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SOCIOLOGICAL PERSPECTIVES ON FINANCIAL AUDITING

The paper's objective is to offer a better picture of the complex process of financial audit. It explores the possibility that understanding the role of the financial audit profession might be enhanced considerably by drawing out some parallels between the developments in sociological theory and those in auditing. The main contribution of the paper is a better understanding of the role of a financial auditor to provide trust at the market place (the functionalist sociological view), while working in a conflict-driven environment (the perspective of the conflict theory) with high expectations from the profession (the interactionist sociological framework).

Keywords: auditing; role; sociology; interdisciplinary; expectation gap.

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1. Introduction. The financial audit profession has been experiencing difficult times. The accounting scandals at the beginning of this century brought financial auditors under critique. Those events are still remembered and debated (e.g., Carnegie and Napier, 2010; Cooper and Neu, 2006; McMillan, 2004) and had important consequences for the profession in terms of relevant regulatory framework. Additionally, due to the current so-called economic and financial "crisis", auditors came again under critique. This state of affairs also stimulated debates about contemporary auditing practices (Sikka, 2009; Humphrey, Loft and Woods, 2009).

What is the role of financial audit in the society? What is currently the **per-**ceived role of auditors? What is the self-perception of auditors? How should auditors be perceived by themselves and by others? What should actually their role **be**? These are only some of the questions triggered by the mentioned events. The **pres-**ent paper aims to offer some answers to these questions by providing an overview on the role of financial auditing from the perspective of 3 theoretical sociological frameworks: functionalism, conflict theory and interactionism. The paper is structured as follows. The first section presents a review of the relevant literature on **the** topic, while the second describes the methodological research approach. In **the** main body of the paper, the traits of these sociological theories are analyzed. Then, within each theory, the financial audit process is analyzed from the theoretical **per-**spective, and parallels between the theory and the developments of the profession are drawn.

2. Literature review. The role of financial audit in the society and the perceptions of auditors have been previously researched in literature (Backhaus, Meffert, Bongartz and Eschweiler, 2003, 625-637). Such issues as pressures on financial auditors, auditor independence, expectation gap, and trust in auditors are still of great interest in this field (Hassink, Bollen, Meuwissen, de Vries, 2009; Mocanu, 2009a, b; Malsch and Gendron, 2009; Ganuza and Gomez, 2007 - to name only a few).

However, in debating these aspects of financial audit, the research builds **upon** certain patterns which are not explicitly stated. Thus, it seems to be a "known fact" **that** auditors work in a so-called "conflict-driven environment"; that their interests **might** collide with those of managers and shareholders; that they must safeguard both **their** independence in fact and in appearance, and that they offer a valuable intangible good for the market economy, namely "trust". Thus, it seems clear that the functions and behavior of a financial auditor, as well as his image, are of great importance in the **cur-**rent society.

Additionally, there is research that analyzes financial audit from different angles: the game theoretical perspective (Coate, Florence and Krai, 2002; Nguyen, 2005), strategic perspective (Turlea and Mocanu, 2010), literary theory (Macintosh, 2002) etc. Recently, researchers also considered the possibility of analyzing financial audit from the sociological perspective (e.g., Power (1995) emphasizes the need to investigate auditing in its organizational context). The present paper builds upon this previous research by bringing additional insights into the audit profession.

3. Methodological approach. The steps in the analysis of auditing from the functionalist perspective are the following: (1) identification of the basic assumption; (2) choice and brief description of the social situation to be analyzed; (3) identification of the needs in this situation; (4) conceptualizing the situation as a system and identifying its constitutive parts; (5) identification of connections between the parts of **the** system; (6) identification of the gaps between what is supposed to happen and **what** the system is able to do; (7) commenting and inferring.

The analysis of financial audit from the perspective of the conflict theory follows 6 steps: (1) identification of the basic assumptions; (2) choice and brief description of the social situation to be analyzed; (3) identification of relevant individuals and social

groups; (4) listing the groups that have more power to control other people and the outcomes of the situation and identifying the values, interests and goals of these groups; (5) listing the groups that have less power and less influence over the situation and identifying the values, interests and goals of these groups; and (6) commenting and inferring.

