

WALKING A FINE LINE: EXAMINING THE POSITION OF THE CONSTRUCTION QUALITY AUDITOR THROUGH THE LENS OF FINANCIAL AUDIT LITERATURE

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Internal and external quality auditors must perform a complex balancing act requiring good judgement, interpretation, emotional intelligence, and empathy to achieve several, often conflicting, objectives. The position of the auditor in the financial sector has been examined in the literature in detail; however, in the construction sector this area has been largely unexplored, a gap in knowledge that this paper aims to help fill. This review considers Power's theory of 'The Audit Society' and the rich financial auditing literature to examine the position and actions of internal and external construction quality auditors. The findings show that the audit is a complex construction of performance and judgement and that the 'facticity' of the audit should not be taken for granted. Auditor independence and competence can be difficult to achieve within the current construction quality regulatory system. Construction quality auditing takes place behind closed doors - greater exposure is needed of auditing practice.

Keywords: auditing; quality management; financial regulation; ISO 9001

INTRODUCTION

Internal and external auditors play a pivotal role in the transparency and credibility of regulation, certifying the accuracy of systems compliance. Internal auditors must manage complex and often conflicting objectives (Guénin-Paracini *et al.*, 2015). They should thoroughly correct identified failings prior to external audits. They must foster trust and a good working relationship with the colleagues that they are auditing to induce their cooperation (Van Peurse 2005). The work of an internal organisation's auditors could be described as 'marking their own homework', whereas the continuing appointment of an external auditor is dependent on the favour of the directors whose company they audit. The same broad principles apply, whether to a financial audit or a construction quality audit. ISO 19011 defines an audit as the "systematic, independent and documented process for obtaining audit evidence and evaluating it objectively to determine the extent to which the audit criteria are fulfilled" (2012, p. 1). It lists the 6 guiding principles which auditors should follow as: integrity, fair presentation, due professional care, confidentiality, independence, And an evidence-

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based approach. These principles apply to both financial audits and construction quality audits, although these audits examine different distinct sectors.

Power (1997) suggested that we live in an ‘audit society’ where organisations are increasingly compelled to externally assess and report their performance against an expanding number of factors - financial and quality management, as examined in this paper - but others including health and safety, environmental performance, diversity, information management and data quality. Audits are inferential, in that they use a sample of documents, interviews and site visits to draw conclusions as to the performance of a company (power, 2000). Audits are intended to ensure legitimacy and accountability (power, 2021), to help a company demonstrate that customer needs and regulatory and statutory requirements are being met (benner and tushman, 2003).

Audit reliability has been widely addressed in accountancy literature (Including Guénin-Paracini *et al.*, 2015, Chu *et al.*, 2011, FRC,2020.) Despite this spotlight on the mechanics and quality of financial auditing, a recent study by the International Forum of Independent Audit Regulators (FRC,2020) Found that audits by the world’s largest 6 auditing firms (KPMG, EY, PWC, Deloitte, Grant Thornton, BDO, and Mazars) were ‘persistently riddled with flaws.’ KPMG are under investigation by the UK financial reporting council for failing to uncover and report misstatements in Carillion’s company accounts before its collapse (Prior, 2022); and PWC have been fined for audit failure with Kier and Galliford Try Accounts (Cruise, 2022).

This raises the question - if financial audits, which are under a research spotlight and stringent regulatory scrutiny, can be unreliable, manipulated or misstated, how dependable are the audits which are carried out in the much less visible world of construction quality management? Recent construction quality control scandals such as the Edinburgh Schools PFI problems (Cole, 2017) and the Grenfell Tower fire (Hackitt, 2018) point to systemic failings in construction quality audits which need further examination.

