on an ordinal scale, use non-parametric tests. For nominal or categorical scales, some of the non-parametric tests, such as chi-square, are appropriate."* (Foster, 1998, p.7).

This study has mostly used the Likert scale and semantic differential. These scales have some correspondence between the size of the numbers and the magnitude of the quality represented by the numbers. Therefore, non-parametric statistical tests are more suitable. It is time now to turn to examine data collected. The responses can be summarised as follows:

Table 7.8 Respondents' Profile

Category	N	%
CEO , Chairman Company Secretary, Non-executive director, Financial Controller	14	21.5
Group Financial Director, Head of finance, Financial Director	27	41.5
Managing Director, Director (AD), Manager	12	18.5
Group Accountant, Accountant	9	13.8
Others	3	4.6
Total	65	100

The detailed analysis is covered in the next chapter 8. Overall, **65** questionnaires returned, representing 25% response rate. Given the sensitive nature of the topic this is considered highly satisfactory. An analysis of non-respondents showed no significant bias in terms size, or industry sector. To reduce bias, confidentiality was emphasised on the covering letter and on the first page of the questionnaire within the instructions how to complete the questionnaire. This approach also helped to increase the rate of return of questionnaires as well as the possibility to contact and interview the respondents or asking for clarity.

7.5.2 UNDERSTANDING THE TYPE OF DATA AND ANALYSIS

This section aims to assess the suitability of the data for regression analysis. Therefore, type of data is explained, why it was collected and how it is to be analysed.

7.5.2.1 The type of data and its distribution

The data was collected in order to analyse and measure the characteristics of each item raised in the questionnaire. To measure a characteristic of an object or person is called a variable (Jacobsen, 1993). Undertaking the study of auditor-client relationship, the researcher has to define the type of scale to use and the type of data to collect. The researcher was under the belief that understanding these basic principles will help appreciate how the data will be organised and analysed. Understanding the type of data and its relevance to the descriptive analysis helps to carry on with further and complex analysis if required. Generally speaking, descriptive statistics are methods applied to data to capture the following four basic characteristics (Banks 1999 quoting Jacobsen, 1993):

- The "average" value
- How the measurements vary
- The symmetry of the measurements
- The shape of the peak of the measurements.

Using all the measurements at once does not make sense to the reader. Therefore, in order to give a meaningful explanation of the ***data distribution***, the researcher decides to apply the most plausible measure to the data in question. This leads to the data distribution test such as K-S Kolmogorov-Smirnov test, which is used to test whether the sample comes from a population with a specific distribution function. When there are two samples of data, it is used to test whether or not these two samples may reasonably be assumed to come from the same distribution. Coolican (2004) points out that when variables are said to be '*normally distributed*', or '*standardised to fit a normal distribution*', we are always talking about ***approximations*** to a pure normal curve. He also explains that:

> "*When we come on to testing significance, the statistical theory often assumes a normal distribution for the population from which samples were drawn. If population values on the variable form nothing like normal distribution, then the conclusions from the* ***significance test*** *may be seriously in error... The curve is called 'normal' for purely* ***mathematical*** *reasons* (p.284).

Therefore, in our study of auditor-client relationships, we are looking for approximations to the normal curve, which is generally presented by the following terms:

μ = (population) mean. It can give us a feel for which direction the average answer is.

σ = (population) standard deviation. It gives us an indication of the average distance from the mean. The interpretation of the standard deviation is:

- A Low "σ" would mean that most observation ***cluster*** around the mean.
- A high "σ" would mean that there are a lot of variations in the answer.
- A "σ" of 0 (zero) is obtained when all responses to a question are the same.

x = variable of interest

Therefore, the idea to use a descriptive statistic and K-S is to provide the researcher with some insights into the data distribution. As the aim of the study is to assess the relationship quality between auditors and their corporate clients, it is deemed necessarily to test the distribution of the data in relation to this construct "Relationship Quality", known as RelQual2. One Sample K-S test (Kolmogorov-Smirnov Z) has been carried out and the results are presented in the table 8.1.

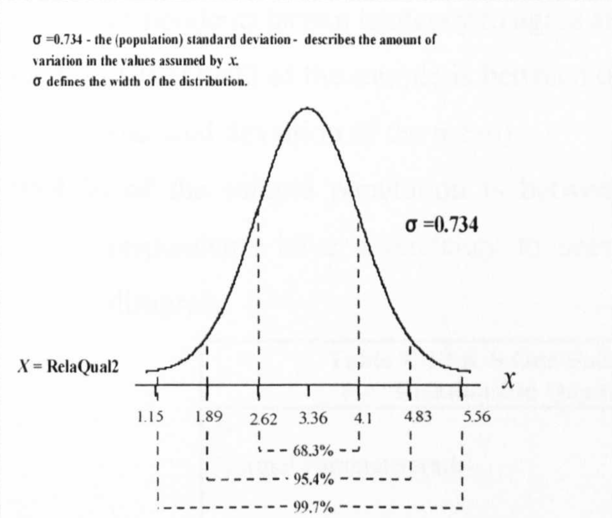
Table 7.9 One-Sample Kolmogorov-Smirnov Test		**RelQual2**
N		65
Normal Parameters(**a**,**b**)	Mean	3.3646
	Std. Deviation	.73494
Most Extreme Differences	Absolute	.067
	Positive	.055
	Negative	-.067
Kolmogorov-Smirnov Z		.541
Asymp. Sig. (2-tailed)		.932

a Test distribution is Normal.
b Calculated from data.

μ = (population) mean =3.3646
σ = (population) standard deviation = 0.73494
x = variable of interest (RelQual2)

The range is between 2.62 and 4.1. 68.3% of the sample is between this range (i.e., 2.62 and 4.1). That means most respondents have a tendency to agree and neutral position (no views).

Figure 7.5 Data Distribution



μ = (population) **mean** = 3.36

μ - σ = 3.3646 - 0.73494 = 2.62966
μ - 2σ = 3.3646 - 1.46992 = 1.89472
μ - 3σ = 3.3646 -2.20482 = 1.15978

μ + σ = 3.3646 +0.73494 = 4.099
μ+2σ = 3.3646 + 1.46992 = 4.83452
μ+3σ = 3.3646 + 2.20482 = 5.56942

1	2	3	4	5	6	7
Strongly agree	Agree	Tend to agree	neutral	Tend to disagree	disagree	Strongly disagree

99.7 % of the responses are scored between 1.15 (strongly agree) to close to disagree. The data distribution is between 1 and 6 which means that 99.7 % of respondents have given responses from 'strongly agree' to mainly 'disagree'. A few responses were scored as 'strongly disagree', i.e., these can be considered as outliers. By removing them, the data distribution will take the bell shape form.

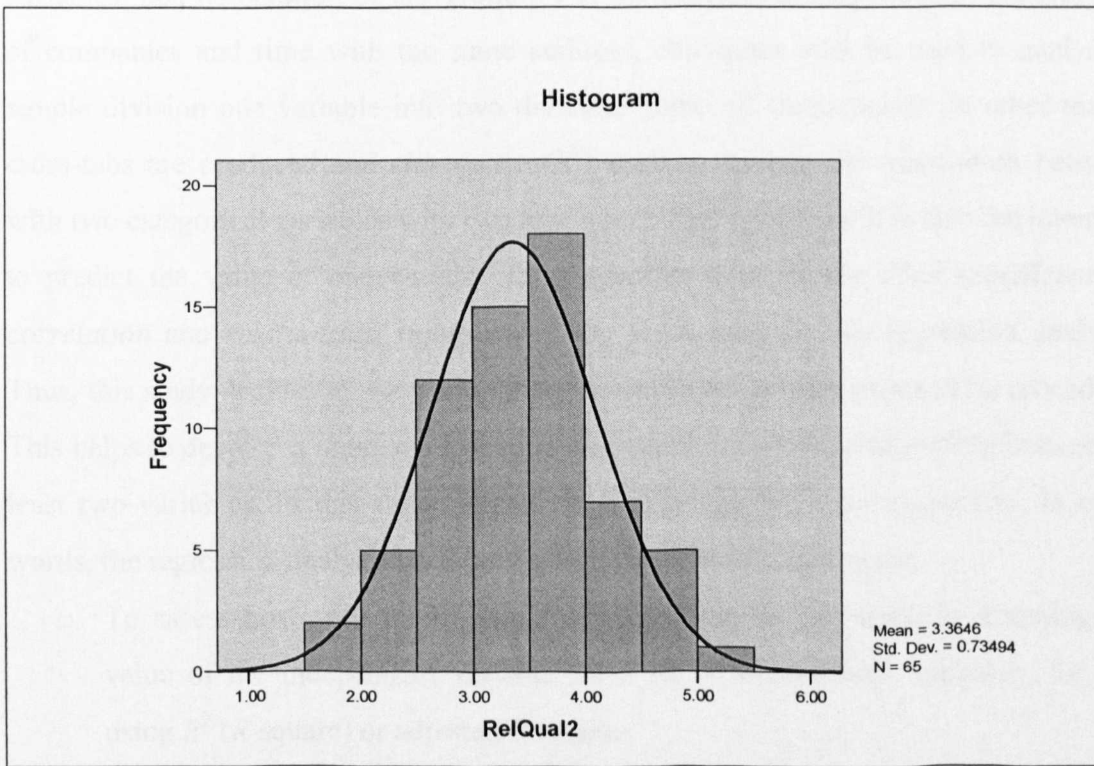


Fig 7.6 Data Distribution of Relationship Quality

68.3% of the sample is between this range (i.e., 2.62 and 4.1). That means most respondents have a tendency to agree and neutral position (no views).

68.3% of RelQual2 of the sample is between this range (i.e., 2.62 and 4.1) (*i.e.*, within 1 standard deviation of the mean).

95.4 % of the sample population is between the range of 1.89 and 4.83. Most of respondents have a tendency to score between strongly agree and agree to disagree.

Table 7. 10 K-S One-Sample K-S Test for "Relationship Quality" variable		**RelQual2**
N		65
Normal Parameters(a,b)	Mean	3.3646
	Std. Deviation	.73494
Most Extreme Differences	Absolute	.067
	Positive	.055
	Negative	-.067
Kolmogorov-Smirnov Z		.541
Asymp. Sig. (2-tailed)		.932

a Test distribution is Normal.
b Calculated from data.

All variables (constructs) used in this study have an approximate normal distribution. The K-S distribution data normality tests of all constructs are presented in Appendix 5.

7.5.2.2 The type of data analysis (correlation analysis and simple linear regression)

The purpose of the analysis is to determine the nature of relationship between two variables, i.e., *association* or *correlation.* For the analysis of respondents' profile, size of companies and time with the same auditors, chi-square will be used to analyse a simple division one variable into two divisions (level of frequencies). In other terms, cross-tabs are produced and *chi-square* (X^2) used to analyse the association between with two categorical variables with two levels each (2x2) analysis. It is also the intention to predict the value of one variable for a specific value of the other (*coefficient of correlation* and *relationship significance*) are to be used for the regression analysis. Thus, this study decides to use a simple and multiple linear regressions as its procedure. This helps to develop a mathematical equation, which shows the relationship between at least two variables. In this study, sometime we refer to them as "constructs. In other words, the regression analysis used here serves the following purposes:

- To assess how well the dependent variable can be explained by knowing the value of the independent variable (or a set of independent variables, for e.g. using R^2 (R square) or adjusted R square.

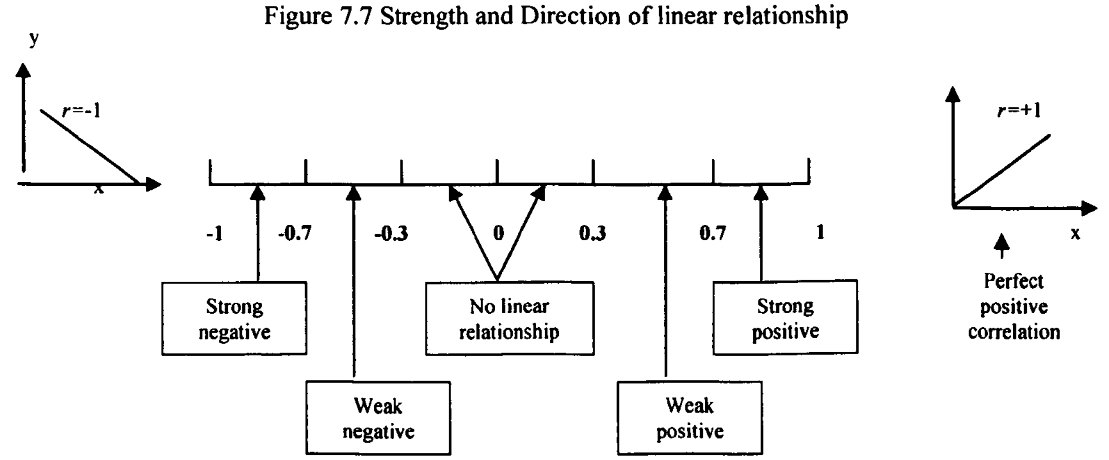
- To identify which subset from many measures is most effective for estimating the dependent variable (stepwise selection approach in section 8.4).

7.5.2.2.1 Correlation

a) Explanation

Basically, correlation is "*measure of linear relationship between variables.*" (Field, 2005) In our study of auditor-client relationships, it is intended to examine whether there is any association between the variables depicted in the model (fig 8.3, chapter 8). So we are looking for a correlation between at least two variables *x* and *y*. There are a number of ways in which two variables have an association. They could be positively related or negatively related as shown in: (Figure 7.7 Strength and Direction of linear relationship). In terms of SPSS 13.00 output, we use *analyse, correlate* and *bivariate.* Then, we look at $r \leq 1$ in the table model summary of the SPSS output or "*beta*" in the coefficient table). In our study, Pearson correlation is mostly used. Pearson's correlation, *r*, measures the strength of the linear relationship between two quantitative variables *x* and *y*, i.e., it is a measure of how close the data points lie to a straight line. A general interpretation of best fit (correlation coefficient) and strength and direction of linear relationship is given below:

Figure 7.7 Strength and Direction of linear relationship



Source: adapted with some slight modification from Pirie, I (2006), lectures' notes 15 & 16. Module BS2114-Quantitative Business Techniques, RGU, VC, unpublished, RGU. Business School.

The study has used the following general rule for results' interpretation of the relationship between tested constructs (Pirie, 2006):

- *r* is always between -1 and +1
- if $\beta 1$(slope of the regression line) is *positive*, then so is *r*.
- if $\beta 1$ (slope of the regression line) is *negative*, then so is *r*.

- if a scatter plot shows that there are outliers or suggests that a non-linear relationship exists between x and y, then the value of r can be misleading. In such situations Spearman's rank correlation coefficient should be used. Spearman's rank correlation should also be applied when one or both of the variables are on an ordinal scale.

b) Model summary explained

A "Model Summary" is generated through the analysis and produced in the SPSS output. What does this table mean? In many statistical studies, the goal to establish a relationship, expressed via an equation, for predicting typical values of one variable given the value of another variable. The simplest equation is that of a straight line:

$$y = \beta o + \beta 1x$$

Relevant SPSS output for ***rapport*** and ***service quality*** is presented below:

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.346(a)	.120	.106	.60330

a Predictors: (Constant), rapport2

The following points explain the content of the above table:

- In the Model Summary table, the value of r is the positive square root of R square. The score of **R square** is 0.120, i.e., 12 % of the variation in service quality is explained by the model (y = 1.597 + .321 x).
- In conclusion, we can say that the coefficient of determination (R Square) r^2 = 0.120. The regression equation provides only a weak fit with 12% of the variation in service quality explained by the regression equation (or explained by rapport).

Once the correlation coefficient between variable is established ($r \leq 1$). Then we determine whether there is a significant relationship between the variables by using regression model and p-value "Sig."

c) Application of the regression model and the method of least squares

Having assumed a linear relationship between x and y, $y = bo + b1x$ is an *estimate* of the regression equation which best describes the relationship between x and y in the population, i.e., bo and $b1$ are *estimates*, based on sample data, of the unknown population parameters bo and $b1$ in the theoretical model. To write the equation of the straight line as a statistical model, a random error *(E)* is added because the points do not fall on the line:

$$y = \beta o + \beta 1x + E$$

Where,

- $\beta o + \beta 1x$ is the straight line that best describes the relationship between x and y. in the population;
- E is a random error term, which accounts for the fact that the points are scattered about the straight line.
- The slope $(\beta 1)$ is the ratio between the vertical change and the horizontal change along the line.

$$\beta 1 = \frac{\text{vertical change}}{\text{horizontal change}}$$

d) The method of least squares

The method of least squares is also used in our study to determine the values of *bo* and *b1* in the estimated regression equation. The Error can be defined as:

Error = ***observed*** value of *y* - ***estimated*** value of *y*

$$E = yi - \tilde{y}$$

Obviously, what the analysis of study is trying to do here is to construct a straight line that passes through the observed data points (responses by participants in the study) in such a way that these errors are small. The *method of least squares* defines the *"best fitting line"* as the line, which minimises the sum of squares of the errors. Expressing this in mathematical terms, this means that the regression line is fitted so that $\Sigma = (yi - \tilde{y})^2$ is a minimum.

7.5.2.2.2 Regression

a) Explanation

After a careful examination of the data set and using SPSS (application guide base 13.00) it emerges that that the most plausible *estimated regression model equation* plausible for our study takes the following form:

$$y = bo + b1x$$

Where, *y* is relationship quality between auditors and client; *bo* is constant; and *b1* is coefficient.

The ***intercept*** (*bo*, or **constant**) is where the line intercepts the vertical axis at $x=0$.

To represent the errors *(E)* in the model, we draw a short vertical line from each point to the line. These vertical lines are called ***residuals*** and are estimates for the true errors.

It is noted that SPSS package uses the methods of least squares to estimate the *slope* and the intercepts. This method minimizes the *sum of the squared residuals* (i.e., the sum of the squares of the vertical line segments).

So, the final equation $y = bo + b1x$ where:

- y is the *dependent* or *outcome* variable, the one you are trying to predict (for example service quality, see fig. 8.1 a);
- x is the *independent* or *predictor* variable (for e.g., trust);
- the *intercept (bo)* and the *slope (b1)* are *coefficients.*
- If the model is a good descriptor of the relationship between the variables, the study can use the estimates of the coefficients to *predict* the value of the dependent variable for new cases as explained in the coming table:

b) Coefficients table explained

Coefficients[(a)]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	0.785	0.262		2.994	0.004
	Trust	0.592	0.093	0.625	6.362	0.000

a Dependent Variable: **ServQual2**

- In SPSS output, **"Sig."** is to denote a ***p*-value.**
- The estimated regression equation (from ***B*** column) is ($y = 0.785 + 0.592x$) with ***p*-value** = 0.000 < 0.05, we can conclude that there is a significant relationship between rapport and service quality but not directly explained by the estimate regression equation ($y = 0.785 + 0.592x$).
- It is to note that the *p*-value (value of Sig.) associated with explanatory variable "trust" that is of interest (see below for detailed explanation).

It is felt to give further explanation about testing for significant relationship so the calculation and tables are reduced to a minimum in this chapter.

c) Testing for a significant relationship

Coolican (2004, p.313) points out that "***significance tests***: *are used to help choose between the null and the alternative hypotheses. The first of these says there is no effect, while the other is usually what we would like to support with our evidence.*"

Once the correlation coefficient between variable is established ($r \leq 1$). Then we determine whether there is a significant relationship between the variable, we refer to *p*-value or "Sig." in the row of the "Coefficient" table corresponding to x variable.

Now, let us take two different variables "Trust" and "Client satisfaction" then, we need to determine whether there is a statistically significant *linear* relationship between the two variables, x and y. In other words, we want to find out if x is used for predicting y or, equivalent*ly,* if x explains a significant proportion of the variation y. To do this, we inspect the p-value at the end of the row presented for the variable x in the **Coefficients** table in the SPSS regression output. (In SPSS output "Sig." is used to denote a p-value). The p-value is the result of a **t-test.** Using the standard 5% significance level (**α=0.05).** The decision rule that we employ is:

- If p-value < 0.05, there is a significant relationship between x and y.
- If p-value ≥ 0.05, there is no evidence of a relationship between x and y.

The following is an example of hypothesise test used in our model auditor-client relationships. Let us examine the first hypothesise H1.

H1: *The greater the trust in the audit firm, the higher the auditor performance.*

Ho: *There is no relationship between trust and auditor performance.*

Testing this hypothesise by examining the next coefficient table.

Coefficients[(a)]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	1.408	0.353	.	2.994	0.004
	Trust2	0.521	0.125	0.470	6.362	**0.000**

p-value

a Dependent Variable: auditor performance.

At the end of the row presented for the variable trust (Trust2), the p-value = 0.000.

p-value = 0.000 < 0.05

Therefore, we conclude that there is a significant relationship between trust and auditor performance. For one unit increase in trust, *auditor performance* rises by 0.521. In other words, knowledge of trust in the relationship is useful predictor for auditor performance. The following are pointers used in our analysis of constructs in our auditor-client relationship marketing.

- The p-value is the result of a t-test used to test the hypotheses:

  Ho: $b1 = 0$ (the slope in the population is zero), i.e., all population means are equal or correlations are zero.

  H1: $b1 \neq 0$ (the slope in the population is not zero)

If the slope in the population is zero, then there is no relationship between x and y (i.e., knowledge of x is not useful for predicting y). In other words, if the probability of the result **occurring under** *Ho* is low, then *Ho* is rejected in favour of alternative Hypothesis *H1*.

If p-value < 0.05, we reject Ho, and conclude that the slope in the population is not zero, in which case there is a relationship between x and y (i.e., knowledge of x is useful for predicting y).

- The p-value is the probability of obtaining the observed sample data if, in fact, there is ***no relationship*** between x and y. Therefore, a p-value is sufficiently small (< 0.05), we conclude that there is a relationship between x and y.

Coolican (2004, p.313) explains that:

"Social scientists reject the null hypothesis when the probability of a result occurring under it is less than 0.05 (the conventional set level of 'alpha' – the level of probability for rejection). This is often called the ***'5%' significance level'****. The area of the probability distribution for a particular statistical test cut off by the set level of alpha is known as a* ***rejection region.*** *If a result falls into the area we may reject* ***Ho****".*

7.5.2.2.3 Multiple regressions

Until now we have assumed we have ONE only linear regression. From our initial auditor-client relationships, we have identified a number of constructs, which might have a strong positive association with the "*relationship quality*", which we intend to examine. Therefore, our regression model will have to deal with more than two predictors, i.e., adding two other independent variables to the linear regression model. The equation model with three variables becomes a ***multiple-regression*** model:

$$\boxed{y = \beta o + \beta 1x + \beta 2x + \beta 3x + E}$$

Applying this equation model is more difficult than a simple linear regression with just one independent variable. This is due to the inclusion of other predictors in the equation. However, techniques have been developed to help researchers to overcome this difficulty, i.e., using multiple stepwise regressions. These will be covered in our data analysis in section 8.4 and 8.5 in this chapter.

7.5.2.2.4 Why does this study use a fit regression model?

In addition to predicting the outcome variable for the data collected through survey, regression analysis serves other purposes:

- To assess how well the dependent variable (relationship quality) can be explained by knowing the value of a set of independent variables. As explained previously the study will be using a number of R^2 values and summary model table through the data analysis and hypotheses testing.

- To identify which subset from many measures is most effective for estimating the dependent variables, i.e. it is to identify and determine which best subset appearing in the study conceptual framework explains the auditor-client relationship model. In the initial model developed by the researcher, there were three subsets leading to the relationship quality (see fig. 8.1). This study has the possibility to explore and examine clusters through statistical models and stepwise regression) to identify the most effective measures for estimating the relationship quality of auditor-client.
- It also answers the assumptions for a normal distribution (see previous section 7.2.5 - type of data and normality test).

7.5.2.2.5 Using t test and Mann-Whitney to compare groups and hypotheses testing

The basic rule of thumb adapted for this study is:

- we use t –test if we use our aggregated values, i.e., individual constructs.
- we use Mann-Whitney if we use individual Likert scale.

The *t* test is used to compare for example, the means between groups For example in our study we want to know if the Financial Controllers answered the question **Qx** differently from the Accountants. Based on this explanation, we are going to run a number of t tests through the data analysis.

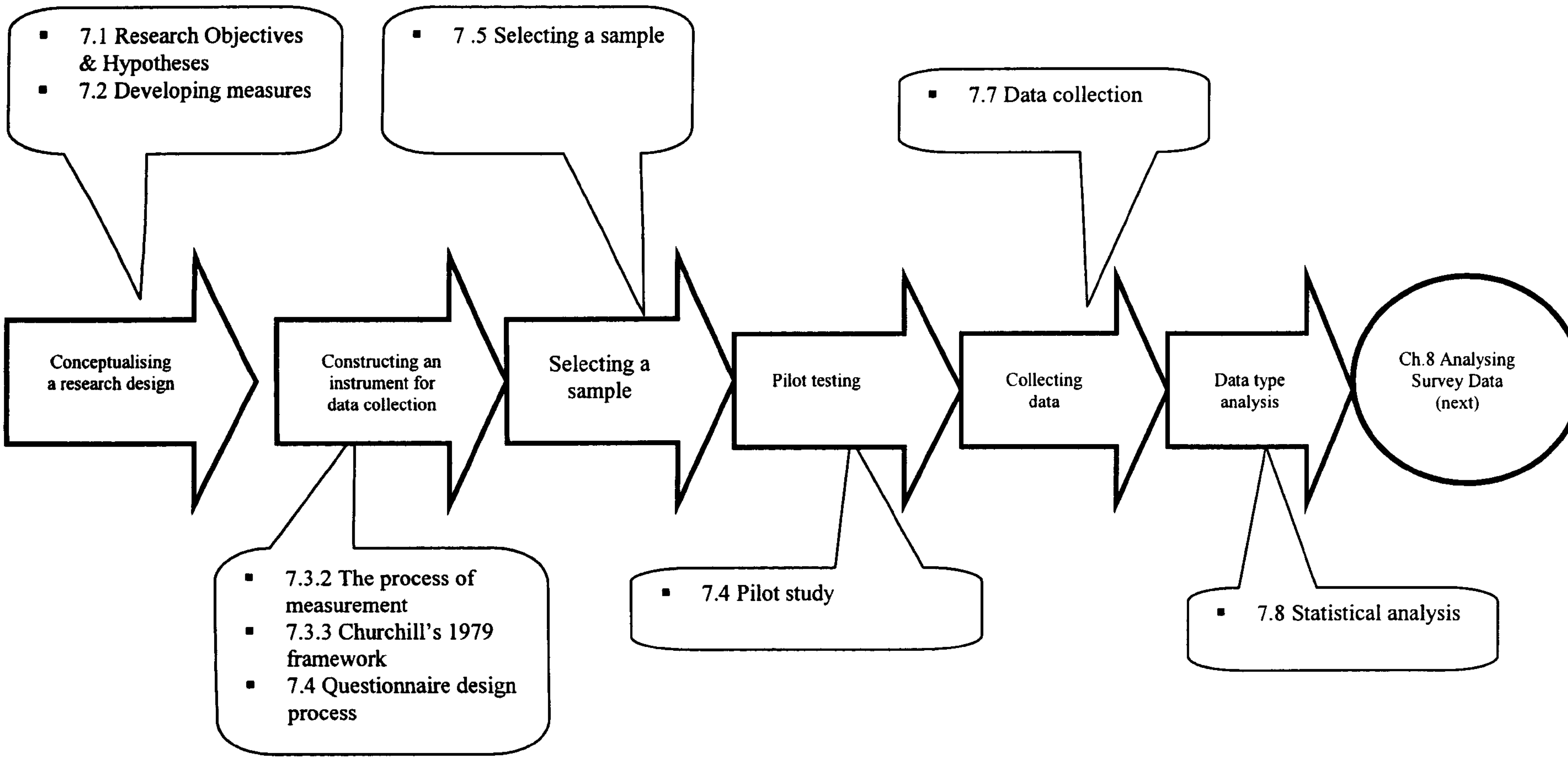
7.5.3 The questionnaire and the missing data or missing value

The research believes that missing data are due to different reasons:

- No doubt the questionnaire is long and there are many questions to cover. Accidentally, the respondent could have been distracted by a telephone call or other distractions.
- The sensitivity of this audit topic leaves the respondent with a dilemma that he/she does not incriminate his company or his auditors or bring any attention to his company in his eyes.

For a statistical analysis, this study follows the argument of Field (2001) that *"Just because we have missed out on some data we do have for a subject does not mean that we have to ignore the data we do have (although it sometimes creates statistical difficulties"* (p.24).

Figure 7.8 Summary of Research Design



CHAPTER EIGHT
EMPIRICAL DATA ANALYSIS

8.1 INTRODUCTION

In this chapter, the data collected is analysed and the auditor-client relationship quality conceptual framework (figure 6.6, chapter 6) is tested. Moreover, it explains the audit phenomenon through the four sections used in the questionnaire. The data collected from the fieldwork helps to finalise and draw conclusions about the study's model. Overall, this is intended to examine the degree to which this framework (auditor-client relationship) represents a real picture of the audit phenomenon, i.e., the fit of the model.

8.2 ANALYSIS OF SAMPLE CHARACTERISTICS, PROFILE OF RESPONDENTS, CLIENT RESPONSES AND NON-RESPONSES

8.2.1 Companies Size (Sales Turnover vs. Number of Employees)

Following the company act 1989, two criteria (sales turnover and number of employees) were used to determine the size of companies. However, it becomes apparent during the analysis of the data that a number of participating companies in this survey have fewer employees because of the nature of business activities they are involved in, i.e., such as investment/ financial companies. This criterion does not go along with their sales turnover. Therefore, it has been decided to use only the sales turnover as a determinant criterion of the size of the participating companies.

Table 8.1 Sales Turnover (size) of participating companies

Size /Characteristics		Size of the company	Frequency	Percent
Valid	£5.6m or less	small	10	15.4
	> £5.6m and < £22.8m	Medium	15	23.1
	£22.9m or more	Large	38	58.5
	Total	100.0	63	96.9
Missing	System		2	3.1
Total		65		100.0

8.2.2 Analysis of size association (Client Company vs. Audit Firm)

A cross-tabulation technique is used to test the degree of association between two variables (size of client company vs. size of audit firm). We are interested in examining the degree of association in term of size between these two variables. The table below illustrates the information relating to these two variables:

Table 8.2 Client Company vs. Audit Firm

Client Company Size (calculated in sales turnover)		Principal Auditors **(audit firm size)**				Total
		Big four	Large audit firm	Medium audit firm	Small audit firm	
Small	£5.6m or less	2	2	2	5	11
Med	> £5.6m and < £22.8m	8	1	4	3	16
Large	£22.9m or more	34	2	1	1	38
Total		44	5	7	9	65

The above information can be interpreted in this way:

Small vs. big four - As far as the small clients association with big or large firms is concerned, reveals a different scenario. The value of 2 represents the number of respondents out of 11 small companies (18.2%) which had used one of the four big audit firms. Therefore, it is to conclude small clients do use four big audit firms, as well as medium and large firms. However, there is a bigger proportion of small clients prefer to be audited by smaller audit firms as well as larger clients to be audited by large audit firms. In our sample, there are 5 out of 11 small companies, which represent 45.5%. One can argue that there are reasons why small companies are audited by larger audit firms:

- It might be that the audit firm can use a smaller client for training purposes for their junior staff.
- The job required by a small client is not that demanding and could constitute an extra earning for the firm.
- Another consideration is the smaller client, i.e., a limited company, is part of a group.

This raises another issue whether size of audit firm is related to the perceived service quality and auditors performance by bigger firms.

From the table 8.3, the Ch-Square Test provides statistical measures of the degree of association between the size of client company and the size of audit firm. In this case the Pearson Chi-Square measure is the appropriate one. By examining the Value (26.868[a]) and the Significance (*p* less than 0.001) this suggests that there is no chance of *no association*. The results show that in the sample employed here, there is a strong positive association between being a large company and using a larger audit firm.

Table 8.3 Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	26.868(a)	6	.000
Likelihood Ratio	26.772	6	.000
Linear-by-Linear Association	22.796	1	.000
N of Valid Cases	65		

a 8 cells (66.7%) have expected count less than 5. The minimum expected count is .85.

8.2.3 Size (Client Company vs. Duration)

It was the intention of the study to use cross-tabs to test the association between the size and the duration as depicted in the table below. The numbers in the cell are frequencies, i.e., a count of number of cases (small, medium and large client and duration with auditor. The statistical test will tell us whether there is a difference in time spent with the same auditors between the three types (sizes) of companies can be considered significant or not.

Table 8.4 Cross-tabulation of Sales Turnover & Time Spent with Auditors

(Size Client Company)		Time with Auditor (Duration) < 1 year	1 - 3 years	4 - 9 years	10 years or more	Total
Sales Turnover	£5.6m or less	0	1	4	6	11
	> £5.6m and < £22.8m	2	4	7	3	16
	£22.9m or more	1	3	18	15	37
Total		3	8	29	24	**64**

Table 8.5 Time spent with Auditors

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	< 1 year	3	4.6	4.7	4.7
	1 - 3 years	8	12.3	12.5	17.2
	4 - 9 years	29	44.6	45.3	62.5
	10 years or more	24	36.9	37.5	100.0
	Total	64	98.5	100.0	
Missing	System	1	1.5		
Total		65	100.0		

The study reveals some limitation by using a *cross-tab.* Generally speaking cross-tabs use (2x2), a classic form of data table for which the researcher calculates a 2 x 2 chi-square in order to discover whether there is an association between two variables ('2x2') because there are two rows and two columns in the table. Since we have (3x4) this has violated the general rule of applying X^2 advocated by Cochran (1954), who argues that no more than 20% of expected frequency cells should fall below 5. These rules out cross-tabs calculations where a single expected frequency cell is below 5. "*Low expected frequencies often occur where too few data have been collected in one of* *the rows or one of the columns"* as explained by Coolican (2004, p.410). Thus, in our frequency table we have already cells of ones, twos, threes and fours. Therefore, the study moves on to use an alternative test, i.e., a simple linear regression to test the association between these two variables.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.024(a)	.001	-.016	.827

a Predictors: (Constant), Sales Turnover

The regression model generated between the size of company client and the time spent with the same auditors, shows there is no relationship between these two variables.

Coefficients(a)

Model	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	T	Sig.
1 (Constant)	3.096	.341		9.071	.000
Size (sales turnover)	.025	.135	.024	.185	.854

a Dependent Variable: Time with Auditor

The model 1 above shows that the client company size measured by the sales turnover does not appear to explain the duration time with the same audit firm. In conclusion, the test reveals there is no evidence of any difference whether the client spent a short, medium or long-term with the same audit firm.

8.2.4 Respondents profile (occupation)

Chief Executive, Chairman, Company Secretary, Non-executive directors, Group Financial Director, Financial Director, Managing Director

Table 8.6 Position

	Function	Position	Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Management	Ch, CEO, C Sec,FC, FR	14	21.5	21.5	21.5
	Finance	GFD,FD,FM	27	41.5	41.5	63.1
	Accounting	GA,AD,Acc	12	18.5	18.5	81.5
	Managers/Directors	MD,D,M	9	13.8	13.8	95.4
	Unknown	Others	3	4.6	4.6	100.0
		Total	65	100.0	100.0	

3 completed questionnaires were returned but respondents did not reveal their identity, occupation or the name of their companies.

8.3 A MULTIPLE REGRESSION ANALYSIS – STEPWISE APPROACH -

It is deemed necessary to examine the data and make it more manageable by identifying the key factors, i.e., data reduction. In other words, it was felt necessary to run other tests which best fits the data. Therefore, the aim of this section is to identify and assess the determinants of relationship quality in the audit market and see what correlations can be substantiated. Then, a *multiple regression* adopting stepwise approach is used. This is a two stage analysis: building a mathematical model by identifying the key predictors and correlation analysis.

8.3.1 - Selecting regression methods and identifying model's predictors

Building and testing models that predict auditor-client relationship quality outcomes, it was decided to use predictors and enter them in the mathematical model. Thus, a number of mathematical models are available and care should be given in selecting these predictors. SPSS allow one to opt for a selection method. The forward, backward and stepwise methods all come under the general label of ***stepwise methods*** because they all rely on the computer selecting variables based on mathematical criteria. For the purpose of this study, the researcher decided to use the stepwise regression decisions as advocated by Field (2005, p.160):

> *"In the **forward** method, an initial model is defined that contains only the constant (bo). The computer then searches for the predictor (out of the ones available) that best predicts the outcome variable – it does this by selecting the predictor that has the highest simple correlation with the outcome. If this predictor significantly improves the ability of the model to predict the outcome, then this predictor is retained in the model and the computer search for a second predictor* (p.160).

Moreover, as this study aims at building and testing an exploratory model of auditor-client relationships, a stepwise method is more plausible as advocated by Wright and Royton (1997, p.181). This means that if there is an existing literature, where concepts have already been used in previous studies, it is to include any meaningful variables in the model of importance. Since the current study has already reviewed these theoretical concepts from existing literature (see chapters 2, 3, 4 and section 6.3 in chapter 6), the study will be based on these concepts which the study may refer to as (predictors, constructs, dimensions or variables).

SPSS 13.00 reveals that out of 14 dimensions depicted in the initial model, three constructs (trust, problem solving and communication) emerged as the major determinants as the following tables (coefficient table and model summary table) show:

Table 8.7 Coefficients [a]							
Model		Unstandardised Coefficient		Standardised Coefficient			
		B	Std. Error	Beta		t	Sig.
1	(Constant)	1.575	.304			5.185	.000
	Trust2	.662	.108	.626		6.120	.000
2	(Constant)	.824	.312			2.643	.011
	Trust2	.520	.099	.492		5.249	.000
	Pbsolv2	.299	.067	.421		4.490	.000
3	(Constant)	.292	.380			.811	.421
	Trust2	.450	.098	.425		4.588	.000
	Pbsolv2	.242	.067	.340		.3.607	.001
	Commun2	.347	.133	.251		2.617	.011

a. Dependent Variable: RelQual2

It is to note that the *stepwise* method in SPSS is the same as the forward method, except that each time a predictor is added to the equation, a removal test is made of any predictor which is no longer significant. As such the regression equation is constantly being reassessed to see whether any redundant predictors can be removed (Field, 2005, p.161).

The last column in the above table reveals that the statistical model-1, "trust" is the *best predictor* in one variable model; *trust* and *problem solving* are the best in two variable model.

The next table demonstrates how the variables are entered in the statistical models. *Pbsolv2* has a Sig = 0.000, i.e., $p<0.05$ and it is the smallest. Therefore, Pbsolv2 enters into the statistical model. In the second data subset 2, the lowest Sig is 0.011, i.e., $p<0.05$. Therefore, the second variable, *commun2*, is entered into the statistical model. However, in the third statistical model-3, all the variables are well above the threshold for entry. All variables (from rapport2, 0.950 to GovInt2, 0.930) are >>0.05. The next smallest is "confResol2" at 0.220. Therefore, at this stage these variables are excluded from our *Relationship Quality Equation Model:*

RelQual=0.292 + 0.450 *(trust)* + 0.242 *(Problem solving)* + 0.347 *(communication)*

$$\boxed{y = bo + b1x + b2x + b3x}$$

Where, y is relationship quality between auditors and client; *bo* is constant and *b1* is coefficient. This means that RelQual2 increases by 0.450 for every 1-unit increase in "trust", the other two variables remaining constant.

Table 8.8 Excluded Variables[d]

Model		Beta In	T	Sig.	Partial Correlation	Collinearity Statistics Tolerance
1	rapport2	.041(a)	.375	.709	.050	.902
	Coop2a	.336(a)	3.397	.001	.410	.904
	Commun2	.364(a)	3.644	.001	.435	.866
	Pbsolv2	.421(a)	4.490	.000	.511	.897
	ClientSat2	-.001(a)	-.005	.996	-.001	.923
	Commitm2	.353(a)	3.278	.002	.398	.772
	ServQual2	.187(a)	1.493	.141	.194	.655
	AudPerfor2	.097(a)	.868	.389	.114	.836
	ConfRes2	.221(a)	2.108	.039	.269	.898
	AudSwit2	.060(a)	.582	.563	.077	.995
	AudSelec2	.091(a)	.857	.395	.113	.934
	GovInt2	-.007(a)	-.067	.947	-.009	.965
2	rapport2	.045(b)	.475	.637	.063	.902
	Coop2a	.127(b)	1.076	.286	.142	.564
	Commun2	.251(b)	2.617	.011	.330	.774
	ClientSat2	.015(b)	.158	.875	.021	.921
	Commitm2	.203(b)	1.877	.066	.243	.645
	ServQual2	.073(b)	.639	.525	.085	.617
	AudPerfor2	.057(b)	.577	.566	.077	.829
	ConfRes2	.167(b)	1.801	.077	.234	.882
	AudSwit2	-.012(b)	-.129	.898	-.017	.963
	AudSelec2	.015(b)	.160	.874	.021	.902
	GovInt2	-.047(b)	-.518	.607	-.069	.955
3	rapport2	-.006(c)	-.063	.950	-.009	.860
	Coop2a	.032(c)	.262	.794	.035	.500
	ClientSat2	-.066(c)	-.710	.481	-.095	.826
	Commitm2	.118(c)	1.047	.299	.140	.559
	ServQual2	.039((c)	.358	.722	.048	.608
	AudPerfor2	-.025(c)	-.253	.802	-.034	.741
	ConfRes2	.115(c)	1.241	.220	.165	.826
	AudSwit2	-.036(c)	-.412	.682	-.055	.952
	AudSelec2	.014(c)	.160	.873	.022	.902
	GovInt2	-.008(c)	-.088	.930	-.012	.926

a Predictors in the Model: (Constant), Trust2
b Predictors in the Model: (Constant), Trust2, Pbsolv2
c Predictors in the Model: (Constant), Trust2, Pbsolv2, Commun2
d Dependent Variable: RelQual2

One can conclude that by using the "stepwise" regression only three main variables (*trust*, *problem solving* and *communications*) are identified at this stage and represent the key determinants of relationship quality for auditors-client relationships. The remaining variables, i.e., study constructs are not all included in the statistical models. Therefore, the researcher is to re-examine the remaining **"excluded variables"** from the mathematical models to determine whether:

- these variables do not explain on their own right their association with the relationship quality or,
- these variables entered explain *similar* aspects of the relationship quality.