The steps followed when analyzing financial audit from the perspective of interactionism are as follows: (1) identification of the basic assumptions; (2) choice of the social situation to be analyzed; (3) identification of different definitions of this situation stemming from different persons or groups; (4) identification of the factors that influence the definition of a situation; (5) analyzing how different definitions influence behavior and interaction with others; and (6) commenting and inferring.

4. The financial auditing process and the main theoretical perspectives in sociology. By definition, sociology is the systematic study of human society, social groups, and social interactions. The sociologists are interested in the study of people and of the rules of behavior that structure interactions between people and groups of people. One of sociology's basic ideas is that all human behavior occurs in a societal context which shapes what people do and think. This section presents 3 theoretical perspectives in sociology by pointing out their main assumptions. In parallel, financial auditing is analyzed from each of these perspectives.

4.1. Functionalism

Overview. The first theoretical orientation of sociology is functionalism (Turner, 2002) which addresses the question of social organization (structure) and how it is maintained (function). The roots of this theoretical perspective lie in natural science. When analyzing a living organism, natural scientists try to identify various parts (structures) and to determine how they work (function) (Brinkerhoff et al., 2007). Thus, functionalists see the society as a system composed of several interdependent parts, such as institutions and roles. Different parts have different needs and different impacts on the form and shape of the society. As Andersen and Taylor (2005) point out, changes of social system occur through the removal of non-functional parts, through the adaptation to newer needs or through increased complexity of the system. In accordance with functionalist views, the society (as a complex system) strives for stability. The need for groups and society to maintain balance explains social behavior. Each part contributes to its stability, namely it is functional for the society as a whole (Andersen and Taylor, 2005).

Financial auditing and the functionalist perspective. Researchers, as well as practitioners in the field of financial auditing, frequently state that the ultimate goal of financial auditing is trust at the market place (e.g. Cheffers, Pakaluk 2007, 39). Starting from this statement, this subsection analyzes the financial auditing function and the previous literature on financial auditing from the functionalist perspective.

The basic underlying assumption in this analysis is that the society is a set of interdependent parts, a system that strives for stability. The social situation is financial auditing, to be analyzed within a wider social institution called "market economy". The main function of financial audit is to offer credibility to the financial statements of the audited companies by issuing an opinion on whether they present fairly, in all material respects, the financial position and performance of that company, in accordance with a certain financial reporting framework. The sole fact that an audi-

tor examines financial statements of a company makes them credible to lenders investors and other stakeholders. Therefore, the main function of financial audit is to meet the need for trust in the market economy.

However, financial audit is not the only functional part of the market economy. First of all, audited companies meet different needs of other companies and entities as well as of individuals by providing them with goods or services. Second of all, regulators meet the need for legislation in the market economy by establishing the regulatory framework regarding not only the activity of the companies, but also their financial reporting process. The interdependence relationship between financial audit, regulators and audited companies is in the fact that, on one hand, financial auditors should be aware of the regulation in force relevant to the audited companies and on the other hand, that the mere existence of financial audit is strictly due to the existence of relevant regulation related to auditing, which thus implicitly recognizes the need for this function in the economy.

Besides companies, regulators and financial auditors (individuals or audit companies), an important part of the system is represented by lenders. "Lenders" is a broader term that includes both creditors and investors which fulfill the essential function of financing businesses. In the market economy no company would survive without adequate financing sources, represented by creditors and investors. This vital need of companies, in general, and of audited companies, in particular, is met by the creditors (source of external financing) and the investors or shareholders (source of internal financing). Since, generally, they are not free of interests in their financing activity, the interest paid (in case of creditors) and the dividends distributed by the financed companies (in case of shareholders) meet their financial needs. Collateral beneficiaries of the financial audit work are also clients and suppliers of the audited companies, as well as their employees. They are all interested in well-functioning of the audited company and in its financial welfare.

Having identified (a) the relevant parts of the market economy understood as system (that is, regulators, financial auditors, audited companies, clients, suppliers, investors, creditors, employees etc.), (b) their needs, (c) the connection between them, and (d) their interdependence, it becomes obvious that, in a functionalist view, all these parts harmoniously work together for achieving stability. One important element of cohesion is the financial audit, which provides trust so necessary for all economic endeavors in the current market place.