Numerous studies examine the independence and authority of auditors in the financial sphere (Including Selim, *et al.*, 2009; Heras-Saisarbitoria and Boiral 2013; Tepalagul and Lin, 2015) and several in other industries regarding ISO 9001 (Ahlawat and Lowe, 2004; Abbott, *et al.*, 2016), But few recent studies have examined the position of quality management auditors in the construction sector. This paper therefore aims to compare research on the position and independence of the auditor in the financial sector (which is plentiful) with that of the position of the auditor in construction quality auditing, using Power’s theory of the ‘Audit Society’ as a lens. The first objective is to explore Power’s theory of the ‘Audit Society.’ The second is to examine internal and external auditor independence, authority, access to information and competence in the financial sector. The final objective is to use this information to raise questions regarding quality management audit practice in construction to provide a road map as a basis for further research into the quality auditor in construction.

Method

Papers were systematically selected from peer reviewed sources in two distinct exercises. For the first, Scopus, Google Scholar and the authors’ institution online library were searched using the terms ‘Financial Audit’ ‘and ‘Audit Regulation’. 83 abstracts were then reviewed to determine which papers met the inclusion and exclusion criteria. Inclusion criteria include papers that examine financial audit

performance, practice, and regulation. Exclusion criteria comprise non-peer reviewed work, studies with a high degree of cross pollination and repetition, and ultimately conference paper constraints. A rich seam of research was mined in this exercise. 33 papers were selected for review, including those on the concept of 'the Audit Society'. The second selection process used same databases with the search terms 'Construction ISO 9001 Auditing' and 'Construction Quality Auditing'. 51 abstracts were reviewed for alignment with inclusion criteria which comprise studies that examine construction quality audit performance and practice. The exclusion criteria above were supplemented with papers that refer to 'financial construction', for example 'the construction of auditing expertise'. Fewer papers were identified in this second search; 13 papers were selected, many are 20+ years old.

The identified literature was critically reviewed, and initial codes generated by hand, to reflect the themes identified by Power and his theory of the audit society. Coding followed the principles of Braun and Clarke (2006), generating themes that are linked to the data, that are distinctive, consistent and are internally coherent. A second stage of coding was then undertaken to refine the hand generated themes using NVivo software under the parent headings of 'Financial' and 'Construction.' Sub-codes were then generated against the headings of external financial auditor independence and competence; internal auditor independence and competence; access to information; and communication. The analysis considers the concept of the audit society and the financial audit literature to identify themes that may be relevant to construction.

The Audit Society and the Auditor

Power (1997) coined the term 'the audit society' to describe the self-generating increase in audit activity over the past decades. He avoids a clear definition of 'auditing' suggesting that 'official' definitions merely project hope and idealise the process. When working on the theory of the audit society within the social sector Kastberg and Österberg (2017) found that audit can be undertaken as a ritual. Auditing happens when an organisation is compelled by institutional pressure to account for a particular aspect of its performance (Bromley and Powell, 2012). Power (2021) contends that the audit has 3 main aspects - it is material (in terms of the documents, records and artefacts that are examined); ideational (in that it expresses the concept that transparency means that it is traceable) and it is processual (in terms of the production and abstraction of information for the audit, and of the process of the audit itself). He suggests that the audit requires complex information to be simplified and standardised. Although 'the audit' is presented as rational, procedural, and value-neutral, it is influenced by the prevailing social pressures at the time and has been characterised by Power (2021) as reductive and unrepresentative, challenging its legitimacy.

Auditors play a mediating and adjudicating role, but they are often portrayed as agents whose choices are replicable, calculable, and comparable (Miller and Power, 2013). This role is "far more complex than might be currently conceived" and is a "complex interweaving of collegiality and friendships, guides and impositions, qualifications and status" according to Van Peurse (2005). During an audit, "the acute compromises that the auditor is forced to make as an individual are rendered invisible" (Power, 2003 p382). Despite this, auditing maintains the appearance of 'facticity' (Friedland, 2017) - a 'taken for granted' objectivity. This 'facticity' is given weight by the documents involved, by cultural and organisational expectation, and by the performance of those involved in the audit. The practices of the audit are

legitimised and are made possible through a system of negotiation (Power, 1996). The auditor's position is socially constructed, and the audit report simplifies, decontextualises and suppresses conflict (Miller and Power, 2013). The records produced during an audit "can be used to beat the system, control others, protect oneself, save time, avoid scrutiny, as well as document that work has been done" (Power, 2003 p386).