Before we move to analyse the remaining variables and their contribution to the auditor-client relationship quality model, let us summarise the findings up to now. One way to do it is by examining the statistical model provided by the SPSS in the following table:

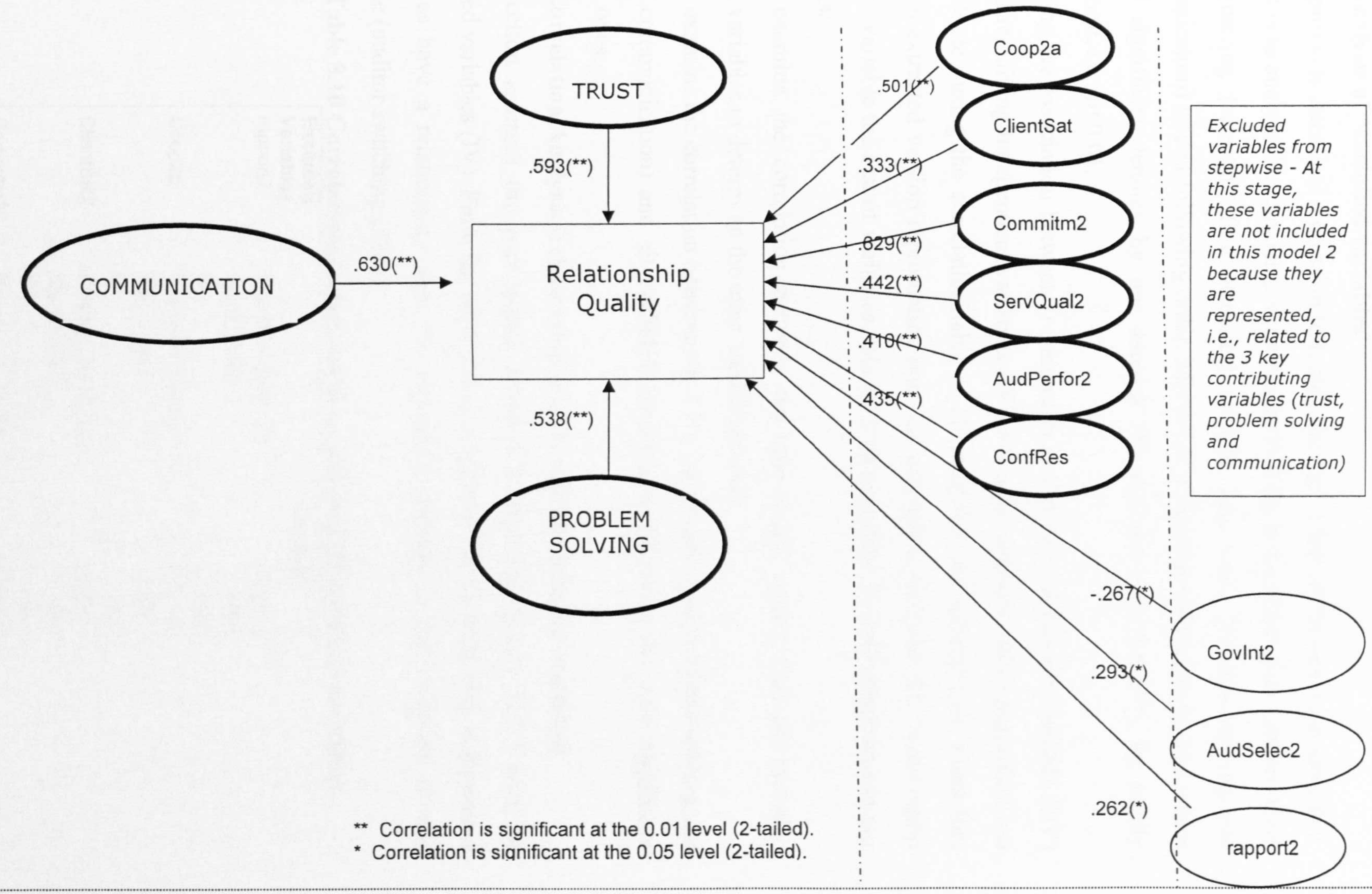
Table 8.9 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.626(a)	.392	.382	.53476
2	.742(b)	.551	.535	.46363
3	.775(c)	.600	.579	.44153

a Predictors: (Constant), Trust2
b Predictors: (Constant), Trust2, Pbsolv2
c Predictors: (Constant), Trust2, Pbsolv2, Commun2

R square (r^2=0.600) means that 60% of the variation in the auditor-client relationship quality is explained by this mathematical model, i.e., by the three key constructs (trust, problem solving and communication). At this point one can argue that 40% remain unexplained, i.e., which were excluded in stage 1 (see excluded variables in the statistical model 3, table 8.9). At this point of analysis, the researcher is aware that the independent variables are highly intercorrelated (figure 8.5) and these procedures used in the stepwise selection do not guarantee provision of the *best* subset in an absolute sense. This has been clearly highlighted by SPSS Application Guide (1999, p.216). Therefore, for the remaining analysis, the researcher relies on his own judgement and personal interpretation in step 2 and step 3, where the association may not be clearly obvious to the reader.

Figure 8.1 **Evolving Model of Auditor-Client Relationship Quality**



** Correlation is significant at the 0.01 level (2-tailed).
* Correlation is significant at the 0.05 level (2-tailed).

proach

8.3.2 Analysis of "excluded variables"

In the previous statistical regression test, only the first 3 key predictors were identified. Now, it is to analyse the remaining variables by looking at the correlation between them after entering (selecting first statistical models, i.e., trust, problem solving and communication) in this following order. Moreover, a Pearson correlation is used where $p<0.05$ significant denotes by one asterisk (*) and two asterisks (**) for highly significant, i.e., $p<0.01$.

Analysing the association between (relationship quality) as a dependent variable (DV) with all remaining independent variables (IV), a simple statistical linear regression has been adopted using the correlation table of all variables (see appendix 6). From that table, an extracted version representing only the correlation between the "*relationship quality*" variable the rest of variables, this we lead us to take the following steps in our analysis:

- examine the correlation between the relationship quality and all excluded variables to determine the most significant ones.
- examine the correlation between the 3 key constructs (trust, problem solving and communication) and all excluded variables to determine the most significant ones.

8.3.3 Correlation Analysis (relationship quality and all excluded variables)

This section assesses the correlations between relationship quality (DV) with all excluded variables (IV). From the table below, it appears that the following independent variables have a relationship with the dependent variable to the exception of one variable (auditor switching client).

Table 8.10 Correlations (relationship quality and all excluded variables)

Excluded Variables		RelQual2
rapport2	Pearson Correlation	.262(*)
	Sig. (2-tailed)	.036
	N	64
Coop2a	Pearson Correlation	.501(**)
	Sig. (2-tailed)	.000
	N	64
ClientSat2	Pearson Correlation	.333(**)
	Sig. (2-tailed)	.007
	N	64
Commitm2	Pearson Correlation	.629(**)
	Sig. (2-tailed)	.000
	N	65
ServQual2	Pearson Correlation	.442(**)
	Sig. (2-tailed)	.000
	N	65

AudPerfor2	Pearson Correlation	**.410(**)**
	Sig. (2-tailed)	.001
	N	64
ConfRes2	Pearson Correlation	**.435(**)**
	Sig. (2-tailed)	.000
	N	64
AudSwit2	Pearson Correlation	.123
	Sig. (2-tailed)	.336
	N	63
AudSelec2	Pearson Correlation	.293(*)
	Sig. (2-tailed)	.019
	N	64
GovInt2	Pearson Correlation	-.267(*)
	Sig. (2-tailed)	.031
	N	65

** Correlation is significant at the 0.01 level (2-tailed).
* Correlation is significant at the 0.05 level (2-tailed).

The first column in the table 8.10 taken from the correlations table (Appendix 6) shows that **all variables** included in this study, except ***"AudtSwit2"*** (p=0.336), have significant correlation with "RelQual2". From a methodological perspective, this demonstrates that the study has followed a proper scientific enquiry where constructs are based on theoretical foundations and care has been taken by the researcher to apply the 1979 Churchill's Model of developing measures for marketing constructs (detailed explanation is presented in research methodology chapter). Now, it is to distinguish between the variables, which have the most significant association with the relationship quality from the ones, which have less significance.

It is worth noting reiterating that the purpose of this section is to measure the associations between variables (study constructs). Thus, statistical correlations have been analysed. The researcher is aware that when carrying this type of analysis (measures of associations), tests of causality are generally not required. However, to provide a meaningful picture and clarity to the subject under investigation, causality tests have been used.

As mentioned previously in chapter 2, there have been a lot of criticisms and how to restore the public confidence in the audit market, some challengers argue that auditors should be changed by their clients every couple of years. However, most of respondents disagree where $p=0.336$. This clearly shows that rotating audit firms or client changing their auditors does not increase the quality of the audit services. In another words, auditors are professionals and carry out their job accordingly whether it is a new or existing client. Here, one has to check whether the duration is reciprocally related to the quality of their relationship.

When testing the "relationship quality" construct against all excluded variables, the multiple-regression, in the table below, reveals that the adjusted R square (0.363) explains the auditor-client relationship quality by 36.3%. However of the 10 excluded variables only *conflict resolution* and *commitment* appear to be highly statistically significant in influencing the relationship quality.

Model Summary (b)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.677(a)	.459	.363	.55402

a Predictors: (Constant), AudSelec2, ClientSat2, rapport2, ConfRes2, Coop2a, AudSwit2, ServQual2, Commitm2, AudPerfor2
b Dependent Variable: RelQual2

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	1.884	.297		6.336	.000
	Commitm2	.492	.096	.556	5.140	.000
2	(Constant)	1.590	.310		5.133	.000
	Commitm2	.422	.096	.477	4.390	.000
	ConfRes2	.185	.075	.267	2.455	.017

a. Dependent Variable: RelQual2

Therefore, our *Relationship Quality Equation Model,* involving all excluded variables will be represented in this form: y =1.590 + 0.422 *(commitment)* + 0.185 *(conflict resolution)*. Where, y is relationship quality between auditors and client; *bo* is constant and *b1* is coefficient. This means that RelQual2 increases by 1.590 for every 1-unit increase in "trust", while the other variable remains constant.

8.3.4 Correlations (Trust, Problem Solving and Communication vs. all excluded variables)

Again by using stepwise approach, two further mathematical models emerged: *cooperation, commitment* and *conflict resolution.* However, one has to be aware of *overfitting,* i.e., including too many variables in the final model. To remedy this situation, the researcher has decided through the filtering process to use as "cut-off" point, i.e., $R \geq 0.4$ i.e., weak but positive relation as depicted in fig 8.2 strength and direction of relationship.

Table 8.11 Correlations

		Trust2	Pbsolv2	Commun2
rapport2	Pearson Correlation	.330(**)	.110	.324(**)
	Sig. (2-tailed)	.008	.385	.009
	N	64	64	63
Coop2a	Pearson Correlation	.359(**)	.647(**)	.533(**)
	Sig. (2-tailed)	.004	.000	.000
	N	64	64	63
ClientSat2	Pearson Correlation	.302(*)	.026	.472(**)
	Sig. (2-tailed)	.015	.838	.000
	N	64	64	63
Commitm2	Pearson Correlation	.526(**)	.458(**)	.623(**)
	Sig. (2-tailed)	.000	.000	.000
	N	65	65	64
ServQual2	Pearson Correlation	.625(**)	.340(**)	.409(**)
	Sig. (2-tailed)	.000	.006	.001
	N	65	65	64
AudPerfor2	Pearson Correlation	.470(**)	.109	.539(**)
	Sig. (2-tailed)	.000	.391	.000
	N	64	64	63
ConfRes2	Pearson Correlation	.326(**)	.227	.393(**)
	Sig. (2-tailed)	.009	.072	.001
	N	64	64	63
AudSwit2	Pearson Correlation	.105	.208	.202
	Sig. (2-tailed)	.414	.101	.115
	N	63	63	62
AudSelec2	Pearson Correlation	.316(*)	.260(*)	.220
	Sig. (2-tailed)	.011	.038	.083
	N	64	64	63
GovInt2	Pearson Correlation	-.217	.026	-.303(*)
	Sig. (2-tailed)	.082	.837	.015
	N	65	65	64

** Correlation is significant at the 0.01 level (2-tailed).
* Correlation is significant at the 0.05 level (2-tailed).

From the above table, two further tables are drawn depicting the measure of association between the variables (the study's constructs). The first table shows the association between the three key constructs which emerged in the step1 (trust, problem solving and communication) and the ones which scored high in their association with these 3 constructs. By comparing the 3 key constructs with the remaining excluded variables. Three other variables showed a positive score of correlation which is significant at the 0.01 level. These variables are cooperation, commitment and service quality.

Table 8.12 Measure of association between variables, which are statistically significant

	Trust	Problem solving	Communication
Cooperation	0.359	0.647	0.533
Commitment	0.526	0.458	0.623
Service quality	0.625	0.340	0.409

** Correlation is significant at the 0.01 level (2-tailed).

The general rule applied here is: a value close to +1 indicates a strong positive association, a value close to -1 indicate a strong negative association whilst a value close to zero indicate no association. From the above, all value show a positive association. The researcher, then, has decided to apply the "cut-off point" of 0.4. For example let us examine the association between cooperation as well as commitment and trust.

- The value of 0.359 between cooperation and trust suggests a weak positive association between these two variables.
- The value of 0.526 between commitment and trust suggest a strong positive association with the two variables.

By filtering down the excluded variables and their association with 3 key constructs, *commitment* and *service quality* are retained. It emerges that problem solving (variable) does not have a very weak association with other excluded variables, which are statistically significant at 0.01 level, i.e., one asterisk (*).Thus, by removing "problem solving", *auditor performance* scored a moderate positive with a correlation coefficient of 0.470 with trust and a strong positive association with communication (see table 8.14 below).

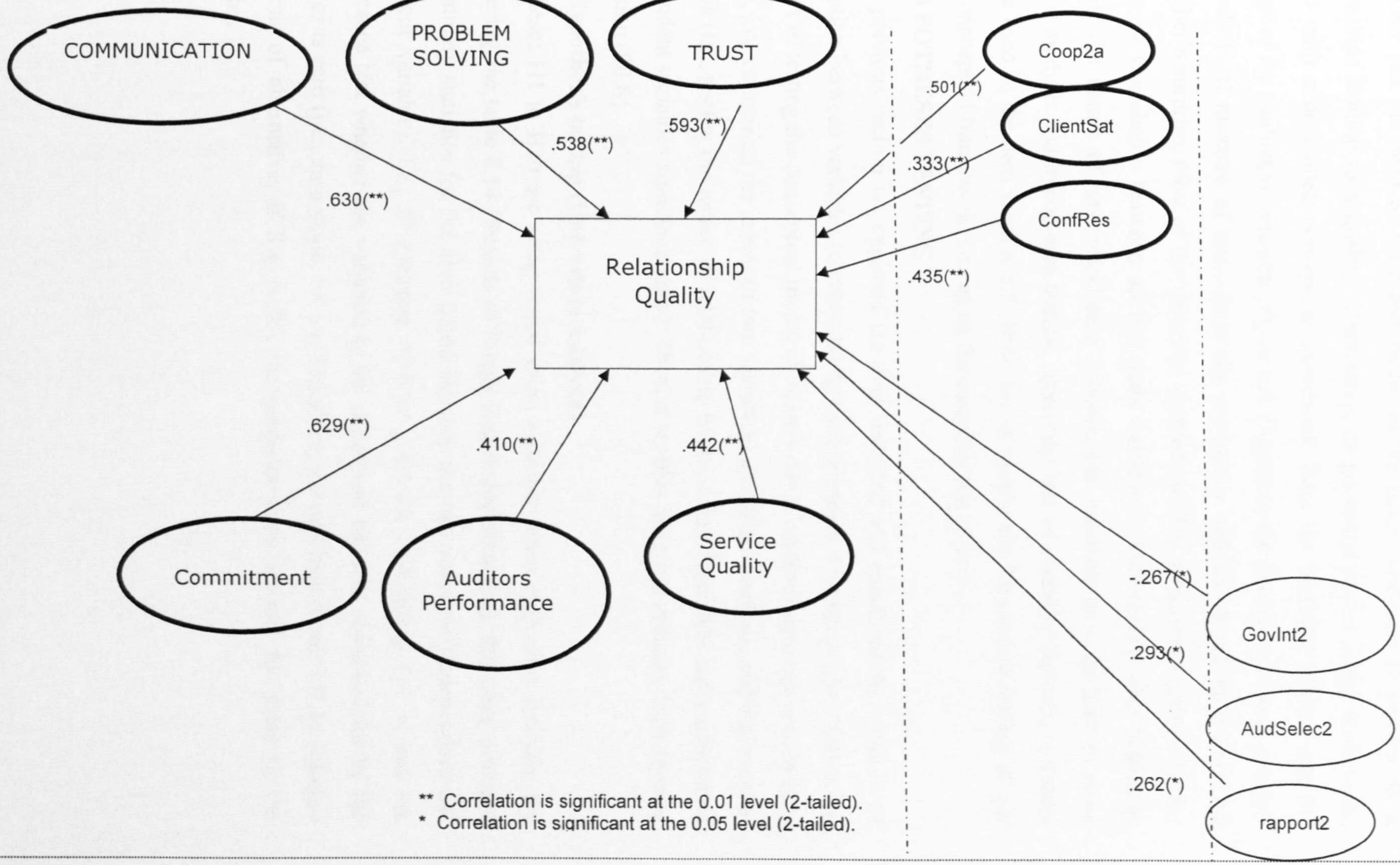
Table 8.13 Measure of association between variables, which are statistically significant after exclusion of problem solving

	Trust	Problem solving	Communication
Rapport	0.330	NA	0.324
Audit Performance	0.470	NA	0.539
Conflict resolution	0.326	NA	0.393

** Correlation is significant at the 0.01 level (2-tailed).

From the above two tables (8.12 and 8.13), the researcher has decided to retain the constructs (variables which have scored a high association). At this stage, variables such as *commitment*, *service quality* and *auditor performance.* Rapport and conflict resolution were not selected because their correlation coefficient is below the set "cut-off point". So the evolving model number two is presented below.

Figure 8.2 Evolving Model-2 of Auditor-Client Relationship Quality



** Correlation is significant at the 0.01 level (2-tailed).
* Correlation is significant at the 0.05 level (2-tailed).

Summary – Section 8.4 has focused on the data reduction by applying stepwise approach and measure of association (Pearson correlation). From the data collected, the researcher felt the need to filter and focus on the main constructs of auditor-client relationships leading to a quality relationship, as generated in the initial framework. Armed with a developed conceptual framework from the literature review and the findings of the qualitative research (figure 6.6, chapter 6) the intension is to see whether the analysis of measure of association can produce a well developed model. To the researcher's surprise, most of the variables showed positive correlations (Appendix 6 - Results of Correlation between all the study variables). This section also helped to examine the nature of any association between the variables as a prelude to more rigorous analysis and hypotheses testing, where the test of causality between variables will be used in the next section 8.5. Now, let us turn to the hypotheses testing of our initial conceptual framework, i.e., using the causality test (t-test).

8.4 HYPOTHESES TESTING

In the previous section we explored the data collected and examined the measure of association between variables (constructs) by using Pearson correlation. As a follow-up and part of testing the conceptual model of auditor-client relationships, this section uses a *t*-test, i.e., comparing the means of two variables (univariate analysis) and multivariate analysis (i.e., testing the nature of relationship between one dependent and a number of independent variables simultaneously). Thus, it enables us to use ordinary least squares regression (OLS).

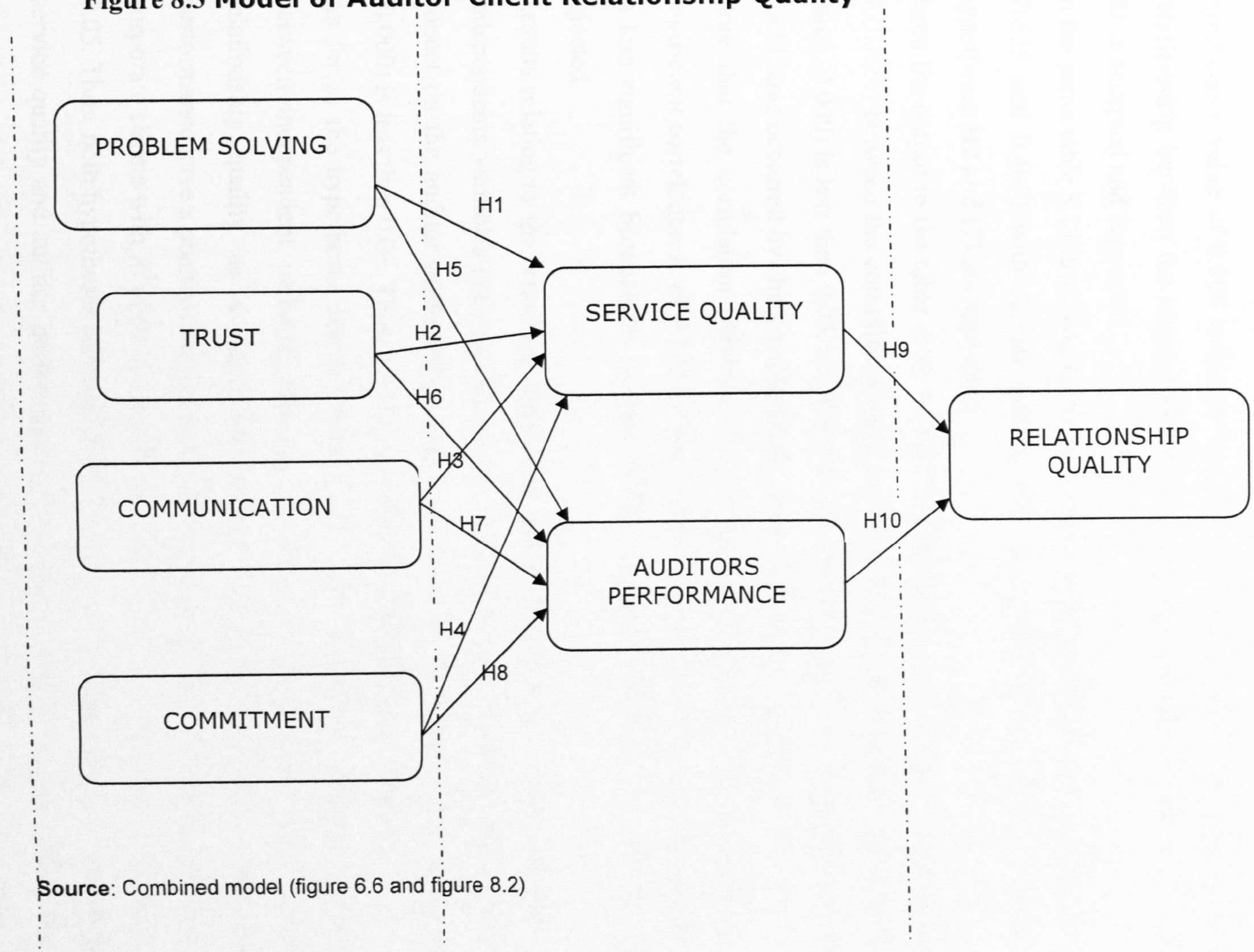
8.4.1 Hypothesis testing (Univariate Analysis)

Hypotheses Hl to H10 are being tested using a simple linear regression analysis. By considering the table 8.14 (Results of Single Regression Analysis). this table provides the summary statistics for the association between the two variables (independent and dependent variable), i.e., R^2 measure of how good the best fitting line is and the significance test whether the variation in the dependent variable accounted for by the predictor is zero (i.e., zero slope, $b1=o$). Therefore, the null hypothesis will be rejected in favour of alternative, if Sig <0.05, the predictor does account for some of the variation.

Table 8.14 Results of Hypotheses Testing

	Model Summary					Coefficients(a)						
Hypothesis	Dependent Variable	R	R Square (R^2)	Adjusted R Square	Std. Error of the Estimate	Independent Variable	Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.	Hypothesis supported Yes/ No
H1	Service Quality	0.340	0.116	0.102	0.60411	(constant)	1.534	0.313		4.903	0.000	
						Problem Solving	0.231	0.081	0.340	2.870	0.006	Yes
H2	Service Quality	0.625	0.391	0.381	0.50124	(constant)	0.785	0.262		2.994	0.004	
						Trust	0.592	0.093	0.625	6.362	0.000	Yes
H3	Service Quality	0.409	0.167	0.154	0.57428	(constant)	1.103	0.371		2.972	0.004	
						Communication	0.473	0.134	0.409	3.527	0.001	Yes
H4	Service Quality	0.424	0.179	0.166	0.58189	(constant)	1.444	0.269		5.370	0.000	
						Commitment	0.320	0.086	0.424	3.712	0.000	Yes
H5	Auditor Performance	0.109	0.012	-0.004	0.74214	(constant)	2.515	0.392		6.417	0.000	
						Problem Solving	0.087	0.101	0.109	0.865	0.391	No
H6	Auditor Performance	0.470	0.221	0.208	0.65916	(constant)	1.408	0.353		3.994	0.000	
						Trust	0.521	0.125	0.470	4.188	0.000	Yes
H7	Auditor Performance	0.539	0.291	0.279	0.62848	(constant)	0.737	0.426		1.729	0.089	
						Communication	0.766	0.153	0.539	5.003	0.000	Yes
H8	Auditor Performance	0.592	0.350	0.340	0.60182	(constant)	1.218	0.291		4.183	0.000	
						Commitment	0.537	0.093	0.592	5.781	0.000	Yes
H9	Relationship Quality	0.442	0.195	0.183	0.66442	(constant)	2.138	0.324		6.595	0.000	
						Service Quality	0.510	0.130	0.442	3.912	0.000	Yes
H10	Relationship Quality	0.410	0.168	0.155	0.66203	(constant)	2.251	0.331		6.803	0.000	
						Auditor Performance	0.399	0.113	0.410	3.544	0.001	Yes

Figure 8.3 Model of Auditor-Client Relationship Quality



Source: Combined model (figure 6.6 and figure 8.2)

Testing the hypothesis whether *H1 "the greater the problem solving in the relationship, the higher the service quality"*, it is using the t-test to test for zero slope. By examining the R^2 variation column and the *significance* (Sig.) column, both reveal that the significance value of 0.006 indicates that there is a 0.006 chance of **no straight line relationship** between the average *problem solving* and the *service quality.* Therefore **H1** is accepted and supported.

In the same table 8.14, trust and communication display significant positive correlations (0.625 and 0.409) with service quality with *(p<0.000)* and *(p<0.001)*. Thus, both hypotheses **H2** and **H3** are supported.

From the output in the table 8.14, we can see that there is a significant correlation with *R* (0.424) between the commitment and service quality. It is significant because the *p*-value (0.000) is less than 0.05, i.e., there is less than one chance in twenty that the result could have occurred by chance. Therefore, **H4** is retained and supported.

Note that the correlation obtained for the hypothesis H5 is weak positive with a coefficient correlation *R* of 0.109 between problem solving and auditor performance. It is less significant because the *p*-value (0.391) is greater than 0.05. Therefore, **H5** is rejected.

Results relating to the remaining hypotheses (**H6, H7 and H8**) in table 8.14 show that independents variables such as trust, communication and commitment have a positive impact on the auditor performance with *R* of (0.470; 0.539 and 0.592) and p-value (0.000) is less than 0.05. Thus, hypotheses (**H6, H7 and H8**) are supported.

As far as the hypotheses **H9** and **H10**, their test results show a positive correlation between independent variables (service quality and auditor performance) with the relationship quality as a dependent variable. The service quality and auditor performance have a positive impact on the relationship quality between auditor and their corporate clients with R^2 of (0.195 and 0.168) and p-value (0.000 and 0.001) is less than 0.05. Thus, both hypotheses (**H9 and H10**) are supported. This leads us to conclude that service quality and auditor performance are regarded as *mediating variables* between (problem solving, trust, communication and commitment) with the relationship quality. While problem solving has a positive contribution to the relationship quality with a Pearson correlation of (0.538**) (see correlation table) but it does not have a strong linkage to auditor performance. This indicates both constructs are important for a relationship quality but do not link with each other.

Amongst all hypotheses tested, only H5 is not supported and rejected. Therefore, model 8.3 evolves again and becomes 8.4. The table 8.14 illustrating results of tested hypotheses is presented.

At this point, we can conclude with certainty that the variables such as (problem solving, trust, communication and commitment) constitute the key elements of *auditor-client working relationship* as depicted in the conceptual framework and the above tests. However, the *mediating variables* (service quality and auditors' performance) have partially explained the linkage between the auditor-client working relationship elements and the relationship quality. Therefore, a multiple regression analysis is deemed necessary and presented in the next section 8.5.2.

8.4.2 Hypothesis testing (Multivariate Analysis)

As mentioned previously, this section intends to use Ordinarily Least Squares (OLS) regression. We are to hypothesise the following functions:

- Service quality=*f* (problem solving, trust communication, commitment)
- Auditors performance =*f* (problem solving, trust communication, commitment)

A multiple regression analysis of these two functions can be taken using SPSS. In this regression analysis we are trying to fit a predictive model to our data and use the model to predict values of the dependent variable (DV) from one or more independent variables (IVs). Simple regression seeks to predict an outcome from a single predictor whereas multiple regressions seek to predict an outcome from several predictors. As advocated by (Field, 2005), this analysis labels "independent variables" as ***predictors***, and the "dependent variable" as the ***outcome***.

a) The analysis of the first function indicates that 41.3 per cent of the variation in the dependent variable (service quality) can be explained by the variations in the independent variables, i.e., 58.7 per cent is due to 'something-else' not included in the model.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.643(a)	.413	.373	.49414

a Predictors: (Constant), Commitm2, Pbsolv2, Trust2, Commun2

Moreover, the following table ANOVA (Analysis of Variance) explains the overall variance in the model. It shows that at least one of the predictor is significant contributor to the model.

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	10.144	4	2.536	10.386	.000[a]
	Residual	14.406	59	.244		
	Total	24.550	63			

a. Predictors: (Constant), Commitm2, Pbsolv2, Trust2, Commun2

b. Dependent Variable: ServQual2

The following table provides estimates of the nature of relationship between the dependent variable (service quality) and each independent variable (*B* or Beta coefficient) as well as the level of significance associated with each of the independent variables (*t*-statistics and significance value).

The *B* coefficient of 0.461 indicates a positive relationship between *service quality* and *trust* within our sample. Furthermore, the Sig. value of 0.000 indicates that the contribution of trust is highly significant. The chance of being wrong is 0.0005

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.327	.368		.888	.378
	Pbsolv2	.105	.075	.158	1.396	.168
	Commun2	.124	.151	.107	.821	.415
	Trust2	.461	.113	.490	4.064	.000
	Commitm2	.024	.105	.033	.232	.817

a. Dependent Variable: ServQual2

To sum up, we explain the content of the above tables:

- In the Model Summary table, the value of r is the positive square root of R square. The score of **R square** is 0.413 i.e., 41.3 % of the variation in service quality is explained by the above model ($y = 0.327 + 0.461x$), where Trust emerged as the most significant variable. One can notice that a multiple regression was turned to a single one by coincidence. It was not the intention of the researcher.
- In conclusion, one can say this is true and supported earlier when **H2** was tested (see table 8.14 Results of Hypotheses Testing), Therefore, service quality multi-regression function turns out to be a single regression, where $y = 0.327 + 0.461$*(trust)*.

Let us turn to the second function, i.e., auditors' performance function, i.e, Auditors' performance = *f* (problem solving, trust communication, commitment).

In this second equation we are trying to predict auditors' performance on the basis of their scores on several other variables, i.e. to predict the level of auditors' performance on the basis of contribution of problem solving, trust, communication and commitment).

b) The analysis of the second function is explained through three tables (Model Summary, ANOVA Table and Coefficient Table). In the table below, the *R Square* value tells us that our model accounts for 46.6% of variance in the auditors 'performance. This is a moderate model.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.683(a)	.466	.430	.55912

a Predictors: (Constant), Commitm2, Pbsolv2, Trust2, Commun2

The second table reposts on ANOVA, which assess the overall significance of our model. As *p <0.005 our model is significant.*

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	15.848	4	3.962	12.674	.000[a]
	Residual	18.132	58	.313		
	Total	33.980	62			

a. Predictors: (Constant), Commitm2, Pbsolv2, Trust2, Commun2

b. Dependent Variable: AudPerfor2

In this final table, we examine Beta (standardised regression coefficients). This beta value is a measure of how strongly each predictor variable influences the criterion variable, i.e., the beta is measured in units of standard deviation.

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.660	.436		1.513	.136
	Pbsolv2	-.173	.085	-.218	-2.027	.047
	Commun2	.404	.173	.284	2.341	.023
	Trust2	.198	.128	.176	1.541	.129
	Commitm2	.390	.119	.434	3.280	.002

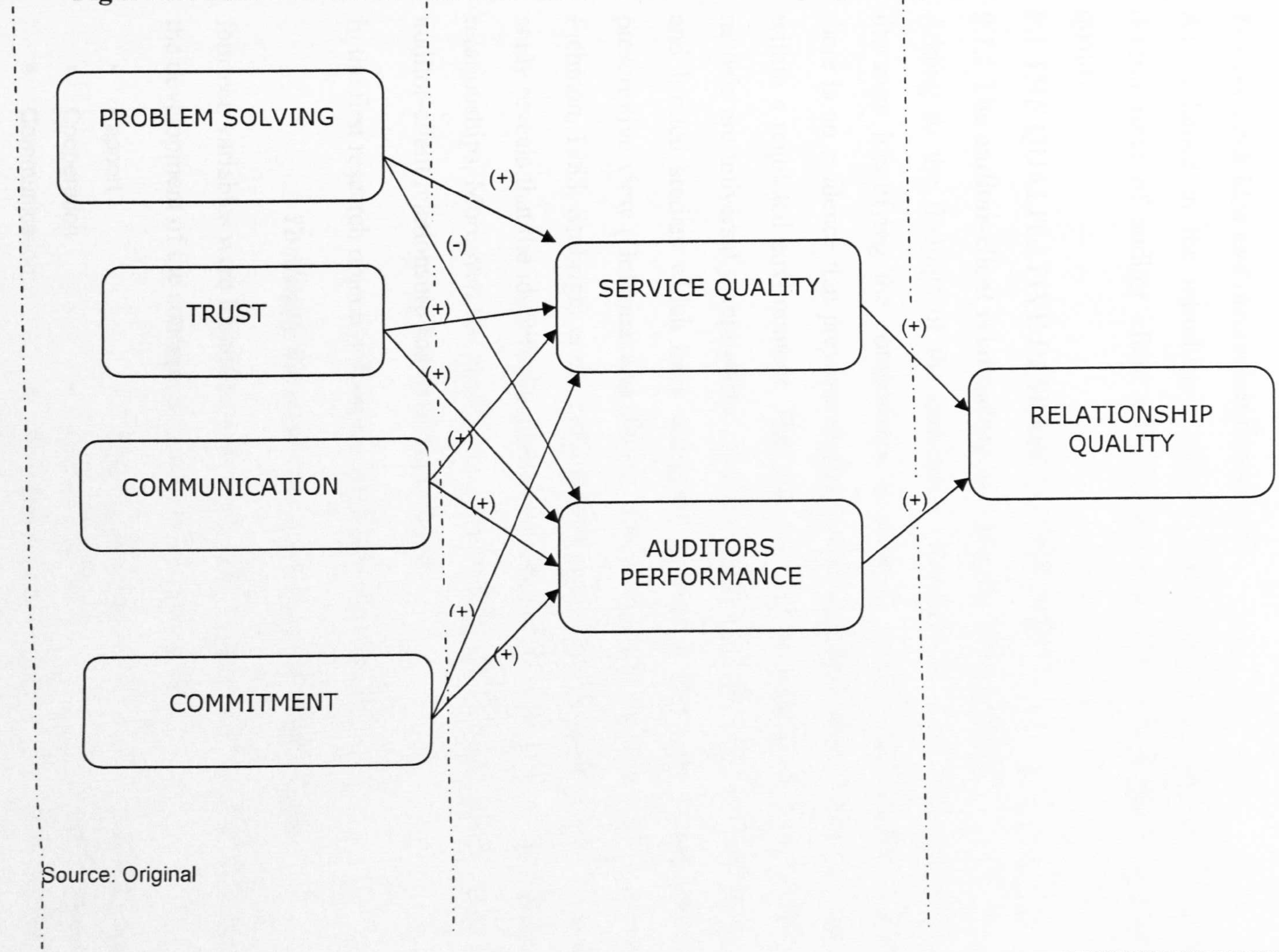
a. Dependent Variable: AudPerfor2

In this final table, the Standardised Beta Coefficients give a measure of contribution of each variable to our model. Trust emerges as a less significant predictor variable with a value of 0.129 (Sig.). The remaining variables (Pbsol2, Commun2 and Commitm2) appear to have more influence on the auditors' performance. Commitment (Beta value of 0.434) and communication (Beta value of 0.284) account for a fairly large percentage of variation in auditors' performance. In this multiple regression, we can simply say that commitment to the relationship and high level of communication between the auditors and their client, will give rise to the auditors' performance.

However, problem solving emerges as negative, i.e., Beta value of -0.218meaning one unit rise in the problem solving yields to a decline of -0.218 in the auditors' performance. Common sense tells us, any increase in problem solving in the client company by their auditors should lead to high performance of their auditors. This negative relationship can be explained by the fact auditors are supposed to be seen impartial and independent when they carry out their audit job. Moreover, a positive relationship would have shown a cosy relationship between auditors and their client, which the accountancy profession and the public (investors) do not like to see.

After the use of both multiple regressions, the final model of auditor-client relationship will take this form as shown in figure 8.4.

Figure 8.4 Final Model of Auditor-Client Relationship Quality



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CHAPTER NINE
CONCLUSIONS AND IMPLICATIONS

9.0 INTRODUCTION

The research idea and theoretical framework

As explained in the introductory chapter, the aim of the study is to explore the determinants of auditor client relationships and their contributions to relationship quality.

9.1 THE QUALITATIVE RESEARCH FINDINGS

9.1.1 The auditor-client relationship development framework

Adding to the findings of the qualitative investigation, there is a growing body of literature identifying the components of business relationships (B2B). Nevertheless, there is no evidence that previous studies have highlighted these business relationships within a regulated environment. Thus, there is still no agreement whether the existing models are universally applicable. In terms of audit-client relationships, there are few and limited studies which have attempted to explore the audit phenomenon from a prescriptive view (Goldman and Barlev, 19974; Nichols and Price, 1976; Levithal and Fichman, 1988; Seabright et al., 1992 and Kleinman and Palmon, 2002). This empirical study reveals that the identified constructs (elements) are important in the auditor-client relationships. Moreover, the quality in a relationship is vital to successful outcomes. The auditor-client relationship has three main stages.

In the first research objective from the qualitative investigation,

To identify the elements of auditor-client relationships,

fourteen variables were identified and analysed in chapter 6. These were key elements in the development of the conceptual framework (figure 6.6).

- Rapport
- Cooperation
- Communication
- Problem solving
- Satisfaction
- Selection of auditors
- Conflict resolution
- Government intervention
- Changing auditors
- Auditors' performance
- Service quality
- Commitment
- Trust

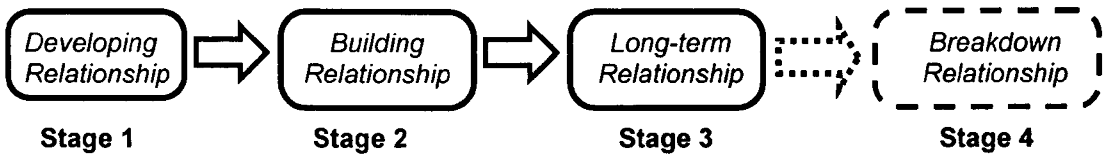
Now, these elements are reflected on when addressing the research objective two:

To explore and evaluate:

- *The development of relationship elements through stages*
- *What makes auditor- client relationship enduring?*
- *What are the external factors influencing the relationship?*

From the qualitative analysis, four stages of auditor-client relationships emerged and presented in figure 9.1.

Figure 9.1 Stages of Auditor-Client Relationships



Source: Original

Stage One – *Developing Relationships* - As with all professional services, new clients are obtained by referrals (company solicitors, banks, etc.), by personal initiation or networking. Previous studies have referred to this as pre-stage (Guemmesson, 1979), the initial stage (Gronroos, 1980) or the pre-relationship phase (Ford, 1980 and Halinen, 1997). Establishing a relationship is not clearly defined because of its legal requirement, the company have to have their accounts audited by a qualified accountant (auditor). Moreover, these accountants either from client firm or auditors from audit firms are well known in their own circle, i.e., accountancy profession are a people business. It is very difficult to put a time scale on the relationship – the audit relationship exists since the creation of a company as a limited entity and continues to do so. Therefore, this establishing relation can be part of the relationship development as defined earlier, i.e., initial stage or pre-relationship. The auditors activities can be referred to as "tell the client what you are good at".