However, the credibility of the audit profession may shatter which implicitly endangers the stability of the entire system. A cause of negative consequences for the balance of the system is the fact that the important function of financial audit may lead to the situation in which other parts of the system (investors, creditors, audited companies etc.) place unjustified high expectations on the financial auditor - generating the so-called "expectation gap". The accounting scandals that burst in 2001, as well as the current so-called economic and financial "crisis" intensified the debate on the expectation gap and on the role of financial auditors.

4.2. *Conflict Theory*

Overview. Whereas the emphasis of functionalism lies on balance, interdependence and cohesion within society, conflict theory emphasizes strife and friction. There are 3 primary assumptions in conflict theory (Brinkerhoff et al., 2007). First,

the foundation for all social relationships is competition over scarce resources; competition but not consensus characterize human relationships. Second, all social structures are characterized by the lack of equality in power and reward; if a particular structure benefits certain individuals and groups, those strive to see it maintained. Third, change occurs as a result of power struggles and conflict between competing interests, not through adaptation; it is often abrupt and revolutionary rather than evolutionary and it is often helpful rather than harmful. The merit of conflict theory is that it shifts the focus of theoretical sociology to the conditions under which varying types of conflict emerge in social systems. As a consequence, various conflict approaches have developed (Turner, 2002).

Financial auditing and the conflict perspective. Researchers, as well as practitioners in the field of financial auditing repeatedly stated, explicitly or implicitly, that the auditor's decision-making process takes place in a conflict-driven environment (e.g. Arnold, Collier, Leech, and Sutton, 2001). Starting from this statement, the present section analyzes the financial auditing process and the previous literature on financial auditing from the perspective of the conflict theory. The basic underlying assumption in this analysis is that conflict is frequent and social change is certain. The social situation chosen for analysis is the financial auditing process. As previously stated, the financial audit process consists of all steps and procedures necessary for the financial auditor to issue an opinion on the financial statements prepared by the audited company.

As sociology always takes into consideration the societal context, it is necessary that, before engaging into a more detailed analysis, to identify this context, as well as the individuals and social groups involved in the social situation that is analyzed. First of all, financial auditors are in the center of discussion. Other relevant groups are the professional bodies, the regulators and the standard setters, which vary depending on the geographical area. The client's management, its accounting department, other experts, auditors previously mandated by the audited company, other professionals etc. also belong to the financial audit environment.

Ideally, the individuals/the groups that have the greatest control over the outcome of the financial auditing process are the financial auditors who actually perform the auditing (by the term "financial auditor" the author designates either an individual auditor or an audit team within an audit company). In fact, there are several other groups that compete for power and control in the financial audit environment and put pressure on the auditor.

On one hand, regulators and standard setters (such as the International Federation of Accountants — at international level) issue new standards, constantly improve the existing ones and issue policy positions on the topics of public interest and comment letters on matters relevant to the profession. They generally adhere to the values of integrity, transparency and expertise. Their stated goal is to serve the public interest by strengthening the audit profession. Their main interest is that the auditors ensure a reliable high-quality auditing process.

This interest is also shared by professional bodies, whose main role is to grant licenses needed for exerting the profession. They also ensure that the members undertake a minimum level of continuing professional development and provide support to them by offering advisory services, technical libraries, training programs etc. Moreover, they facilitate professional networking and career and business develop-

ment and support the connection between the academic environment and the profession. Their values, among others, are professionalism and integrity, as their goal is to protect the interests of the profession.

The power of regulators, standard setters, professional bodies, and sometimes the academics consists in shaping the regulatory framework for the financial auditing process. As regulation plays a critical role in exerting this profession, their power measures up to this state of facts, and therefore, is higher. However, it may happen that the interests of regulators collide with those of the professional bodies which represent the profession (and vice versa). This leads to a conflict and competition over control and power in the audit environment, in accordance with the main assumption of the conflict theory presented in the previous section.

On the other hand, there is an extensive body of literature that emphasizes several other types of conflict related to the financial audit environment. First of all, as Goldman and Barlev claim (in Gray and Manson, 2005), the client organization (management and shareholders) may strive for power and control over the outcome of the financial auditing process. It is said that the cause of this conflict between a financial auditor and a client organization resides in fact that the truthful audit report collides with the interests of management or shareholders or both groups. The main source of power for management and/or shareholders resides in the fact that a client organization is the one that mandates and remunerates the financial auditor.