Although the audit is presented as a structured, 'technical' exercise, much rests on the auditor's judgement (Power, 2003). The understanding of Auditor independence, professionalism and faith in the audit practice have been generated by consensus and reproduction (Power, 2003). Power examines the gap between the official version of the audit and what happens in practice. He suggests that "the roles and operations of auditing are never fixed and self-evident" (2003, 388), and that the audit is a social exercise that focuses on 'community, rules and authority.' The literature examining the complexity, negotiation, and selective presentation of information during an audit and the position of the auditor within this system in the financial sector, is reviewed in the next section.

Financial Accounting and Auditing Literature

Auditor independence is required for an effective audit (Abbott *et al.*, 2016). Power (1997) suggested that in the absence of independence, an audit has no value. Bazerman *et al.*, (1997) examined the psychological barriers to maintaining auditor independence, claiming that even honest auditors cannot fail to be influenced by the factors mitigating impartiality, primarily conscious or unconscious auditor bias. According to Bazerman *et al.*, this bias is induced by auditor self-interest, itself generated by desire for continued business through the client's ongoing appointment of the auditor. He claimed that "people tend to confuse what is personally beneficial with what is fair or moral." As a result, auditors tend to rationalise the exploitation of ambiguous standards to the benefit of their clients and, by extension, themselves. Guénin-Paracini *et al.*, (2015) examine the real-world relationship between the auditor and auditee. In their observations, the auditors are reliant on maintaining an ongoing positive relationship, leading to a relationship as a 'kind of therapist' and only using sanctions as a last resort. This type of close working bond may compromise the auditors' willingness to uncover and report errors.

Conflict of interest is a common theme across accounting scandals (Moore *et al.*, 2006). In the financial sector, an auditor serves both the directors of the organisation who appoint him; the organisation's shareholders and investors (Guénin-Paracini *et al.*, 2015); and assumes a public responsibility which should override the client relationship. Moore *et al.*, (2006) describe the post rationalisation of questionable decisions by auditors through their 'moral seduction' theory. They state that, if the conflicts of interest are not acknowledged and dealt with, auditors can fall down a 'slippery slope' of lax standards and letting minor deviations go. Auditor independence is gradually eroded through a process of unconscious bias - which they claim is more prevalent than outright cheating and fraud. This process happens gradually, imperceptibly, through the willingness of the auditor to 'go along' with biased proposals made by the auditees, or to internalise the client organisation's way of thinking (Guénin-Paracini *et al.*, 2015). This unconscious bias may be motivated and aided by personal, firm and client interests, or through ignorance (Peytcheva and Warren 2011). Auditor rigour depends to some degree on whether they perceive that their actions will be uncovered by their professional bodies and by the auditor's firm

(Peytcheva and Warren 2011), and on the likelihood of litigation (Tepalagul and Lin 2015).

Internal auditor function and effectiveness can be opaque (Power 1997) and is an 'enigmatic phenomenon' (Lenz, *et al.*, 2018). Arena and Azzone (2009) found that internal auditor effectiveness was influenced by the characteristics of the internal audit team, in terms of their competence and resources, and that auditors must be sufficiently resourced and have enough capacity and knowledge of the subject under audit to have legitimacy at manager level. Lenz *et al.*, (2018) link legitimacy with effectiveness thus: "legitimacy is needed in order to survive and providing evidence of added value and effectiveness is one way to be perceived as legitimate in the eyes of major stakeholders."