Stage two - This second stage is *building relationships.* This stage can be referred to as the involvement phase (Yorke, 1990) or the constant phase (Halinen, 1997). In a new business situation it can be characterised as when the auditors try to show its client what the audit firm or the whole accountancy firm is capable of and where it excels, i.e., "Do what you are good at it". Contacts are frequent and depend on the learning process, the size of the client as well the need requirement of the client firm. The level of communication increases in order to maintain an open dialogue and problem solving whenever it is required. This is an opportunity to cross-sell other non-audit services. Regular contacts and client visits helps to increase the level of trust within the client firm.

Stage three - is the *long-term relationship stage*, i.e., the relationship is here to stay. Some clients and auditors do not know when the relationship started – 20-30 years. When the company was founded, current staffs were not there. The continuity of staff is seen as an important factor in the success of the relationship. Audit staff who started at a junior level will progress to audit manager or senior partner and are always familiar with the business as well as having a personal relationship. This stage has no equivalence in the exiting business models. Communication at the senior level is seen as a primordial but at the lower level, relationship disturbance is reduced to a minimum, i.e., audit team makes sure that junior staff do not upset the relationship or go around asking unfamiliar questions. The audit work is planned and agreed between the two parties and surprises are avoided. At this stage, commitment and trust are seen as key factors to a successful relationship. Non-audit services can be used to help the client to perform as well as problem solving.

Finally, **stage four** - *relationship breakdown* is not really a proper stage since it is not expected from the client firm to change their auditors every second year or five years. There have been calls to rotate senior audit partners to restore public confidence and show auditors are independent. Moreover, if a company starts changing its auditors, questions will be asked in the City and might lose the confidence of its investors, shareholders, etc. However, there are various reasons when auditors are changed but this is not strictly speaking a management decision. Amongst the reasons are company takeover, merger with another firm, ceased to trade and company size becoming too big for an audit firm with limited resources.

Referring to relationship development stages, it should be noted that respondents are never aware of other stages occurring between establishing, developing and long-term stage. As it has been confirmed in previous study (Beloucif et al., 2004) it is not easy to have a specific delimitation between the stages and their time span. Nevertheless, these stages are vital in auditor-client relationships. Based on these observations, this current research has explored how a quality relationship between auditors and clients is built within the context of business-to-business relationships. The constructs and their contribution to the interaction with relationship quality were expressed as hypotheses for testing (see chapter seven and eight).

The third research objectives were:

To examine the implication of a close relationship

Addressing this research objective, the qualitative findings reveal that the relationship has been developed at the personality level between the audit partner and the audit manager and the chief executive of the client. Moreover, *keeping in* *touch* is one way to maintain relationships and plays an important factor in relationship disturbance. This concept closely interacts with the dialogue element. Therefore, *regular contacts* are used to keep a dialogue open and consequently produce close relationships at the top level of management in both sides. This has a tendency to conclude that statutory and working relationships are based on personal and professional relationship. Also, people background is related to personal familiarity, i.e., auditors and financial directors do have similar accounting training. Some of them are recruited by either side i.e. financial director was an auditor with the same audit firm before joining the client management.

The qualitative analysis has demonstrated how *rapport* is very important not only for establishing and developing the relationship, but also in building and maintaining it. In this case, some members in the client company believed that it would be damaging to the company reputation if it is not happy with the kind of auditors and might give a warning to the client. When it comes to the non-audit services, clients do not want to be seen buying all services (audit and advisory services) from the same firm. As a big company, it is better to be seen buying other services from different firms. Somehow they are showing or promoting their auditors' independence. This is one way to avoid public scrutiny and avoid suspicion or scandal. Moreover, the whole picture touches the image of the quality of service. In another case, one of the matching relationships between auditor and his client highlighted the closeness existing between auditor and his client in acquiring companies and transferring the audit job to them.

In another situation, the analysis has outlined matching the relationship as well the closeness of external auditor and internal auditor. There is continuity at the top level. An audit manager known to the client replaces retired partner. This shows that the turnover of staff does not affect the continuity of the relationship.

As far as audit planning is concerned there are a number of people involved such as the financial director, internal auditor, external auditors, audit committee and chief executive. This requires a good communication system. However, disagreement occurs from time to time and is resolved by dialogue and negotiation. The disagreement is defined by the client as an internal problem of communication due the close involvement in preparing and carrying out the audit work, i.e.; external auditors do rely on some reports produced by internal auditors. The internal auditor and his staff draft the audit plan and put it under a continuous review through the whole year despite the external audit taking only three months. While preparing the audit plan, a number of elements are taken into consideration: (1) assessment of the risk to the company, (2) risk causing changes within the organisation and (4) actions and reflections.

External auditors put pressure on the management to be open and disclose information to the shareholders and the users of accounts. Management seems not to have any problem with it, since both agree after dialogue and negotiation about the materiality audit. i.e., auditors make sure that the shareholders interests are protected when it comes to a disclosure of information as notes in small print in the accounts. Finally, clients proclaim and praise themselves for having an audit committee and apply the Cadbury recommendations.

External auditors are aware of directors' pressures. They recognise the difficulty of working with the management and reporting to the shareholders who do not have any intimate relationships. However, auditors have to balance between their independence and business philosophy, i.e., client-centred.

> *"We might be put under pressure by the directors really to agree to an accounting policy that we feel is a bit suspect a bit dodgy. Now, at the end of the day we have our reputation to protect. If we are seen going along with something that is not generally acceptable. That puts our reputation at risk. So we have to stand back from that. That is why in the large firm there are usually two or three partners involved. So that the partner who is directly in contact with the directors has some safety net or some consultation procedure to go through. So that the firm as a whole is protecting its interests"* (Case 4).

There is a tension to get a balance between the short term pressure and the long term objectives of the firm which are in terms of maintaining its position within the marketplace and being seen as reputable quality and market leader.

Having looked at the key issues of closeness between auditors and their client, it is time to turn to the fourth research objective and examine how to deal with the public scrutiny. Therefore, the fourth research objective was set as:

To critically examine how to restore public confidence.

In order to address this research objective, a model (figure 2.4) based on a systems approach was developed from the critical review of the accountancy profession in chapter two. Based on this model, marketing recommendations to restore public confidence are presented in the next section 9.2.

9.2 MARKETING RECOMMENDATIONS TO RESTORE PUBLIC CONFIDENCE

Based on the analysis of the accountancy profession in chapter two, this section examines the marketing recommendations to restore public confidence. One can argue that the loss of public confidence is a marketing problem and a marketing approach is required to solve the problem. A poor image can occur in one of two ways. One way is where there is a fundamental problem with the `product'. If this is the case then the product must be improved to meet the demand of the market and its customers or, alternatively, replaced by a better product. In this case the product is auditing services. The second way a poor image occurs is a failure to communicate the benefits of the service in the right way or to the right audience. If this is the problem then more transparency and better communication is required to the appropriate audience. To redress the balance, it is recommended that those responsible for auditing services focus on the three main marketing issues; strategic vision, a marketing implementation plan and a focus on quality.

9.2.1 Strategic vision

The strategic vision must centre on a need to establish the integrity of the audit as an essential service in its own right. From our review of the literature there seems to be a general consensus on this point but a lack of clarity about how this can be done and who can do it? One approach is that individual firms can take on this task through tactical product launches. For example, Coopers & Lybrand launched "Positive Audit" in 1987 which intended to persuade clients of the "added value" flowing from Coopers' audit. Other firms have attempted similar initiatives. The big firms have tried to use external communication and re-branding to effectively market themselves (Haigh, 2000). However, there is a need for others in the process – government, auditors, clients and others to act in a more cohesive way.

Over the long term a campaign initiative by the big firms does appear the most feasible solution, i.e., only a major organisation has the authority and influence to mount a campaign of this sort on behalf of the profession. DiPiazza and Eccles (2002) produced a report for PwC on how to build public trust. They argued that restoring public trust requires that firms should embrace and live by three core concepts: a spirit of transparency, a culture of accountability and people of integrity. A similar approach to achieve the same result is through a major firm restructuring the big four. The advantage of a major firm conducting the campaign would be the resources available, the quick decision-making on strategy and messages and the likelihood of a world perspective. Whoever takes up the challenge, it is urgently needed but the problem of cooperation is unlikely to meet with widespread approval.

Perhaps a more likely scenario is for the associations to conduct such a campaign. It would have the authority it requires, at least within its domestic market and should avoid mistakes of the past. An example of the traditional disdain for the public occurred when a money programme titled *"Question of Profits"* broadcast on BBC2 (1991), the profession declined to appear on the programme to answer questions related to the collapse of companies. Bruce (1991) commented on this programme, which criticised financial reporting: *"if the profession was to retain his confidence then it had better look sharp about it, the profession might have been expected to relish the chance of getting its side of the story across. But it did not... In their view (public) the profession had a fair bit of explaining to do and was perfectly capable of doing so. The problem was that it did not seem to think that explanation were important-... The chance to show the positive side of the profession to over a million viewers was shunned by the majority of those asked to contribute"* (p. 54).

The first problem in a coherent strategic vision is that there must be commitment to it. This means that all parties must subscribe to the belief in the integrity of the audit to be transparent, honest and as objective as possible.

9.2.2 Marketing Implementation Plan

Belief, expressed in a strategic vision is important but to avoid this being mere empty rhetoric managers must make this vision a reality. Following Normann, 1991 a service delivery system, is recommended, whose core ideas are:

- Segmentation and specialisation (see also, Haigh, 1992). There are simply too many accountancy firms, large and small, chasing the same business, claiming that any auditor can audit any client whatever sector. There has been a growing recognition by medium-sized firms that sector specialism is a way to provide a very competitive service to clients and to widen profit margins. To achieve this effectively requires that those clients with similar characteristics can be grouped to form a 'target market' that audit firms can satisfy by providing a combination of industry and sector knowledge that others cannot match.
- The service concept. Perhaps, despite being a long established and core service concept, the audit profession have failed to embrace the service concept which incorporates both the tangible and intangible characteristics consisting of core and peripheral activities and processes features. Some of these can be measured and specific (explicit) while the others may be equally or more important but are imprecise (implicit). An example may elucidate. For example advice on

international exchange for a small firm whether to hold dollars, euros or sterling would be considered out with the remit of the auditor but should not deter those with experience of the sector to advise without commitment, on best practice. Likewise, an assessment on stock turnover rates could be an indication of good management to financial stakeholders as well as the management of the firm.

- Service delivery system. Vital in the audit process is the personnel involved but often the customer is also a co-producer and the support activities, the auditors themselves and any manager/partner involvement can facilitate the interface between the parties. Good standards, procedures and people combine to deliver on what is expected at `the moments of truth' when provider and client interact.
- The image. Recently, accountancy firms have developed an appreciation of marketing tools and are using tailored brochures, advertising and direct marketing techniques. However, some still consider marketing to be unethical. Haigh's prediction that *"by the end of 1990s such attitudes will be gone for good. I believe that public perception will have improved towards audit and accountancy-related services and that more specialised competition will increase the need for a marketing culture from top to bottom of the profession"* (Haigh, 1992, p.44) is only partly fulfilled and this problem is not entirely solved. Others (Lordan, 2002; Daugherty, 2003; Temple, 2003 Stone, 2005 and Schoenberg, 2005) advocate the use of PR and strategic planning when responding to a crisis.
- The culture and philosophy. This embraces the total package the client receives and this forms into a relationship over time.

9.2.3 Quality

The British Government has been encouraging a debate between stakeholders (representatives of auditors, investors, business and regulatory bodies) and set up an Audit Quality Forum where its purpose is to encourage stakeholders to work together by promoting open and constructive dialogue in order to contribute to the work of government and regulatory and by generating practical ideas for further enhancing confidence in the independent audit (DTI, 2007).

In a service offering this means an alignment of client's expectation with the actual service experienced and vice versa. It is influenced by the client's perception of value. This has at a basic level a price tag, at another level a competitive dimension but there is also value in the behavioural component and the idea of adding value by delivering above expectations and providing an ability to contribute towards the operational and strategic objectives of the client firm.

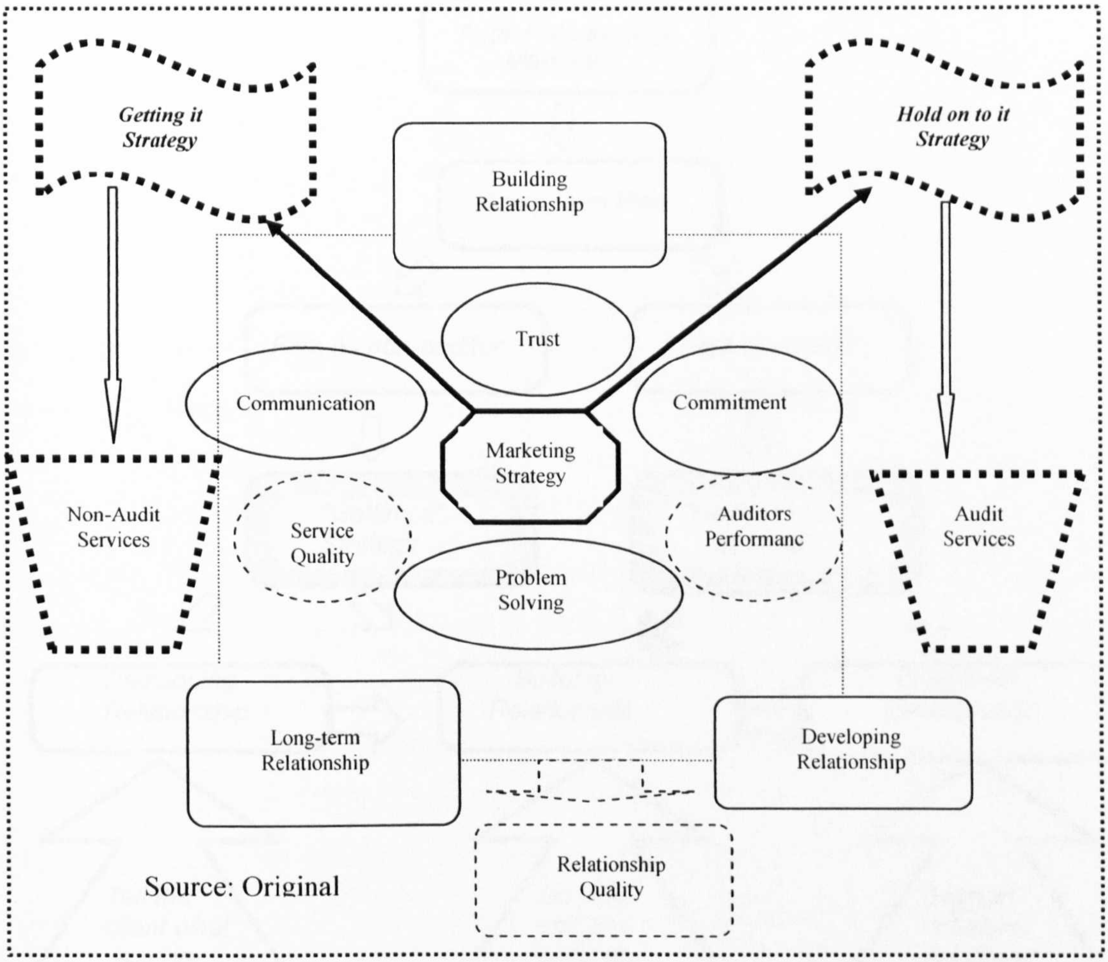
Academics, as advocates for change, have been looking at the audit phenomenon in a socio-political context. Thus, they argue that the auditing profession's dominant influence on auditing regulations must be replaced. The auditing standards and audit objectives need to be formulated by bodies independent of the accountancy profession and the Department of Trade and Industry. This would result in socially acceptable audit objectives being agreed (Sikka et al., 1999). However, the government has not pushed to replace the self-regulated body but has favoured the recommendations from CGAA for a single accountancy regulator (DTI, 2003).

Finally the government believe that changes have been introduced. *"Our approach has been measured and proportionate but we have been tough where we needed. Today's announcement puts our corporate governance structures amongst the best in the world for the good of the millions of pensioners, saver and business that depend on them"* (DTI, 2003). However, the government has been warned that any new break-up of one or more accounting firms would have a repercussion on the world stage and the regulatory bodies must seriously consider the issues of competition and consumer choice because further consolidation or collapse of a Big Firm would have serious implication for choice and in the UK audit market (Oxera, 2006 and McMeeking, 2007).

9.3 UNDERSTANDING THE MARKETING STRATEGY USED BY AUDITORS

There are two evolving models emerging from the integrative process (model 9.2a and Model 9.2b). There are two types of strategies and their target markets. The first strategy *"getting it strategy"* is aimed at clients who are not audited by the firm yet. The second marketing strategy *"hold on to it"* is aimed at the exiting clients who are already audited by the audit firm. These two strategies are explained and graphically represented in figures 9.2a and 9.2b:

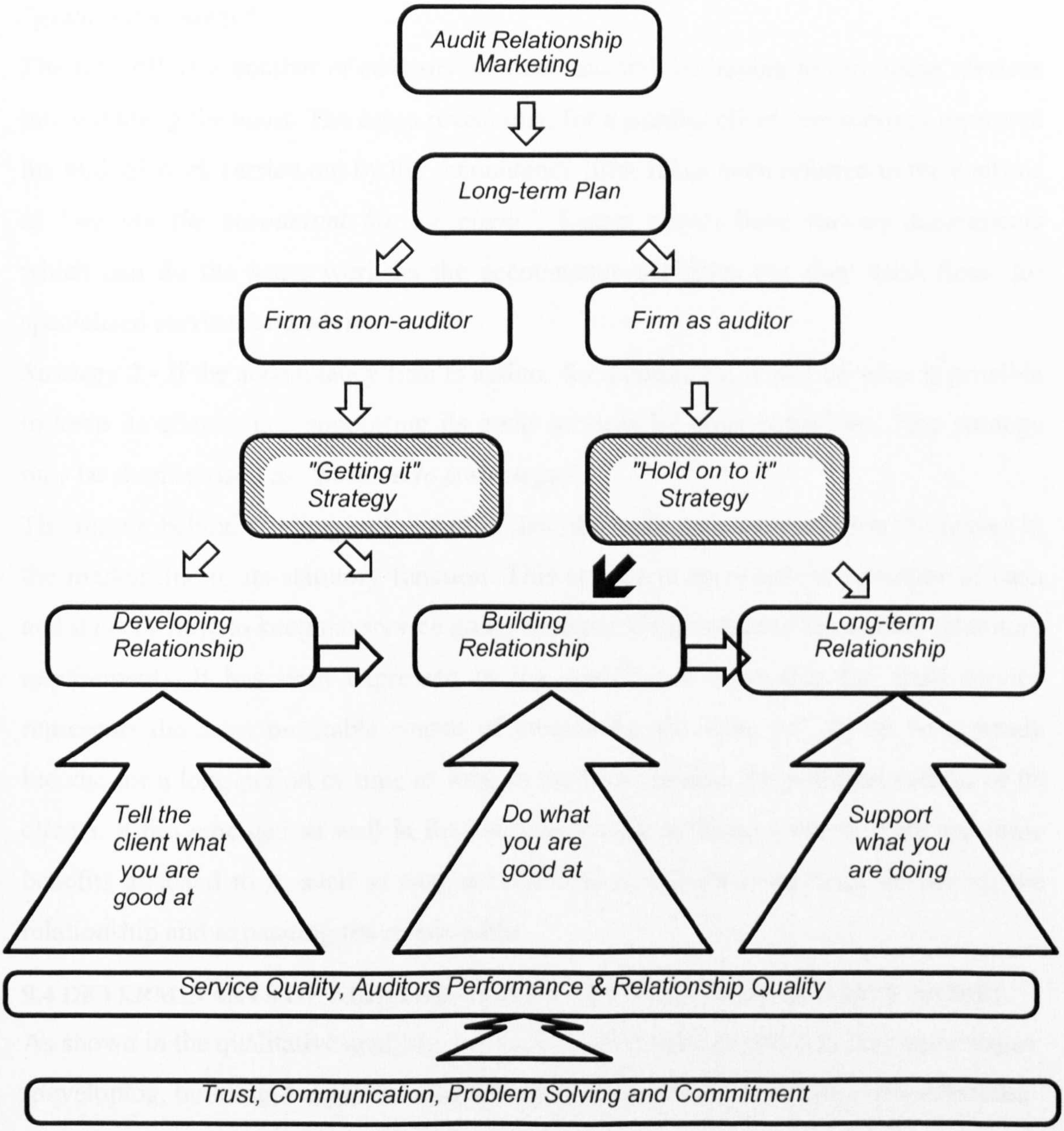
Figure 9.2a - A Marketing Strategy for Auditors



Source: Original

From the analysis, it emerges that accountancy firm's objective is to have a secure income by providing a portfolio of services. In the accountancy market, audit service appears to be the *"bread and butter"*, due to its statutory function. However, the accountancy firm has to work hard and compete to have it. The model is presented in figure 9.2b.

Figure 9.2b: Relationship Marketing Strategy for an Auditor



Source: Original

Strategy.1 - If the accountancy firm is not appointed as auditors for a potential client, it works towards obtaining it. This point is expressed through all cases. The following quotation from auditor in case 1 is to confirm it.

> *"They are always selling themselves. But, they may not be trying to sell their audit capacity; they may be trying to sell other particular skills. And I am not naive to think that this is **a sprat to catch the mackerel** in fact to get us on the hook with taxation, or management consultancy or whatever computer expertise. What matters is at the end of the day is to sell the whole service"* (case 1).

So to achieve this, the audit firm needs a marketing strategy which is a long term strategy, i.e., go out there and look for potential audit clients. This is well reflected in the activities of accountancy firm such as organising clients' evening (gathering firm's clients and potential clients from the same industry). This can be characterised as *"getting it strategy"*.

The firm offers a number of advisory services and will be hoping to turn these services into obtaining the audit. The cases reveal that, for a smaller client, the services represent the bulk of work carried out by the accountancy firm. It has been referred in the analysis as *"we are the accountant for the client"*. Larger clients have various departments which can do the same work as the accountancy activities but they need firms for specialised services and advice.

Strategy 2 **-** If the accountancy firm is auditor for a company, it will do what is possible to keep its clients, i.e., supporting its audit services by other capacities. This strategy may be characterised as *"**hold on to it strategy**"*.

The reason behind holding on to audit is that, the audit service represents the leader in the market due to its statutory function. This service is an excellent generator of cash and it needs little to keep the service going because of the nature of the market (statutory requirement). It has been expressed in the analysis of cases that the audit service represents the most profitable source of income for the firm, i.e., it can be a steady income for a long-period of time as long as the firm remains the principal auditor of its clients. It has emerged as well in the analysis that by auditing a client, there are some benefits attached to it, such as easy accessibility to sell other services, deepening the relationship and expanding the relationship.

9.4 DETERMINANTS OF AUDITOR-CLIENT RELATIONHSIP QUALITY MODEL

As shown in the qualitative analysis, the auditor-client relationship has four main stages (developing, building, long-term relationship and breakdown). The main characteristics of each stage were identified and its key components and characteristics were discussed in the qualitative study. After developing a conceptual framework (figure 6.6), the study moved to test it by addressing two quantitative research objectives and 10 hypotheses:

Research Objective One -

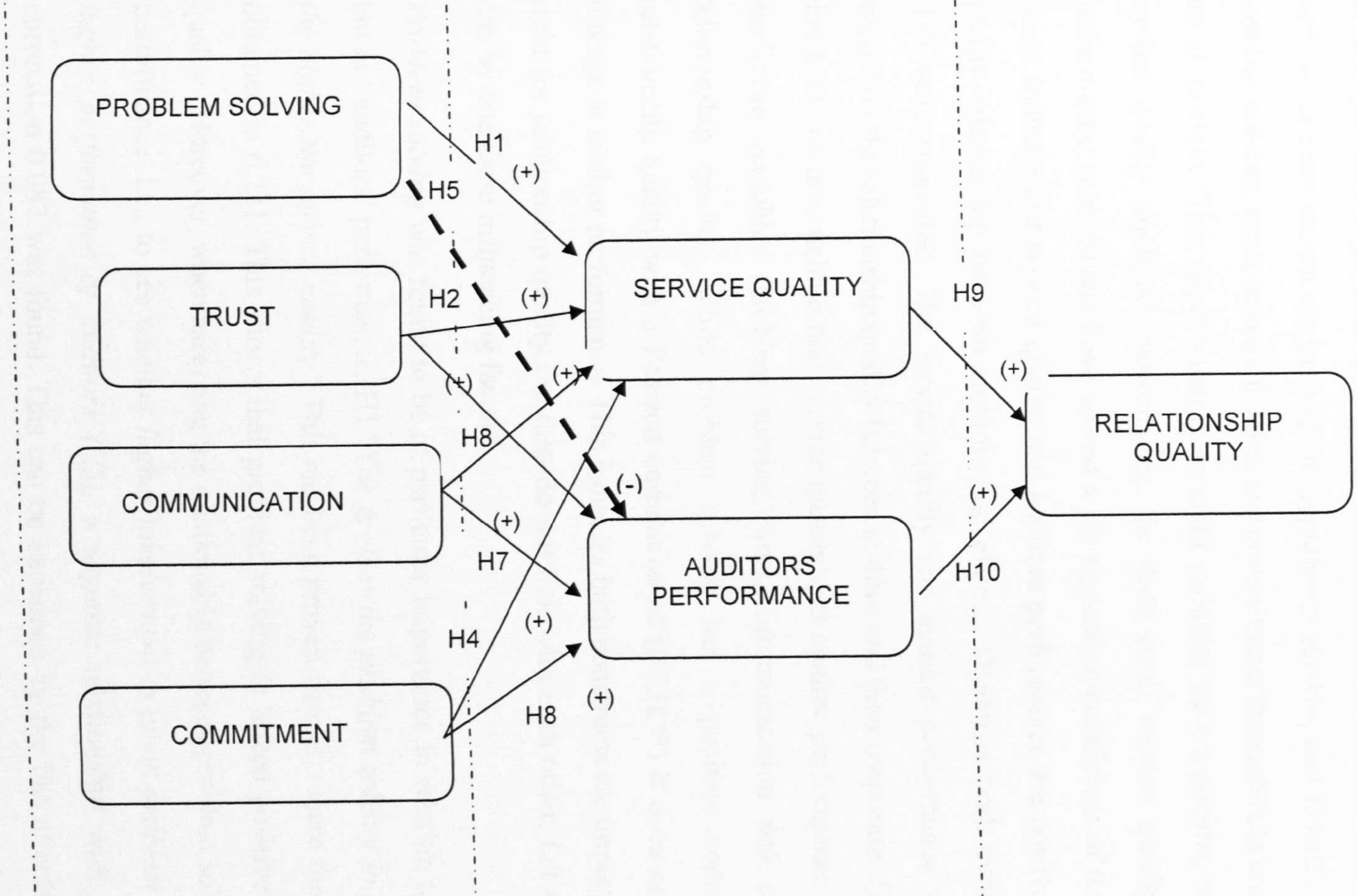
- *To critically assess how problem solving, trust, communication and commitment work as components in enhancing service quality and consequentially build a quality relationship between auditors and corporate clients.*

Research Objective Two -

- *To examine empirically how problem solving, trust, communication work as components in enhancing auditors' performance and consequentially build a quality relationship between auditors and corporate clients.*

Thus, a final model of auditor-client relationship quality evolved and presented in the next figure 9.3 and reproduce in the next page.

Figure 9.3 Model of Auditor-Client Relationship Quality



Source: Original

It is evident that quality relationships are developed with the existence of six basic elements; problem solving, trust, communication, commitment, service quality and service provider's performance. The importance of service quality and auditors' performance are shown respectively in hypotheses H1-H4; and H5-H8. Their link with problem solving, trust, communication and commitment through beta coefficients scores are all positive. This implies that these eight variables have a positive relationship with service quality auditors' performance. In their turn, service quality and auditors performance; respectively have scored a *(B)* regression coefficient of 0.510 and 0.399). These indicate that service quality and auditors performance are positively linked with quality relationship between auditors and clients. Therefore both hypotheses H9 and H10 were supported. The service quality and auditor performance have a positive impact on the relationship quality between auditor and their corporate clients. Moreover, this leads us to conclude that service quality and auditor performance are regarded as *mediating variables* (problem solving, trust, communication and commitment) in relationship quality. While problem solving has a positive contribution to the relationship quality with a Pearson correlation of (0.538**) it does not have a strong linkage to auditor performance. This indicates both constructs are important in their own right for relationship quality but they do not link with each other. Let us now examine one by one these influencing factors.

Problem solving was found to be of particular importance in relation to service quality but not auditors' performance. H1 "*The greater the problem solving in the relationship, the higher the service quality*" This has been proven correct, where the beta coefficient obtained is 0.231. This shows that problem solving is linked positively to the service quality. Moreover, when assessing the relationship between problem solving and auditor performance, i.e., to see whether *higher involvement in client problem solving leads to higher performance of auditors (H5),* a negative relationship with a score of beta correlation 0.087 was found. This can be explained by the fact clients responses were geared towards avoiding any negative publicity or anything showing them having a cosy relationship with their auditors and especially after the collapse of big corporations. It is understandable that clients do not want to admit that auditors come in before audit and under the cover of consultancy and advise clients how to report transactions, i.e., agreeing on creative accounting techniques and the same auditors will comeback and audit the account as it was revealed in the qualitative findings. Avoiding any information leading to a situation crisis, it helps also their auditors to appear impartial and independent.

Trust appears to be especially important when uncertainty and risk are present and warranties absent - as in the case with many professional services. The continuity of the relationship depends on the trust in the service provider (audit firm). One believes that: *The greater the trust in the audit firm, the higher the service quality provided by an audit firm (H5).*

However, as mentioned in the qualitative findings the relationship is there to stay and is not expected to change every year. This will attract the attention of investors in the City and might face drastic consequences. It is not in the interest of client firm to change their auditors every year or two years. Nevertheless, the continuity is expressed in terms of people and especially senior management. Trust is found positively related to both service quality and auditors performance. Auditors are perceived by clients as qualified accountants, capable of carrying out their job and understand client business. This includes a number of items the client looks for in their auditors; auditors are expected to demonstrate flexible attitudes towards their clients, i.e., by understanding their circumstances. As one client reported to the researcher off the record that – we agree with auditors if we run into a bad year that it was a bad business if there are well known external circumstance and we show good improvement with some results in the following year. Moreover, auditors are expected to be more proactive as well as respond quickly to their client requests and demands. This leads to demonstrate that *the greater the trust in the audit firm, the higher the audit firm performance is (H6).* Moreover, clients always expect a consistency to feel secure and trusted. This means that clients rely on their auditors' performance and also rely on the organisation's integrity and have confidence in them because the level of past performance has been consistently satisfactory. Relationship marketing theory proposes that relational factors are principal antecedents to positive relationship outcomes (Ganesan, 1998 and Morgan and Hunt, 1994).

Communication – The third hypothesis relates to the fact, the stronger the communication effectiveness in the relationship, the greater the service quality perceived by the clients (H3). Therefore, assessing this construct was mainly based on items generated from the preliminary qualitative research, where clients expect open dialogue with their auditors and continuity of staff as seen in the other concept (trust). One can ask an important question in terms of how effective communications are developed between auditors and clients. The answer is based on the extent of work involved between auditors and client staffs. Moreover, the courtship is important in building and maintaining a quality relationship. As noted in qualitative research findings, regular contacts are used with existing clients not only for audit work but also for the sale of non-audit services. This indicates that *the stronger the communication effectiveness in the relationship, the greater auditors' performance will be (H7).* This might be a strategy used by auditors to maintain an effective working relationship and communicating with the client on a regular basis. No doubt, this shows that communication is positively linked to service quality and auditors' performance and where regression coefficients scored respectively (0.473 and 0.766).

Commitment – The importance of commitment is shown in two hypotheses, where a *high commitment to the relationship by the client leads to high service quality of audit (H4) and a high commitment to the relationship by the client leads to high performance by auditors (H8).* As it has been defined previously commitment is an enduring desire to maintain a relationship. Moreover, together with trust, it is the core element of relationship quality. Their presence lead directly to cooperative behaviour that is conducive to relationship management success. H4 and H8, with a regression coefficient of 0.320 and 0.537, show that commitment is linked positively with service quality and auditors' performance. This is portrayed through a number of interaction elements and client's expectation. One answer is found that few changes of auditors take place over the years by a single client. Auditors were found to provide advice to their clients even before the audit takes place. This demonstrates not only closeness between auditors and their clients but also commitment to their clients' business. Overall, one can see this commitment extended not only to non-audit services provided by auditors but also assisting client in identifying their problems and helping resolving them. One can explain why the clients and audit firms do not want to be seen having a close relationship despite some of respondents refer to the relationship as a partnership. This is quite clear and is demonstrated by a negative link between problem solving and auditor performance discussed earlier.

Problem solving, trust, communication and commitment emerged as key components in audit working relationships. Adding to these components, service quality and auditors' performance appear to be mediating variables, which in turn lead to high relationship quality between auditors and clients. Although positive associations were found among these eight variables, to the exception of problem solving with auditors performance, Pearson correlations were strong as shown in the correlation table.

Based on these findings, positive associations were found among the key components of relationship quality, apart from the one between problem solving and auditors' performance. Thus, one can conclude that the auditor-client relationship model was supported empirically. Therefore, the model provides a theoretical and practical background for companies (audit firms and client), that can be used to assess their relationship. Moreover, audit firms can reflect on their relationship and develop marketing programmes accordingly. Reflecting on emerging relationship quality model, it is apparent that four key components (problem solving, trust, communication, commitment) lead to high service quality and greater auditors' performance, which in turn leads to relationship quality between auditors and their clients. Finally, the model outlines the key components and explains the underlying logic of relationship quality.

To this end, this study claims 1) a continuity of contribution to the development of framework for studying dyads as advocated by (Lindgreen, 2001); 2) a contribution is a continuity in developing framework for studying business relationship from a systems approach in financial services (Beloucif et al., 2004) and business dissolution (Beloucif et al., 2006).

9.5 RESEARCH IMPLICATIONS

9.5.1 Contribution to the body of knowledge

It is to be noted that all elements pertaining to the nature of auditor client relationship phenomenon have not yet been clearly identified in previous studies in the area, understood and conceptually developed. To the knowledge of the researcher so far few studies in the UK have taken up the challenge to explore the nature and development of auditor-client relationships, with the exception of Yorke (1990) who looked at relationship marketing in a professional service area. There have been a few attempts in the USA to look at the relationship from an economic analysis perspective (prescriptive studies). This study aims to contribute to a better understanding of the elements affecting the development of long-term relationships between two organisations, how to build a positive and lasting relationship and its implications on auditor independence. The study will join the effort carried out by the IMP group in developing the relational concept in professional services. The attention given to the elements and process of buyer-seller in a regulated environment such as an audit appears to be a contribution to the development of marketing knowledge.

Interpersonal relationship theory- The findings of this study go along within the arguments put by Maister (1982), Gronroos (1979), DeMoutthoux (1978) and Turner (1969), the fact that professional service firms tend to sell to its clients the services of particular individuals (or a team of such individuals) more than the service of the firm and business success is thought to depend primarily on how well individual consultants can build social network and keep loyal clients.

Interorganisational relationship theory - Blois (1996) points out that there have been a number of literatures trying to define what is *relationship marketing* and questions its applicability in all areas. He argues that building and maintaining relationship is a costly process. It is therefore important for a supplier to determine whether or not the costs involved are justified. This study joins the debate whether relationship marketing is applicable to the professional service firms (like audit) operating within a regulated environment, i.e., auditor-client attachments (Levithal and Fichman, 1988); dissolutions (Seabright and Levithal, 1992) and understanding auditor-client relationships (Kleinman and Palmon, 2001). There has been no doubt whatsoever; the relationship marketing is plausible for this sector as it has been demonstrated through the recent interest of academic researchers.

Exchange theory - One can argue that exchange theory promotes a common ground for the study of both interorganizational relationships and interpersonal relationships. This can be seen within the basic definition of marketing itself (Dwyer et al. 1985). Baker (1983) defines marketing as follows: *"Marketing is a process of exchange between individuals and/or organisations which is concluded to the mutual benefit and satisfaction of the parties', then clearly this proposition would go far beyond what most people consider to be the scope of the subject"* (p.4). Clearly, this author asserts that the essence of marketing is a mutually satisfying exchange relationship either between people or organisations or both. This study does not share the harsh criticism of Blair (1977:134), who comments on Baggozi's article, marketing as exchange, that *"Marketing theory now lacks delimitation"*. But this study goes along with the work of Houston and Gassenheimer (1988). Their investigation of marketing and exchange has lead to turn exchange events into exchange relationships. They argue that *"Good marketing management emphasises the building of long-term relationship... we mean by* *long-term relationship with prospective exchange partners that leads to a long-term relationship.*

Their definition comes as to filling the gap in Baggozi's seminal work. Therefore, the concept of *exchange relationship marketing* has emerged to deal with these weaknesses. Although it is an interesting contribution to exchange relationship, it failed to show that the exchange between dyadic members is taking place within a system, and their relationships affect and is affected by the environment. Therefore this study proposes the following definition of exchange relationship marketing:

> *is building, maintaining and extending the exchange relationship between individuals and their organisations which operate within an environment. Their relationships may affect or be affected by the environment.*

This leads to appreciate the contribution of the systems approach to this study.

The marketing concept has various definitions. Some writers define it as a philosophy of business, marketing orientation or exchange process. However, there has been some interest in looking at marketing from a system approach (Alderson, 1957 and 1965; Fisk, 1967, Fix and Dixon, 1967 and, Beloucif et al. 2006)). The view of systemic approach in marketing here becomes evident. Organisations are clearly dependent on some elements of their task environment, and both channels and buyer-seller literature stress the importance of the *open system approach,* i.e., the interaction of the organisation with the environment and the lack of clear boundaries between the two (Thompson, 1967; Stern and Reve, 1980; Dwyer and Welsh, 1985; Achnol, Reve and Stern, 1983; Anchol and Stern, 1988).

This study provides a specific contribution to the marketing knowledge, i.e., defining relationship marketing concept from a system approach view. In his book, entitled marketing of services, Gronroos (1990) dealt with it in general term, but not in a regulated environment.

Auditors' switching **-** There are two opposite dimensions to the auditors' switching. A number of academics have investigated the impact of auditors' switching on the audit service but no evidence has been found to support this argument (Krishnan et al., 1996; Abu Tahir Abdul et al., 2006). Clients change auditors for various reasons as mentioned earlier, and on the other hand they recruit auditors and offer them new posts within the company. It emerged from the analysis of the fieldwork that there is a phenomenon of auditors switching to other professions, i.e., auditors are recruited by their previous audited clients to a post of financial director or group financial director. After being an auditor for the client for a number of years, they become their own employees. This area suggests a future investigation to see why this is happening.

9.5.2 Managerial implications

Accountancy profession - Criticisms have been raised in the British Parliament, whether to introduce new regulation where auditors should be allowed to stay with the same client only for a limited period. Some Members of Parliaments (mostly Labour MPs) wish to introduce government statutory body to regulate the auditing function. In this, the accountancy profession body will lose its privilege. The findings of the study have produced a discussion model (figure 2.4, chapter 2) as to *"how to restore the public confidence in the auditing function"*. Some marketing recommendations such as developing a marketing implementation plan, quality of service, etc.) are made to the accountancy profession on how to improve and build a better relationship not only with their clients but also with third parties. Details are presented in the previous section 9.2.

9.6 FUTURE RESEARCH AREAS

From an earlier study by the researcher (Beloucif, 1997), three types of relationships were identified:

(i) The protectionist relationship

(ii) Statutory and Working relationship

(iii) Stewardship relationship

This current study focused only on statutory and working relationships, i.e., auditor-client relationships. It is worth investigating the other two relationships. Moreover, Goldman and Barlev (1974) argue that the auditor is potentially involved in three conflicts of interests. These represent different sources of pressures on the auditors to produce a report not according to professional standards and represent potential threat to his independence. These conflicts are:

1. The auditor - firm conflict of interest;
2. The shareholders-management conflict of interests;
3. The self- interest - professional standards conflict.

These authors point out that conflict of interest has important implications on the auditors' independence. They suggest three solutions to the auditor-client conflict of interest: (1) decreasing the potential power management *vis-à-vis* the auditors by limiting management freedom of action, (2) reducing auditors' flexibility of action, and

(3) changing the structure of the auditing role. This current study suggests these conflicts should be studied within these three identified type of relationships.

The impact of selling non-audit services on the audit clients - Interestingly, the European tradition militates against professional cross-selling. Both France and Italy have regulations preventing audit firms providing management consultancy and other services. The European Commission is also keen to separate the provision of management services to avoid abuses. But the accountancy profession is fighting to block what many see as sensible practice.

Auditors - Nonprofits organisation relationships - Is there a conflict of interest between auditors and non-profit making organisation (charitable organisation) which some of them are not required by law to be audited. However, there are situations where audit firms are involved in the raising funds for them (For example Comic Relief).

The role of the marketing department within the audit firm - Through the analysis, it emerged that there are existing problems between marketing people and auditors (case 3). Some believe that marketing people have no place in the relationship with the client. Some believe that they are useful for advice and support and organising events for clients. Some senior partners view marketing as a central function like other functions such as personnel. Therefore, it will be interesting to explore the role of the marketing person within the firm and its interactions with the other departments.

Audit firms as limited companies - From the findings expressed in figure 2.4 in chapter two - changes to restore public confidence- an important issue emerged as a conflict of interests, i.e., as PLCs the audit firms report on their own accounts and later on audit them. Even, if it is done by another firm, one can argue that that they still are members of the same profession and the organisation is there to defend the interest of its members. Future research in this area will highlight whether there is an area of potential conflict between the audit firms and which might bring the whole profession under scrutiny again.

Investigation on coordinating audit work between rival companies - The principal auditors do share audit work with their rival firms. After acquisition, generally the client does keep the same auditors for the acquired company. When it comes to co-ordinate the audit work for the whole group, principal auditors sit down with "auxiliary" auditors and go through their file to see how they conducted their audit work. Sometimes, an audit certificate is sent to the principal auditors. However, the study does not completely agree that this practice is widely applied by all principal auditors in the UK. In the collapse of Maxwell group, principal auditors did not unveil malpractice by Maxwell Limited Company. One has to wonder whether good communication existed between principal auditors and auxiliary auditors.

