

The Audit Society - Second Thoughts¹

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ABSTRACT

This essay reviews the central arguments of *The Audit Society* (Power, 1999) and re-considers the causes and consequences of the audit explosion. It is argued that many of the claims require further empirical support and that more research is needed, particularly to demonstrate that the audit explosion is not simply a UK phenomenon. Although the word 'audit' may have decreased in significance since the book was written, the arguments can be applied to other forms of monitoring activity.

Key words: audit; audit society; audit explosion; auditability; internal control.

SUMMARY

This essay reviews the central arguments of *The Audit Society* (Power, 1999) and re-considers the causes and consequences of the audit explosion. In the UK during the 1980s there was a systemic growth of auditing activity which needed to be explained. The causes of this audit explosion can be found in three areas: the rise of the 'new public management; increased demands for accountability and transparency; the rise of quality assurance models of organisational control. It is argued that these hypothesised causes require further empirical support and that more research is needed, particularly to demonstrate that the audit explosion is not simply a UK phenomenon. The consequences of the audit explosion are also considered and the role of auditable performance measures in shaping individual and organisational activity is discussed. Again, it is concluded that greater empirical analysis is required. The essay then

addresses the criticism that the book does not define auditing sufficiently clearly. It is argued that the vagueness of the word 'audit' was an important condition of possibility for the audit explosion. Finally, the prospects for reconstructing audit to avoid dysfunctional side effects are considered.

INTRODUCTION

Financial auditing is an *inferential* practice which seeks to draw conclusions from a limited inspection of documents, such as budgets and written representations, in addition to reliance on oral testimony and direct observation. There is an established tradition of investigating this inference process experimentally within the frame of cognitive science, although very little, if any, of this kind of auditing research is done in the United Kingdom. In contrast to this experimental tradition, a smaller body of work has focused on the *social* and *institutional* support for the elements of this inference process. Indeed, it is argued that the appropriate organizing model for understanding auditing is not that of the isolated act of practitioner judgement, but that of collectively negotiated settlements (Power,

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1995). From this point of view, the very possibility of individual judgement is the product of many other factors, including training in institutionally accepted practices of evidence collection, such as statistical sampling (Power, 1992; Carpenter and Dirsmith, 1993).

This modest sociological project was given a new context and a dramatic shift of focus as auditing broadly understood began to play a prominent social and economic role during the mid to late 1980s. For example, the word 'audit' began to be used with increasing frequency by politicians, regulators and consultants in many different fields: health and safety, medicine, education, intellectual property, environmental management as well as the more established corporate financial auditing area (Power, 1994). During some ICAEW funded research on the border territory between environmental and financial auditing (Power, 1997) I had a hunch that something systematic was going on, something that could not be captured or explained only by reference to financial auditing. This required a fresh view of financial auditing as just one possibility in an evolving assembly of techniques and procedures. From this point of view, it made sense to explore the connections and resemblances between financial auditing and other forms of assessment, evaluation and inspection. In short, it was necessary to look beyond the 'silo' of financial auditing studies at monitoring, checking and reporting in their most general sense.

The label for the hunch that something systematic was going on over and above financial auditing was the 'audit society'. The concept was invented, like many ideas before it, in the LSE staff bar sometime in 1994; it was a kind of marker, a logical space for future work, rather than a well-defined concept with a clear point of reference. The German sociologist Max Weber once wrote that: 'an ingenious error is more fruitful for science than stupid accuracy' (Quoted in Collins, 1992). It is for others to judge whether, for all their flaws, the arguments supporting the idea of the audit society are a useful error (See the critiques by Bowerman et al., 2000; Humphrey and Owen, 2000). It is clear that the ideas of the 'audit society' and of the 'audit explosion' (Power, 1994) require a great deal more conceptual and empirical work. As the essays in this special volume of the *International Journal of Auditing* suggest, we are still 'in search'

of the audit society and the purpose of this essay is to revisit the central arguments and to pick up where they should be developed further.

To understand the audit society it is not sufficient, although undoubtedly useful, simply to quantify the amount of auditing going on. It is also important to understand the growth and circulation of an idea of audit, a growth in which accountants have been powerful agents in selling their auditing capabilities but which cannot solely be explained in this way. A practice like financial auditing is not simply a collection of routines for collecting and evaluating evidence. It is also very importantly an idea or model circulating in the institutional environment, an idea whose fortunes practitioners themselves cannot control, hence the 'expectations gap' for financial auditing. This means that auditing is not merely done in a technical sense, it is also used and appealed to, blamed, praised, regulated, reformed, written about and debated. The idea of audit and what it can or might deliver expresses the *aspirational* dimensions of the practice(s), dimensions which are not always closely linked to actual operational capacity. In short, the further one is from the detail, the easier it is to talk of what auditing might, can and must do. Naturally, some of this talk takes place in the profession itself, but it is not only an internal affair.