The internal auditor can play a key role in enhancing the quality of financial reporting (Abbot *et al.*, 2016). Internal auditing is "an independent objective assurance and consulting activity designed to add value and improve an organisation's operations" (Selim *et al.*, 2009). Internal auditors must be both dependent and independent of management (Glascock 2002). Ahlawat and Lowe (2004) found that it is difficult for internal auditors to remain truly independent, providing objective feedback, when this conflicts with their role to provide best value solutions to issues identified on behalf of their company; auditors are heavily influenced by their desire to advocate for, and present the 'best face' of, their company. Sarens and de Beelde (2006) suggest that internal auditors should cultivate an 'open and friendly attitude' and act as 'conduits for whistleblowing.' Internal auditors' associations with management can be 'close'; however, on occasion, internal auditors are required to report their direct managers' non-compliance to higher management, and make their voice heard to senior management. This can create conflict (Van Peursesem 2005). Organisational stress factors including role conflict, when an individual is expected to manage competing, conflicting demands, are a source of stress for internal auditors (Larson 2004). The Institute of Internal Auditors Research Foundation stated that "IA [Internal Audit] is, by its very nature, a schizophrenic management function. On one hand, it needs to be completely integrated and knowledgeable. But it also needs a measure of independence required of all auditors. Therefore, IA has a built in cognitive disconnect" (IIARF, 2011, 14).

Abbot *et al.*, (2016) include competence as a measure of auditor independence - that is, the auditor must be able to recognise when what they are seeing is contrary to regulations, to uncover anomalies, report and prevent their recurrence. Power (1999, 132) linked competence to the "ability [of auditors] to detect material misstatements." Guénin-Paracini *et al.*, (2015, 224) interview an auditor who describes the "skill you need to acquire: figure out when you're being told fibs, read the body language." Van Peursesem (2005) found that managers did not find internal auditors to be credible when they did not rate their knowledge of the subject under audit; if this was the case the managers would ignore the auditor's advice. Financial auditors tend to be qualified accountants, although even they may not sufficiently understand complex technical areas of accountancy (Nehme 2017).

The concept of 'materiality' is important to the financial audit - that is, how wide is the scope of the audit, and what documents and processes are deemed to be relevant to the audit. It refers to the 'sampling' process and is a complex matter of professional judgement (Canning *et al.*, 2019). Canning *et al.*, (2019) find that when data is ambiguous, this materiality becomes more difficult to judge and yet is central to the

quality of an audit; and that auditors need to deploy intuition, expertise, and flexibility to address this issue. The audit is a classic example of information asymmetry - where those under audit may understand the information in far greater depth than those examining it. Auditors must rely on documents and information provided by those they are auditing, which gives an opportunity for selective disclosure or manipulation (Abbot, *et al.*, 2016).

Financial regulation requires full access to accounting information for financial auditors. Given the regulation requiring cooperation with auditors, those being audited have in their arsenal an array of techniques for delaying and otherwise undermining the audit whilst still complying with the letter, if not the spirit, of regulation. The timescale of the audit - typically a day or two to examine a year's worth of reports or accounts - ensures that any delay in the provision of information to the auditor can reduce the scope and depth of their investigation. Delaying techniques include putting the auditors in a room far from the information they need, not giving them contact details for those they need to speak to, or those under audit making themselves scarce to the auditors (Guénin-Paracini *et al.*, 2015). The opposite approach can also be used to deny information. This entails appearing to give the auditor everything they need in a single room and discouraging them from leaving the room to speak to others and probe beyond what they are given, leading to 'in-chamber audits' where the information given to the auditor is controlled and the auditor only sees what the organisation under audit wants them to (Guénin-Paracini *et al.*, 2015).

Communication style is an important skill that auditors, both internal and external, employ to manage and navigate the conflicting demands placed upon them (Selim *et al.*, 2014). Their tools include listening, gentle persuasion and consensus building to get a message through to people that 'just don't want to hear' (Van Peurse 2005). Successful auditors must constantly moderate their communication in response to those being audited, undertaking a constant negotiation of the audit process, and acting differently according to the context in which they are operating (Guénin-Paracini *et al.*, 2015). However, due to the requirements of the audit and the time constraints involved, the best auditors know when to stop cajoling and 'draw the line' (Van Peurse 2005). Giving audit feedback requires sensitive communication and use of language, as the feedback usually involves pointing out where individuals have made mistakes. Guénin-Paracini *et al.* (2015, p219) quote an interviewee who says, "you have to be very careful in handling the professional ego of your client." Techniques for 'sweetening the pill' described in this study include use of euphemism, anonymisation, de-dramatisation, downplaying, self-deprecation, and humour.