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APPENDENCES

Appendix 1 – Topic Guide -

STAGE1: PRE-RELATIONSHIPS STAGE

(a) Background information about accounting firms
(b) Work promotion

STAGE 2: ESTABLISHING INITIAL RELATIONSHIP

(a) Handling the initial contacts
(b) Keeping in touch
(d) Operational relationship

STAGE.3: BUILDING ON RELATIONSHIPS

(a) Personal interests
(b) Communication
(c) "Being a partner"
(d) Being treated as special
(e) Building credibility

STAGE 4: MAINTAINING & EXTENDING RELATIONSHIPS

(a) Working with the client
(b) Showing care and communication
(c) Problem solving
(e) Termination of relationship

Appendix 2 –Alpha Numerical Coding

AUDITOR		CLIENT	
A1 Developing relationship	A49 Taxation	C1 Developing relationship	C49 Management responsibility
A2 Availability	A50 Selling services	C2 Personal familiarity	C50 Audit budget
A3 Responsiveness	A51 Learning process	C3 Auditor appointment	C51 Negotiation
A4 Business philosophy	A52 Company knowledge	C4 Management	C52 Fees negotiation
A5 Client orientation	A53 U.D.M.	C5 Capability	C53 Audit advice
A6 Referral	A54 Auditor rivalry	C6 Management satisfaction	C54 Audit consultancy
A7 Pull strategy	A55 Client involvement	C7 Auditor transition	C55 Taxation
A8 Keeping us in mind	A56 Selling services	C8 Expertise	C56 Shopping around
A9 Creativity	A57 Agreement	C9 Non-audit buy	C57 Buyers
A10 Keeping in touch	A58 Work relationship	C10 Beauty parade	C58 Maintaining relationship
A11 Company size	A59 Inspection	C11 Keeping auditor	C59 Staff interaction
A12 Audit cost	A60 Firm resources	C12 Audit image	C60 Mutual understanding
A13 Audit work	A61 Discussion	C13 Growth	C61 Service delivery
A14 Thank you for the business	A62 Growth	C14 Audit fees	C62 Auditor switching
A15 Problem solving	A63 Successful relationships	C15 Personal relationship	C63 Work relationships
A16 Non-audit services	A64 Flexibility	C16 Locality	C64 Partnership
A17 Personal relationship	A65 Personal interests	C17 Mutual background	C65 Accessibility
A18 Organisation Interactions	A66 Audit fees	C18 Professional familiarity	C66 Audit quality
A19 Regular contact	A67 Time delivery	C19 Auditor independence	C67 Auditor job
A20 Personalised services	A68 Auditors' relation	C20 Communication	C68 Fee income
A21 Competition	A69 Partnership	C21 Courtship	C69 Company size
A22 Firm size	A70 Existing relation	C22 Promotion	C70 Relationship disturbance
A23 Client needs	A71 Accountant for Client	C23 Competition	C71 Special relationship
A24 Promotion	A72 Point of contact	C24 Audit buy	C72 Work communication
A25 Business Knowledge		C25 U.D.M.	C73 Fee agreement
A26 Credibility		C25 Shareholders	C74 Keeping auditors
A27 Communication		C26 Shareholders	C75 Auditor transition
A28 Audit Quality		C27 Information	C76 Audit market
A29 New client		C28 Client experience	C77 Audit cost
A30 Building relationship		C29 Feeling comfortable	C78 Specialisation
A31 Courtship		C30 People business	C79 Accountancy market
A32 Audit plan		C31 Buying process	C80 Non-audit services
A33 Personal familiarity		C32 Long-term relationship	C81 Audit services
A34 Industrial knowledge		C33 Computerisation	C82 Firm size
A35 Client evening		C34 Benefit	C83 Selling competition
A36 Invitation		C35 Problem solving	C84 Conflict of interest
A37 Staff interaction		C36 Business knowledge	C85 Trust
A38 Continuity		C37 Time delivery	C86 Professional ethics
A39 Audit team		C38 Regular contact	C87 Confidentiality
A40 Staff interaction		C39 Audit time	C88 Perception in the City
A41 Partnership role		C40 Investigation	C89 Industrial knowledge
A42 Maintaining relationship		C41 Company knowledge	C90 Continuity of staff
A43 Expertise		C42 Audit work	C91 Audit team
A44 Auditor switching		C43 Auditors' relationships	C92 Fees' agreement
A45 Acquisition & Merger		C44 Audit certificate	C93 Value for money
A46 Environmental influence		C45 Skills	C94 Bargaining
A47 Specialisation		C46 Skill limitation	C95 Honesty
A48 Computer service		C47 Commitment	C96 Ability
			C97 CA training
			C98 Management consultancy
			C99 Invitation
			C100 Feeling comfortable
			C101 Audit sharing

Dyadic Relationship One:

~ A Plant Hire Company ~

1.0 INTRODUCTION

The objective of this appendix section is to present the analysis of matching relationships between the audit firm and the client company.

It should be emphasised that this case was not analysed in isolation and process was informed by reference to the other cases under study.

Therefore, section 1.1 outlines the background of the relationship for this case. The coding process, explained in qualitative methodology, has a code-list attached in appendix.

Section 1.2 outlines the analysis of elements, stages and process of auditor-client relationship.

Section 1.3 provides the analysis of the environmental conditions, which help to see the relationship from a holistic view.

Section 1.4 describes the outcomes of the analysis and the benefits of long term relationship, the type and implication of relationships and the emerging issues.

Finally, it should be emphasised that figure in the analysis have a specific quotation:

- Establishing relationship will be represented with all figures with letter **B** followed with a number,
- Relationship development with letter **D** and followed with a number,
- Relationship building with letter **E** and followed with a number
- Maintaining relationship with letter **F** and followed with a number
- Successful relationship with letter **I** and followed with a number
- Types of relationship with letter **J** and followed with a number
- Implication of relationship with letter **K** and followed with a number
- Other emerging issues with letter **L** and followed with a number.

All cases are analysed and figures presented in this way. Moreover, it is to note that the following legend has been used through all cases.

Causality
Similarity
Opposition

1.1 BACKGROUND OF RELATIONSHIP

In this case, the *audit firm* was formed by the amalgamation of two well established Glasgow firms. The first of these firms was formed in 1920s and early records of the second firm suggest it commenced as early as 1880.

The firm is auditor of *two Public Companies* and a very wide range of *Private Companies*. The firm is also responsible for preparing the accounts of many small incorporated businesses together with all related taxation work. Apart from its role as auditor and accountant, the firm also acts as the financial adviser to many clients both corporate and personal and it prides itself in being able to give all clients an efficient and personal service.

In this case, the client is the company Hendersen-Smith. Its chairman, Sir Martin Gallagher, a chartered accountant, formed Hendersen-Smith in the early 1960s. He selected somebody that had been with him when he learned how to be an accountant and he appointed him as auditor for the business in 1968 when the company went public.

1.2 ANALYSIS OF ELEMENTS, STAGES AND PROCESS OF RELATIONSHIPS

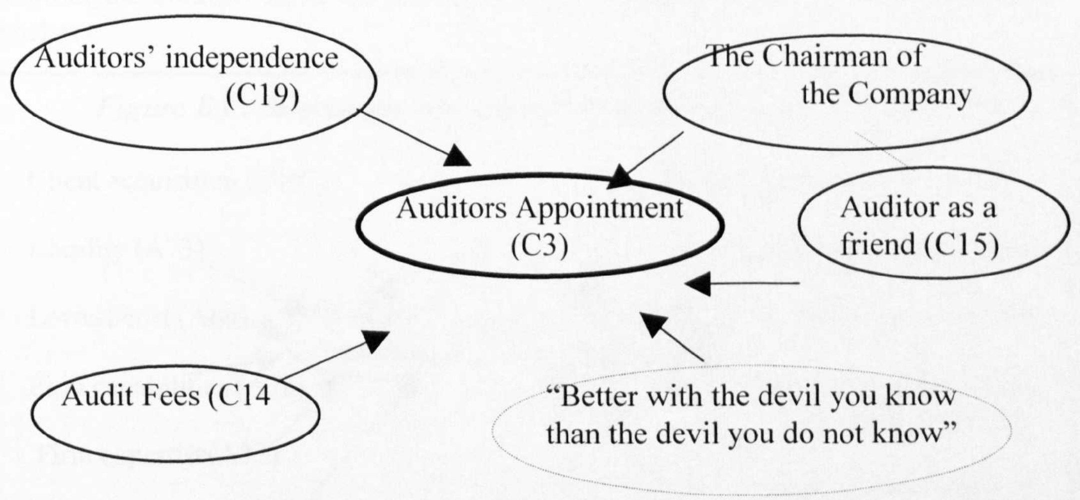
1.2.1 Establishment of Relationship

In this case, it has been revealed that the relationship is established not only with the audit firm but with a number of professional services providers such as banks, lawyers etc.

Establishing relationship pre-existed when the chairman was a partner in the firm which he appointed as auditor for his own business.

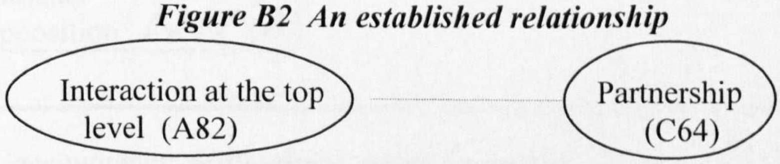
> *"... and I have to be brutally honest with you that I have my chairman Sir Marin Gallagher who you wrote to was originally a professional accountant. And when he formed our company Hendersen-Smith in the early sixties he selected somebody that he had been with him when he learned how to be accountant and appointed him auditor for the business."*

Figure B1 - Establishing Relationship (auditor appointment)



Moreover, this case shows that establishing relationship between auditors and their clients is made at the top level.

Figure B2 An established relationship



It is to note that *establishing relationship* with client is an on-going process for the accountancy firms. *Regular contacts*(A19) and *courtship* (A31) are used frequently by the accountancy firms to gain new clients and keep the existing ones.

> *"I am just thinking, I was in lunch at PriceWaterhouseCoopers last week, I have no relationship with PwC at all. They phoned up and asked me to come for lunch. I had lunch there. I have had lunch with PWC this year, I have had lunch with Ernest & Young."*

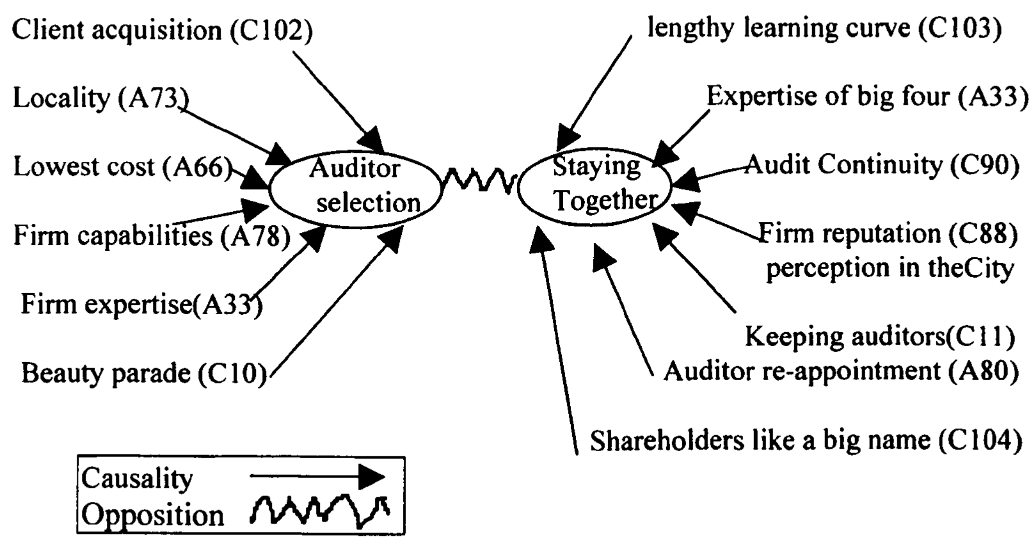
Audit firm selection (A79) had been the decision of the chairman of the company and was based on *personal* (A33) and *business familiarity* (C88) of the auditors. However, the client does not give the audit of acquired companies to their main auditors. This might suggest that the client prefers to diversify and put themselves in a bargaining position when it comes to determining the audit fees for the new acquired companies. Therefore, sharing audit job with another firm is related not only to the expertise of auditors but the audit cost reduction. Moreover, the client has not used *beauty parade* in the selection of auditors as the following quotation reveals:

> *"We have not yet and we do not yet see the necessity to hold some sort of beauty parade in order to decide who our auditors should be."*

However, the client believes if the company grows and gets involved in international operations and the auditors cannot cope with the expansion. Then, it will be time to raise the question of changing auditors. At this moment, there is a belief that the client auditing and tax problems are relatively straight forward and there is no matter of concern to look for another audit firm.

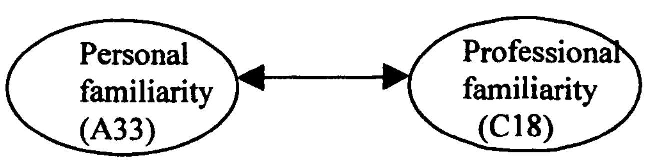
One important factor emerged in this analysis that the client does not see their auditors as a medium-sized firm is going to affect their perception in the City (88). However, if the company grows to an international level, the question will be whether the auditors have the resources and capabilities to follow them in overseas markets.

Figure B3 : Selecting a new audit firm & Staying with the same firm



Here, the accountancy professional circle expressed in this case demonstrates that professional familiarity (C18) and Personal familiarity (A33) are interrelated concepts.

Figure B4 : Accountancy Profession Circle



> *"...indeed I think it is inevitable in city of the size of Glasgow somebody in my position or my chairman position, Sir Martin Gallagher, is also a chartered accountant, it is inevitable we know a lot of partners, a lot of the leading partners in the big firms. It is our business, that was our trade before we come into the industry. And therefore, I think that will be very difficult for us in Glasgow to have an auditor who is entirely unknown to us. In the circles we move in we meet the people who are in charge of the accounting firms. And therefore, Martin and I, between us, almost certainly know of each of senior partners of the big four and six and ten or twelve leading accountancy firms in Glasgow on more than just a casual basis. So any suggestion that the auditor has got to be unknown to you it is very difficult."*

> *"It is our business that was our trade before we come into the industry. And therefore, I think that will be very difficult for us in Glasgow to have an auditor who is entirely unknown to us."*

Auditor switching (A44) is not seen necessarily for the client. Management feels comfortable and happy with the audit service. Moreover, it believes that changing auditors does not change anything in way the business is run since the company is not expanding abroad and becoming an international company.

> *"As long as our business remains as relatively simple as it is just now, I do not find that is necessarily."*

International operation (C13) and *size* of the client (C69) will be the two major factors in deciding whether to stay with the same auditors or change them. In this case study, management still doubt whether their auditors (medium-sized firm) would be able to go international and follow them and in particular to the USA. One factor emerging from the analysis is that the client might keep the same auditors but not as **principal ones**, i.e., they will remain auditing the client in Scotland and become **auxiliary auditors**.

As far as *changing auditors* (A44) because of their size i.e., the question whether clients prefer to be audited by one of the big four because they are well known in the City. This does not bother at the entire client in this case who sees the attitude to the size of audit firm and their image in the City has changed over the time. Shareholders are not interested in paying big fees because the audit firm is one of the big four. Any audit firm given the resources (C12) can carry out audit work.

Accountancy firms are no more promoting themselves just as auditors. They sell non-audit services and promote themselves as specialists in certain areas.

> *"Auditing does not any longer feature as being the business they are in. It is still the business that is seen to be done. But, they are out there flogging the other services as fast as they can go."*

The point to be made here is that small firm do provide audit services. It does not to be one of the big four firms to receive a quality of audit services as proclaimed by both auditor and client.

To sum up this section, client has not used any beauty parade to appoint new auditors for the principal activities of the company nor for the acquired companies. Instead the policy appears to be keeping the same auditors. Moreover, client seems to be happy to receive an internal control letter from the "auxiliary auditors". This is reflected in the service received. So, management appeared to be satisfied with both audit firms. Therefore, no audit switching is required as expressed in the following quotation:

> *"We are quite happy... I do not think... well your next question might be -Do you not think you are a bit complacent by not going out and having a beauty parade to shake the whole thing up. I really if I have any doubt about all the control of the quality of service, I would certainly do that. I have no worries about it."*

1.2.2 Relationship Development

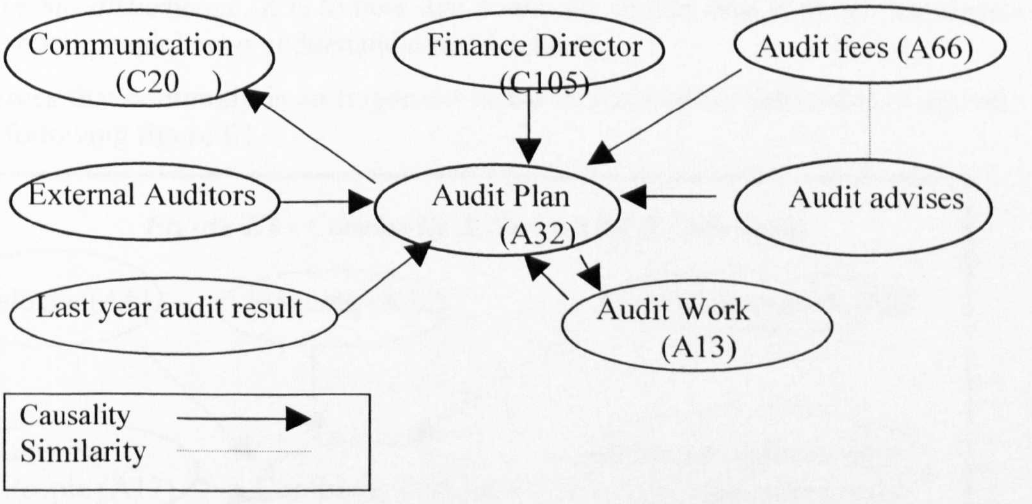
Developing relationship is not only focused on exiting clients but also on the potential ones. Auditors make themselves available for enquires and invite potential clients to contact them if they need any explanations or help. They do this by sending leaflets and information, which might be useful to the companies.

> *"...We make ourselves available to clients and they know where we are, they recognise this is the place where either they get information or the source of the information, which we will find out for them and point them in the right direction."*

By doing this, it increase the auditors *credibility* (A26) Auditors will be seen as a *source of referral* (A6), professional competence (A79), helpful and problem solvers (A15).

Regular contacts (A19) are maintained through the year. The actual audit work (A13) takes only three to four months. However, auditors are needed through the year for *problem solving*. Auditors are called from time to time to investigate activities in other subsidiaries under the umbrella of internal control reviews. Since, client does not have an audit review; auditors are called to carry out the internal audit.

Figure D1 Working Relationship (Audit work)



Before the audit work starts fees are agreed after negotiation and where auditors are to justify their work:

> *"... He has to demonstrate on what is going to spend and how well he is going to do it and what sort of report he is going to give us and what sort of time table."*

It emerged that audit advises during the year are not included in the audit fees except that in particular when auditors carry out some inspections job or internal audit (C115). However, it is different from taxation, which is seen as advisory service and bought from the same accountancy firm. Other non-audit services are bought from other firms.

> *"Suddenly we realised we reached the end of our ability to make decisions on this. And we went out to the leading accountancy firms not including our auditors. We said- right*

> *here is our problem what can you do about it-. And in fact Ernest & Young came up with the best solution. They took the things and said this is the way..."*

Another factor expressed by the client is that developing a relationship is to have some expectation, i.e., **feeling comfortable** with auditors because it is *people business.*

Problem solving (A15) is a *continuous process* (C90) where auditors are to assist client in identifying shortcomings in system and resolve them. Adding to this, the client is more concerned about fraud due to the nature of its business (hire plant). When the client was asked about whether they feel treated by their auditors as *special client*, the answer was not positive even though the client is one of main important client. The client does recognise as an important client to the auditors but it does not want to be perceived as treated differently from other clients.

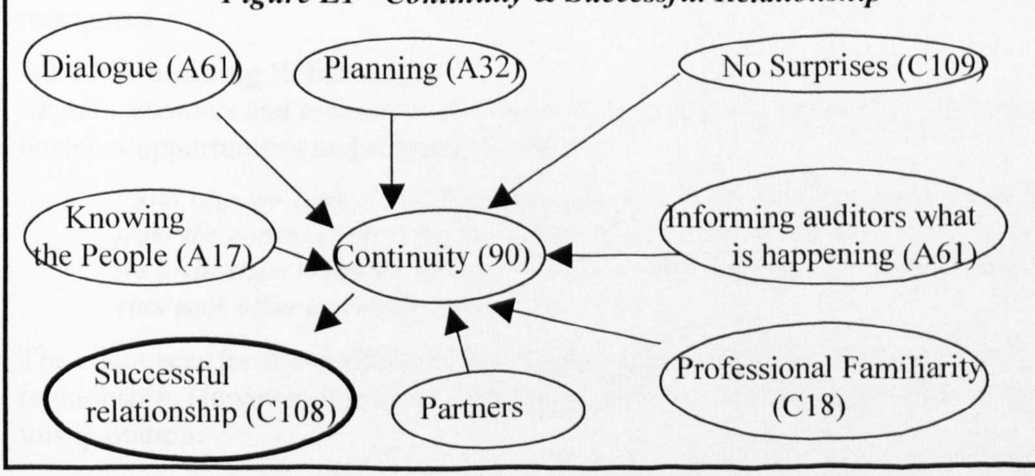
1.2.3 Relationship Building

Dialogue (A61) is seen as important factor in building relationship. The client believes that if their auditors have any areas of disagreements, they will make it clear to the management because they are very professional people. This suggests that there is a strong *rapport* between auditors and the management.

Another factor in building relationship is *Continuity* (C90). It has been described as the most important element in the relationship building. Continuity is passed on to the succession of audit teams. What really bothers the financial director in charge of the audit within the Client Company is having new faces to ask the same question which might lead to disturbance of relationship. So continuity of staff is one way to reduce the *relationship disturbance*. It is to note that *continuity* in this case is about "continuity of partners and people" who understand client business.

It emerges that continuity is an important factor in successful relationship as shown in the following figure E1.

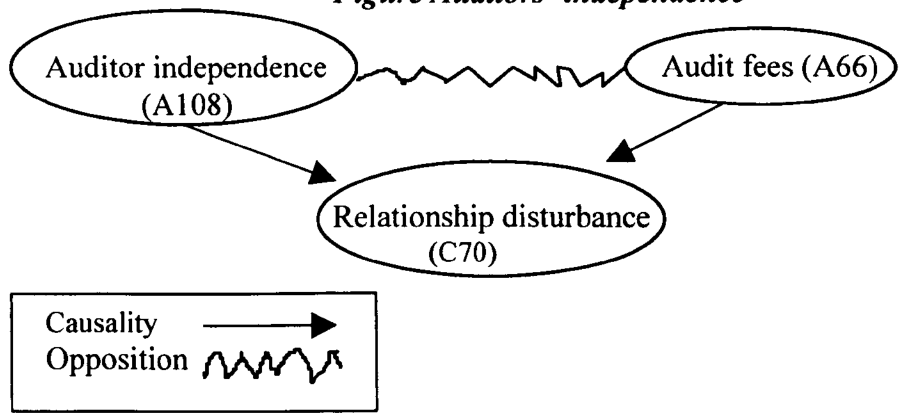
Figure E1 - Continuity & Successful Relationship



Moreover, when it comes to their audit job. Management has sometimes-different expectations. In this case, the client recognises that it is not the job of auditors to detect fraud and manipulation for defalcation. Although that is not auditors primarily role as stated in their status which is to produce a "*True and fair view*". Moreover, they are not going to be held responsible for it. However, the client still believes that an auditor has a *good nose for it.* This shows the Client Company suffers from frauds and subsidiaries level and auditors are there to help to resolve this problem. Here they are working as partners and auditors needs to show more commitment by detecting frauds and malpractice.

It emerges that auditors have a certain percentage of income fees to receive from one client. It appears if the audit firm generate more than 10% of the total audit fee income with one single client, this would lead to raise a number of questions and speculation and in particular the auditors' independence. Therefore, the relationship will be disturbed if it comes to that point. The client is left to buy other advisory services from other accountancy firms to show that the company is not depending only on one firm. In fact, this is to help in promoting the *auditors' independence.* This answers the question why client does not like to be seen having a *special relationship* with the auditors. Instead they feel they are *significant partners* but not having a special relationship.

Figure Auditors' independence



Adding to this, there is a *commitment* factor, which is expressed through the audit work. This work commitment is related to the *fee agreement* i.e., auditors should not expect to increase audit fees every year. All is left to *negotiation* if the increase is reoccurred.

1.2.4 Maintaining Relationship

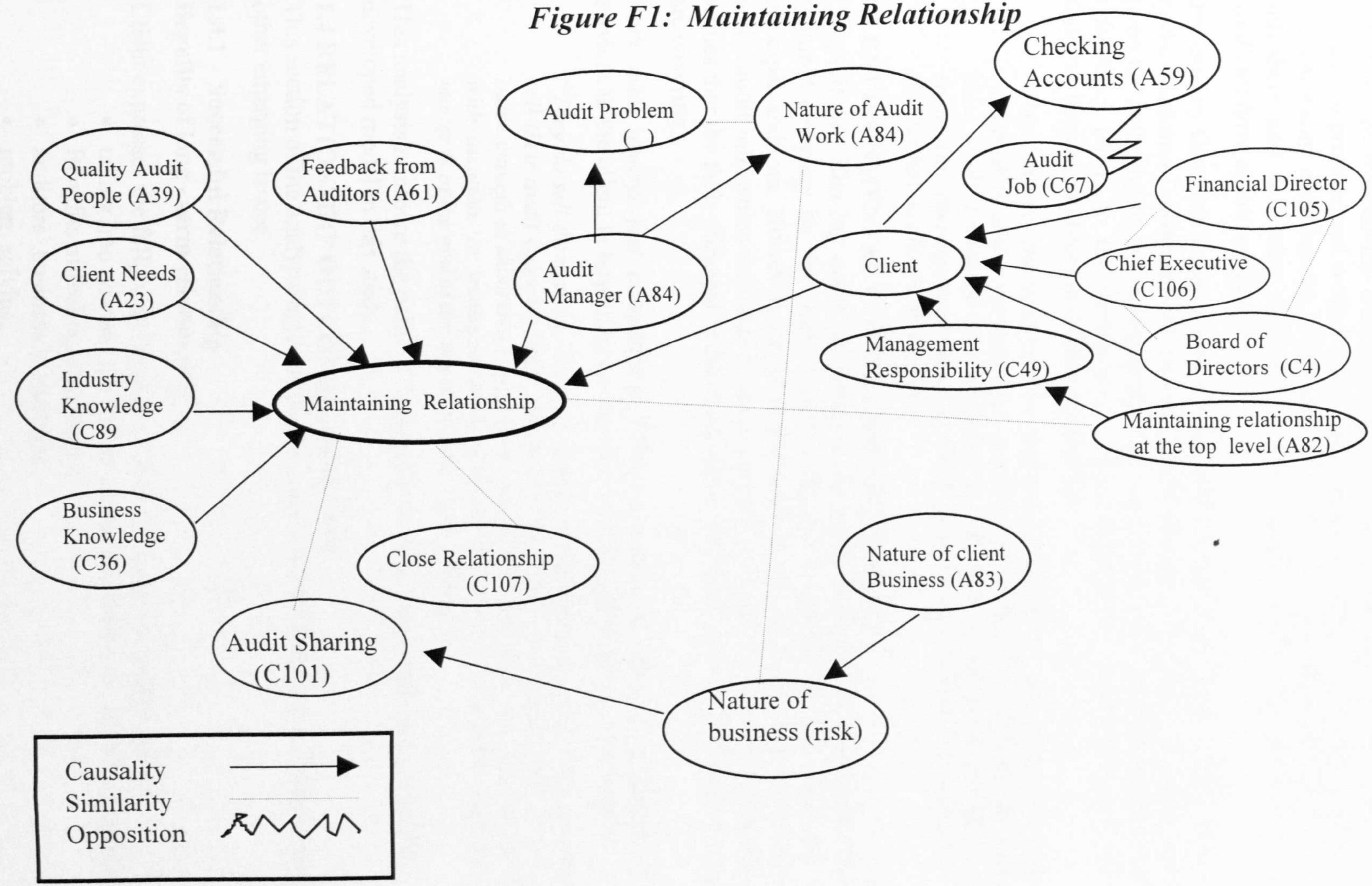
Regular contacts and *courtship* are used to keep potential clients and also create business opportunities and referrals for them.

> *"And also we have a regular client evening, where we invite for example our clients from the construction industry, builders, architects, plant hirers, surveyors etc... and we invite them to the Westerners Club for a night and we have a few drinks. And we all chat each other and some business gets done."*

The client sees the relationship with auditors is there to stay i.e., a long-term relationship. However, it is quite different from other advisory services as is shown in this quotation:

> *"... now many other people are having a four year of five year beauty parade. Now funny enough we have not done it with our auditors, but if you are to think like our insurance brokers they have got a step forwards every four or five years and they go through the book."*

Figure F1: Maintaining Relationship



The client argues that the auditors have never done anything wrong to worry about it. Therefore, the relationship is maintained and long-lasting. For the client, auditors have managed to produce and work with a large number of staff and not upsetting them (i.e., no relationship disturbance). They have showed a *mutual understanding in* working with them and delivering the audit on time. In the whole, the client believes that *"auditors have delivered the interests"*.

One can say there is a sense of *partnership* (A69) in the relationship, which is expressed by the freedom of movement of auditors within the client company, i.e., they have been given the authority by the management to go anywhere and to any subsidiaries and give a *feedback* (A61) to the management. This demonstrates the existence of an *open dialogue* between auditors and the management.

> *"They have got the total freedom they can go anywhere... and when they want. They can speak to senior managements. And they are absolutely no restriction imposed on them at all. I think that is the correct way. People would say the auditor sit in that room. He (management) does not allow people to go and see him - forget it - The auditor has no chance to do his job."*

1.3 ENVIRONMENTAL CONDITIONS ANALYSIS (2c)

Competition - Sharing audit job between principal auditors and auxiliary auditors of acquired company by the client does not appear as problem to the client nor to the principal auditors. However, the principal auditors would like to have control of the entire audit job, which will lead to an increase of audit fee. In the other side, the client argues that the their principal auditors recognise their limitation and are happy what they are covering.

Both sides always feel competition. Other accountancy firms are offering advisory services to the client in hope they get the client to buy audit services from them.

> *"They do sell themselves. They are always selling themselves. But, they may not try to sell their audit capacity, they may trying to sell other particular skills. And I am not naive enough to think that is a sprat to catch the mackerel in fact to get us on the hook with taxation, or management consultancy or whatever computer expertise. What matter is at the end of the day to sell the whole service."*

This analysis reinforce the point of *"getting it strategy"* explained later on in the developed model in this study.

1.4 RELATIONSHIP OUTCOMES ANALYSIS

This section of the analysis outlines the successful relationship, type of relationship and other emerging issues.

1.4.1 Successful Relationship

Benefits of long - term relationship

Client expresses the following benefits of having a long-term relationship;

- taking into account the nature of industry where the client is operating,
- Benefits of feeling comfortable.
- auditors' business knowledge,
- problem solving,
- auditors expertise
- regular contact

Feeling comfortable is an important factor for the client. So the client can use the regular contact to address problems and issues to the auditors who will take part in resolving them. Moreover, understanding client business is seen one way to show capabilities and expertise, and in particular speedy response to a problem or question facing the client. This encourages further an open *dialogue* and *mutual understanding*.

1.4.2 Types of relationships

The types of relationship in the case are the same in case 2. Therefore, detailed explanation is found in case 2.

1.4.3 Implications of Auditor-Client Relationships

Different from case 2, this case reveals the denial of existing of special relationship between the auditors and their client.

1.4.4 Other Emerging Issues

1.4.4.1 Personal relationship and business relationship

The case reveals that establishing relationship is always having in mind a cosy relationship.

> *"... he arranged that the firm he was partner in and the firm his friend was partner... were appointed our auditors in 1968 when we went public. Now, that may sound terribly cosy but we have made sure that they are capable of supplying services and the expertise we need over the years."*

There is a close link between *personal relationship* and *business relationship*. However, both side of the relationship argues that the auditors are independent.

> *"So, I think the question of independence of auditors is one that is difficult for the limited number of plc or perhaps the ones have a registered office in Scotland. I do not think I see it as a problem for me but I can understand people outside looking and perceiving that the relationship is not about arms length. I do not accept that. I am quite clear that if our auditors have some areas of disagreements, they make it very clear to us, very clear, because they are thoroughly professional people."*

In conclusion, the relationship marketing is "*people business*" and Marketing audit services is *marketing individuals auditors*

> *"I will sell myself to you, not to Davidson Walker CA (audit firm). I am selling me. When I speak to you as my client, if you don't like me then you don't like Davidson Walker. So, you have got to like me, you have to feel I can do the job for you."*

As far as the non-audit services, professionals bring work in different ways. Generally, work such as taxation is based on referral.

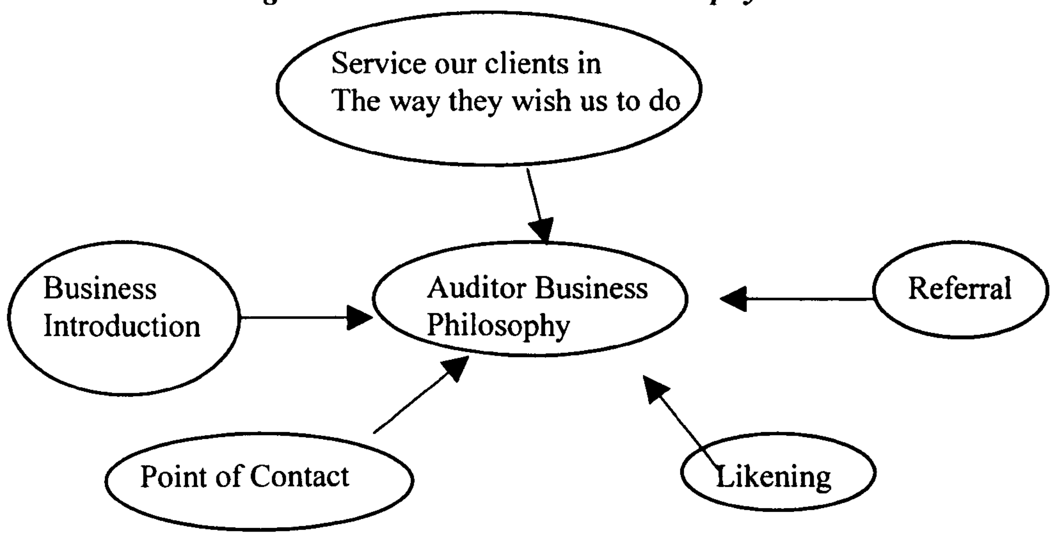
1.4.4.2 Sharing audit work with another firm as well as being a rival

The principal auditors do share audit work with their rival firms. After acquisition, generally the client does keep the same auditors for the acquired company. In this case, when it comes to co-ordinate the audit work for the whole group, principal auditors sit down with "auxiliary" auditors and go through their file to see how they conducted their audit work. They do ask specific questions to satisfy themselves that the audit has been carried properly. However, the study does not completely agree that this practice is widely applied by all principal auditors in the UK. In the collapse of Maxwell group, principal auditors did not unveil malpractice by Maxwell Limited Company. One has to wonder whether a good communication exists between principal auditors and auxiliary auditors.

It might be due to nature of business that some companies (bank in case. 2); *audit sharing* will disappear once the merger is finalised. The audit of acquired business will go automatically to the principal auditors. One factor was single out in case two is client make sure that no audit firms used by a rival company should be involved in.

1.4.4.3 Auditor business philosophy
The philosophy of business applied by the auditor is summarised in the following figure L1.

Figure L1 Auditor Business Philosophy



1.4.4.4 Business ethics
Accountants, in particular are not supposed to recommend or being used for recommendation. However, this case reveals that the auditors find always away around to do it. This exactly where auditors Stoy Hayward were criticised of writing letters of recommendation for their client Levitt group which collapsed later on. The letter reads:

> *"We can confirm that we have acted for Mr Levitt and the Levitt group for a number of years. And we have an extremely high regard for the professional business approach and integrity of the group and its directors."*
> *Source: Money programme, BBC 2, February 17th, 1991.*

The following quotations from auditor.1 support this point of view.

> *"For example if they don't have a lawyer we will find them one, we will recommend a good lawyer."*

> *"And also we have a regular client evening, where we invite for example our clients from the construction industry, builders, architects, plant hirers, surveyors etc... and we invite them to the Westerners Club for a night and we have a few drinks. And we all chat each other and some business gets done."*

Clients and its competition. If the client finds itselself audited by the same firm as their rival in the industry. They do expect their auditors to be impartial and use their professional ethics, i.e., not to reveal client trade secret to the rival company. However, using their experience, client can be advised without referring or disclosing rival information. This is not seen as conflict of interests but as a *trust* established between clients and their auditors.

1.4.4.5 Quality service

Quality of service (A28) has been defined by the client in the subjective way, i.e., the client believes that auditors should ask the correct questions, look for what are supposed to look at. In general terms, it is management satisfaction about what auditors are doing such as checking fraud and wrong doing in the company's subsidiaries. Moreover, as stated in case two *audit quality* varies from client to client and from an individual to another.

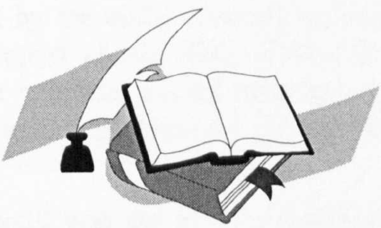
It is to note that the audit manager in case 2 has defined quality service in the same,

1.5 CONCLUSION

This has outlined the analysis of case 1 and showed some links between case 1 and case 2. This section went on looking at the different stages of relationship (establishing, developing, building and maintaining relationship).

A number of issues emerged and presented in form of figures. The next part looks at the analysis of case 2 in the same way as case 1.

End of Case Study.1



Dyadic Relationship Two:
~ A Scottish Bank ~

2.0 INTRODUCTION

2.1 Background of relationship

Auditors and Client have been in relationship for the last 10 years. The auditors have their head office in Edinburgh, which deals with the financial side of the business but also through the banking relationship in London. In the other side, the client has a number of centres spread around the world, which are controlled by the bank out of Edinburgh.

As far as the audit is concerned, the firm does the entire audit for the client worldwide. There are no other firms involved with the audit relationship (audit sharing). So instructions would come from Edinburgh office to other branches abroad.

2.2 Analysis of Elements, Stages and Process of Relationships

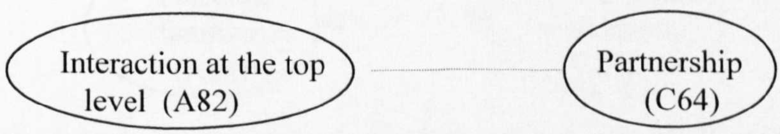
Elements, stages and process of auditor client relationships are analysed in the coming sections.

2.2.1 Establishment of Relationship

This is an *established relationship* (A1) between auditors and their clients (banking group). Verbatim comment by the audit manager expresses that the relationship is through the annual audit report (A74). This relationship started before even the respondent joined the audit practice, a long time ago. In 1985, the audit firm was awarded the audit job in a tender situation (A75) and they become sole auditors of this bank.

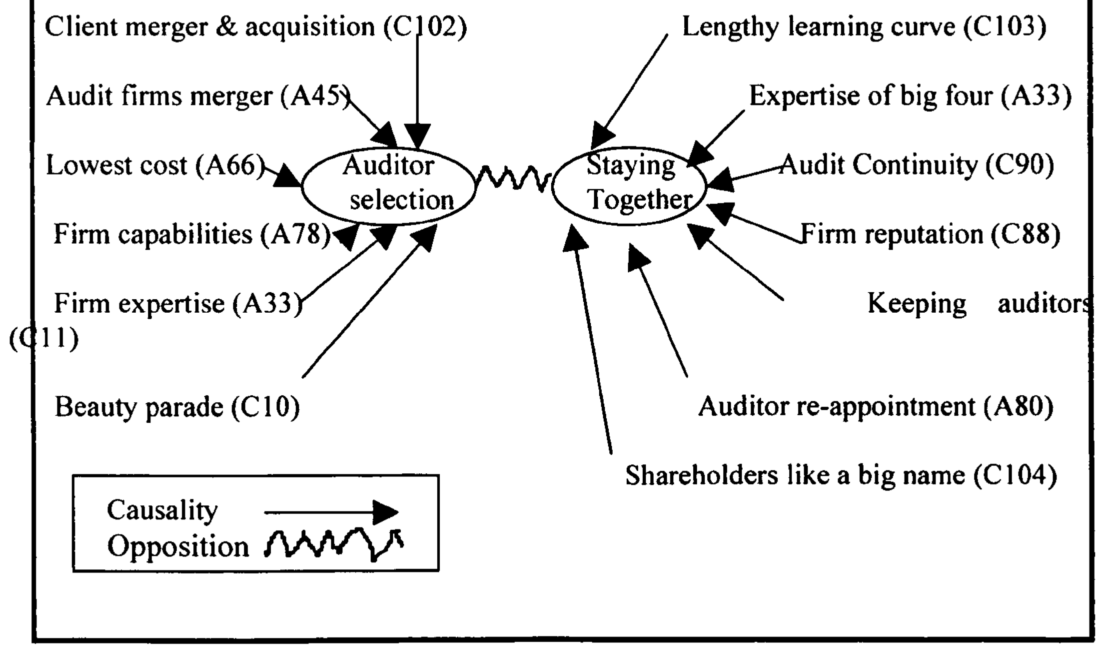
Audit firm selection: The audit was put to tender and three audit firms were short-listed for the "Beauty parade." (A76) They were asked to do a presentation why are suitable for this job and to give a quotation (A12). The cost (A12) played an important factor in selling the audit (A50). Audit firm, which came in with the lowest quote, was given the work. However, the client took into account past experience dealing with the same firm. The top management knew auditors they had contact with them through the Glasgow office, i.e..