Another possible conflict that is frequently cited in the literature is the conflict between managers and shareholders (Gray and Manson, 2005). Managers may wish to mislead shareholders, even if only in a short term. Last but not least, a client organization may wish to deceive outside providers of finance (such as lenders) regarding its position, in order to increase the probability to receive further financing, although this may not be in the best interest of a third party.

4.3. Interactionism

Overview. The third major framework of sociological theory is interactionism. Interactionist tradition (Blumer, 1969; Stryker, 1980; Burke, 1991) includes the so-called symbolic interactionist theory. Instead of conceptualizing society in terms of abstract institutions, symbolic interactionists consider that human interpretation constructs the society (Andersen and Taylor, 2005). As its name implies, symbolic interactionism is based on the symbolic meaning people give to different behaviors, events or things in the process of social interaction.

According to Brinkerhoff et al. (2007), there are 3 major premises of symbolic interactionism. First, symbolic meanings are important. Any behavior, gesture or word can be interpreted in many different ways. In order to understand human behavior, researchers must learn how participants interpret and define a certain aspect of life or society. Second, meanings grow out of relationship. The change in relationship drives the change in meaning. Third, meanings are negotiated. People do not accept others' meanings uncritically. Each person plays an active role in negotiating the meaning that things will have.

Financial auditing and the interactionist perspective. Researchers, as well as practitioners, claim that a financial auditor does not exert his/her profession in a social vacuum. The debates on this issue are mainly related to the ethical requirement of auditor independence. Starting from this statement, the present section analyzes the

financial auditing process and the previous literature on financial auditing from the perspective of interactionism.

The basic underlying assumption in this analysis is that societies and persons in them are guided by the way they define and interpret events, behaviors etc. The social situation to be analyzed from this perspective is financial auditing, defined by the Oxford Dictionary of Business and Management as "an independent examination of, and the subsequent expression of opinion on the financial statements of an organization. This involves the auditors in collecting evidence by means of compliance tests (tests of control) and substantive tests (tests of detail)". Consequently, the idea of independence is inherently related to the very definition of financial auditor. As independence is considered to be the cornerstone of the profession, the following section will particularly address this issue.

The definition of financial audit mentioned above is shared by both regulators and the general public interested in the final audit report. IFAC (International Federation of Accountants) differentiate "independence of mind" from "independence in appearance" (IFAC 2009, Paragraph 290.8). On one hand, independence in mind is the state of mind that allows the expression of a conclusion without any influence that compromises professional judgments. On the other hand, an auditor must avoid facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that the auditor's integrity, objectivity or professional skepticism has been compromised (independence in appearance).

As explained in Mocanu (2009b), the metaphor underlying this definition can be formulated, according to Reiter (2004), as follows: "Independence is separation". This metaphor originates in the separative model or ethics of rights perspective according to which human beings are considered autonomous and immune to social influences. This approach, however, is in obvious contradiction with the sociological analysis of financial audit. It ignores the fact that a financial auditor is still an individual, a member of the society, who does not work in a social vacuum and, as any human being, cannot avoid influences of the family, friends, attitudes and standards of the community he/she belongs to (Reiter, 2004, p. 11).

5. Conclusions. None of these three sociological theories is complete in itself. Together, however, they provide a valuable set of tools for proper understanding of the role of financial audit in the societal context. In the present paper the financial audit process was viewed through these 3 lenses. From the functionalist perspective, financial audit represents a functional part of the system called "market economy" and meets a vital need - the need for trust at the market place. From the conflict perspective, the financial audit process takes place in a conflict-driven environment, with the following potential areas of conflict: between an auditor and a client organization (management and shareholders), between management and shareholders, and between an audited company and its lenders. From the interactionist perspective, a financial auditor does not live in a social vacuum, thus the metaphor "independence is separation" does not seem appropriate. However, this definition of an auditor and his/her independence is common among most stakeholders and puts enormous pressure on him/her. These 3 sociological perspectives on financial audit offer a better understanding of the auditing profession, this being the main contribution of the

present paper. However, the limits of the paper are due to the lack of empirical evidence on this topic — and this can be a subject for future research.

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