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Literature review: How is auditor commercialism related to audit quality and efficiency?

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I. Introduction

Professional service firms, such as public accounting firms, face a unique challenge relative to other types of for-profit enterprises. While auditors are charged with serving an important societal function, they are also engaged in for-profit enterprises. This raises an important question: does engaging in commercial activity compromise auditors' professionalism?

Occupations which achieve professional status are expected to abide by a social contract wherein they serve as safeguards for the public good (Robson et al. 1994). However, auditors and other professionals are often under considerable commercial pressure to increase sales and cater to their clients (Bamber and Iyer 2002). In brief, theory suggests that commercialism and professionalism are fundamentally opposed, and that emphasizing one will necessarily lead to a reduction in the other (Suddaby and Greenwood 2005).[1]

In contrast to the claims of critics of the audit profession, other stakeholders including academics posit that commercialism and professionalism need not be mutually exclusive and could instead be complementary (Gendron 2002). This alternative perspective suggests that audit firms operate successfully by developing cultures and systems in which each perspective serves to constrain the excesses of the other. Commercialism ensures that the firm receives adequate compensation for its professional activities to remain viable in a competitive economy, while professionalism ensures that profit-seeking does not undermine the activities that maintain the public trust.

What is missing from much of the research that discusses the trade-off between commercialism and professionalism is a careful discussion and empirical examination of quality control within audit firms. Audit firms are unique professional service organizations with a clear mission to serve the welfare of society. Unlike many other professions, such as the legal or medical profession,

[1] The European Commission, among others, appears to share this concern. In its response to concerns raised by stakeholders regarding its 2010 Green Paper, the Commission cited that mechanisms to instill a more professional orientation among auditors was of particular importance.

where the first-order consideration is the individual directly receiving the service, auditors must be mindful of a myriad of other stakeholders that will rely upon their work. Quality control mechanisms could effectively allow the audit professional to serve both commercial and professional ends.

In Section II of this research synthesis, we will present the arguments from both sides. After reviewing the relevant literature discussing the trade-off theory, we will proceed in Section III by discussing how organizational control within public accounting firms has evolved over time. Lastly, in Section IV we will bridge these two streams of literature together and discuss their joint implications for audit practice.

II. The Trade-off Theory

Auditors are often under considerable pressure to increase sales and cater to their clients. Commercialism and professionalism are theorized to be fundamentally opposed and that emphasizing one will necessarily lead to a reduction in the other (Suddaby and Greenwood 2005). Theory suggests this friction is particularly acute in auditing because even ex post it is difficult for clients to evaluate audit quality as it is unobservable (Causholli and Knechel 2012). In addition, while other professionals like lawyers and doctors can engage in actions that benefit themselves at their client's expense, they are not required to adopt a mindset of independence for the client. In the legal and medical professions, the service provider is expected to be a client advocate. In contrast, independence from the client is a fundamental characteristic of the audit profession.

Commercialism is characterized by a desire to align oneself with the client and in an auditing context this means satisfying company management (Hanlon 1996). Commercial auditors engage in catering because they are first and foremost concerned with being engaged again next year and they recognize that company management has considerable influence on the decision to renew the auditor. Therefore, the trade-off between commercialism and professionalism is more pronounced in auditing.

The friction is not only greater, but it is also potentially more damaging to service quality in auditing (Wyatt 2004; Zeff 2003a, Zeff 2003b). In addition to issues around auditor independence, commercial auditors are also theorized to be more interested in making audit engagements profitable within the near term and are not as focused on long-term concerns (Humphrey and Moizer 1990; Gendron 2002). There are several studies, many of which utilize the qualitative methodology, which provide evidence that commercialism has become more important over time and receives greater emphasis than professionalism within accounting firms (see Bazerman et al. 1997; Wyatt 2004; Gendron and Spira 2010; Lord and DeZoort 2001; Suddaby and Greenwood 2001; Suddaby et al. 2007; Suddaby et al. 2009).

If auditors invest more time and effort in commercial activity, all else equal, there is less time available for them to audit their existing clients. Auditors may also perceive that investments in professional development through learning and education are less important relative to investments in growing business. These two points would suggest that commercial activity will be negatively related to individual auditor performance. However, there are several possible reasons why higher levels of commercialism will not be negatively related and may be even be positively related to auditor and audit engagement quality.

First, it is likely that the two logics must both be present in these organizations and seeking to reduce commercialism is not necessarily possible (Gendron 2002). Instead, firms are better served to ensure that the two logics can co-exist and allow for both to be considered during the decision-making process (Malsch and Gendron 2013). In fact, there is evidence that many decisions by auditors remain heavily influenced by professional considerations despite the increased presence of commercial interests (Aranya et al. 1981; Aranya and Ferris 1984; Gendron 2001, Gendron 2002; Gendron and Spira 2009; Gendron and Spira 2010). Second, auditors that invest more in commercial activity may simply exert more overall effort in order to commit adequate time and consideration to maintaining audit quality as disregarding audit quality would impair their commercial interests (Gendron 2002). Third, audits are conducted in teams and so an individual audit partner may be able to leverage the knowledge, technical skills, and effort of subordinate team members to maintain quality while deciding to invest more time in commercialism (Greenwood and Empson 2003). Fourth, it is possible that individual auditors that engage in relatively more practice development will have their work evaluated favorably if the firm establishes an incentive and evaluation system that rewards commercial effort. This would be consistent with the evidence in Gendron (2002) which shows that certain firms organize and reward individuals for their commercial efforts more so than for activities that would be labeled as purely professional. Fifth, auditors that pursue commercial interests may obtain greater work satisfaction (Herrbach and Kosmala 2006) which would lead to higher quality output.