Figure B1 An established relationship



Audit firm selection.(A79) is also based on the firm's ability (A77) to cope with an audit of the size of the company (group) (A11) and ability to grow with the client (A62). In case of merger, acquisition or amalgamation (C102) there is an intention by the client to keep a *continuity of the audit.* Therefore, this audit firm is re-appointed (A80) when the audit is put to tender. *Continuity* of audit (C90) appears to have some advantages for the client. The client does not want to have a new auditor (A79), who is going to spend up to 18 months, which represents a fairly lengthy learning curve. In order to reduce this learning curve, the client prefers to keep the same auditors (C11). The following figure B2 shows the dimensions involved for a company (client) to decide whether to select new auditors or to stay with the same firm.

Figure B2 : Selecting a new audit firm vs Staying with the same firm

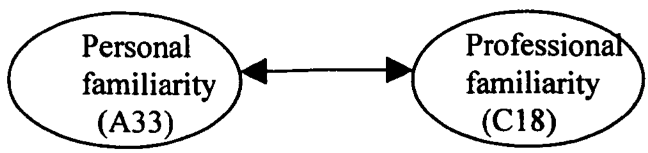


The client believes that any firm from the big four (A22), has the capabilities (A78) and the expertise to carry out the audit (A13).

It emerges that establishing relationship is found within the two categories: Personal familiarity (A33) & professional familiarity (C18). As in their position of qualified chartered accountants, auditors and top management know each other and are familiar with the audit business.

> *"Completely. I mean all of us... Graham used to be a partner in the firm, he was an audit partner, and he worked on this job. The bank was one of his client"*

Figure B3 : Accountancy Profession Circle



Some auditors change side and take new post as financial director with the Client Company. Others are very close to be appointed auditors. The latter emerged in case 1 where the audit partner formed a new company and appointed his friend as auditor.

2.2.2 Relationship development.

Company size (C69) is seen by the auditors as important and worthy to work with the client. The client is described as an unusual because there are more than core centre and it is very much a Scottish controlled bank out of Edinburgh with international operations.

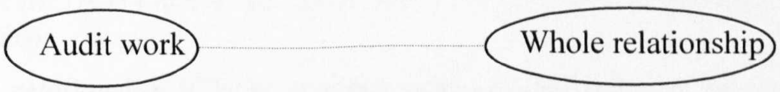
International operations (C13) *and size* (C69) of the company are important factor in developing the relationship (A1). Here, the capabilities are expressed in two senses, for the audit firm shows it has the means to carry out international operations. For the other, it is the ability (A77) to pay big fees.

Because the client is a group with a number of divisions, which are controlled out of different geographical areas, for instance London, Boston and Edinburgh, the audit firm has different people to handle these relationships. These people are based locally. So, the *physical location* (A73) of these people assigned to the audit assignment are the same where the decisions making are. *"It is ludicrous to have an Edinburgh partner looking after Boston relationship..."* as it is expressed by the audit manager. So auditors take the opportunity to develop relationship when they are called to help to solve a problem. It emerges that *Problem-solving* (A15) is a continuous process (C90). It is not only trying to assist the client to prepare his account (A71), but also help them to meet their operational and financial problems. One way to do it, it appears that auditors try to assist with a minimum disruption and annoying the client (C70) in order to avoid loosing the client to the competition (A44). However, the auditors are aware of the reasons that can loose their client.

Within *rapport* as one of the major dimension in audit relationship, there are elements such *personal factor* (A81), which help to develop the relationship. Moreover, the audit, it is seen not just as a piece of paper signed by auditors but as the *whole relationship.* This leads to developing rapport based on the *personal relationship*. (A17)

> *"When it comes to our ordinary relationships with clients we believe there is no substitute for getting to know people at the highest level, i.e., the decision makers. If you have to go elsewhere to get that information then you have not got that relationship..."*

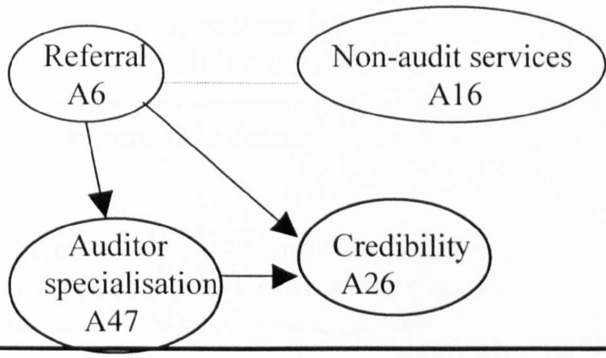
Figure D1: Audit Relationship



Referral (A6) emerges as a component of *credibility* (A26) used by auditors, especially in creating job for other departments. Auditors see that there are existing opportunities with their clients and believe that it is a useful mechanism for targeting work. Department requiring insolvency work, which tend to be one off, receive referral from other departments and from a number of professional friends like lawyers, bankers etc. (figure D2)

As far as the *Non-audit services* are concerned, the client buys them from the same firm.

Figure D2: Credibility



Another unveiled factor within this analysis is *Capabilities* (A78). Auditors believe what is perceived by the client, i.e., it comes down to people how they see their auditors. Generally, it is taken for granted by the client that the firm has the technical expertise (A43) and the ability (A77) to the job.

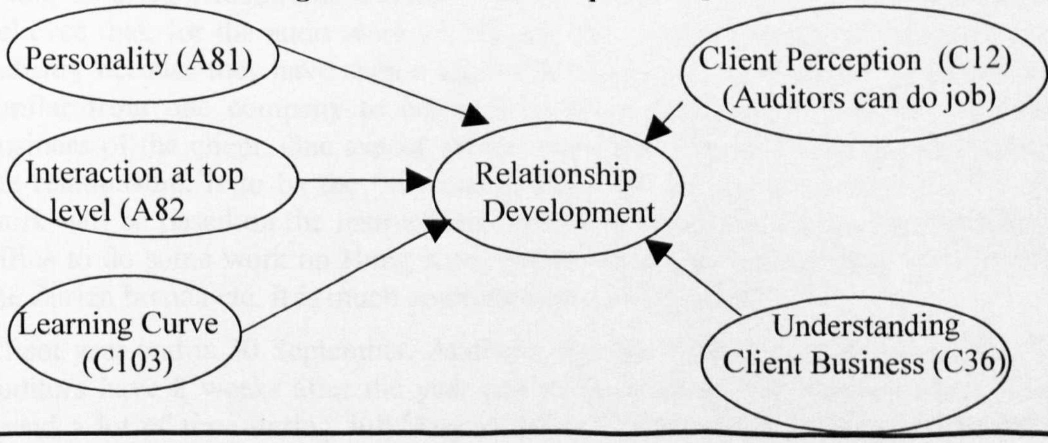
Auditor specialisation (A47) *& quality of services* (A28). This audit firm has more than on major banking client. It has a group of specialised partners (A43) based in London who are advised on all the bank audit through the UK and move around the country to discuss technical issues with different branches to ensure the quality of the audit service is to a high standard (A28).

The relationship is believed to be developed on the "*personality*" (A81) level between the audit partner (A41) and the chief executive of the bank (C4). The *rapport*, taking the form of personality is developed through time and when the auditor works closely with the client. It is believed that it takes time for a new auditor to learn (A51) about the client system (C41), and to understand about his business (C36)

Developing relationship (C1) is working with an audit team (A39). Client asserts that to operate, as a teams is much easier in that respect rather than talk on to one-to-one (A17). Moreover, for the client is;

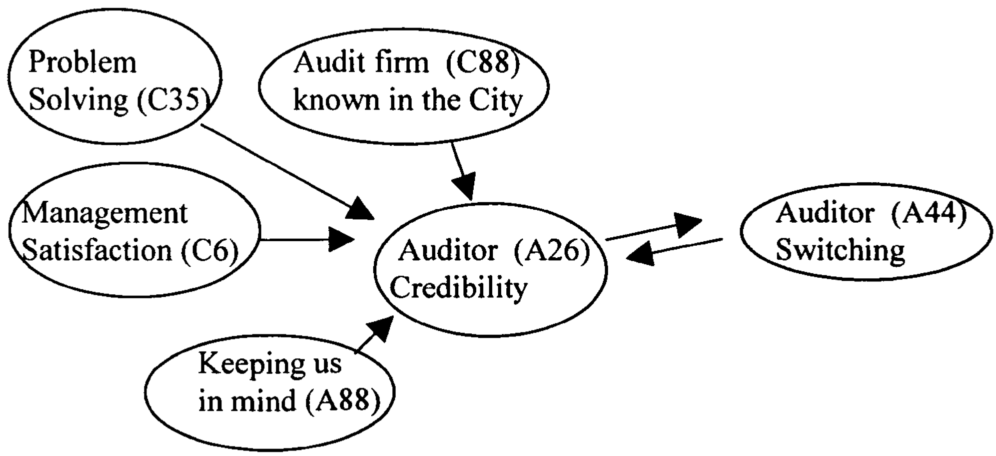
> *"Starting form the basis, what we probably look for the audit is someone with whom a good working relationship has been established. Someone who does not upset us."*

Figure D3 - Relationship Development



It emerges that the credibility of auditors (A26) is related to other factors such as the size of the firm rather than the auditors themselves. At this point, the analysis reveals that the size of the firm not only reflect its capabilities following the client in its international operations but also ensure their credibility within the City. Thus, auditors switching is interrelated to the credibility of auditors.

Figure D4 : Interaction between credibility & auditor switching



Auditor credibility - As long as you have one of the big four accountancy firms, the credibility is there, as it is believed by this client. The client feels confident because their auditors are one of the big four. The client in case 1, who has a medium-sized firm as auditor for his business, has refuted this belief.

> *"The credibility of our auditors! - I really do not think there is any doubt about that point. If we doubted our auditor credibility then we should be asking ourselves some questions such as why are they our auditors. As we are not asking ourselves that question then we do not doubt their credibility. As far as, employing the big four firms goes then, they are all credible."*

2.2.3 Building Relationships

The study reveals that building a relationship between auditors and their client starts with the audit work and the work relationship.

Working relationship (A58) has been expressed through a good *communication* within the financial side of the business in Head Office in Edinburgh, and banking relationship in London.

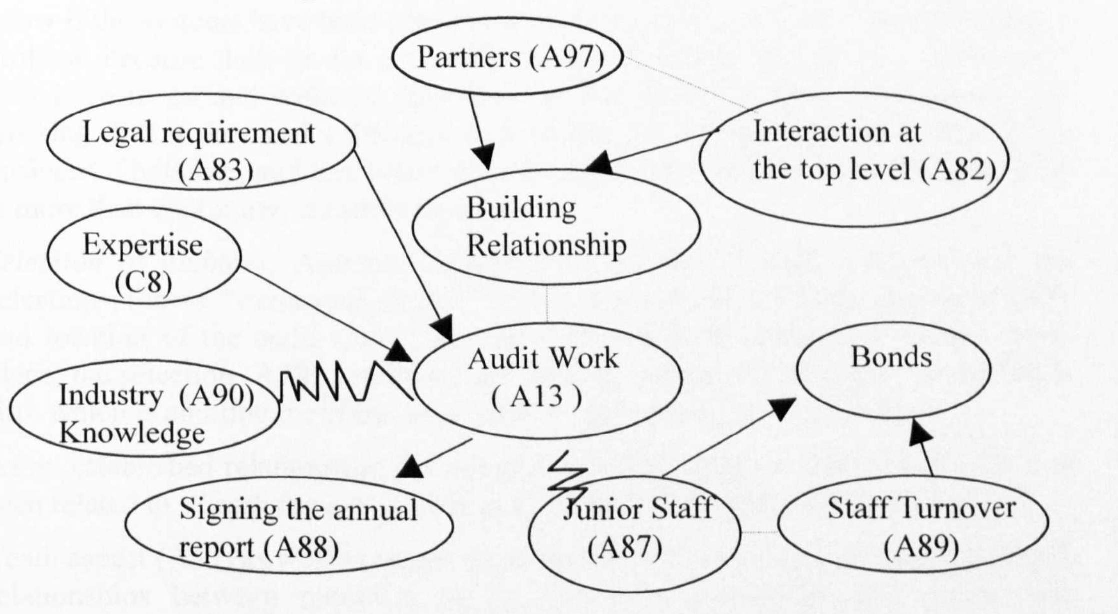
Audit, as a legal requirement (A83), companies have to have it. Moreover, client believes that, for the audit work (A13), any big firm can do the job disregard the industry because they have such a variety of audit works and all the techniques are similar from one company to another. *Audit work* is carried out for the entire business of the client. One aspect, which encourages the building and maintaining the relationship, is to be the only one to carry out all the audit work (C101). All work will be based on the instructions coming for Edinburgh office to Hong Kong office to do some work on Hong Kong branch or to the Zurich office to work with the Zurich branch etc. It is much controlled out of Edinburgh.

Client year-end is 30 September. Auditors sign the accounts 29/30 November. So, auditors have 8 weeks after the year-end to do work on the Balance Sheet. They spend a lot of time during July/August doing interim work, looking at bad debts, provisions, computer systems, which is a very large part of the bank. So, it does take four to five months to the audit. Moreover, *signing the annual report* (A88) takes place after all information arrive from audit offices through the world in the first week of November and the annual report is signed at the end of the same month. The actual work of group consolidation takes less than ten days.

Audit working relationship is described as a very good one and both of them have knowledge of each other. Moreover, the relationship is seen as consistent due to the continuity of the partners (A38).The junior staff although is important, has less impact on the relationship comparing to the relationship at the top level (A82). However, despite the junior staff changing a lot (A89), some of them remain working with the same client and move upward the level of hierarchy and become an audit manager or partner. During this period, i.e., from junior level to managerial level, personal relationship (C15) is developed and bonds are established (A90).

> *"Obviously the junior staff will be working away in the background, doing the checking that is necessarily on transaction and entries on accounts and that sort of things. A lot of mundane points will come up through the management report that is produced at the end of the day. But that happens in the background and the top level of management only see the end results coming through the management letter that follow when the audit is completed."*

Figure E1: Building Relationship



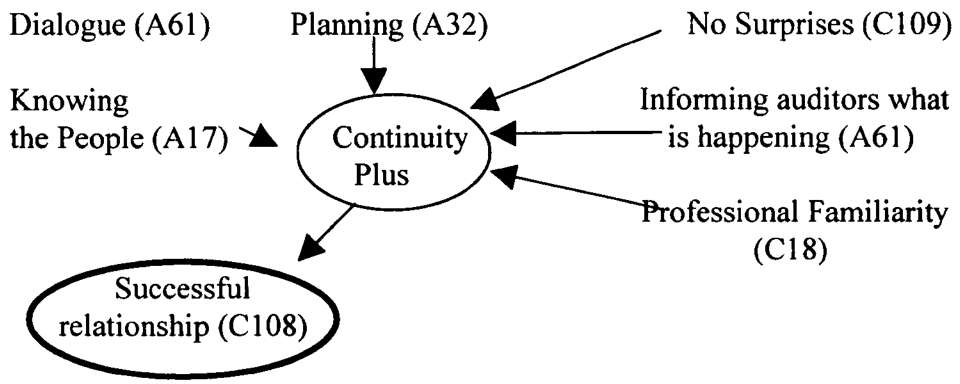
Audit team (A39), from the Edinburgh office doing the top level consolidation audit, they will have about a dozen of people working on the year accounts. Smaller teams are operating in other centres.

Continuity (C90) is not expressed on time of people they spend working with the client but other factors.

> *"What could happen in continuity is that someone could audited us for one hundred years and all what happens is a month after the year end, they come here they work on our books for two months and go away and we do not see*

> *them for ten moths. That is continuity it is not necessarily a successful relation . What I am saying is you need more... dialogue... planning, no surprises and to let them know what is happening. So that what happens to make it as success. That is a large part of a successful relationship."*

Figure E2 : Continuity & Successful Relationship



Continuity is seen as a *continuous dialogue* between this auditor and its client, not as a number of years they spent together. The reasons behind it, it is important to know people you work with in order to do the audit work. For instance, auditors presume the systems have not changed. If there is no dialogue then they would not know if the systems have been changed until they arrive next year. That will cause a problem because they do not expect changes in the client system. If it is the case, they have to go and redesign their test. So this shows that the continuity is not working. But if they had a dialogue in between, i.e., meeting and discussing client business. Therefore, auditors know what is happening and they can react to it. So it is more than continuity, it *continuity plus*.

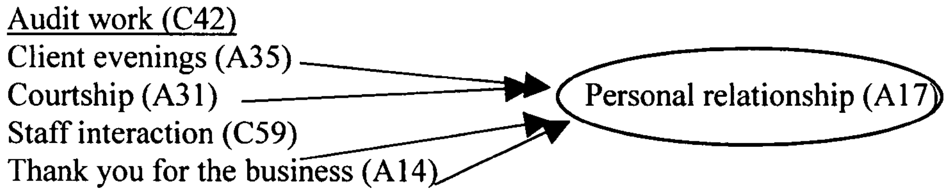
Selection of auditors. Auditors' appointment is done through a tender and the selection process *"Beauty of parade"* (C10), client looks for cost reduction (A12) and location of the audit firm (C16). In 1985, when the merger of auditors took place, the selection (A79) was based not only on cost but making sure not having a firm which is auditing the client main rival in the banking sector (C110).

As an established relationship, the re-appointment of auditors (A80) every year is a seen related to *"heath factors"* (A90) as described by the audit manager (A84).

Team aspect (A39) as well as *social relationship* (A31) are important factors. Social relationships between members of the two teams (auditors and clients) are encouraged during the course of the audit by both sides. (Figure E3)

> *"We have at least two or three drinks evenings or perhaps a lunch with a few members from the clients team and vice versa throughout most of the audit to try to help us relax each other to do the work because it is along time- it is a long time to do the audit work. So it is good to unwind and just have a beer."*

Figure E3 : Interaction between Audit work & Social Relationship



Both building and *maintaining the relationship* is not left only to the top people to take care of it. It is lowered down the hierarchy. Everybody will be involved whether they are students (A94), supervisors (A95), manager or senior partner (A97). It has been recognised that the relationship should be maintained at the top level (A82). However, efforts should also be produced by all the audit team at their different levels (A87).

Composition of *audit team* is very important and where personality character (A81) take over the skill (C45). Audit supervisor watch closely their audit team in order to avoid any clash of personality or disruption (C70). If a member of the audit team does not get on with the client staff. He will be singled out at the end of the audit work and will be assigned to an other team to a different client.

> "... *Although that person may be good at their job and getting the audit done but they are rubbing up the client the wrong way. Then we could take action because it would just create friction and make it difficult for everyone else.*"

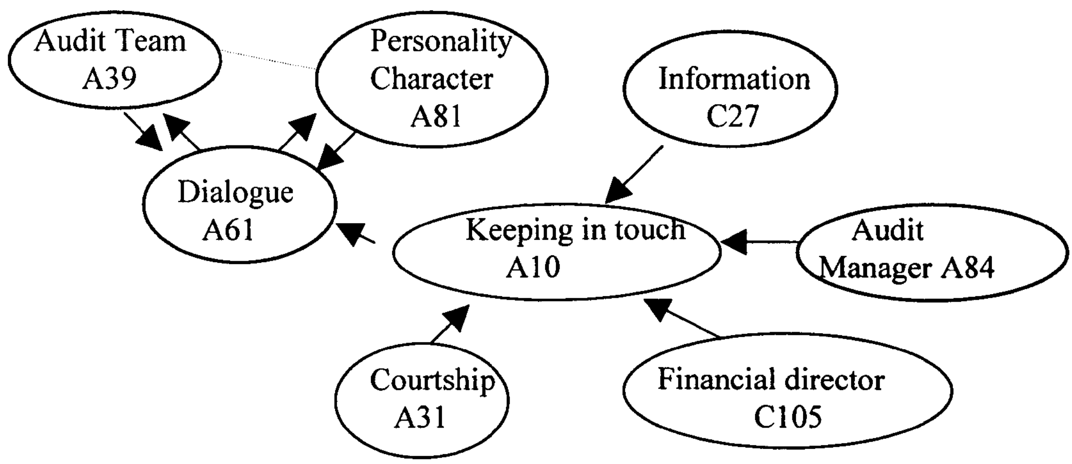
Moreover, at the national level and international level, senior audit management make sure that client handling team world-wide meets together regularly to discuss the quality of the firm service to the client. That would happen then world-wide once a year and in the UK every three months.

Clash of personality does happen but not so often and are dealt with as quickly as possible. Precaution are generally taken to avoid any misunderstanding which can be developed into a clash of personality. Supervisors are there to guide junior staff so they will not be asking the same questions or seen to be learning audit work at the expenses of the client time.

Getting on with personalities is an important element in *building relationship.*

> "*Yeah... I think they (Auditors) are very conscious... right down to the junior level. I am sure they are very conscious of having to go and ask questions. I am sure they take a great care not to over burden anyone particular area with questions. They do what they need to do satisfy themselves and they have the right answer. I certainly have not come across any problems arising from that side of their work.*"

Figure E4: Relationship Disturbance



Keeping in touch (A10) is helped by a computer database. Auditors have a computer system where their core clients, the most important clients' names, interests, hobbies (A65) etc. are stored. Two or three partners are assigned responsibilities to see the finance directors and group finance of their clients. Moreover, they keep record of invitations to request pamphlets, books about technical matters, tax, investment and anything general which relate to the services which the firm can provide (C27). *Courtship* (A31) is used often in the audit relationship.

> *"Social events and individuals... not just the invitations to seminars but invitations to come along to the opera or to a cricket match or lunch even one to one basis. It is good to have an invitation to seminars but that is not ideal for getting close to people."*

So, *keeping in touch* (A10) is used as a way of building and maintaining the relationship (A42). However, auditors do not believe they need excuses to keep in touch with their clients. It depends on individuals how their social lives operate (A65). But, if an auditor has a good professional relationship with finance director, does not need to look for excuse to meet his client. It is believed that the professional relationship is always there. If an auditor looks for an excuse for a situation, then it appears that a good professional relationship does not exist. *Regular contacts* expressed through regular meeting, are often considered as part of an *audit planning*. Meetings take place for various agenda, for instance audit related or a technical related or a business related. It is always a long agenda to talk about because it is complex business.

Regular contacts (meetings) with the top management, not the whole audit team. *Continuity* is maintained at the top level; partner-management relationship. It is believed by the two parties that *continuity* which makes the relationship successful and enduring. *Keeping us in the mind* (A8) of the client might have an influence later on. However, if there is a problem and the client is not happy with their auditors, it happens that he will go to the firm he has already in mind (A8).

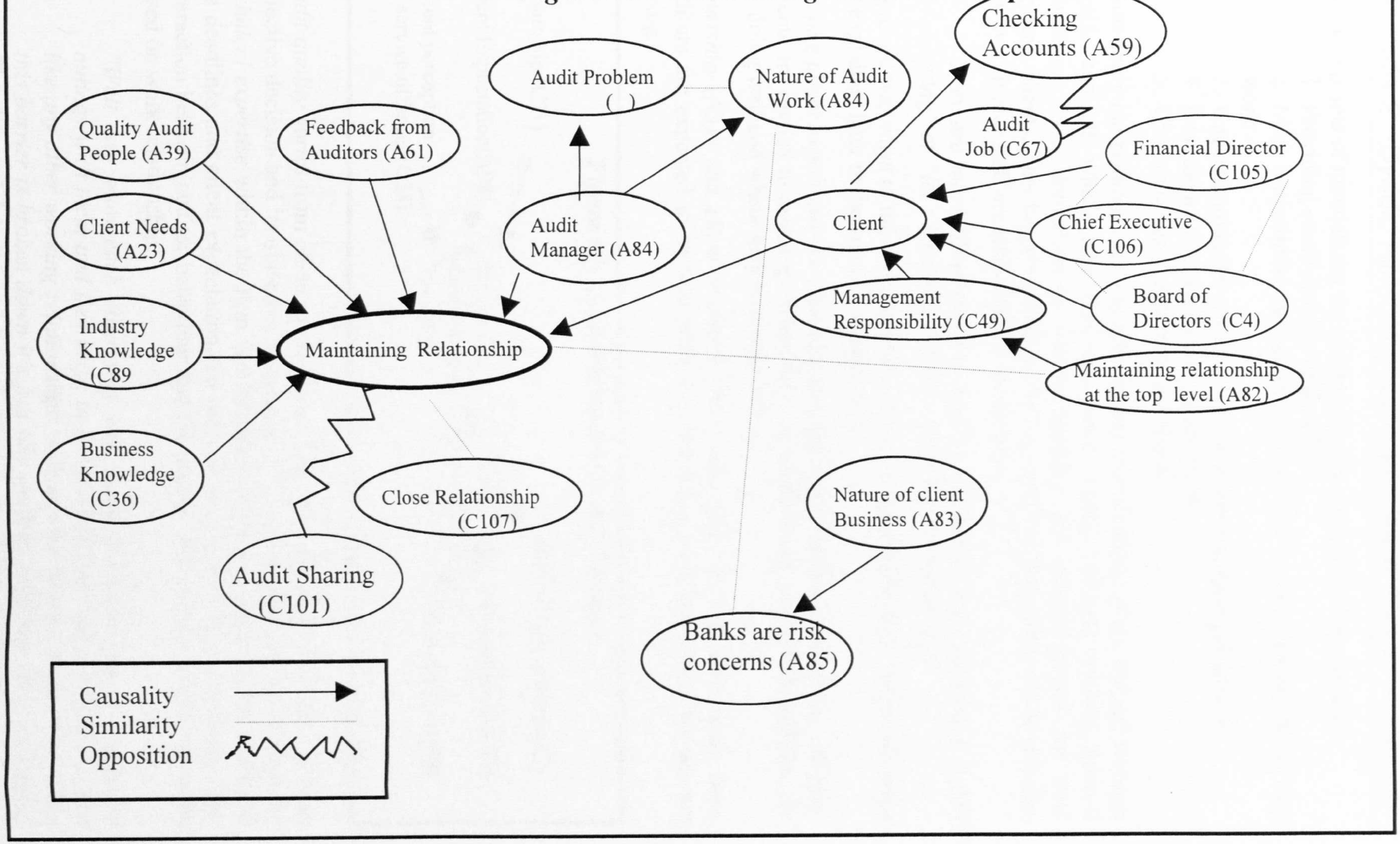
2.2.4 Maintaining the relationship

Maintaining the relationship (A42) is generally related to the nature of the audit (A82). Audit manager (A84) does not believe that the firm has a problematic relationship with their client. Clients do not look at audit job (role) as checking the accounts (A59), because bank directors (C4) understand that it is not simply a checking exercise to go away and pay the fees. They are not looking for a situation where they can minimise the cost and minimise the burdens of its overheads because it is a bank business and banks are very risk concerns (A85). If things go wrong and if the systems are not correct then a bank will fall flat and it will very quickly perceive the situation as that.

When it comes to *maintaining a relationship* (A42), emphasis is put on making sure and a clear understanding and appreciation of the concern (A85) and expectations of the *chief executive* (C106), the top man in the company, not just the financial people because he is the man who decides. But, views of the directors are taken into account as well. This is to say, audit firm target and find out who is the decision maker. Auditors try to be closer to their clients in order to recognise who the key players are on any board of directors of any company.

The following figure F1 presents all elements involved in maintaining the relationship for this case.

Figure F1: Maintaining the Relationship



The main points of maintaining the relationship summarised by the client are:

1. Providing *quality people* to the client.
2. Must *understand* the client *business and industry* before doing any work.
3. Understanding the *client needs* and *wants* and its expectations
4. Develop a *close relationship* with people.
5. Give an *honest feedback* to the client.

Maintaining the relationship. The relationship is maintained at the top and through regular contacts which take different forms, social outings, sending general information, etc.. Invitations to various sporting and cultural events are send regularly clients. This happens often at the top level but does filter down very far. However, junior staff are left to their own devices.

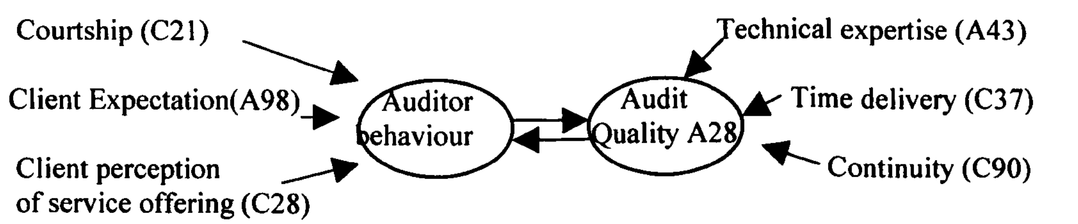
> *"They are more likely to sit around the table and say "let's have a golf outing" or "let's have lunch or do a buffet for the junior staff."*

There are two ways to maintaining and expanding the relationship. These two ways are explained later in the types of relationship.

Meeting client expectation is often checked through a feedback on service offering. Clients are invited to meetings where they are asked to say where their auditors are not doing well and where they would do better.

Courtship (A31) and *client feedback* (A61) take place in the same time. here, auditors are expected to be told what they are doing well and what they are not giving.

Figure F2: Auditor behaviour & Audit quality



Audit quality varies from client to client and from an individual to another. It is an objective decision and its objective judgement. The audit quality is seen through the *technical expertise* within the firm and Edinburgh office to conclude the audit and the deadlines and client expectation. To achieve this, it is to have continuity. The interaction between auditor behaviour and the quality of the audit is believed to be based on work relationship.

> *"Well they know each other very well know. We have one or two social outings with them and that helps to break down any barriers and it is just like any other working relationships with anyone works for the bank. Once this barrier is broken down it's just like working with any other colleague. They have a job to do and you help them as much as you can."*

This leads to a successful relationship, which is discussed in section 8.4.1 of this case.

2.3 Environmental Condition Analysis

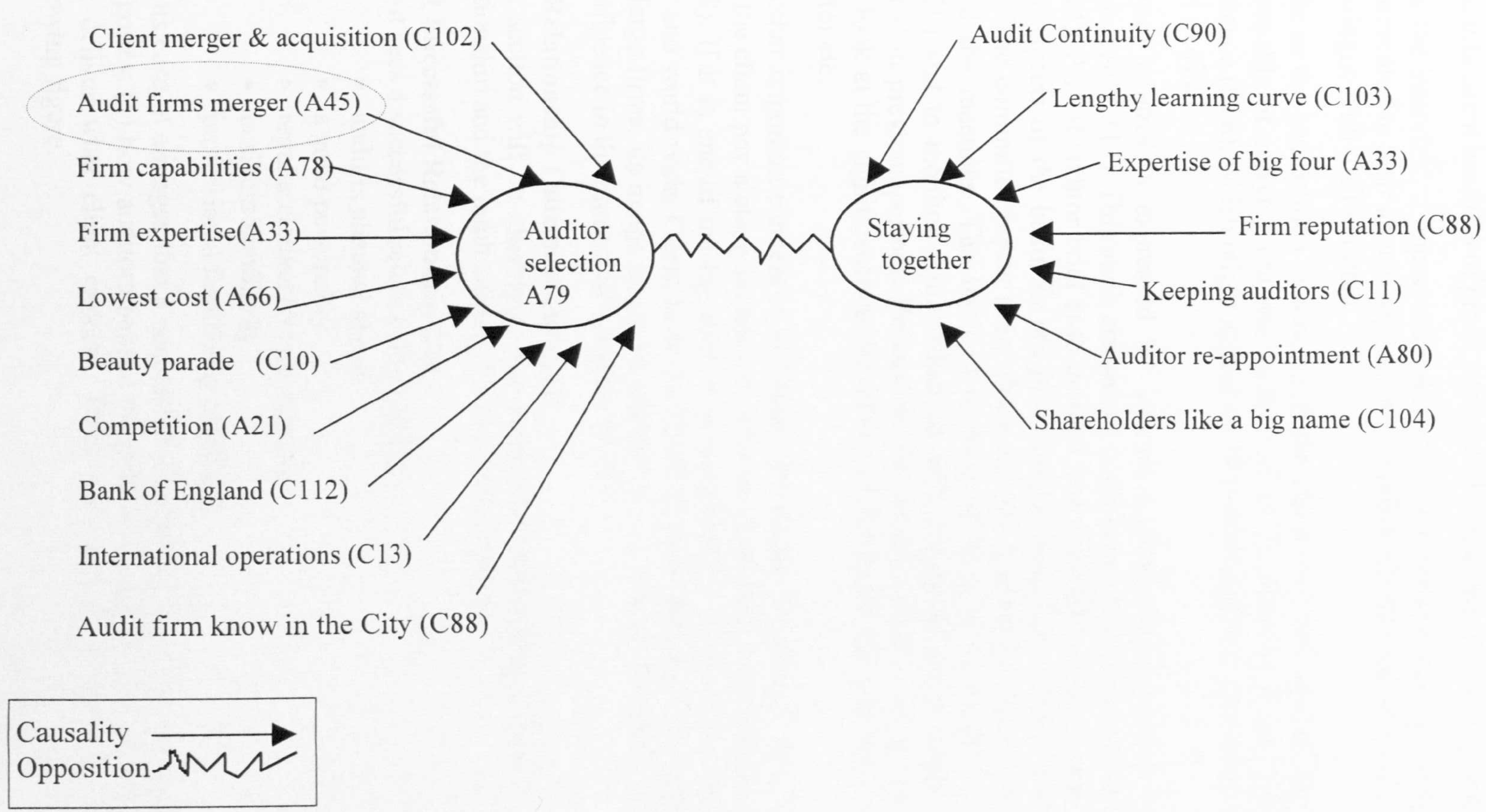
There are a number of external factors influencing the relationship: information disclosure, merger between audit firms, competition, formation of audit committee, internal control and other factors.

Disclosure of information (A99) is important to US and UK shareholders (C26). As information (C27) is given freely under the US requirement under the form 20F which is a filing document with Washington. Therefore, the client believe that the same information should be given to the UK shareholder as well. So, as a set of accounts which go from page 30 to 55 of the annual report are audited by the auditors. However, there are another ten pages at the back of the report which cover additional financial information (A99) as a large clearing bank and as one of the top *bank management* believe they should disclose this information.

Merger between audit firms is another factor which has an impact on the relationship. The audit firm has merged with another audit firm in 1985 and become one of the big four. At the start, there was a fear that the merger will have a severe impact on a number of its clients. It is only affected about three or four clients world-wide. Clients were lost in Boston, Zurich and Singapore, but not nationally.

Audit sharing. Sharing audits with competition disappear once the merger between clients companies take place, as well as the audit firms. Any type of merger whether in audit firms or between clients will create a loss of an audit, i.e. audit switching.

Figure Selecting a new audit firm & Staying with the same firm



In this case, client switching auditors is more due to the merger rather than to *competition* (23). In Scotland, the client sees only one major bank as its main rival (C110), which is not audited by their own auditors. Their main rival has also international operations. Their profits, shown in the balance sheet represent 5% while this client has 20% of profit attributed to their international operation.

From the interview, it appears that this client is interested how the main rival profit are presented in their annual report. One wonders whether this is used in negotiation or dialogue with their auditors.

As far as the competition is concerned, the clients is aware that all big four (C104) are capable of carrying out any audit work (C5). There is a very little perceived difference (C28), which might appear on firm claiming their specialisation in certain areas (A47).

Internal control is expressed by internal auditors and overseen by the *Audit Committee* (C113). This audit committee is governed by the *non-executive directors* (C114). Part of auditor brief is to monitor and comment on the control (A100) and audit aspects of the business not just external audit but *internal audit* (C115) as well. The committee meets every three months, and invite executives directors to attend the meetings. The function of these meeting is to explore control issues (A100) and to monitor action taken on with regard to the problems which have existed in previous periods. Because of the function of the committee, they would also look at the significance in the quality of the audit, the appointment of internal auditor etc.

An other important element is the *Audit firm image.* It emerges from the interview that the client pay a close attention to how the audit firm is perceived by the outside (C88). If it is one of the big four, it is recognised in the business community, the City and world-wide. Client believes that if an audit firm does not belong to one of the large firms, its image might be affected (C12). Hence, the audit firm image has an influence in the process of selection (A79).

2.4 Relationship Outcomes Analysis

This section will be identifying the successful relationship elements, the types of relationship and the implications of a close relationship.

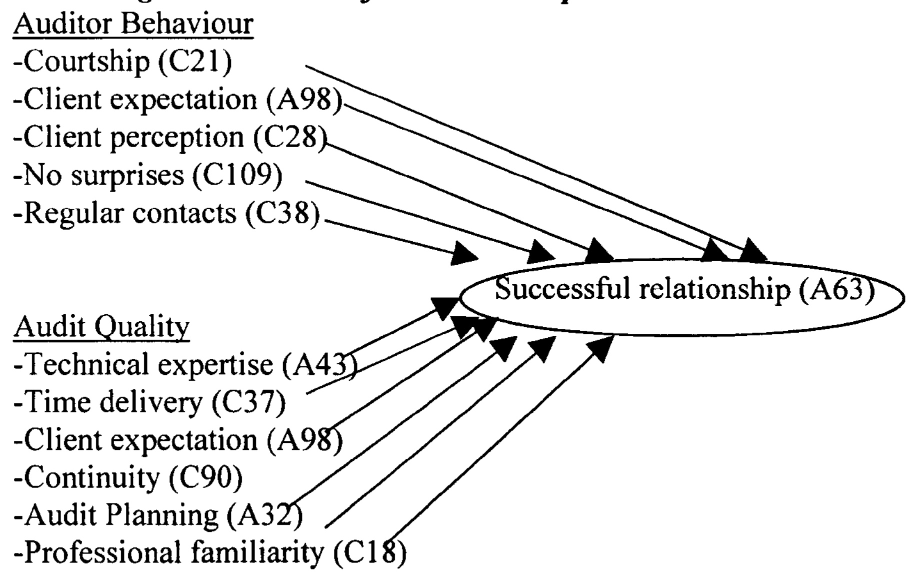
2.4.1 Successful Relationship (3a)

Client sees a successful relationship (A63) as:

- audit is planned ahead
- a good personality
- regular contact and no surprises
- business familiarity
- professional familiarity continuity

In this case, it emerges that a successful relationship is closely linked to two major categories: (1) how auditors behave towards the management, (2) whether auditors will deliver what client expects. These two categories are represented in the following figure.

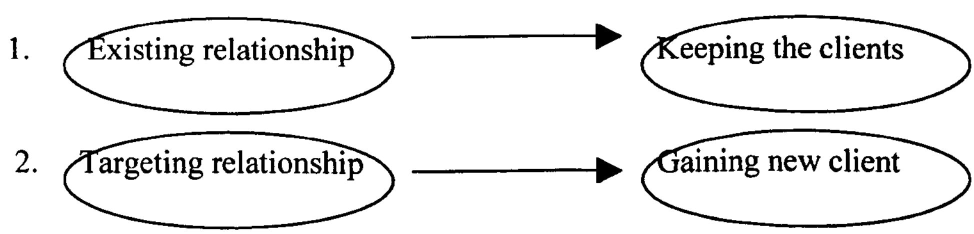
Figure I1 : Successful Relationships



2.4.2 Types of relationship(3b)

The analysis reveals two types of relationships - *exiting relationship* and *targeting relationship* (A101). If the audit firm is expanding or developing its business. It has two ways to expand its business services. Either it increase the level of its services (C80) and fees to its exiting clients or to obtain work from new clients (A29).

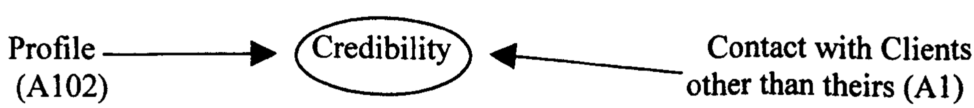
Figure J1 : Emerging Relationships



By putting emphasis on the first, audit firm tends to establish its credibility (A26) and be more helpful (A3) to the client. For new client, it comes down to people (A17) and when the firm cannot just rely on referral. The firm has to have the presence and the contacts as well.

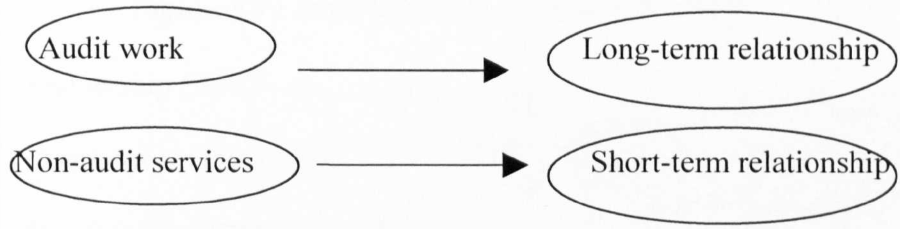
The second type of relationship is *gaining a new client.* Contacts with non-client i.e. (client other than theirs) help the audit firm in increasing its profile. This also leads to enhance the firm's credibility.

Figure J2: Auditors' credibility



On the whole, there are two types of relationships between accountancy firm and its clients. Long term relationship is based on the audit work and the short term relationships are related to one off work, i.e., non-audit services.