Value for Money (VFM) auditing is a good example of the thesis; it was a powerful idea for public sector reform long before it approached anything like a consistent and coherent practice at the operational level. Indeed, the nuts and bolts of VFM auditing continue to be hotly debated (e.g. whether effectiveness auditing extends to evaluation type work) and the concept itself circulates freely despite considerable operational variety (Pollitt et al., 1999). So the audit explosion was not only the explosion of concrete practices, it was also and necessarily the growth and intensification of an idea about audit in a number of different spheres. But why?

CAUSES

Although it is undoubtedly a simplification, three more or less discrete causes or pressures gave rise to the audit explosion in the UK in the late 1980s:

1. The cluster of ideas which constitute the 'New Public Management' (Hood, 1991)

increased demands for financial and VFM auditing. The 1980s were characterised by financial constraint and a commitment to organisational and financial reform in public sector institutions. In this setting auditing and inspecting practices became highly valued and important tools of change. In different ways the National Audit Office and the Audit Commission became prominent forces in government, playing an evolving and complex constitutional role. In the late 1990s these pressures for change in the UK have not abated: for example, the Audit Commission will establish a 'best value' inspectorate (Thatcher, 1999) and in health care standards of clinical practice will be enforced by the Commission for Health Improvement (CHI). While the word 'audit' may have decreased in importance, the demand for monitoring has not. A fresh explosion may even be predicted on the back of 'best value' demands.

2. The audit explosion was also driven by closely related political demands on behalf of citizens, taxpayers, patients, pupils and others for greater accountability and transparency of service providing organizations. These demands in the name of accountability were not only confined to the public sector; they have also surfaced in the private sector, most notably in the developments in corporate governance. Indeed, private sector corporate governance thinking now provides a template for the organisation of public sector control (London Stock Exchange, 1998). As accountability and governance issues span the traditional public-private divide, financial auditing has been drawn into, and affected greatly by, these pressures. It is still unclear how many of the proposals in the much discussed 'Audit Agenda' (APB, 1994), which was an exploration of the *idea* of financial auditing, will work out and the field is being pushed in many new directions in the name of accountability and assurance (AICPA). For example, internal auditing is acquiring a new prominence, particularly as a result of recent guidance in the UK on internal control (APB, 1998; ICAEW, 1999; Power, 1999) and organisations like the National Health Service are investing in risk management practices.

3. The third related cluster of pressures for an audit explosion have come about from the rise of quality assurance practices and related transformations in regulatory style. The origins of these

pressures are complex and diverse, but a simple and plausible story can be told with two parts.

The first part of the story concerns the emergence of quality assurance from an industrial production context to become a universal schema (e.g. ISO 9000). This all purpose structure is represented in figure 1.

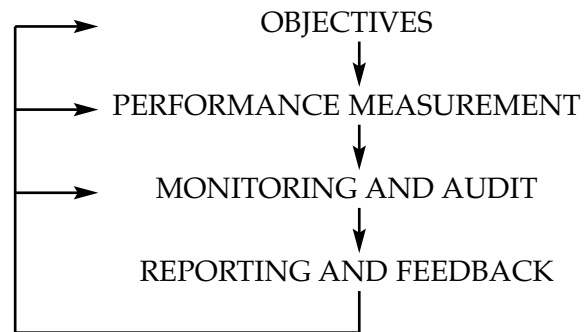


Figure 1: A General Model of Self-Auditing and Control

Quality assurance programmes require that organisations and their sub-units establish objectives, design performance measures to reflect those objectives, monitor actual performance and then feed the results of this monitoring back for management attention. Quality auditing works both as the specific monitoring and reporting part of the system and also, importantly, as the verification of the system structure as a whole i.e. the integrity of the entire loop of self-observation which this procedural structure represents. This epitomises 'control of control' (Power, 1999, p.66).

The second part of the explanation is a parallel transformation in regulatory style, which is moving away from a command and control mode of operation. The intention is to regulate target organizations indirectly 'from below'. Audit in its various forms becomes an important possible solution to the problem of regulatory compliance, it defines a space in which regulatory compliance can be negotiated and constructed (Hutter, 1997). Regulatory systems rely increasingly upon 'control of control' i.e. the audit of self-control arrangements which are increasingly characterised in terms of risk management. The audit of these internal controls or self-checking arrangements is a growing industry, an internal control 'explosion' (Maijor, 2000) which borrows its structure from

the quality assurance model in figure 1. Perhaps nowhere is it more apparent than in the financial services industry where regulation is explicitly designed to rely on internal and external checking functions (Goodhart et al., 1998). Whether regulators are relying on in-house risk management models for derivatives, or systems for teaching quality (Gray and Berry, 2000), the general model in figure 1 is the same. Delegation and internalization of control are coupled to audit processes which seek to reconcile local learning and improvement mechanisms to demands for performance and regulatory compliance.