III. Organizational Control

Historically, professional service firms employed almost no formalized system of control to ensure the quality of the services provided (Leicht and Fennell 1997). As professional service firms leverage unique knowledge to deliver their services it has been theorized that utilizing bureaucratic control will not succeed in achieving quality control (Abernethy and Stoelwinder 1995; Mueller et al. 1994). Public accounting firms, for example, organized as professional partnerships and initially did not adopt formal control systems for this reason (Greenwood and Empson 2003).

In the last few decades, public accounting firms have undergone a transformation. These firms now have more rigid structures in place where younger, less experienced professionals work under close supervision. Rather than focus on autonomy across individual audit partners, audit firms are now classified as heteronomous professional organizations, meaning that staff and even audit partners have become more subordinated to an administrative structure (Scott 1982; Greenwood and Miller

2010). The empirical evidence shows that there is less reliance on collegial control and greater formal integration (Cooper et al. 1996; Greenwood et al. 2005; Miller 2003).

In spite of this shift, prior literature noted that professionals continued to exercise control over professionals similarly to the historically collegial way (Leicht and Fennell 1997). It is only more recently, as professional service firms have continued to evolve over time, that now professionals (at lower and higher levels) are subject to control by non-professionals (Tolbert and Stern 1991; Leicht and Fennell 1997). Some evidence suggests that the integration of non-professionals who exert control over audit professionals has not weakened professionalism among auditors as the audit firm creates organizational boundaries which preserve professional norms (Suddaby et al. 2009). While audit firms are moving toward more bureaucratic structures and oversight, including systematic quality control, it is unclear whether more formalized structures of controls will be effective. There is evidence that practitioners believe bureaucratic controls can mitigate the potential negative influence of commercialism (Gendron and Spria 2009). However, auditors that subscribe to more collegial control mechanisms may not adhere to quality control policies requiring things such as consulting with subject matter experts on highly complex or risky issues. Further, if auditors believe that asking for help will negatively reflect upon their technical ability, they will be more likely to forego making such requests. It remains an open empirical question how structured quality control mechanisms influence the relation between commercialism and professionalism, if at all.

IV. Conclusion and Implications

Our discussion of the trade-off theory and of organizational control makes clear that theory and empirical evidence suggest professional service firms face significant challenges relative to other for-profit enterprises. Chief among these issues, the trade-off theory suggests that professionals cannot simultaneously pursue their commercial interests while fulfilling their professional obligations.

Additionally, as professional organizations, such as public accounting firms, have evolved, the pursuit of commercial interests has pushed these firms to implement a system of organizational control that is thought to be less professional.

This perspective is not universally accepted in the literature. Some theory posits that professionals can fulfill their responsibilities as professionals and pursue commercial gain. Further, changes in organizational control need not reduce service quality. Formalized practices, such as consultations with subject-matter experts, could ensure that audit engagement partners obtain requisite technical assistance when making difficult judgments. In fact, consulting partners, who are not actively managing individual audit engagements, can serve as an additional check against the lead partner's potential desire to cater to a specific client. There is also a stream of literature that suggests that individuals whose professional identity is tied closely to their technical competence are less likely to seek help from others (Lee 1997) and this is true for auditing in particular (Griffith 2015). This suggests that auditors who have a stronger commercial focus could be more likely to seek assistance from technical experts and make greater use of quality controls within the audit firm leading to higher audit quality.

We believe, given the competing theory and mixed empirical evidence discussed in this synthesis, that there are several unanswered questions that require further investigation. In particular, we believe it would benefit audit practice to examine how an auditor's commercial activity relates to audit quality. Additionally, standard setters, regulators and practitioners would benefit from a study of the extent to which an audit firm's quality control systems are effective and if any differences in the propensity for audit partners to utilize quality control depending upon their level of commercial focus exist.

We will address these gaps in the existing literature by testing how auditors' commercial activities are reflected in individual performance evaluations and promotion decisions. We will also test whether commercial activity is related to indicators of audit quality such as internal firm evaluations or external quality reviews. We expect that auditors' commercial efforts will be rewarded and, critically, that commercial activity will be positively related to audit quality. Our rationale is that auditors who receive high evaluations for their commercial activities base their professional identity more on being successful at this aspect of their work. In turn, they are more willing to rely on others to aid in technical and personnel management issues that lead to high audit quality and high engagement efficiency. Our examination will provide important evidence addressing these questions and will be the first direct evidence of which we are aware about the benefits of the commercial motivations of auditors.

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