Figure J3: Nature of Service & Types of Relationship



2.4.3 Implications of auditor-client relationships. (3c)

A close relationship can be *disruptive.*

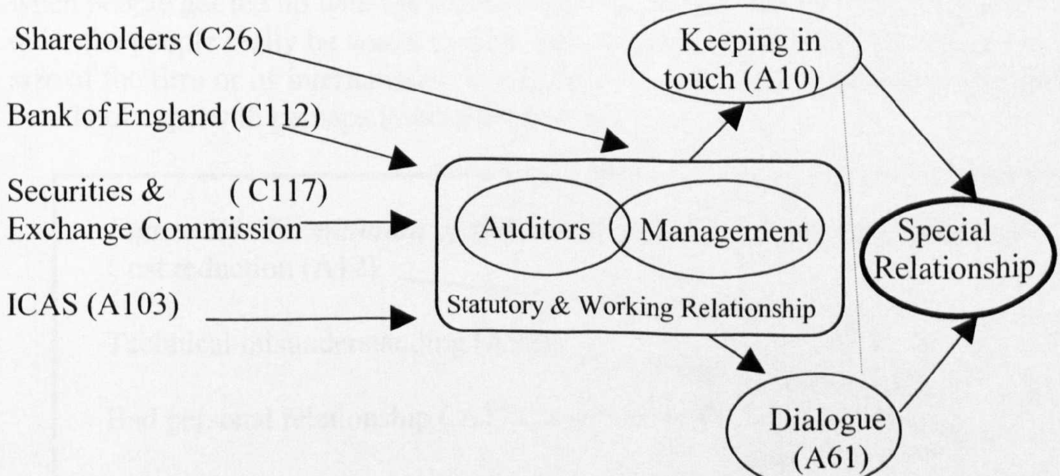
> *"How we are able to assist our clients in meeting their operational and financial problems and how we actually do our audit?... The answer is whether we interrupt the client and annoy them or we try to minimise the disruption that - because an audit is disruptive, everyone is disruptive."*

Keeping in touch works both ways. Auditors try to have regular meeting with their clients throughout the year. This is imposed upon them by the nature of the banking business.

> *"The nature of the business is that there is so much happening now both on regularity front as well as compliance with the accounting standards you find that you have to see them more often an more often."*

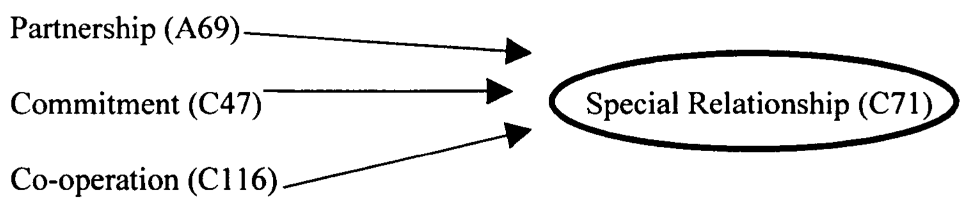
To the client, auditors perform various roles in the bank and not just as auditor reporting to the shareholders. They hold the reporting accounting role to the Bank of England and also required to sign off our returns to the securities and_exchange commissions in Washington. If the bank is doing loan capital issues or share capital issues and it has done few of these in the past five years. Then, auditors are involved in looking at the figures and are part of the team that eventually put solid documentation for these issues together. So, the client believes that it has been a very close working relationship that they have had with them.

Figure K1: Close relationship



The implication of a close relationship is expressed through the auditor involvement in preparing a "solid documentation" for a loan capital issue or share capital issue. They are part of a team. This lead to see the relationship developed to a *"a partnership"*.

Figure K2 : Implication of a close relationship



Partnership (A69) is seen as working as a part of a team, *It is very much a joint effort. It has got to work that way. The complexity of the documents that are produced, it has to be that way."*

Commitment (C47) is about perception of what the client make of their auditors, such as whether they take their role very seriously. They take interest what is happening within the company and talk to the right people in the company (A61). So, being informed and knowing what is happening it helps avoid as king the same questions again and again by the audit team.

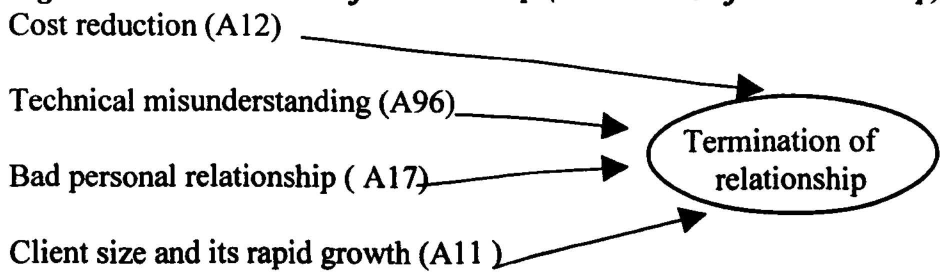
Co-operation (A104) is part of doing business and getting the audit work done. It is about meeting and discussing (A61) the various aspect of business.

The implication of close relationship. Auditors are not seen as *inspectors* to check accounts but rather helpers. However, client believes that auditors have to satisfy themselves that *proper controls* (C115) were in place.

> *"Obviously a good few of their meetings this time around focused on the levels of bad debt provisions. That has been the main focus of a lot of meetings."*

Termination of relationship (Auditors switching). It is difficult to understand why a company would put the audit out for tender or to obtain new auditors. Some of the reasons indicated by the audit manager as popular are *cost* that client want to have, a *cost reduction* in the audit fee. Other reasons given generally would be *technical misunderstandings* or *technical grievances* where the management do not believe that the audit firm will allow them to do something which they wish to do. Thirdly, when people get fed up with the relationshipit is when thinka that the people are not quite the people really he wants to deal with on annual basis. The four reason is the size of the firm or its international dimensions, for example a small audit firm which could not cope with perhaps international needs of its client.

Figure K3: Termination of Relationship (or unsuccessful relationship)

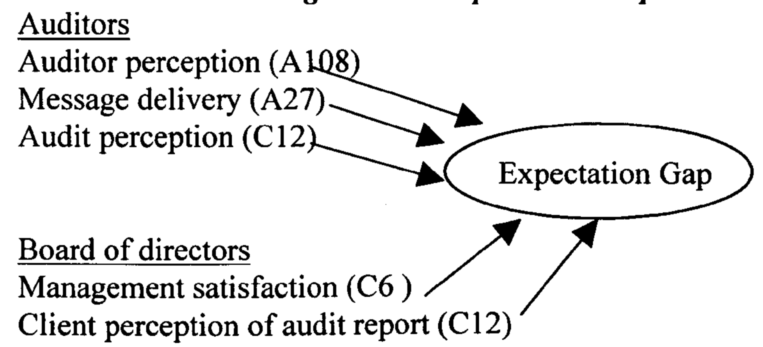


Client believe that companies tend not to change auditors, and certainly that has been the historical experience in the UK. They tend to stay with the same auditors. This suggests that conflict of persons is linked to understanding each other expectation.

> *If the firm does not understand what the directors are expecting and what they want and if they are giving the wrong messages then that could jeopardise the relationship.*

Expectation gap (A105) Auditors try hard to communicate (A27) with their clients. However, they feel that some of their messages delivered to their clients are not well received due to the message delivery or not to be accepted by the board of directors. This is defined as *"expectation gap"*

Figure K4 : Expectation Gap



Expectation gap (Auditor & management)

> *"you have a non-financial director who expects different things from an annual audit report and perhaps he does not understand the scope of the work that is undertaken. What you are obliged to do under the Companies Act and what we actually do under technical guidance in the firm."*

> *"It is common to just about every audit you will come across. If the senior management is knowledgeable about the shortcomings of an annual audit then that is fine. It is where certain directors believe that an audit is a complete review of everything in the company. This is a method by which management can maintain dozens of helpful points to run their business better and hopeful points which will help management to run the business better. But he focus of the work is to the figures not to the way the business is run all the time because if we did that we would be charging a higher audit fee."*

Conflict of interest. When an auditor is working with another client because he specialises in one industry would jeopardise the relationship with another client with the same industry and it depends much on how much control exist within the audit firm to investigate those conflict between rival companies. This audit firm does not have this problem because they have different work teams working on different assignments and allocated to different clients within the same industry, i.e.,

> *"In banking sector that is not such a problem because first of all we have the Chinese wall imprint between the teams who have to work for that. But also because we have a central pool of expertise coming together and experience. That actually enhances the quality of services too..."*

Conflict between people. The conflict is general between people not about audit. The conflict is resolved through discussion and argument.

> *"If a professional advisor is not testing the customer then he is not a good professional advisor. Everything is always hunky dory and going on fine - it means it is too cosy. - and the professional advisor is not suggesting alternative ways of doing things which may be better for the customer. If that conflict on people is on personal relationship and is apparent - say there is a lot of conflict of people - not just the suggestions or technical side then I think there are dangers.*

This suggests that conflict of persons is linked to understanding each other expectation.

> *If the firm does not understand what the directors are expecting and what they want and if they are giving the wrong messages then that could jeopardise the relationship.*

Auditor independence. It touches the image of the quality of the audit they are doing for the client, if they cannot be seen as being independent.

2.4.4 Emerging issues

The core product of relationship is the audited opinion. The product of an audit is simply defined as *"audit report"* or can be defined in wider sense as *"being relationship with your client"* over this five months and find that this situation develops.

> *"We see, in our firm the product is the service and it is important that we set up our service delivery in such way that it is what the client expects and demands and satisfied with it."*

Client perception of auditors' role. The role of auditors is seen differently by different clients. Different directors have different views on what an audit should be and what the purpose of relationship is. One view of these directors may just be looking at all accounts checking. Then, audit is seen as a sort of inspecting, taking the money and going away.

Audit firm merger is a complex in its nature. When this actual audit firm merge with another firm, *"they just come together"* i.e., other offices were allowed to go on their own way and did not join the merger with other firms. Audit firms merger is different in general terms.

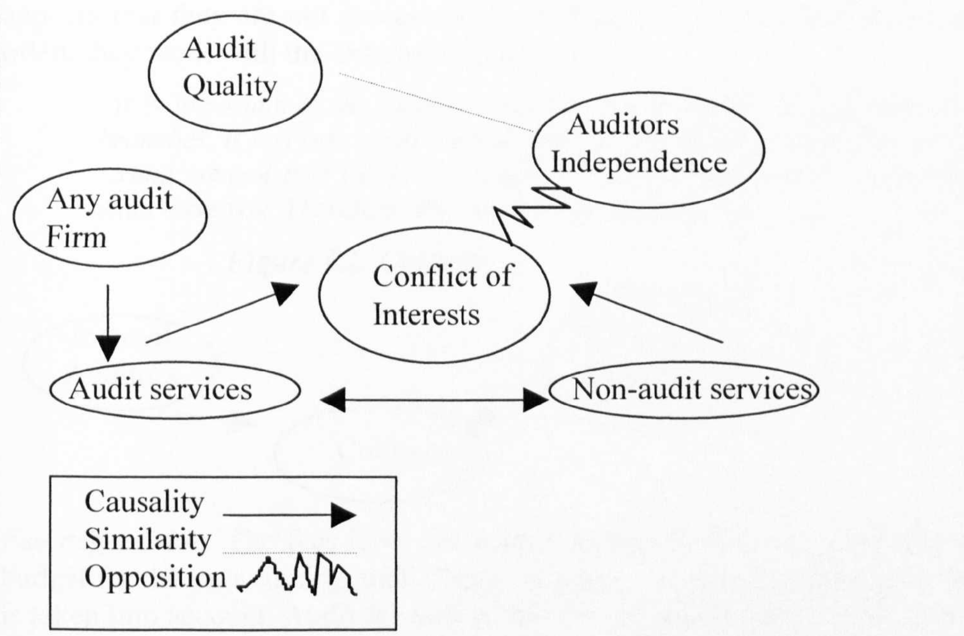
Non-audit services. Client is generally aware what is on offer as non audit services. The company knows where to get them because it is in touch with other accountancy firms.

> *"... We could go outside the big four and it could have some of the specialist consultancy firms... our short list may include them as well as one of the big accountancy firms who are known for a specific area. So they are competing as consultants rather than accountants."*

The client does not want to give the impression that they buy all their services from one accountancy firm because they want to keep that image their auditors are *"independent"*. Moreover, it does not want to have non-audit services, in value-terms, to be greater than the audit fees. One thing the client does not want to be seen doing is, to have the same firm advising them on systems, then later on they come to audit them.

This idea of not buying all non-audit services from the principal auditors, is simply to show that the auditors are independent from their clients.This picture is portrait across all cases.

Figure L1: Conflict of Interests



Buying non-audit services from an accountancy firm which is the main rival to its audit supplier is acceptable by the whole competition. Moreover, non-audit services are generally bought from the market leaders even if they audit their rival companies. However, client believes if there is a hint of scandal that will pull down their reputation.

> *"Actually PriceWaterhouseCoopers are doing some work for us in our treasure department and helping us with a consultancy project there. What they are advising us is publicly available... they have different pamphlets on it anyone can read the stuff. What they are doing is taking their expertise and applying to us. Now with another bank say midland for example they will use the same expertise but they will design it to fit Midland. So you start with the same product but you design it to the need of the client."*

Auditor selection. When selecting an audit firm, client takes into consideration the firm *reputation* within the City and its international operation. A medium sized firm is accepted by the City and some people within the company believe it would not do any harm to the company image if it is selected. As a bank, the *Bank of England* would make some comments if it is not happy with any bank's auditors.

Double role of shareholders - The shareholders are part of the company but when it comes to look at the relationship between the management and the auditors, their role is the same as external players, i.e., invest or not invest in the company. However, *auditors* are part of a team when it comes to loan capital issues or share capital issues.

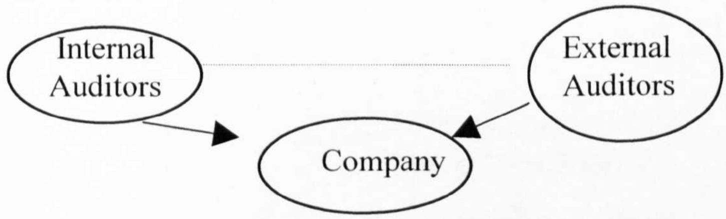
Personal familiarity & professional familiarity - As in their position of qualified chartered accountants, auditors and top management know each other and are familiar with the audit business. **Recruiting the same auditors** for the top management of the company.

> *"Completely, I mean all of us... Graham used to be a partner in Deloittes, he was an audit partner, he worked on this job. The bank was one of his client"*

Internal audit. The Client (bank) has an internal audit, because they have so many branches. They used to call them inspectors who go around and visit the branches. It appears that they are not perceived any different from the external auditors. Quite often, they work with the external auditors.

> *"it is important to the external auditors that we have internal auditors going to branches. It is a very good control function. the external auditors can see this as a strong control that we invite people to visit the branches to carry out tests and what have you. Therefore, the two work in conjunction."*

Figure L2: Control



Fee negotiation. The fees have not been negotiated until now, Auditors produce a budget for the year coming audit. They compare it to previous charges. Inflation rate is taken into account. Audit fee will be the sum of audit cost plus inflation rate. Any other increase than the inflation rate has to be justified by the auditors to the client.

2.5 Conclusion

Some of the key points are summarised as follows:

Professional relationship does not relate only to their professional qualification, training and skills, which can be referred to as professional familiarity, but also to the way audit team interact.

Problem solving is arrived at through a well established control system and the involvement of the non-audit committee.

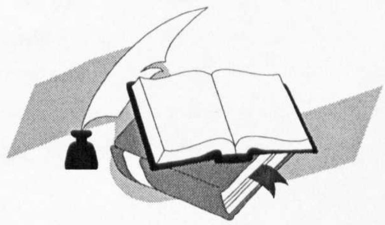
Auditors by using contacts with clients other theirs tend to build their *credibility* along with developing relationships with potential clients as audit clients.

The relationship has been developed on personality level between the audit partner and the audit manager and the chief executive of the bank (Client in this case). Moreover, *keeping in touch* is one way in maintaining relationships and plays an important factor in relationship disturbance. This concept is closely interacting with dialogue element.Therefore , *regular contacts* are used to keep a dialogue open and consequently what produce a close relationships at the top level of management in both side. This has a tendency to conclude that statutory & working relationships is based on personal and professional relationship. Moreover, people background is related to personal familiarity, i.e., auditors and financial directors do have similar accounting training. Some of them, are recruited by either side, i.e. financial director was an auditor with the same audit firm before joining the client management.

This case has demonstrated how the *rapport* is very important not only for establishing and developing the relationship, but also in building and maintaining it. It is believed because of the client and its international operations, their audit firm should be one of the big four known in the City. Some members in the client's company believe that it will be damaging to the company reputation if it is not happy with the kind of auditors, might give a warning to the client. When it comes to the non-audit services, clients does not to be seen buying all his services (audit and advisory services) from the same firm. As a big company is better to be seen buying other services from different firms. Somehow they are showing or promoting their auditors' independence. This is one way to avoid public scrutiny and avoid suspicion or scandal. Moreover, the whole picture touches the image of the quality of service.

Auditors do not seem to worry about their client buying advisory services from other competing firms. Their clients believe that audit can be carried out by any firm but advisory services are the task of calibre staff and specialists in the area. Therefore, there is a belief that in audit, skill limitation does not exist as long as the client has a favourable perception toward the firm.

End of Case Study.2



Dyadic Relationship Three:

~ A Holding Company ~

3.0 INTRODUCTION

3.1 Background of relationship

This Holdings Company is loosely described as a mini-conglomerate. It has grown substantially over the last 10 years. There are four main operating divisions. Among them, Animal health, Pharmaceuticals, transporting goods and retails operations. The turnover of the company is around £140 million. So far company expansion such acquisition is given to the auditors.

3.2 Analysis of Elements, Stages and Process of relationship

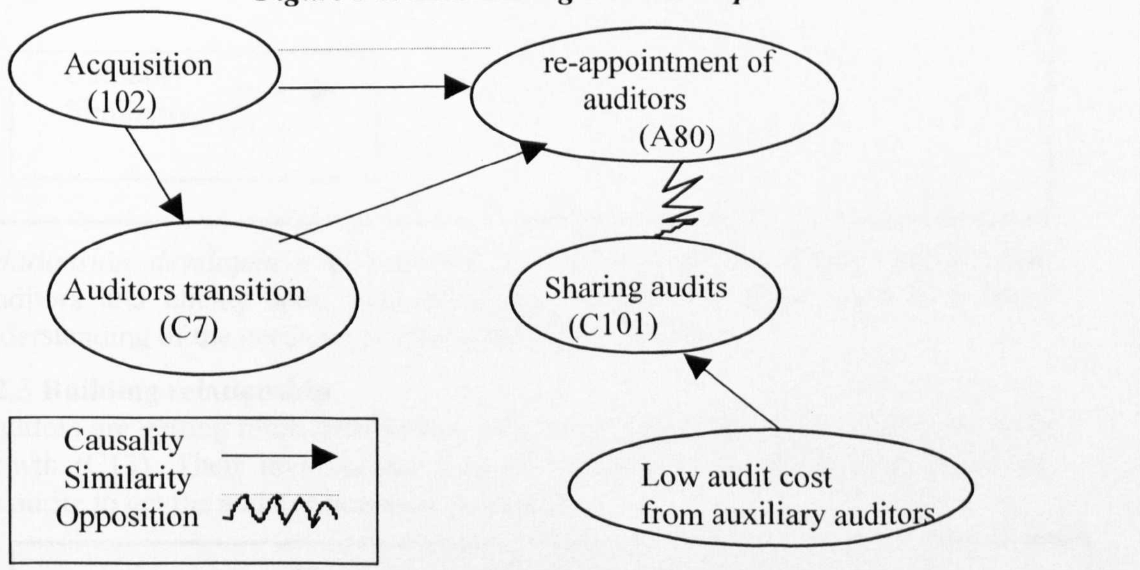
Elements, stages and process are analysed in the coming sections.

3.2.1 Establishing relationships

There was no such establishing relationship at this stage. It has been there before and currently running operations. The company has had the same auditors for the last 30 years since the formation of the company.

For an acquired company, it has no power to keep their auditors or to change them. Generally, the acquirer decides. In this case, auditors are involved in the audit acquisition process and try to get the best deal for their client. At the end they are rewarded with another company to audit. More fees to earn, from preparing the acquisition to other regular fees (Cash cow).

Figure B1: Establishing Relationship



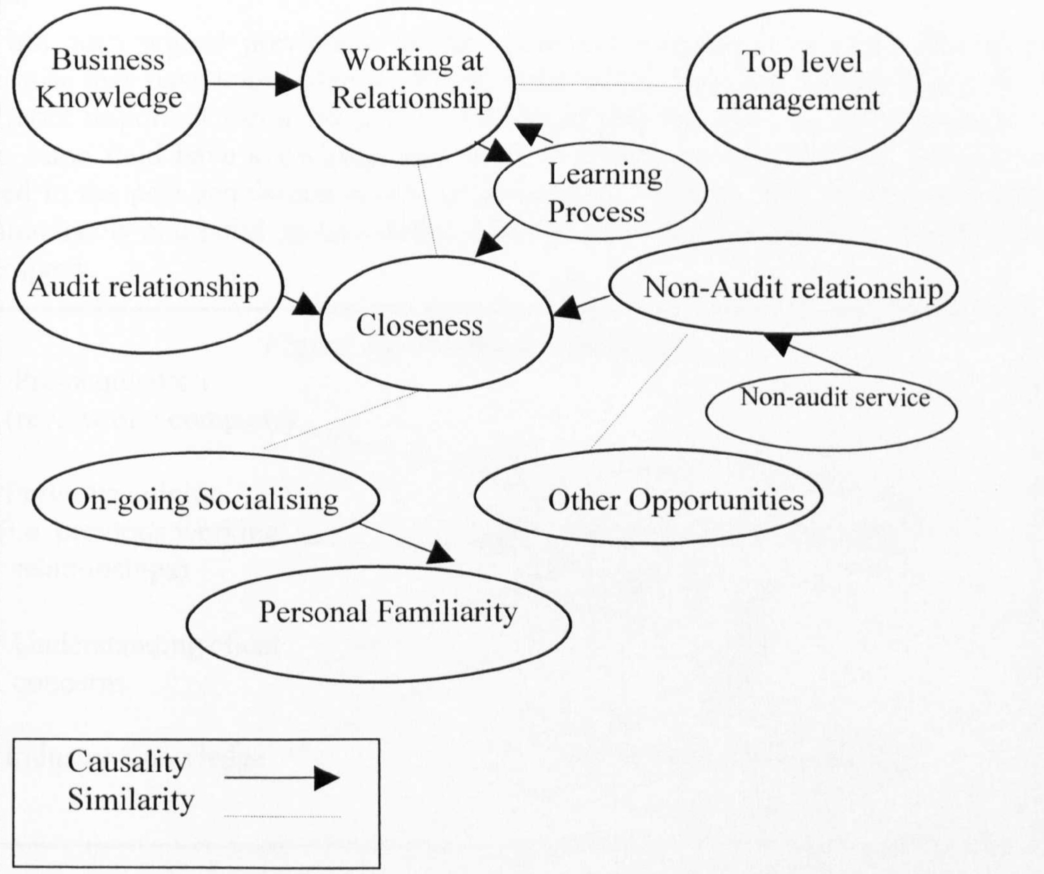
Existing auditors of acquired company will be kept for while and the fees will remain the same during the transition period. The new auditors will be charging the same fees or increasing them. This triggers that in acquisition auditors keep fees low or to the same level in order to keep the client. That is to share the audit.

3.2.2 Developing relationship

Within an existing relationship, auditors and clients (especially top management) will try to develop the relationship after changes take place in one of the two parties. Both will go through a learning process where the effort of developing an understanding is the first priority.

There is a strong belief in the client that buying non-audit services (C9) is a way to develop closeness and an understanding (C36) which cannot be developed through an audit job (i.e., audit relationship).

Figure D1: Developing Relationship

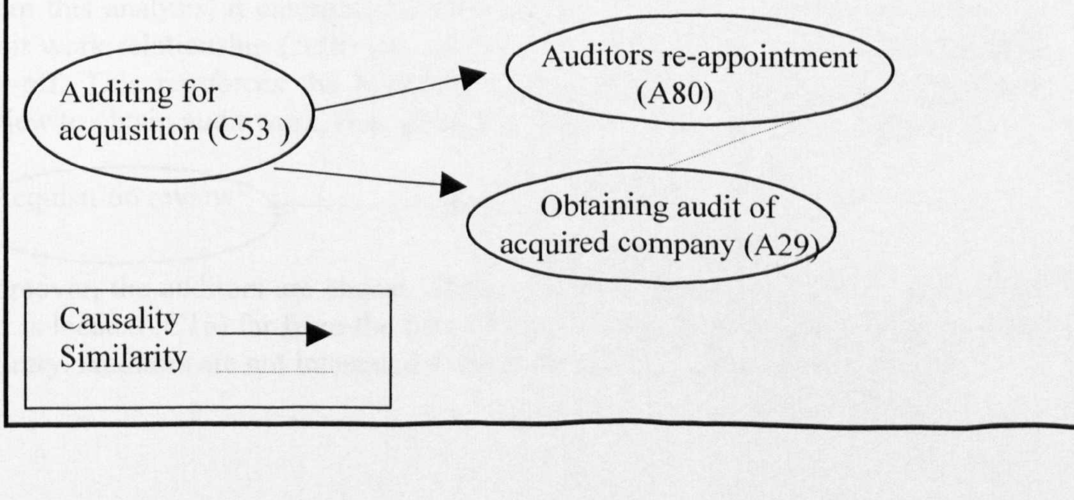


Relationship development is reflected as well through the efforts put by both (auditors and client) upon working at the relationship which lead to a better understanding of the needs and expectations of each other.

3.2.3 Building relationship

Auditors are getting more involved in the company business and in particular in its growth (C13). Their involvement in audit acquisition (C53) has lead to be the favourite to get the audit of acquired company.

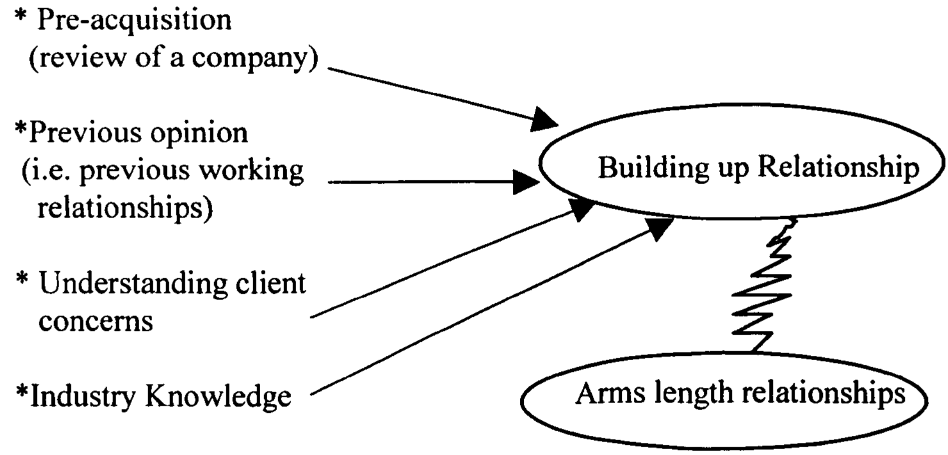
Figure E: Auditors' Involvement



It emerges that the main auditors are interested in gaining audit work from acquired company which are of a good size, i.e. the bigger the acquired companies are the bigger the audit fees will be.

It has been argued previously by the client that keeping local audit firm (C16) because they have knowledge (C36) and skills (C45). However, the audit fees (A12) is more important factor because it is believed that the main auditors operating in the same field have knowledge and skills. It is believed that the fact auditors are used in the post acquisition review of a company. So they build up the knowledge immediately and build up knowledge with the new client i.e. people in the acquired company.

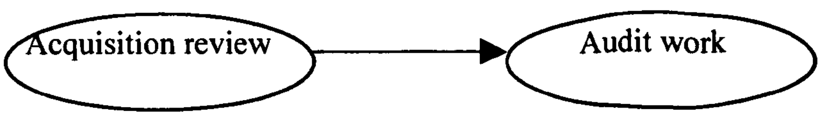
Figure E2: Building relationship



Learning process (A51) is associated with particular company regardless of the industry. This category emerged as an outcomes of relationship building. Auditors build up their company business (C36) and industry knowledge (C89) through (i) post acquisition review, (ii) similar audit work in the same field (i.e., within the same company group). Their close involvement with the client expansion through acquisition made them not only building up relationship with client staff and acquired company staff but also developing a partnership scheme.

So acquisition review or post-acquisition review gives an opportunity to both auditors and client to build up relationship in term of audit work and of social interactions (A37).

From this analysis, it emerges that building up a relationship is not only based on audit work relationship (A58) but also on non-audit service (A16) which might be one-off. This reinforces the belief that using non-audit service such acquisition review to obtain audit work, (i.e., getting it strategy as seen in case 1 and case 2)



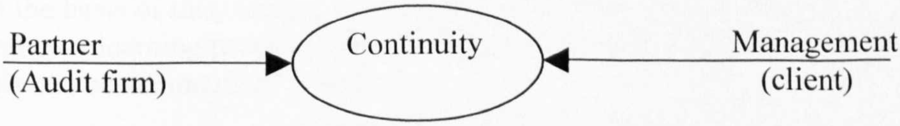
Moreover, the auditors are choosy. If the size of acquired company (A11) is small and is located (C16) far from the firm office or firm does not have operation in that country. Auditors are not interested to audit that operation for the time being.

In the acquisition contract, an agreement of audit completion is taken into account and the fee is negotiated accordingly with the existing auditors. Later on, the audit is carried out by the principal auditors.

Figure E3 : ***Acquisition v.Audit Work***

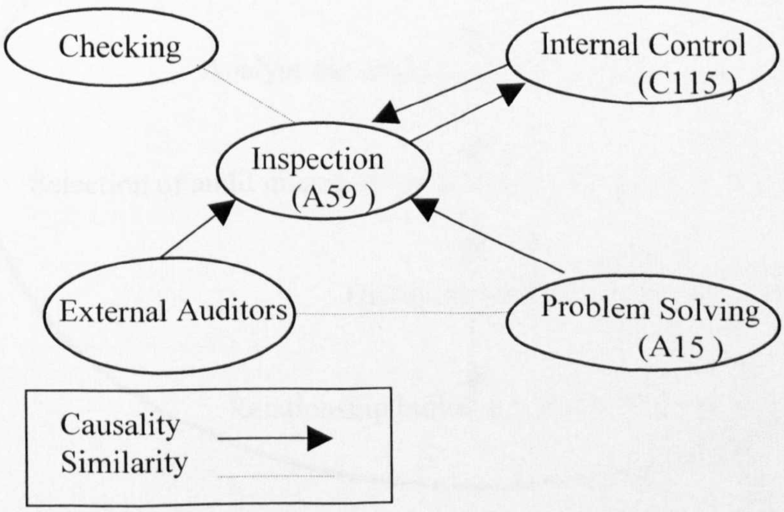
Building up relationship is through *learning process* (A51) and while giving auditors opportunities to develop *knowledge about the company* (C36) and *industry* (C89), both parties increase their *mutual trust* (C85)

Maintaining *Continuity* (A38) at the top level (partner and audit manager) is seen as an important factor in building relationship. Changes of staff (A89) at the lower level of the relationship does not cause nay harm to on-going relationship. It is more important to keep the smooth running of relationship at the top level (A82) (decision making level).



Client does not see any problem of auditors doing inspection job. The inspection concept of an audit is acceptable to the client as a part of internal control .

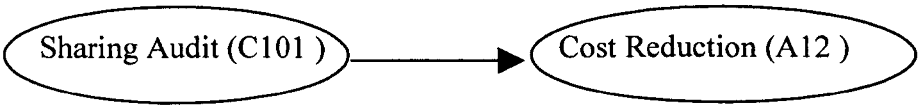
Figure E4 : Audit Control



It appears when client does not have an internal audit (C115) they rely on the feedback from the external auditors and when problems happen or expected to happen, they call upon the auditors to help to solve them through an inspection.

One situation is clearly apparent is that *internal audit* does not exist but client claim that the *size* of the company as a conglomerate does not need an internal audit since they are operating in different industries. Moreover, the auditors are to do the *inspection* for them. This suggests that there is a strong belief that external auditors have the resources and since they do the audit work for the different divisions and have knowledge of individual businesses, they are better equipped to do it than having internal auditors.

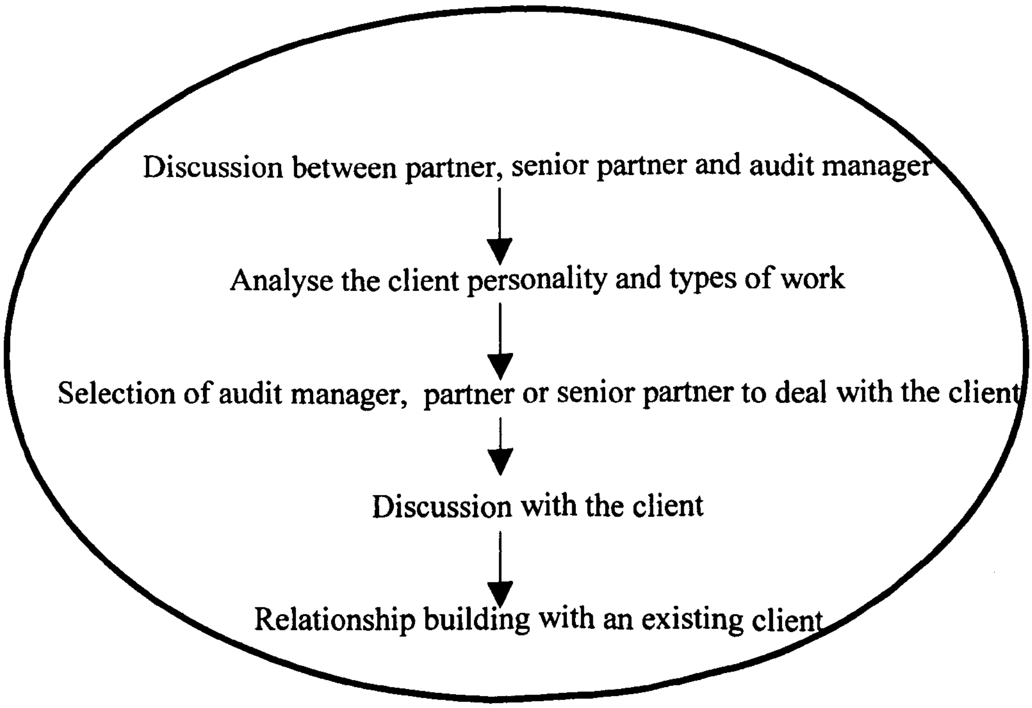
Sharing audit job (C101)is cost reduction (A12), especially for small operations i.e., the size of the subsidiaries and their foreign location.



3.2.4 Maintaining relationship

In case of retirement of audit manager, some dispositions were taken to ensure the smooth running of the audit work and maintaining the relationship. The future audit manager (A84) was introduced and got involved with the client over a period of time. Audit firm saw the relationship as a very important one and the retiring partner discussed (A61) a number of options with other potential members within the audit firm. They talked about pros and cons of the individuals within both parties and in particular the right person to interact with the financial director. After a discussion between the retiring auditor and the top management, they reached an agreement as to whom the best replacement would be.

On the basis of this, retiring audit partner took the replacement (new audit manager) through a learning process (A15), which include work and social interactions (A31). This can be summarised as follows:

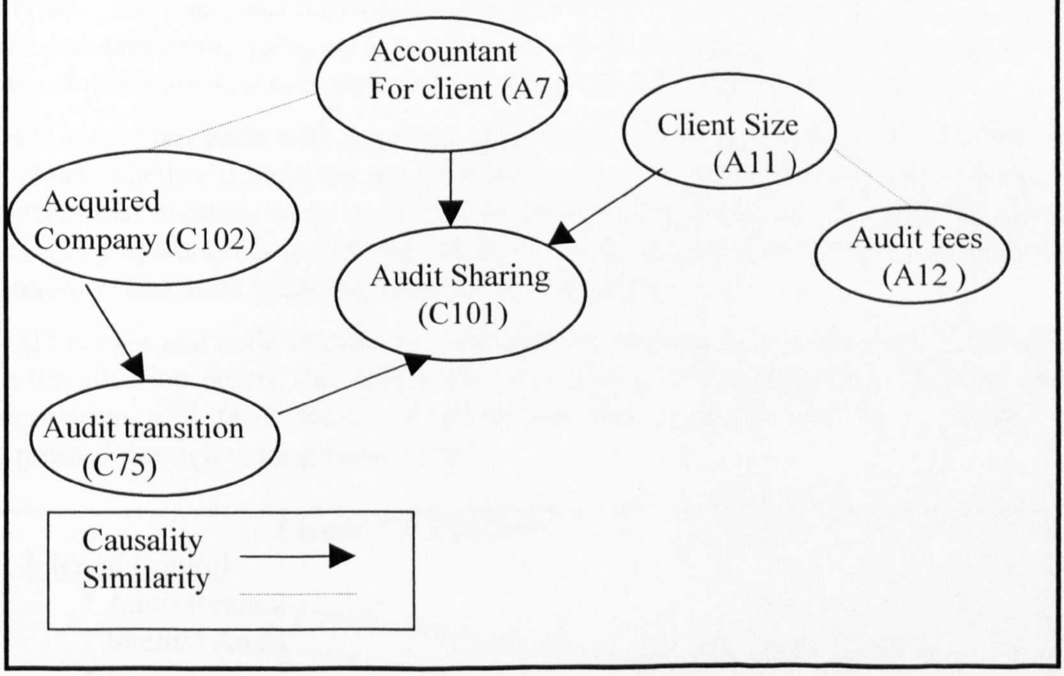


Audit sharing with the local firms (C101). One way to maintain the relationship is that both the client and auditors try to be *flexible* with each other. Auditors do not mind sharing audit work with rival firms in overseas countries as long as the operations are small. It is cost effective.

Auditors are happy to leave it to local audit firm (abroad) who will charge a small audit fee and all the parties are happy. So both clients and auditors are happy about audit sharing (C101) and audit cost reductions (A12). It is to note as well that all major client divisions are audited by the principal audit firm.

There are a number of reasons why client prefer that audit work should be shared by audit firms. Some of the reasons are (1) local audit firm abroad does not only audit job but act as an accountant as well, (2) They have long term knowledge and experience, (3) cheaper to keep them than to give the audit to the main auditors who do not have an office in that country.

Figure F1 : Sharing Audit Work



Once accounting system in the newly acquired company is put in place and where auditors are not required to do accounting for client, auditors will be changed and audit transition will take place.

The attitude of *changing auditors* because of *changes in partners* is not there.

> *"There have been changes in the partners dealing with the operations both centrally here and other operations through the country and the world but each time there has still be a core and they have handled the relationship change and dealt with that. So there has been no need to make any fundamental change."*

Buying non-audit services - Clients do not have to buy all advisory services from their principal auditors. In this case, it is found that client buy two main non-audit services (1) acquisition advises and (2) tax advises. Even in house tax are prepared and supervised by the main auditors.

Closeness (as an emerging category described in figure D1) was singled out in this case. It was obvious that it was so important through all stages of relationship. Within this category (closeness) other subcategorise such as on-going socialising relationship; working at the relationship and buying non-audit services) showed similarities in reaching the main objective of bringing the relationship to a closeness.

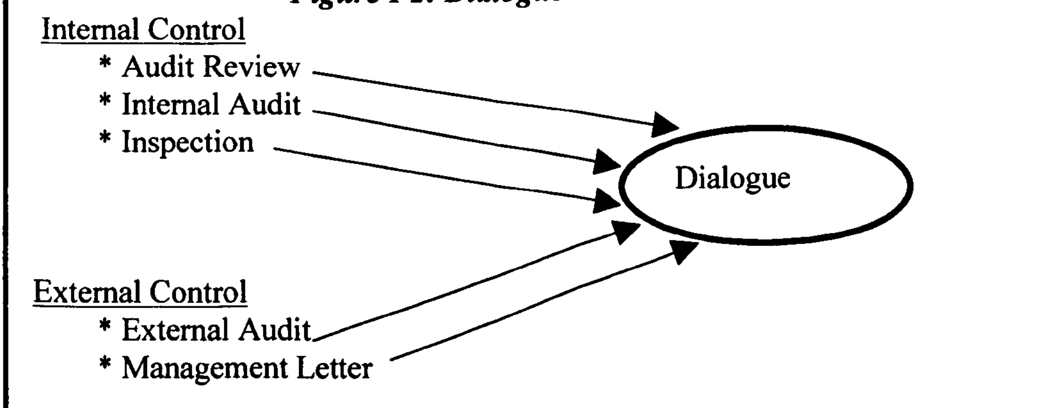
On-going socialising relationship is expressed in other forms. Auditors use "defensive measure", as described by the client. The defensive measure is used when audit firms try to record personal interests of their corporate clients and store them in their database. Clients receive from time to time and according to their personal interests invitations to social activities. This defensive measure is trigged by the fact business relationship is based on social relationship. This is to say, business relationship is tied up to the fact of losing a client but also losing a social relationship and its closeness.

Closeness was more pronounced in this case, and took the form of almost an utopian state of outcome. This category receive influences from working at relationship expressed through the business interactions which contain audit and non-audit services. The non-audit relationship provides a set of opportunities to develop, build and maintain an on-going audit relationship. While on-going socialising relationship have similarities with closeness, it leads to personal familiarity development.

Audit work start early with a pretext of an *audit review* or *an audit interim.* This is to check whether if there are nay problem or foreseen problem to the main audit. It appears that auditors carry out two a strategy of preparing the client for the audit, i.e., (1) preparation or preliminary work for audit, (2) feedback to the management, discussion and audit planning, (3) audit the company.