FINDINGS

Only a handful of studies look at quality management audits in construction (including Calder, 1997; Cheetham, 1997; Goh *et al.*, 1996; Gunning, 1995 and Gunning, 2004); excluding those which look at Total Quality Management the authors can find no studies which have been published within the last 10 years. Recent research has looked at construction quality management (including Brooks, *et al.*; 2021 Khalfan *et al.*, 2020; and Neyestani, 2016), but none has focussed on the audit process itself, or the position of the auditors within the system. This lack of recent investigation, Power's work on the Audit Society and the financial literature critically examining the audit, indicate that more research on the construction audit is needed.

Both financial and quality management audits are designed to increase public trust in an organisation and increase its legitimacy as described by Power (2003), although

quality management audits are voluntary and financial audits are a statutory requirement (Kouakou, *et al.*, 2013). In construction, ISO Quality Management audits, crucial to maintain certification, are based on the verification of documents that are provided by the company under audit. Manipulation of the information presented may be used to 'beat the system' (Power, 2003), which necessitates the reduction and simplification of information (Power, 2021). The auditor may be tempted to 'go along' with what is being presented (Guénin-Paracini *et al.*, 2016). More construction specific research is needed to investigate these concepts in greater detail.

Some construction literature accepts the rationality of the quality management system and its 'facticity' at face value (Bubshait and Al-Atiq, 1999) and focus purely on the benefits of ISO 9001 implementation (Cachadinha, 2009; Ali and Rahmat, 2010). Goh *et al.*, (1996) look at the 'effectiveness' of the audit in construction from a technocratic point of view and do not consider the factors raised by Power's 'audit society' (1997, 2021) that can make an audit reductive and unrepresentative. The mediating role of the construction auditor and the judgement that they use is under researched. Gunning (2004) suggests that auditors often act with either 'extreme leniency' or pedantic adherence to detail. Cheetham (1997, p280) suggested that procedures were circumvented by some auditors "when production needs dominate." More critical research, which examines the compromises that auditors must make (Power, 2003), the social pressures that they are operating under (Power, 2021) and does not accept the 'facticity' of the construction audit as a given, is needed.

Regarding auditor competence, financial auditors tend to be qualified accountants; although even they may not sufficiently understand complex technical areas of accountancy (Nehme, 2017). The training and expertise of ISO auditors is not as consistent or as well developed as that in financial auditing, according to Boiral and Gendron (2011), with less codified requirements for audit, leading to what Kouakou *et al.* (2013, p1284) describe as "less demanding norms of professional practice." This means that some auditors must rely on the technical expertise of those they are auditing, which compounds the information asymmetry already inherent in the audit situation. Gunning and McCallion (2007) reported a conversation with a construction quality manager who claimed that he could fool an auditor into granting ISO 9001 certification to any company, regardless of its worthiness. Gunning (2004, p. 1092) suggests that construction quality audits would benefit from more sector specific auditors who would fully understand "the technical complexities of construction processes."

CONCLUSION

To 'build back wiser' we must learn how to improve practice from other sectors. Construction quality auditors and researchers have much to learn from the breadth of research undertaken in the financial auditing sphere; this paper contributes to knowledge through use of Power's concept of 'the Audit Society' and the abundant literature on financial auditing to derive concepts that may equally apply to construction quality auditing, to propose areas for future research. Construction auditors need to be more reflexive, considering their own motivations and actions. They must be made aware of the context in which they are acting - and should be sceptical about the taken for granted 'facticity' of the audit. Research should focus on the independence, competence, judgment, and mediating role of construction auditors.

The importance of transparency in financial auditing is unarguable, given its statutory status and the reliance placed by investors on independent financial audit reports. The

financial services industry was forced to take action to improve accounting audits in the wake of several high-profile scandals, including regulation in response to the collapse of Worldcom and Enron. Oswald, *et al.*, (2021) argue that in the wake of the Grenfell disaster, more work is needed to examine the construction industry's systemic failures, borrowing concepts from other disciplines. The authors of this study agree and assert that research which examines the process of the construction quality audit and addresses the conflicts of interest that are inherent in the position of internal and external construction auditors is overdue.

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