Audit review and audit interim are requested by management. They want a feedback on the situation before the main audit work starts. At this stage, it is believed that negotiation will take place and prediction can be made and what should be expressed through management letter.

Figure F2: Dialogue



This shows auditors and management work as partners within a continuous dialogue and negotiation. This leads to a trust building. Both gain from this dialogue. Auditors would add advice services to their audit fee and management will be happy to be seen performing well by the shareholders.

Management of an External Audit is very low due to the fact audit review or interim review are there to find important problem. It is meant to prepare terrain to avoid any foreseeable problem while doing the external audit. Nevertheless, management try to resolve their problems, in particular accounting techniques before external auditors point out to them. This is seen as a good working relationship.

3.3 Environmental Condition Analysis

Competition (C23) increases between rival audit firms, in particular between auditor acquiring company and auditors of acquired company. Here, it depends on the power of management (C118) and the auditor influences. If auditors are involved in the acquisition expansion, they have a bigger chance to add the acquired company to their client portfolio. On the other hand, management prefers to keep auditor of acquired company as a bargaining chip to reduce audit fees A12).

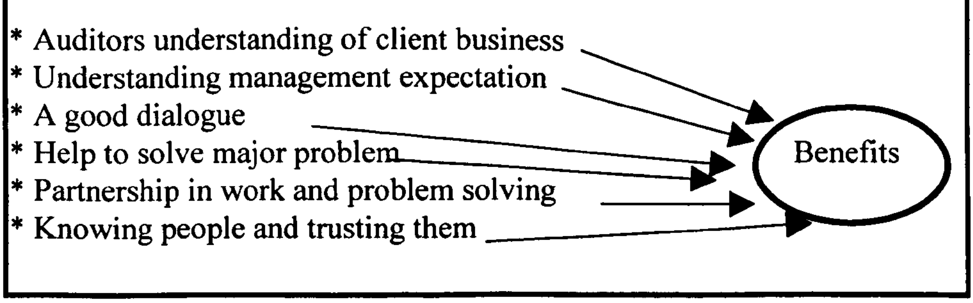
> *"...we have got to use them. We don't have a problem in using auditors others than ours occasionally. One has been kept on for specific reason in a particular country but that has just made it a harder relationship. If you live for....(our auditors) to deal with because they had somebody outside of their own group auditing one part."*

3.4 Relationship Outcomes Analysis

3.4.1 Benefits of long-term relationship

The benefits of long-term relationships are expressed through a number of dimensions presented in figure I1.

Figure I1 : Benefit of long-term Relationships



However, three important dimensions emerged in these analysis i) understanding client business and industry, ii) having a good communication and iii) ability to negotiate and use ones influence.

(i)Understanding client business and industry makes auditors a better backstop to check client activities.

(ii) Developing a special communication language

> *".. I think the key one is what I referred earlier is we understand what they say and what it means because one person saying something does not matter or saying something that is very important and significant is not necessarily the same as another."*

Both management (Financial director) and auditors have the same training and a good understanding of accounting system and techniques. One wonders what type of language they need to develop over the years to communicate to each other. It emerges from this analysis that establishing or developing a communication system whereby they express their concerns and worries about certain issues and their degrees and come to a compromise. Understanding an auditor and its communication patterns are the key element to maintaining relationship. However, difficulties appear from time to time in the communication process (A27) between auditors and client. This leads to a breakdown of communication. Generally it is due to a misunderstanding and disagreement (A96). These misunderstanding and disagreement happen but very rarely. It happened not with the main auditors but with the acquisition service, i.e., people from the same audit firm but not the usual auditors the client has been dealing with. They were skilled people in the industry and though they will give the client a better service, management expectation ( ) is completely different. Management prefers to deal with the same people. This shows that management by dealing with the same auditors as external auditors and advisers for acquisition, it puts them in a better position for future negotiations.

The analysis shows that management prefer to use the same auditors (people) known to them in order to occupy a stronger bargaining position later on when it comes to audit fees determination. This might lead to a conflict of interest.

> *" I would rather have somebody I know whatever their skills background at given level of an audit."*

(iii) Power - Negotiation

These two concepts emerged as an important issue within auditor-client dialogue and depending on how important the relationship was.

> *" I think it vary and a lot will depend on whether fundamentally the auditors see it as back and white issue or not. A lot of things are very grey... it is technically correct obviously our auditors would recognise it. The debate is then only over how much it is and yes you would expect then level of give and take review and argue about the number would be."*

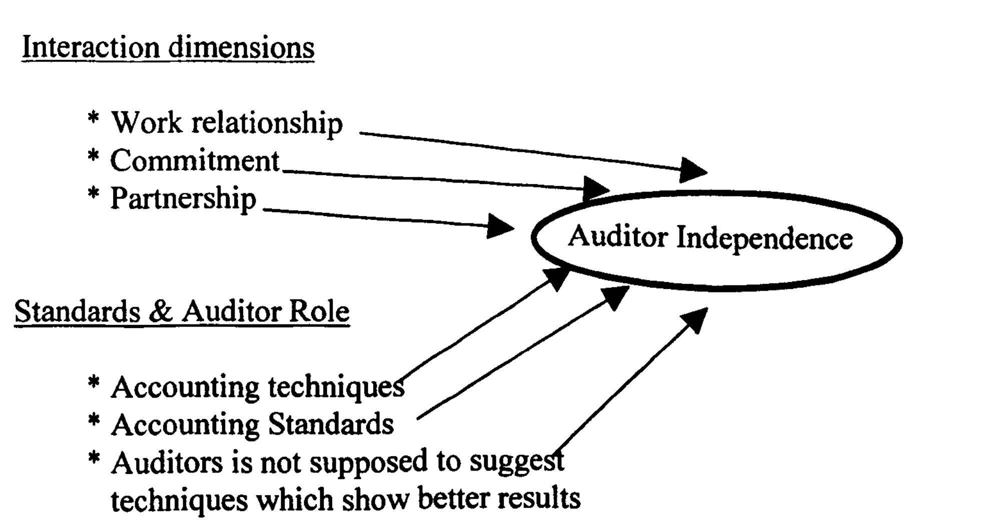
> *"... but if they say you cannot do something I would ask them to try and accept something or come to a compromise or something that was not compromisable if you like."*

From the case, it emerges that *Commitment* (C47) and *partnership* (A69) lead to a compromising situation, which the client describe as auditors should be innovative i.e., in case of disagreement related to the accounting system or accounting techniques used by the client, auditors should suggest other techniques which lead to the same results wanted by the clients.

This shows, there is a compromise from auditors who are not only involved in agreeing that technique is correct but also suggesting other methods. This leads to a conflict of interest and auditors independence will be questioned. Here, the shareholders would not be aware of it and their protection is not as such described by the Company Act.

The *auditor independence concept* receive many influences and are described below:

Figure J1 : Influences on Auditor independence



This case reveals that audit review, interim audit, using the same auditors for non-audit services (acquisition) and asking auditors or even using techniques approved by auditors but which are not too obvious to the *general public* and *shareholders*

The negotiation process takes place and conflict of interest and auditor independence emerge as the two categories which contribute as well to a long standing relationship.

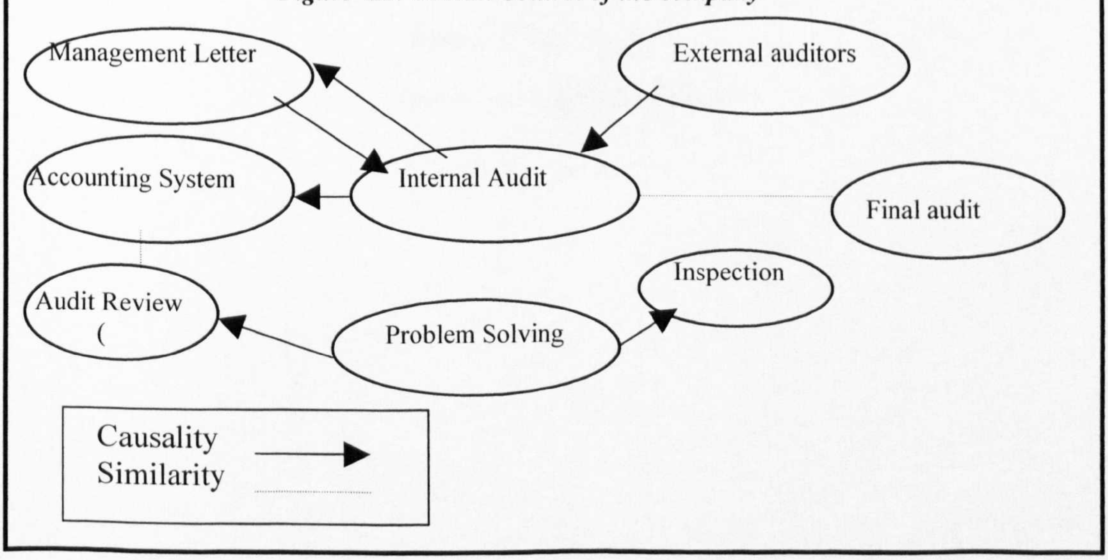
One would ask how far these auditors can go doing these? One has to look at the collapse of well known companies and the techniques have used before their collapse. (cf table **?** in chapter 2, p. 118)

3.4.4 Other emerging Issues -

(i) Dealing with the internal control.

Client does not have an internal audit. They rely on auditors to do from time to time an "audit review" (C115). It appears that they rely most of the time on the "management letter" produced by the auditors. The audit review is called when ever a problem is suspected.

Figure L1: Overall Control of the company

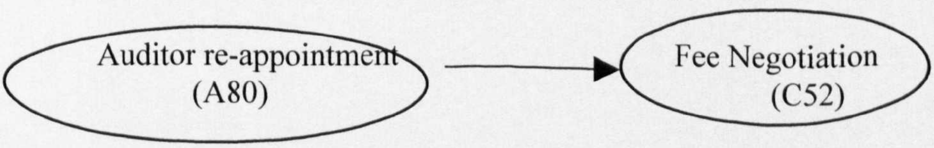


In the absence of an *internal control*, client rely heavily on auditors for problem solving and accounting *system improvement*. Moreover, whenever a problem is suspected such as *stock evaluation* . Client will turn to auditors to resolve it. This suggests that clients and auditors are working as partners.

(ii) Auditor appointment for an acquired company

No beauty parade has taken place. In the acquisition agreement, which is prepared by the main auditors, it is stipulated that the actual auditors will automatically resign and a new appointment will take place. However, the main auditors takes over the audit job, unless it is small job and not a cost effective and stated otherwise in the contract of acquisition.

Re-appointment of auditors (A80) is not going to increase audit fees, regardless how the main auditors do their audit work. This leads to audit fee negotiation (C52).



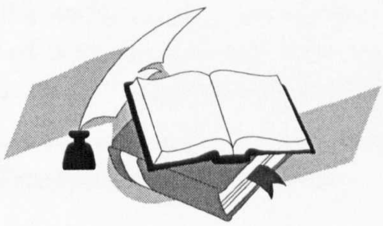
(iii) Emerging issues related to Building and Maintaining Relationship

Relationship building and maintaining takes place not only within a new relationship but also with an existing relationship, especially if changes occur within one or both of dyadic members (retirement of an audit partner, change of management in the client).

3.5 Conclusions

The analysis of the third case of a matching relationship between auditor and his client has highlighted the closeness existing between auditor and his client in acquiring companies and transferring the audit job to them. Moreover, elements and process of were discussed through the four stages of relationship and a number of emerging issues were presented.

End of Case Study 3



Dyadic Relationship Four:
~ Energy Supplier ~

4.0 Introduction
This is the fourth and final matching relationship case study. Its analysis follows the same steps as the previous cases.

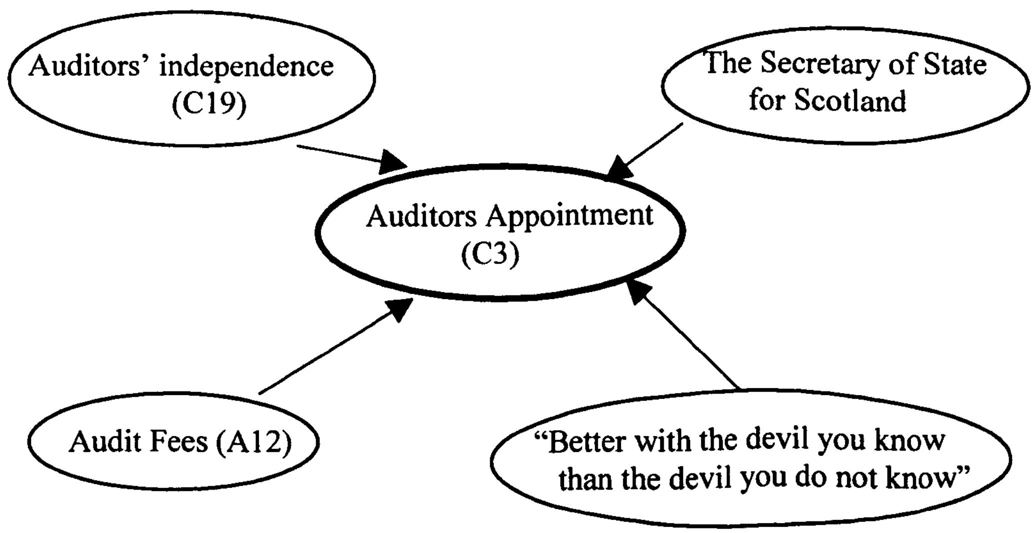
4.1 Background of Relationship
In this case, the relationship between clients and their auditors goes back to 1955. At the time, auditors had different name. Since then, a number of mergers between small and medium firms progressed to become one of the big four.

The company used to be a nationalised industry in power sector. Due to the state owned nature of the company, i.e., (a nationalised industry) the Secretary of the State for Scotland appointed auditors in past and remained since.

4.2 Analysis of Elements, Stages and Process of Relationships
4.2.1 Establishment of Relationship
As stated above, the relationship is an existing one and started in 1955 and remains even after the privatisation of the company.

Referring to the auditor appointment, it has been stressed that the auditor selection relies on the perception whether the auditors are independent (C19) and the fees they charge. Even though, the Secretary of State for Scotland who appointed the auditors in the past had no doubt looked at the auditors' independence and the level of fees.

Figure B1 Establishing Relationship



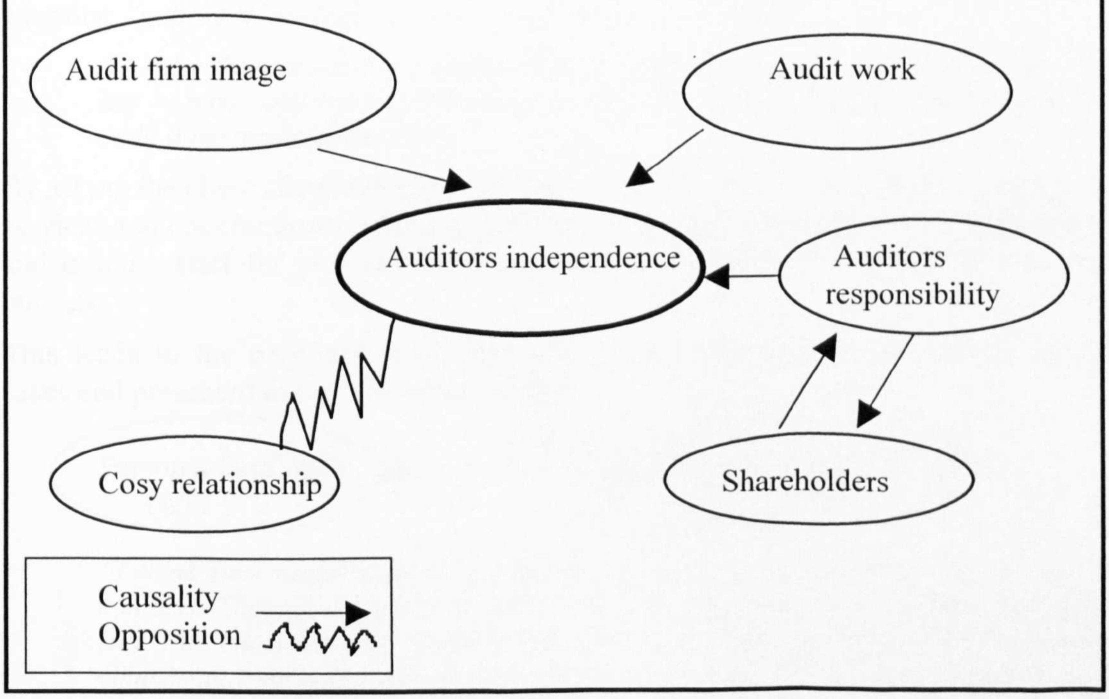
Now, the main shareholders are the public. The government holds some shares after the privatisation. The company has not used a "Beauty Parade" for the audit firm selection but only for advisory services such as lawyers, bankers etc.
The client believes there is no difference to who appoint the auditors whether it is The secretary of State or the shareholders in public companies. Bboth of them will look at the state of mind of the auditors , i.e., their impartiality and their independence in doing the job.

> *"are your auditors of an independent state of mind to work for the shareholders rather than for the directors of the company?"*

Moreover, client sees the independence of auditors based on three main factors:

1. Image, i.e., auditor seen as independent,
2. Audit work, i.e., and the way they carry out the audit work, including the staff turnover.
3. Auditors responsibility, i.e., they have a duty to shareholders. It is to give an opinion on client's account to the shareholders and any other users of the accounts.

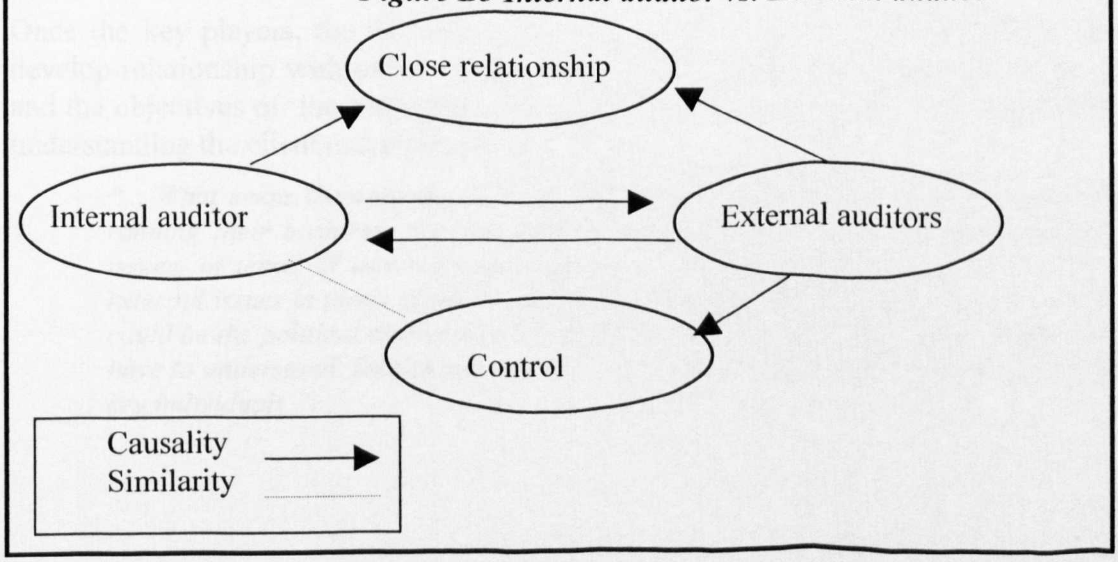
Figure B2 Auditors Independence



Auditors' appointment: There is a tendency to be *"better with the devil you know than the devil you don't know."*

In the past the company was a nationalised industry and used the same audit firm for reporting accounts during the privatisation process. There, it was the one who helped the company with the prospectus, i.e., floating the company in the stock exchange after privatisation. Auditors were the reporting accounts, giving an independent view on the company 's accounts.

Figure B3 Internal auditor vs. External auditor



It emerges that *internal auditor* agree with *external auditor* what type of control should be used within the company. Therefore, external auditors rely on the internal audit work.

> *"What we must achieve is that we don't audit the same areas at the same time and things like that. They rely upon the work we do. And I don't want to spend a lot of time examining controls which I know they are examining as well. So there is a need of close relationship between the two."*

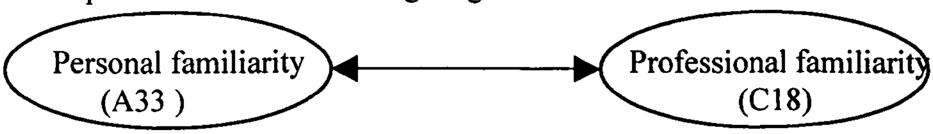
Relationship establishment

In general, accountancy firms are always trying to establish contact with key clients, i.e. adopting *"getting it strategy" as expressed in case 1, 2 and 3.*

> *" I know there at least one another firm has their eyes on us. And CA firms they would like to have and try to establish contacts with a view to taking over the audit if the audit if the opportunity arises."*

By asking the client about the approach these firms use, it was revealed that selling other services and communicate with potential clients by sending to them leaflets, information and training staff for professional qualification. Moreover, senior partners use social outings.

This leads to the concepts of accountancy professional circle expressed in previous cases and presented in the following diagram.



> *"I think they would appoint one partner in charge of the operation to try and win contacts. They scour papers for any little leaks any ways into the company, cultivate any little chit-chat. They would attend dinners and various things and just establish contacts.... I got a phone call from a partner of another firm not our auditors, telling me that they could help me train my graduate to get a membership of ICAS. They obviously want to establish themselves."*

Establishing relationship has been described by the audit manager as identifying the key people within the client' s organisation. People targeted are usually financial directors, chief executive and the chairman of the company. These individuals have obvious role and functions and the one to develop relationship with.

> *"I would probably put as the priority items of who are the key people within the client. Because you don't develop relationship with the client - being a company - you develop relationship with people within the client..."*

Once the key players, the potential buyers of the audit, are identified auditors try to develop relationship with them. It starts with understanding the company's objectives and the objectives of the individuals. So developing relationship has been expressed as understanding the client and its business.

> *"... What keeps them awake at night. What concerns them. What worries them about running their business. That might be internal issues in terms of human resources issues, in terms of internal organisation structure, reporting issues, or it might be external issues in terms of the market place. Their relationship with their customers. It could be the political environment. It could be a whole range of business issues that we have to understand. So that we are aware of what we understand what concerns those key individuals."*

4.2.2 Relationship Development

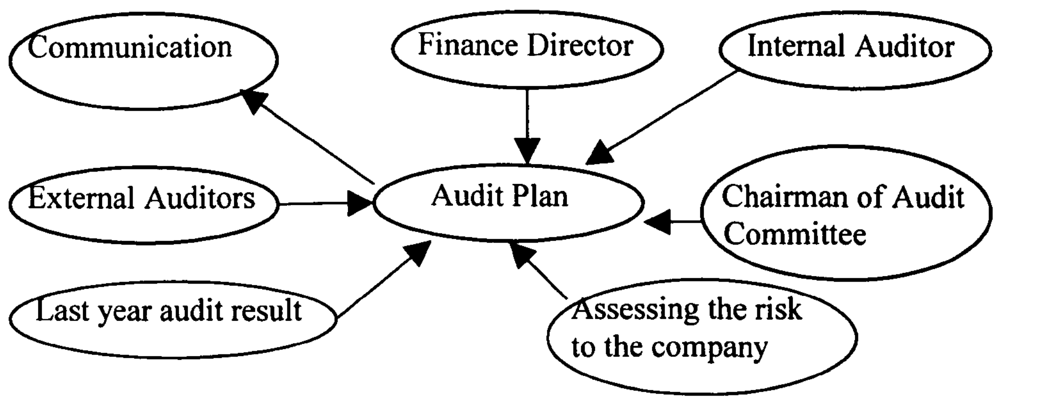
Auditors find themselves at the different stages with different clients. It sometimes happens with even an existing relationship. Some efforts are produced to develop the relationship because a change has taken took place within the client's organisation, i.e., such as appointment of a new chief executive or chairman.

> *"You need to develop the relationship- that is we are trying to do -we are trying to cement the relationship and trying to enhance it - try to expand it."*

The auditor describes the relationship as it might start off doing the basic audit and expand the service offerings to the client, i.e., consultancy work. This situation leads the analysis to the term used as *"Hold on to it" strategy* discussed in the Model of marketing strategy for auditors.

Auditors recognise that in order to move through stages of relationship, it might take longer and depend on the needs of the clients. For instance, the client might want just an audit service as cheaply as possible. So, to be able to sell other advisory services might take longer for an accountancy firm to do so.

Figure D1 Working Relationship (Audit plan)



Internal auditors and external auditors are involved in the preparation for the audit plan. Approval is generally obtained from chief executive and the chairman of the audit commission. This shows that the structure of the different parties involved is such that it will not cause any disagreement or set back in audit work. An issue emerged here, is the close relationship between the internal auditor and the audit committee. The study reveals the secretary of the so called non-executive committee has as its secretary the internal auditor. This questions whether there is a conflict of interest. It seems logical that the internal auditor is not an executive director. However, he works closely with the external auditors who check his own internal control. Details are expressed in the emerging issues in this section of case analysis.

There are a number of factors which are taken into consideration when preparing an audit plan:

- internal auditors assess the risk to the company
- bearing in mind the last year results (recommendations)
- assessing risk of changes
- re-thinking about actions and flexibility

Audit Planning

These are all statements of intent by the internal auditors and his staff involved in the preparation of the audit plan. This actual physical preparation takes over a couple of months. But, it is done through out the year, i.e., drafting an audit plan, which is put under a continuous review. The external auditors carry out the main audit works over 3 months. Moreover, they seem to have a continuous presence within the Client Company who appears to be an important one.

Auditor selection - There is a pressure from the banks, institutional investors and other users of the accounts on the company. They are always looking for business confidence. Therefore, client wants audit firm with a good reputation and international capabilities. This leads to the way management are assessed on their performance. An other element is taken into account in the selection of auditors is the "innovative approach" proclaimed by the auditors. Innovative approach is described as the firm having a quality of audit manager, experience in the client business sector, accessible and a speed of response. Adding to this, auditors praise themselves as providing a service plus, i.e., At the end of the audit exercise, they take time and efforts to sit down with the clients and asking them what they did well and what they did wrong and what they like the auditors to do. This is part of an open dialogue aimed to have a total understanding of what each other expects.

Auditors' capabilities have been expressed through the following items by the auditors:

- ability to meet the deadlines and to present reports on time,
- to get the mailing lists with correct names and addresses of clients.

Therefore, the firm capabilities to render services on time and being in touch with the clients constitute its brand image.

Other interesting factor in developing relationship is having client's business knowledge. Understanding client business might take a longer period depending on the client size. Auditors are aware of that it could several months or several years to fully understand the client business. Therefore, it is a lengthy learning curve. Moreover, client operates within a dynamic environment where changes take place regularly. Auditors find themselves continuously re-assessing their understanding of client's business.

As part of developing their relationship with clients, auditors look at the changes in the marketplace and keep their clients informed of what is happening and what they can do for them. What they have in terms of service offerings. This is expressed as *keeping auditors in the client mind* and having a *regular contact.* So the clients know where to turn for help if needed. Moreover, this reinforces the audit firm credibility.

4.2.3 Relationship Building

Building a relationship is described as the ability to manage it. There is a believe that the client perceive auditors as technically proficient. The extras are on that ability to be proactive in perceiving client's problems and helping in resolving them.

Adding to this, using personality the partner in charge manages his way the relationship with the client.

> *"It is actually acknowledges the personalities- and very much of those types of issues which cannot be measured. To take a simple principle which is not all of it in accountancy terms - but personality terms. They will look at the company which is a client at the outset and may be match individuals."*

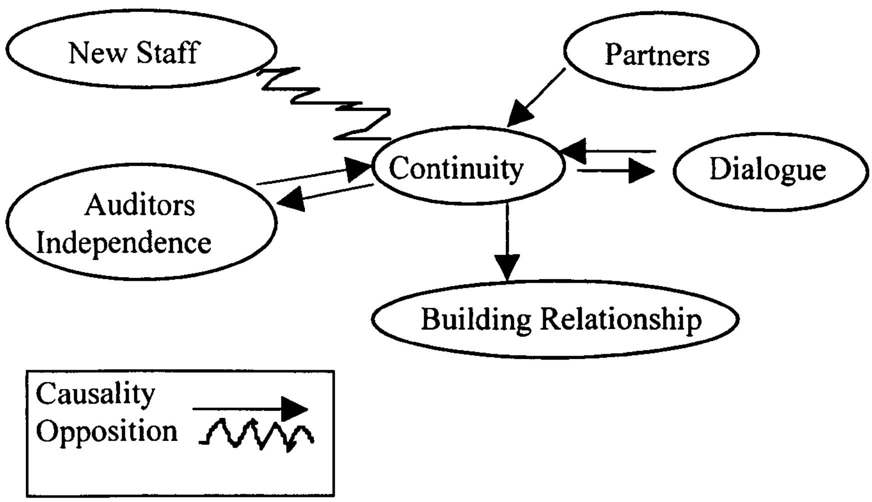
The concept of *continuity* has been singled out in this case. It is believed that all big firms have knowledge of their clients and they need to maintain that continuity of audit work. *Continuity* is desired by both parties (client and management). The client know their auditors and does not want to go through period of disturbance, i.e., knowing people and company business helps to keep client satisfied and reduce its *disruption.* However, *disagreement* between management and external auditors somes occurs.. Therefore, it is resolved by *dialogue* (A61). The disagreement occurs in certain areas of perceived risk and its level by the two sides. The auditors have to show that accounts represent a "true and fair view" and their degree of materiality are much wider.

> *"They could accept an error of up to £10 million or something... It still gives a true and fair view of the company."*

Due to the size of the client, the sum of £10 million might be less of significance since it could just represent an increase or a decrease of 10 pence on shares value at the stock exchange. What is seem very important in the negotiation between auditors and management has to do something about the irregularity and stop its recurrence. This shows how a disagreement leads to a fruitful dialogue by the two parties.

Dialogue (A61) is described by the client as an encouragement from the external auditors to the management to go towards the spirit rather than the letter. *Dialogue* and *Continuity* of audit work and staff are two important factors in building relationship.

Figure E1 Building Relationship

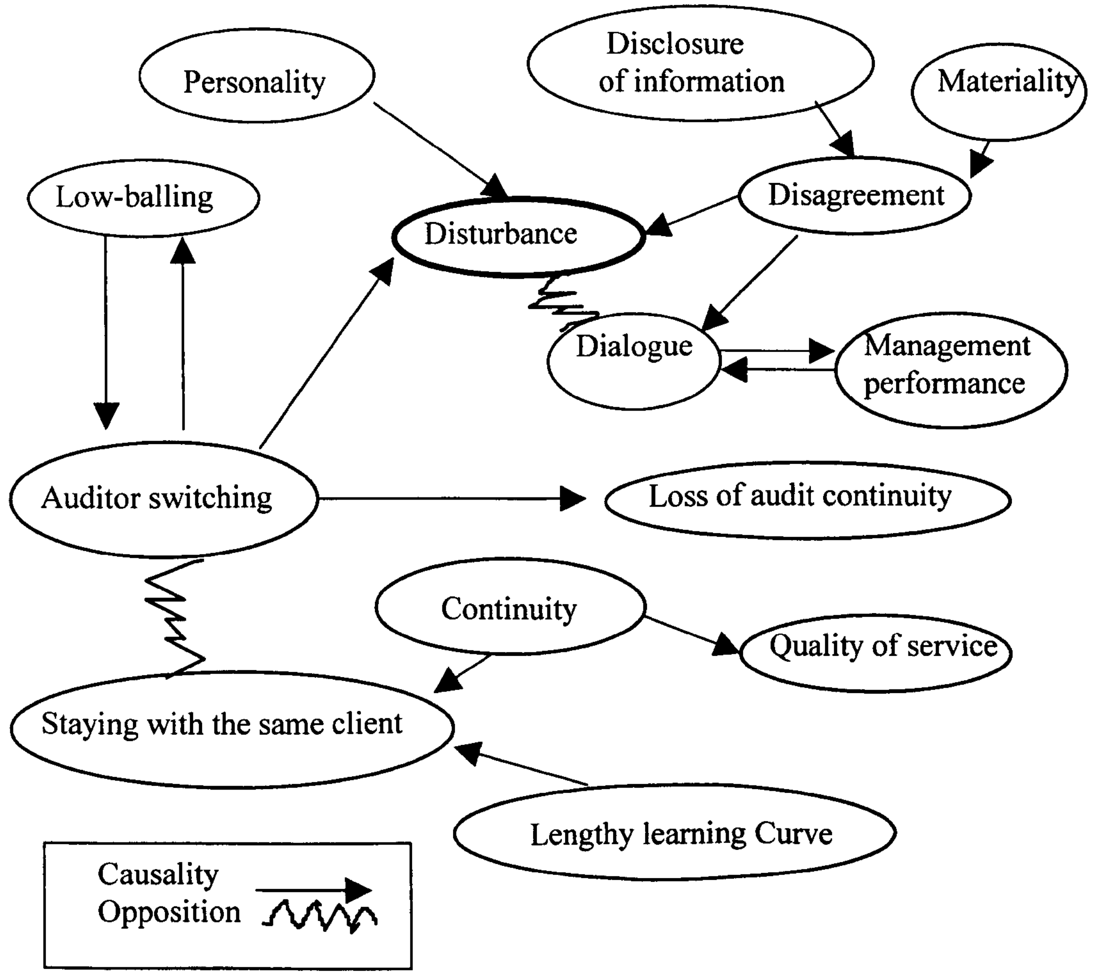


At the working (operating) level, it has been acknowledged that there is a constant change of staff, i.e., new faces coming to do the background work for the audit. However, continuity is maintained at the senior level. The replacement of a retired partner did not affect the continuity of relationship since the new audit manager is well known to the client and its staff and worked with them before. It has been expressed that some junior staff progress through their training within the same client company and stay with the relationship. Others trainee, after their graduation leave the audit firm altogether for another job.

Asking the management whether they will recruit an ex-auditor to work for them. The company has not done it yet but it will be willing to do so when a vacancy takes place within the finance department.

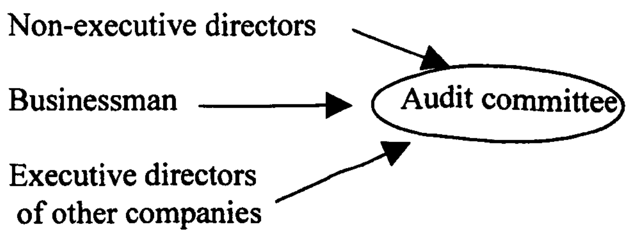
In the absence of *rapport*, the relationship faces disturbance and where audit staff are replaced to safeguard its continuity at the operational level.

Figure E2 Relationship Disturbance



The continuity (C90) appears to reinforce the desire to keep the same auditors and built in reluctance to change auditors () and leads to a quality of service. Client reveals that company should not toss their auditors unless somebody is using low-balling. This suggests that client always turn round to their auditors and use low-balling to lower their audit fees.

As far as the quality of service is concerned, it has been described as very subjective and difficult to determine because it is about perception of decision-makers that are not necessarily accountants. Moreover, the quality of service is checked somehow by the audit committee, which is formed of non-executive directors. Who themselves are at the top management of other companies. (Details on company control are analysed under other issues)



Building relationship is related to the continuity of the audit and the interface with the external auditors. Client believe that the auditors must satisfy themselves that their client have an adequate internal control system.

External auditors do examine the reports on internal control and place reliance on the end results. This shows that there is a *built trust* between two parties.

> *"They place some reliance upon me and they also get copies of all my reports. My department issues something up to a 100 reports on various aspects of things the company is doing. Now they can place some reliance on there. They examine my working papers, check that I am actually reporting what I see. They carry out some tests as well on the systems. Test that the system is working. But at the end of the day they are concerned with the way the accounts are closed and brought together and that adequate provisions have been made..."*

By having an internal audit, Management are reducing the audit work for external auditors and consequently reducing the audit cost and reinforce the image of the existing internal control system. Management see that there is a work balance between external auditors and the internal auditors. The fact, internal auditors are continuously reviewing the company whereas the external auditors work tend to be a snapshot for the publication of the interim results and the final results. From this analysis, a table relating to the role of each auditor is presented as follows:

Role of auditors	
Internal auditors	***External auditors***
• employed by the company and protect its interest by making sure; • tight control exists, • balance of risks, • profitable operations • company not expose to unnecessary risks • identify costs saving and profit improvement.	• protect the shareholders interests • produce an independent report

4.2.4 Maintaining Relationship

One factor, which emerged within maintaining relationship is the fact, the audit firm tries to support its audit activities by providing accountancy training to the client staff.

Moreover, maintaining the relationship might go back to the selection factor, i.e., selecting auditors for the job. Asking the client about what constitute a good relationship, a number of factors emerged:

- happy relationship
- friendly auditors
- professional in their attitude and behaviour
- respect of different opinion
- maintaining a regular contact
- Helping each other.

However, the analysis reveals in the selection process of auditors, a number of influential factors are used and expressed in this citation of the client:

> "... *auditing is particularly difficult because in the law, client is really the shareholders and it is slightly different. It is often things like deciding why influential people... and who has the influence. It varies from company to company... who would liked to be to have been auditors of Robert Maxwell? - what kind of auditors does he want? Do you go for the most competent one that you can find, or look for someone who can easily bully? - I think this company's directors are very conscious of their role as stewards of assets which are held by a range of shareholders and take it very seriously...* "

This citation reveals how the selection of auditors is part of power relationship and influences between clients and their auditors. One has to ask whether relationship is only based on *personal relationship* and *familiarity* or on the power - negotiation and influences.

Clients praise themselves that the existence of the audit committee and the application of best practice recommended by the Cadbury report in the company. However, the analysis reveals that it is a long way to show that there is a best practice where certain points are not clarified, i.e., as we saw earlier that the internal auditor plays the role of the secretary for the audit commission and works closely with the external auditors to avoid duplication of work and reducing the audit cost.

Communication has been expressed as an important factor in maintaining the relationship. Client needs to have a main point of contact in order to maintain that *continuity*. In case of change of staff, the main point of contact informs and discusses with the client the future replacement. It is about matching personalities. The audit manager believes that a breakdown of communication might be very damaging for the audit firm.

Communication is expressed through not only providing the services, and keeping the client informed but also ensuring that he perceives that he is getting the best service. To communicate is to find about the client needs and wants to satisfy them through the innovative approach defined earlier. It is also to obtain feedback from the client how he perceives audit services.

It is to note that aintaining relationship at the top has been the concern of the auditors.

> *"So that communication is important. I mean we maintain our lead partner on the relationship. He would meet with the chief executive or the chairman, maybe every month, certainly every two months to discuss the key businesses.... used to discuss what we are doing. To find out from the clients what they are doing and how they perceived us. So that is relationship building."*

The above quotation shows that there are different stages of relationships with different clients. It might be an existing relationship with a change at the top. So communication factor is important at all the stages of the relationships whether establishing, developing, building or maintaining it.

Recruiting auditors and offering them new post within the client's organisation has taken place within an going relationship. This has been encourage by both sides of the relationship. Junior staff who finish their training with the firm and establish a good *rapport* with the client might be offered a new post if there is a vacancy. This happens not only at a junior staff level but also at the audit manager level as we saw in case 2.

Business familiarity and *personal familiarity* are used to gain new client. The Firm keeps in touch with its newly qualified trainees, who moved to a client or to a non-client. It constitutes an important link for the firm to have and obtain businesses.

Problem solving is expressed through as helping the client to run his business. In the management letter, recommendations are put in to improve client performance through accounting records or accounting systems etc.. Problem solving is seen also as identifying issues and demonstrating that these issues are well understood by auditors and can help to do something about them. Trying to solve client's problem and understanding his expectation lead to have a close working relationship as a form of a *partnership*. Therefore, advises are provided through the sale of other services as expressed in the quotations below:

> *"...We see ourselves as being not just auditors but business advisers and we have a relationship. Our whole firm has a relationship with the client. So it is a bit like what I was saying earlier the developing of the relationship."*

> *"... I would say that value is by helping the clients to achieve their business objectives. So we are really acting along side them almost as a partner to advise them to get to their goals as quickly and efficiently as possible."*

4.3 Environmental Conditions Analysis

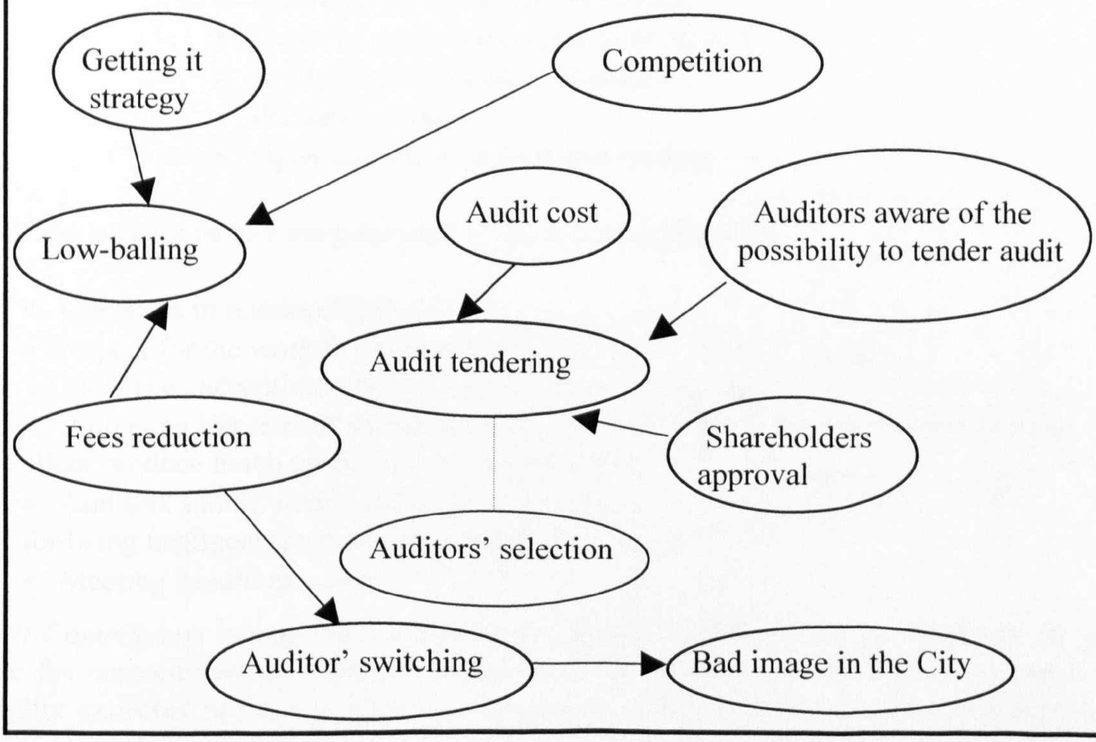
Competition - Low-balling has been recognised by the client as a general practice but does not use the term describing it. Auditors are also aware that other firms are interested in their important client. Because the client is one the largest company in the Scotland.

When the audit manager was asked about the *low-balling*, he expresses his view that the term means different thing to different people. The justification of reducing the fees is simply a respond to the market pressure and help to gain some businesses.

> *"So if you distinguish between costs and fees you might have a discount in the early years to attract the business... Once you are there and you have got the relationship. You can then increase the fees and get nearer towards the cost base."*

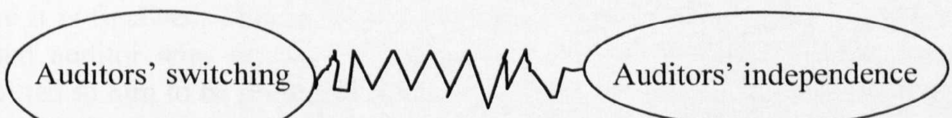
Moreover, it has been argued that low-balling does not affect the quality of the audit work. It is believed that if the fees are below the normal cost structure is seen as a perfect sensible response to the market conditions.

Figure Competition and Auditors' switching



The chairman of an organisation can take auditor's switching decision. Then, there will be no problem convincing the shareholders. This may lead to a bad publicity in the City. The degree of the publicity depends on the circumstances why the auditors were changed, i.e., they have had a difference of opinion on the presentation of the accounts.

> *"So there is obviously a stigma attached to a company disposes of its auditors because they are professional people totally independent and they get kicked out because they did not agree with them."*



Another important factor emerged from this analysis is that directors have the power to decide on the shareholders structure.

It is to note that client might have the desire some desire to change *auditors* for *cost reasons* but the company does not perceive that at the moment. It is believed that the client is getting a value for money. Client argument is based on the fact that the shareholder structure is such it helps and deters problems if the company wants to change auditors. Moreover, client reveals in his verbal comments that changing auditors is not difficult at all, since reasons for doing it can be found easily and presented to shareholders.

4.4 Relationship Outcomes Analysis

4.4.1 Benefits of Long-term relationships

It emerges from the analysis of this case that there are a number of factors related to the benefits of long-term relationships and what makes the relationships last longer.

(i) The benefits factors are as follows:

- Controls are thoroughly examined
- Continuity of audit and staff
- Business and company knowledge
- Ideas for profit improvement from auditors
- Apply ideas from other businesses
- Personal relations
- Openness and mutual understanding

(ii) The success factors are presented in the following figure I:

- Openness in relationships
- respect for the work from the others point of view (i.e., accepting other accounting techniques)
- Protecting interests of shareholders by making client produce much profits for the shareholders
- Auditors should watch and avoid to be sued for being negligent (protect firm image)
- Meeting deadlines

Successful relationship

(iii) Commitment is expressed at two levels. At the working level, management do not see the commitment as important at the lower level due to the staff turnover but it is highly expected at the top level. Commitment is shown throw personal relations and rapport established with the client staff. There are scenes where commitment is lacking at the lower level within junior staff who are less able and ardent during the period of their training.

4.4.2 Types of relationships

4.4.3 Implications of Auditor-Client Relationships

A close working relationship is described as exchanging work drafts between external auditors and internal auditors for comments before putting the final touches to them. Moreover, the letter of management is presented in its draft form to the internal auditor before it is finalised. This is believed to help maintain relationship. In addition to this, internal auditor who sits on the audit committee as its secretary, the letter will be submitted to him to be presented to the rest of the committee later on. Both internal and external auditors are involved in the drafting of the management letter. Both admits that they work on partnership.

This close relationship emerges from the work relations. Both sides need to agree to the content of the management letter. Otherwise, once it gets to the audit committee, different opinion would emerge and the chairman of the audit committee might decide about the corrective actions.This situation express the necessity of an open dialogue. Moreover, *mutual understanding*, *personal relationship* and *personality* emerge as important factors in the success of the relationship. These factors stress the need for a good *rapport*. As mentioned earlier, absence of rapport might cause relationship disturbance.

4.4.4 Other Emerging Issues

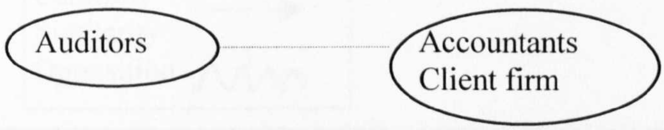
Audit fees is related the perceived value the client obtain from audit firm. *Fees determination* is expressed as a difficult issue and cannot be generalised. But, it is always agreed as last year fees plus the rate of the inflation. Auditors try to understand the client's constraints when it comes to determine fees and emphasise the benefits from the relationship. So having a relationship with a big firm which charge high fees has benefits to the client as far as the image and confidence is concerned.

Asking the audit manager about the added value to the audit. His answer is to help the client to generate profits.

Changing auditors or arriving at the decision to seek change. The decision is generally made through tender situation or through knowledge of other firms in the market.

Professional qualification and membership. The analysis reveals that client staff, after their training by the audit firm, obtains the professional qualification and become member of the same professional body. One needs to look at whether the same professional ethics and guidelines bind both. Moreover, in the case of a collapsed company, accountants do not seem to be affected as much as auditors are. However, being a member of the accountancy professional body, has a tendency to enhance the professional image.

Figure Professional Membership



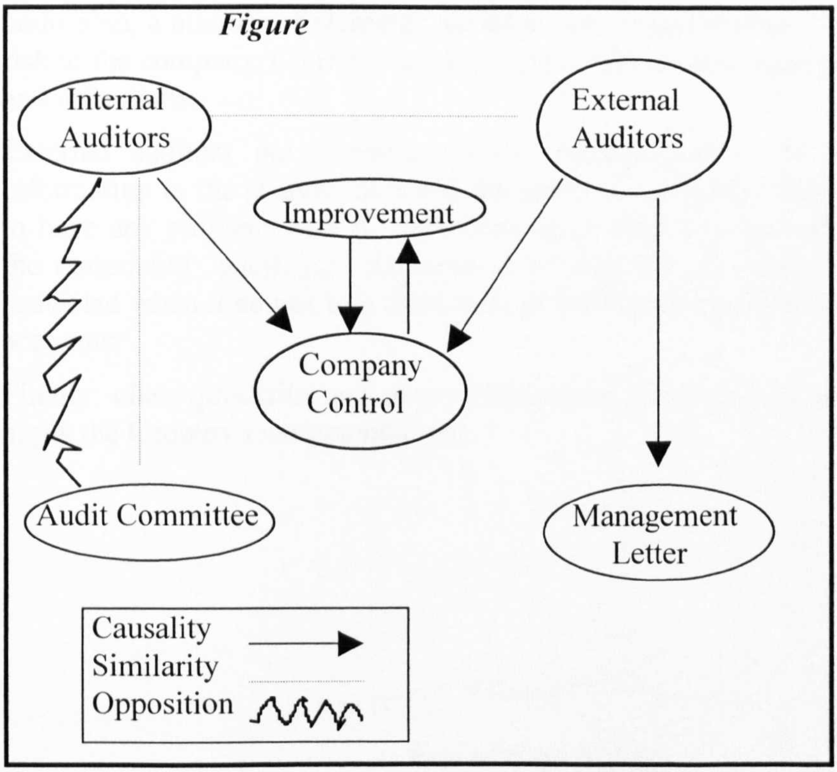
Company Control Issues

Audit Committee (non-executive director) is there to give their opinion on the quality of audit work, which is based on the letter of management produced by the external auditors. However, the non-executive judgement is report what the external auditors have found but they are unlikely to check the way the audit has been carried out. This is due to the time involved in carrying out the audit check and the skill of the members of the audit committee, i.e., members are required to be qualified accountants. Moreover, the analysis reveals that the audit committee is supposed to be independent from the management of the company. However, it has been found that the secretary of the non-executive committee is himself the internal auditor. This leads to question whether there is conflict of interests in the exercise of the company control.

It has been argued by the internal auditor that the chairman of the audit commission is himself of an other PLC and is a chartered accountant by training. The whole committee is formed of knowledgeable people and perceived by the shareholders as such. So their interface with the different departments within the company and the external auditors is important.

The audit control (carried out by external auditors and audit committee) is agreed upon as a way to improve the company performance. i.e., suggesting improvement to the actual operations and control system within the company. However, it is not denied that auditors have tendency to report on things need to be improved on, in particular on the company control system.

The role of audit committee appears to be limited in this situation to assess the management letter produced by external auditors. Moreover, on the basis of the recommendations mentioned on the letter, the audit committee would be more concerned with whether these items would be re-emerging again the following year, i.e., there should be a commitment from the management to put things right. So, it would not appear again in the next year management letter.



Directors pressures

Auditors recognise the difficulty of working with the management and reporting to the shareholders who do not have any intimate relationships.

> *"We might be put under pressure by the directors really to agree to an accounting policy that we feel is a bit suspect a bit doggy. Now, at the end of the day we have our reputation to protect. If we are seen going along with something that is not generally acceptable. The, that puts our reputation at risk. So we have to stand back from that. That is why in the large firm, there are usually two or three partners involved. So that the partner who is directly in contact with the directors has some safety net or some consultation procedure to go through. So that the firm as a whole is protecting its interests."*

There is a tension to get a balance between the short term pressure and the long term objectives of the firm business which are in terms of maintaining its position within the marketplace and being seen as reputable quality and market leader.

4.5 Conclusion

This final analysis of matching relationship outlined as well the closeness of external auditor and internal auditor. There is continuity at the top level. An audit manager known to the client replaces retired partner. This shows that the turnover of staff does not affect the continuity of the relationship.

As far as the audit planning is concerned there are a number of people involved such as financial director, internal auditor, external auditors, audit committee and chief executive. This requires a good communication system. However, disagreement occurs from time to time and is resolved by dialogue and negotiation. The disagreement is defined by the client as internal problem of communication due the close involvement in preparing and carrying out the audit work, i.e.; external auditors do rely on some reports produced by internal auditors. The internal auditor and his staff draft the audit plan and put it under a continuous review through the whole year despite the external audit takes only three months. While preparing the audit plan, a number of elements are taken into consideration: (1) assessment of the risk to the company, (2) risk causing changes within the organisation and (4) actions and reflections.

External auditors put pressure on the management to be open and disclose information to the shareholders and the users of accounts. Management seems not to have any problem with it, since both agree after dialogue and negotiation about the materiality audit. i.e., Auditors make sure that the shareholders interests are protected when it comes to a disclosure of information as notes in small print in the accounts.

Finally, client proclaim and praise themselves of having an audit committee and apply the Cadbury recommendations.

End of Case Study.4

THE ROBERT GORDON UNIVERSITY
ABERDEEN

ABERDEEN BUSINESS SCHOOL

A SURVEY ASSESSING THE IMPORTANCE OF RELATIONSHIPS IN THE AUDIT MARKET

Guidelines to the Questionnaire

1. Questions can be answered by ticking the appropriate box or circling the appropriate number.

2. Questions are grouped in four sections. The first section deals with information, which enables classification of companies according to selected characteristics. Section Two relates to the extent that factors contribute to the effectiveness of the working relationship between companies and their auditors. Section Three is to assess the importance of commitment, trust and quality of services in the auditor-client relationship. Finally, Section Four deals with the auditor's performance, conflict resolution, auditors' changes and government intervention.

All replies will be treated with total confidentiality and used only for academic research purposes

SECTION 1: COMPANY BACKGROUND

1 Please indicate the key business activity of your company ____________________

____

2 Which best describe the legal status of your company? (Please tick the appropriate box)

- A listed public company ☐
- An unlisted public company ☐
- A private company ☐
- A company limited by guarantee ☐
- Others, please specify ____________ ☐

3 Is your company?

- American ☐
- Japanese ☐
- European, please specify ____________ ☐
- Other, please specify ____________ ☐

4 Please tick the appropriate boxes relevant to your company in the United Kingdom.

£ Sales Turnover (2005)		**Number of employees**	
Turnover 5.6 million or less	☐	Employees 50 or less	☐
Turnover greater than 5.7 million and less than 22.8 million	☐	Employees 51-249	☐
Turnover 22.9 million or more	☐	Employees 250 or more	☐

5 Are your principal auditors?

- One of the big four ☐
- Large audit firm ☐
- Medium sized audit firm ☐
- Small audit firm ☐

6 How long has your company used its current audit firm? (Please tick the appropriate box)

- Less than a year ☐
- 1 - 3 years ☐
- 4 - 9 years ☐
- 10 years or more ☐

7 Do you use another audit firm to join the audit work?

- Yes ☐ .... years
- No ☐

If No, please go to Section 2

8 In your opinion, what are the particular reasons for using a joint audit?

- Auxiliary auditors have expertise ☐
- Management policy to keep the same auditors ☐
- Keeping the same auditors after acquisition / merger ☐
- Cost reduction ☐
- Principal auditors do not have office in that area ☐
- Other, please specify________________________________ ☐

SECTION 2: YOUR VIEWS OF CLIENT-AUDITORS RELATIONSHIPS

9 The following statements relate to the extent that the factors contribute to the effectiveness of working relationship with your auditors. Please state, by circling one number for each statement, the extent to which you agree with the following statement:

1	2	3	4	5	6	7
strongly agree	agree	tend to agree	neutral	tend to disagree	disagree	strongly disagree

(Circle one)

Good personal rapport at the lower level of the organisation is essential for an effective audit work	1	2	3	4	5	6	7
Personal relationships are important in the audit business	1	2	3	4	5	6	7
Feeling comfortable with auditors is important criteria to the success of the audit	1	2	3	4	5	6	7
Audit is a people business	1	2	3	4	5	6	7
Auditors should have knowledge of their client's business and its environment	1	2	3	4	5	6	7
The size of the audit team is important when the audit work is carried out	1	2	3	4	5	6	7
Larger audit firms have better resources to carry the audit	1	2	3	4	5	6	7
Technical expertise reinforces the working relationship	1	2	3	4	5	6	7
Personal relationships do not play a significant role in maintaining the audit relationship	1	2	3	4	5	6	7
Auditors are involved in solving management problems	1	2	3	4	5	6	7
Clients do not like surprises from auditors	1	2	3	4	5	6	7
Auditors are needed throughout the year for problem solving	1	2	3	4	5	6	7
Continuity of senior audit staff is one way of reducing relationship disturbance	1	2	3	4	5	6	7
Auditors show a mutual understanding with management in the working and delivering the audit on time	1	2	3	4	5	6	7

In terms of dialogue, if auditors have any areas of disagreement, they should make those clear to client's management	1	2	3	4	5	6	7
Continuity is seen as a continuous dialogue not as the number of years that auditors have had contractual relations with the same client	1	2	3	4	5	6	7
Junior staff are important to the audit relationship	1	2	3	4	5	6	7
Junior staff have less impact on the audit relationship than top management	1	2	3	4	5	6	7
Auditors are effective at communicating with their clients	1	2	3	4	5	6	7
Client firms believe in true & fair view concepts, i.e. truthful reporting by auditors	1	2	3	4	5	6	7
Auditors should be effective in providing management solutions	1	2	3	4	5	6	7
Referral is used when the audit firm is unable to solve a problem	1	2	3	4	5	6	7
Problem solving is a continuous process in the audit function	1	2	3	4	5	6	7
Problem solving assists the client to prepare the final accounts	1	2	3	4	5	6	7
The client intends to keep the audit firms indefinitely	1	2	3	4	5	6	7
The audit is not just a piece of paper (legal contract) signed by auditors but a complete extended business relationship	1	2	3	4	5	6	7
The client should put effort into maintaining the relationship with its auditors	1	2	3	4	5	6	7
At times, client should question whether to retain auditors	1	2	3	4	5	6	7
The relationship is developed on a personal basis between the senior audit partner and top management of the client	1	2	3	4	5	6	7
The relationship is seen as consistent due to the continuity of the audit partners	1	2	3	4	5	6	7
Social relationship is an important factor in developing and maintaining long-term relationships between the organisations	1	2	3	4	5	6	7
The client has an effective working relationship with its auditors because:							
(a) Our auditors understand our business and its environment	1	2	3	4	5	6	7
(b) Our auditors are involved in our problem solving	1	2	3	4	5	6	7
(c) Our auditors are very effective in providing management solutions	1	2	3	4	5	6	7
(d) Our auditors are fully committed to us	1	2	3	4	5	6	7

10 Please rate the following statements with respect to their relative importance in auditor-client communications:

1	2	3	4	5	6	7
very important	important	slightly important	neutral	slightly unimportant	not important	not at all important

	(Circle one)						
During the audit preparation, close relationship between both teams, is important:							
(a) To receive information	1	2	3	4	5	6	7
(b) To answer questions	1	2	3	4	5	6	7
(c) To provide help	1	2	3	4	5	6	7
(d) To provide a statement to the shareholders, audit committee and creditors	1	2	3	4	5	6	7
Regular contacts are frequently used by audit firms to keep existing clients	1	2	3	4	5	6	7
Courtship is a part of building quality relationship	1	2	3	4	5	6	7
Auditors make themselves available to clients for enquiries	1	2	3	4	5	6	7
Auditors invite also prospective clients to contact them if they need any explanation or help	1	2	3	4	5	6	7

11 How would you rate your company satisfaction in terms of:

1	2	3	4	5	6	7
very satisfied	satisfied	quite satisfied	neutral	slightly dissatisfied	dissatisfied	very dissatisfied

	(Circle one)						
Quality of the audit service provided by the auditors	1	2	3	4	5	6	7
Auditors' communication skills	1	2	3	4	5	6	7
Socialising between audit teams and client staff	1	2	3	4	5	6	7
Technical expertise	1	2	3	4	5	6	7
Meeting client's expectations	1	2	3	4	5	6	7
Prompt response to queries or problem solving	1	2	3	4	5	6	7
Auditors' ability to meet client deadlines	1	2	3	4	5	6	7

SECTION 3: THE ELEMENTS OF COMMITMENT, TRUST AND QUALITY OF SERVICES IN RELATIONSHIPS

12 The following statements are about the extent of commitment, trust and quality of services in the relationship between auditors and their clients. Please state by circling one number for each statement, the extent to which you agree with the following statements.

1	2	3	4	5	6	7
strongly agree	agree	tend to agree	neutral	tend to disagree	disagree	strongly disagree

	(Circle one)						
The audit team carries out its commitment to the client	1	2	3	4	5	6	7
Overall, time and effort are spent in building, developing and maintaining the relationship with the client	1	2	3	4	5	6	7
Auditors advise on accounting techniques	1	2	3	4	5	6	7
Auditors treat their clients as partners	1	2	3	4	5	6	7
Auditors assist their clients in identifying problems and resolving them	1	2	3	4	5	6	7
Continuous dialogue is a strong sign of commitment between auditors and their clients	1	2	3	4	5	6	7
Personal familiarity is an important factor in building trust between auditors and their clients	1	2	3	4	5	6	7
The auditors understand the personal circumstances of their clients	1	2	3	4	5	6	7
Trust is an essential ingredient in a successful relationship between auditors and their clients	1	2	3	4	5	6	7
When the client loses trust in its auditors, the relationship ends	1	2	3	4	5	6	7
Trust is when auditors meet their client's expectations	1	2	3	4	5	6	7
Auditors should have freedom of movement within the company to talk to anyone	1	2	3	4	5	6	7
Auditors are trustworthy people	1	2	3	4	5	6	7
Auditors have a great deal of integrity	1	2	3	4	5	6	7

13 The following statements reflect various factors that might have an influence on the audit service quality. Please state by circling one number for each statement, the extent to which you agree with the following statements.

1	2	3	4	5	6	7
strongly agree	agree	tend to agree	neutral	tend to disagree	disagree	strongly disagree

	(Circle one)						
Auditors should show genuine care and interest in the company's circumstances	1	2	3	4	5	6	7
Auditors should provide a courteous and friendly service	1	2	3	4	5	6	7
Auditors should respond promptly to a client's requests	1	2	3	4	5	6	7
Auditors should work to an agreed audit schedule and produce an audit report on time	1	2	3	4	5	6	7
To have a quality audit service, auditors should look at agreed areas of assignment only	1	2	3	4	5	6	7
The size of the audit firm provides confidence in the City	1	2	3	4	5	6	7
Feeling comfortable with the audit team is an important criterion in producing a quality annual report	1	2	3	4	5	6	7
An audit firm with no previous involvement in the client industry can provide a quality service	1	2	3	4	5	6	7
Auditors view accessibility to their services by the client as important criteria to produce a quality audit service	1	2	3	4	5	6	7
Auditors flexibility helps to produce a quality audit service	1	2	3	4	5	6	7
The image of audit firm is reinforced by its ability to produce a quality audit report	1	2	3	4	5	6	7
Management should feel comfortable with the audit service	1	2	3	4	5	6	7
Auditors are expected to deliver to the client's expectations	1	2	3	4	5	6	7
Audit tendering will increase the quality of audit service	1	2	3	4	5	6	7
The company should adopt accounting techniques which give a better quality audit without interference from auditors	1	2	3	4	5	6	7

SECTION 4: AUDITOR PERFORMANCE, CONFLICT RESOLUTION, AUDITORS' CHANGES & GOVERNMENT INTERVENTION

14 To the best of your knowledge, please rate your auditors' performance relative to the overall relationship with your company in terms of: (Please circle one number for each item listed below)

1	2	3	4	5	6	7
excellent	very good	good	satisfactory	quite poor	poor	very poor

	(Circle one)						
(a) Value for money	1	2	3	4	5	6	7
(b) Ability to deliver	1	2	3	4	5	6	7
(c) Quality of the audit	1	2	3	4	5	6	7
(d) Knowledge of client business	1	2	3	4	5	6	7
(e) Knowledge of client industry	1	2	3	4	5	6	7
(f) Continuity of personnel	1	2	3	4	5	6	7
(g) Good rapport	1	2	3	4	5	6	7
(h) Good working relationship	1	2	3	4	5	6	7
(i) Problem solving	1	2	3	4	5	6	7
(j) Commitment	1	2	3	4	5	6	7
(k) Quality of advice	1	2	3	4	5	6	7
(l) Local business experience	1	2	3	4	5	6	7
(m) International business experience	1	2	3	4	5	6	7
(n) Technical capabilities	1	2	3	4	5	6	7
(o) Innovative approach	1	2	3	4	5	6	7
(p) Other, please write in below	1	2	3	4	5	6	7

____

____

____

15 The following statements reflect various factors that might have an influence on conflict resolution Please state by circling one number for each statement, the extent to which you agree or disagree with the following statements.

1	2	3	4	5	6	7
almost always	frequently	often	occasionally	very ocasionally	seldom	almost never

	(Circle one)						
When disagreements or disputes occur between auditors and the management team, how often were they handled in each of the following ways:							
(a) By changing some members in the audit team	1	2	3	4	5	6	7
(b) By avoiding the issues	1	2	3	4	5	6	7
(c) By smoothing over the issues	1	2	3	4	5	6	7
(d) By allowing senior client's management and senior partner resolve the issues	1	2	3	4	5	6	7
(e) Involving both parties in discussion	1	2	3	4	5	6	7
During the audit preparation (work), how much are both teams (auditors and client) involved with each other for each of the following reasons:							
(a) To receive information	1	2	3	4	5	6	7
(b) To answer questions	1	2	3	4	5	6	7
(c) To provide help	1	2	3	4	5	6	7
(d) To prepare a statement for shareholders, audit committee and creditors	1	2	3	4	5	6	7
For a quality audit to be provided, how often does the audit team need information from the client?	1	2	3	4	5	6	7
Auditors should agree with the client the accounting techniques to be used	1	2	3	4	5	6	7
An audit firm should not sell management advisory services to its audit clients	1	2	3	4	5	6	7
Auditors are effective in acting independently without regard to self-interest	1	2	3	4	5	6	7

16 Who makes the decision to put the audit out to tender? (Please tick the appropriate box)

(a) Chief Executive ☐
(b) Managing Director ☐
(c) Group/ Financial Director ☐
(d) Board of Directors ☐
(e) Non-Executive Directors ☐
(f) Sub Committee of Board ☐
(g) Audit Committee of Board ☐
(h) Other, please specify ☐

____

____

____

17 Auditors are changed for the following reasons. (Please circle one number for appropriate answer)

1	**2**	**3**	**4**	**5**	**6**	**7**
strongly agree	agree	tend to agree	neutral	tend to disagree	disagree	strongly disagree

	(Circle one)						
(a) Cost of audit (high audit fees)	1	2	3	4	5	6	7
(b) Group/ Company policy	1	2	3	4	5	6	7
(c) Company take-over	1	2	3	4	5	6	7
(d) Merger with another firm	1	2	3	4	5	6	7
(e) Company size	1	2	3	4	5	6	7
(f) Need for an audit firm with an international operation	1	2	3	4	5	6	7
(g) Litigation	1	2	3	4	5	6	7
(h) Changes in management	1	2	3	4	5	6	7
(i) Dispute over principles	1	2	3	4	5	6	7
(j) Qualified opinions	1	2	3	4	5	6	7
(k) Rotation policy of client	1	2	3	4	5	6	7
(l) Clash of personality	1	2	3	4	5	6	7
(m) Difficult working relationships	1	2	3	4	5	6	7
(n) Poor commitment	1	2	3	4	5	6	7
(o) Poor communication	1	2	3	4	5	6	7
(p) Lack of co-operation	1	2	3	4	5	6	7
(q) Other reasons, please write in	1	2	3	4	5	6	7

____

____

____

18 Auditors are selected for the following reasons. (Please circle one number for appropriate answer)

1	2	3	4	5	6	7
strongly agree	agree	tend to agree	neutral	tend to disagree	disagree	strongly disagree

	(Circle one)						
(a) Competitive fees	1	2	3	4	5	6	7
(b) Management and auditors already have a good personal relationship	1	2	3	4	5	6	7
(c) Audit firm's reputation in the City	1	2	3	4	5	6	7
(d) Investors / Shareholders prefer "Big Four"	1	2	3	4	5	6	7
(e) Good working relationship	1	2	3	4	5	6	7
(f) Local presence	1	2	3	4	5	6	7
(g) International presence	1	2	3	4	5	6	7
(h) Problem solving capability	1	2	3	4	5	6	7
(i) Accessibility	1	2	3	4	5	6	7
(j) Wide range of services	1	2	3	4	5	6	7
(k) Referral	1	2	3	4	5	6	7
(l) Industry/ client business knowledge	1	2	3	4	5	6	7
(m) Firm technical expertise	1	2	3	4	5	6	7
(n) Other reasons, please write in	1	2	3	4	5	6	7

____

____

19 The following statements ask about your views on the introduction of government intervention in relation to the audit. Please state by circling one number for each statement, the extent to which you agree or disagree with the following statements.

The quality of audit work is not adequately overseen by self-regulation	1	2	3	4	5	6	7
Too much is expected of auditors by the financial community, i.e. investors	1	2	3	4	5	6	7
An audit firm should not sell non-audit services	1	2	3	4	5	6	7
An audit firm should not be formed as a profit making organisation	1	2	3	4	5	6	7
Government officials should appoint auditors and supervise audit work	1	2	3	4	5	6	7
Audit fees, if determined by government officials will lower the quality of audit service	1	2	3	4	5	6	7
Auditors have been under a lot of criticism recently, a government intervention will increase the quality of audit service	1	2	3	4	5	6	7

Please write any other comments

Thank you very much for your time and help

Name: ______________________________

Position: ______________________________

Number of years with this company: ______________________________

Address: ______________________________

____

____

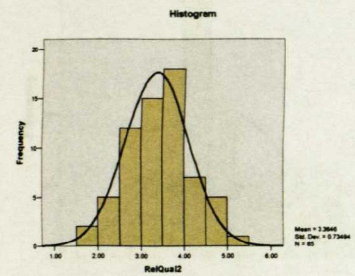
____

Please return the completed questionnaire to:

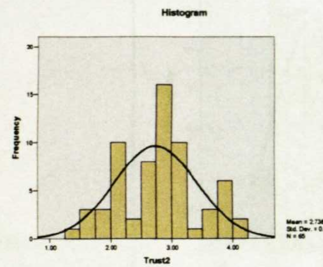
Ahmed Beloucif
Aberdeen Business School
The Robert Gordon University
Garthdee Road
Aberdeen AB10 7QE
Tel: 01224 263828
Email: a.beloucif@rgu.ac.uk

A reply-paid envelope is enclosed for your convenience

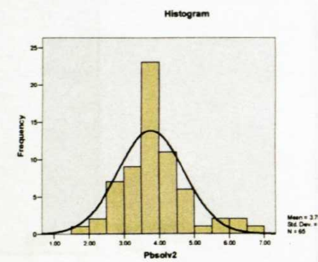
Appendix 5: Data Distribution



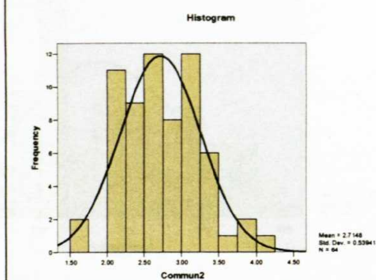
Relationship Quality
- normally distributed
- symmetric
- scores from 1- 6



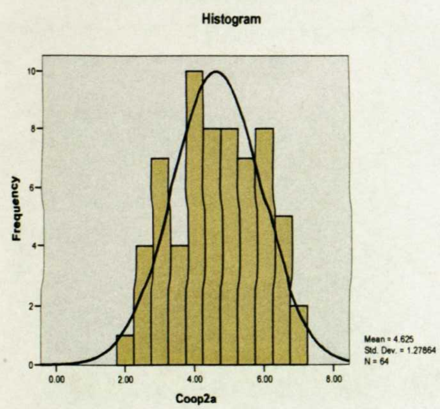
Trust
- symmetric
- scores from 1- 7



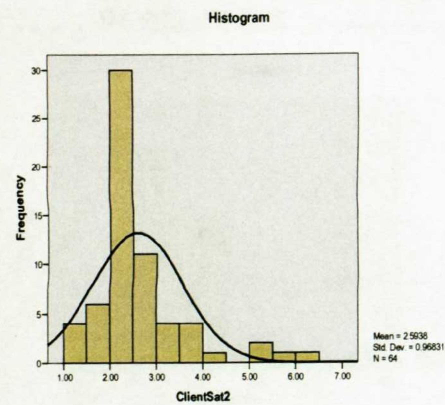
Problem Solving
- well normally distributed
- symmetric
- scores normal distributed from 1 – 7



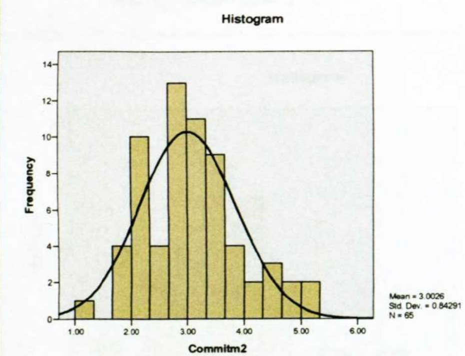
Communication
- slightly asymmetric
- scores from 1.5 – 4.5
- positively skewed



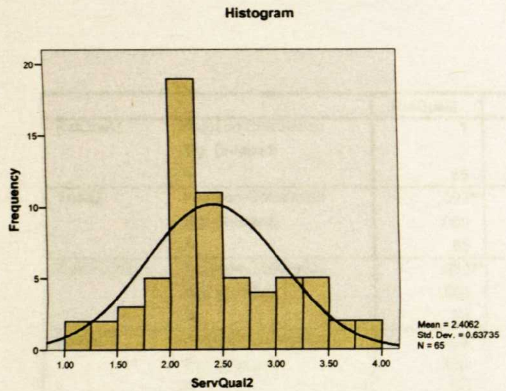
Cooperation
- normally distributed
- symmetric with Bell shape



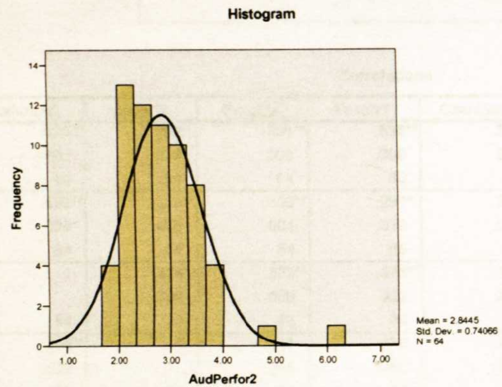
Client Satisfaction
- positively skewed
- scores concentrated between 1 - 3



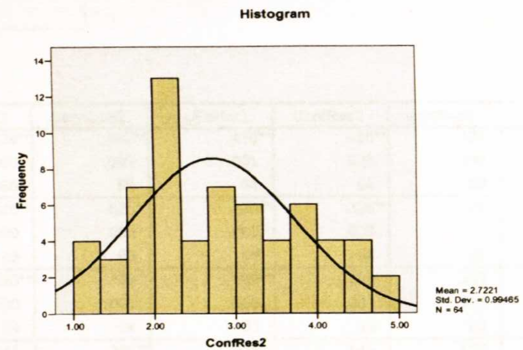
Commitment
- normally distributed with Bell shape
- But slightly skewed



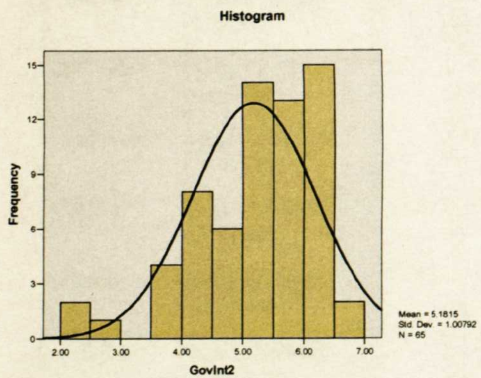
Service Quality
- normally distributed
- slightly skewed
- scores between 1 – 4



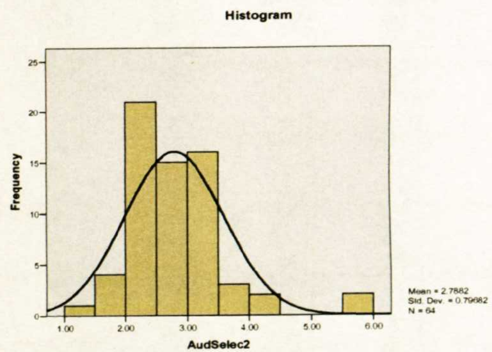
Auditors' Performance
- normally distributed
- but slight positively skewed
- scores 1- 7, i.e., from strongly agree to strongly disagree



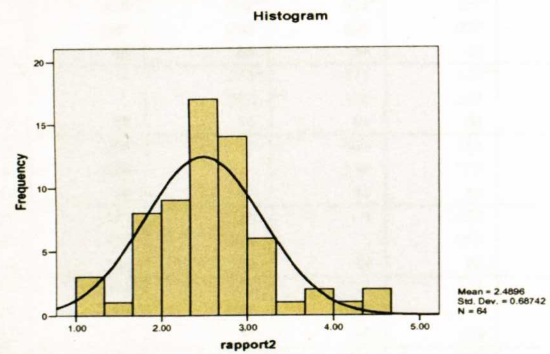
Conflict resolution
- mainly normally distributed
- slightly positive skewed
- scores between 1- 5



Government Intervention
- negatively skewed
- Although bell shape
- Scores between 2 – 7



Auditors 'Selection
- normally distributed with bell shape
- scores between 1 – 6



Rapport
- normally distributed with bell shape
- scores between 1 - 5

Appendix 6 Results of Correlations

Correlations

		RelQual2	Trust2	Commun2	rapport2	Coop2a	Pbsolv2	ClientSat2	Commitm2	ServQual2	AudPerfor2	ConfRes2	AudSwit2	AudSelec2	GovInt2
RelQual2	Pearson Correlation	1	.593**	.630**	.262*	.501**	.538**	.333**	.629**	.442**	.410**	.435**	.123	.293*	-.267*
	Sig. (2-tailed)		.000	.000	.036	.000	.000	.007	.000	.000	.001	.000	.336	.019	.031
	N	65	65	64	64	64	65	64	65	65	64	64	63	64	65
Trust2	Pearson Correlation	.593**	1	.452**	.330**	.359**	.291*	.302*	.526**	.625**	.470**	.326**	.105	.316*	-.217
	Sig. (2-tailed)	.000		.000	.008	.004	.019	.015	.000	.000	.000	.009	.414	.011	.082
	N	65	65	64	64	64	65	64	65	65	64	64	63	64	65
Commun2	Pearson Correlation	.630**	.452**	1	.324**	.533**	.376**	.472**	.623**	.409**	.539**	.393**	.202	.220	-.303*
	Sig. (2-tailed)	.000	.000		.009	.000	.002	.000	.000	.001	.000	.001	.115	.083	.015
	N	64	64	64	63	63	64	63	64	64	63	63	62	63	64
rapport2	Pearson Correlation	.262*	.330**	.324**	1	.144	.110	.058	.211	.346**	.135	.149	.130	.181	-.016
	Sig. (2-tailed)	.036	.008	.009		.255	.385	.651	.095	.005	.291	.240	.315	.155	.899
	N	64	64	63	64	64	64	63	64	64	63	64	62	63	64
Coop2a	Pearson Correlation	.501**	.359**	.533**	.144	1	.647**	.178	.517**	.292*	.310*	.284*	.133	.295*	.039
	Sig. (2-tailed)	.000	.004	.000	.255		.000	.163	.000	.019	.013	.023	.304	.019	.761
	N	64	64	63	64	64	64	63	64	64	63	64	62	63	64
Pbsolv2	Pearson Correlation	.538**	.291*	.376**	.110	.647**	1	.026	.458**	.340**	.109	.227	.208	.260*	.026
	Sig. (2-tailed)	.000	.019	.002	.385	.000		.838	.000	.006	.391	.072	.101	.038	.837
	N	65	65	64	64	64	65	64	65	65	64	64	63	64	65
ClientSat2	Pearson Correlation	.333**	.302*	.472**	.058	.178	.026	1	.488**	.018	.728**	.209	-.031	.026	-.273*
	Sig. (2-tailed)	.007	.015	.000	.651	.163	.838		.000	.889	.000	.100	.808	.842	.029
	N	64	64	63	63	63	64	64	64	64	64	63	62	63	64
Commitm2	Pearson Correlation	.629**	.526**	.623**	.211	.517**	.458**	.488**	1	.424**	.592**	.331**	.281*	.343**	-.199
	Sig. (2-tailed)	.000	.000	.000	.095	.000	.000	.000		.000	.000	.008	.026	.006	.113
	N	65	65	64	64	64	65	64	65	65	64	64	63	64	65
ServQual2	Pearson Correlation	.442**	.625**	.409**	.346**	.292*	.340**	.018	.424**	1	.273*	.171	.402**	.470**	-.206
	Sig. (2-tailed)	.000	.000	.001	.005	.019	.006	.889	.000		.029	.176	.001	.000	.100
	N	65	65	64	64	64	65	64	65	65	64	64	63	64	65
AudPerfor2	Pearson Correlation	.410**	.470**	.539**	.135	.310*	.109	.728**	.592**	.273*	1	.120	.115	.355**	-.315*
	Sig. (2-tailed)	.001	.000	.000	.291	.013	.391	.000	.000	.029		.348	.373	.004	.011
	N	64	64	63	63	63	64	64	64	64	64	63	62	63	64
ConfRes2	Pearson Correlation	.435**	.326**	.393**	.149	.284*	.227	.209	.331**	.171	.120	1	-.028	.096	-.272*
	Sig. (2-tailed)	.000	.009	.001	.240	.023	.072	.100	.008	.176	.348		.829	.456	.030
	N	64	64	63	64	64	64	63	64	64	63	64	62	63	64
AudSwit2	Pearson Correlation	.123	.105	.202	.130	.133	.208	-.031	.281*	.402**	.115	-.028	1	.535**	-.070
	Sig. (2-tailed)	.336	.414	.115	.315	.304	.101	.808	.026	.001	.373	.829		.000	.588
	N	63	63	62	62	62	63	62	63	63	62	62	63	63	63
AudSelec2	Pearson Correlation	.293*	.316*	.220	.181	.295*	.260*	.026	.343**	.470**	.355**	.096	.535**	1	-.021
	Sig. (2-tailed)	.019	.011	.083	.155	.019	.038	.842	.006	.000	.004	.456	.000		.872
	N	64	64	63	63	63	64	63	64	64	63	63	63	64	64
GovInt2	Pearson Correlation	-.267*	-.217	-.303*	-.016	.039	.026	-.273*	-.199	-.206	-.315*	-.272*	-.070	-.021	1
	Sig. (2-tailed)	.031	.082	.015	.899	.761	.837	.029	.113	.100	.011	.030	.588	.872	
	N	65	65	64	64	64	65	64	65	65	64	64	63	64	65

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).