These then are three overlapping pressures for increased auditing, evaluation and monitoring activity. But does this story make too little of accountants and of Thatcherism in the 1980s? Certainly the large accounting firms have been influential agents of change, and the position and role of accountants within economic and political life in the UK as compared to other countries has undoubtedly been a decisive factor in shaping the rise of auditing in this context. However, that this is an incomplete picture is suggested by the fact that financial audit, following the Eighth Directive, is itself subject to the same style of auditing, through the operations of the Joint Monitoring Unit (JMU), as many hospitals, schools and other organizations. One can hardly talk of a conspiracy, a rational one at least, when the conspirators are subject to the very same changes they are imposing on everyone else. It is interesting that many small UK accounting practitioners have complained about the 'audit' of their auditing practices in exactly the same terms that have been levelled against quality and medical auditing i.e. it is too bureaucratic and too focused on form and process.

That *The Audit Society* is not simply about the consequences of 'Thatcherism' is clear from the intensification of the 'culture' of checking under 'New Labour' in the UK. The welfare state is increasingly being displaced by the 'regulatory' state, and instruments of audit and inspection are becoming more central to the operational base of government. However, it remains to be seen how well this argument travels to other countries and systems. The analysis was intended to be generic, and one can hypothesise that an audit explosion would follow the diffusion of the new public management.

Further comparative research is needed to test this view.

CONSEQUENCES

It has been suggested that society is experimenting on itself (Beck, 1992). Certainly, there has been little planning or testing of new auditing practices. Auditing has been introduced as an agency of organizational change without a measured consideration of benefits and possible dysfunctional effects. Although some assessment in terms of compliance costs has been introduced, audit and related ideas of monitoring continue to be understood uncritically; they can be rapidly disseminated without developing an understanding of what may be at stake. In this respect it is plausible to suggest that the audit explosion is fundamentally an ideologically driven system for disciplining and controlling doctors, teachers, university lecturers and so on, and not an instrument of genuine accountability.

To analyse the consequences of auditing it is necessary to focus on the development of what is audited i.e. the performance measures and other forms of accounting which provide an auditable front stage for an organization (see figure 1). There is a developed research literature which draws attention to the role of accounting innovations, particularly in management accounting, in constructing organisational life (Miller 1994). This is not just a matter of what has been called 'creative accounting' i.e. the games that exist to circumvent the intentions behind rules and regulations. Rather, accounting practices, and performance measurement systems more generally, create and support a window on organizational life, one which is often demanded by outside agencies, and which makes various kinds of internal and external intervention possible.

The hunch behind *The Audit Society* is that the design of accounting reports, and of the performance measures by which organizations can be judged, is greatly influenced by the imperative of 'making them auditable', and that this has much to do with agendas for control of these organisations. It follows that many audit processes are not neutral acts of verification but actively shape the design and interpretation of 'auditable performance'. Audit agencies, such as the UK Audit Commission, are active in shaping performance measures which enable audit and

inspection. Indeed, Bowerman et al (2000) argue that it is audit which is really a by-product of a more fundamental performance measurement explosion. They have evidence that many performance indicators are produced but are not audited, and that there is more of an audit 'mess' than a coherent 'audit society'. However, just because a performance measure is not in fact audited does not mean that it was not designed with potential auditability in mind. In the end the argument is an empirical one.

Empirical work also needs to focus on the growing population of 'auditees', ie on the individuals who have experienced an intensification of checking and evaluation of what they do. We are beginning to see how different games of 'creative compliance' are being played around the audit process, games which both frustrate official intentions and which also lead to dysfunctional behaviour. Auditing can create new interests at the expense of others. Academics in the UK do not need to be told about some of the pitfalls of teaching and research evaluation exercises (Various, 1999). In some cases elaborate bureaucratic systems (reflecting the figure 1 template) are created to manage an external evaluation process. Whatever the performance measure (emissions levels, profitability, examination results, research quality, effectiveness of medical care etc), the audit process concentrates primarily, but not always exclusively, on the loop itself, on the integrity of the structure of self-observation and control which is the internal control system.

The audit explosion refers to the rise of this systems structure and its role in supporting regulation and managerial control. However, figure 1 and the system loop are only a blueprint. There is an extensive literature which questions whether organizations do or could ever function according to the formal self-transparency and vigilance required of figure 1 and its real world instantiations (such as ISO 9000 and its variants) (See Strathern, 1997). The formal management control system functions primarily to make a certain style of auditing possible; it buffers the auditor from an increasingly complex evidence base, is cheaper than extensive attention to actual organizational process, and permits the audit to provide more or less comforting signals to regulators and politicians.

In *The Audit Society* I argue that institution-alised pressures exist for audit and inspection

systems to produce comfort and reassurance, rather than critique. If this is true and auditing systems are primarily about reaffirming order, then it will be interesting to see how auditable outcome based performance measurement progresses in the face of system decay, especially given political rhetorics of zero tolerance for poor performance. We can expect to see acute problems for anxious managers who, much like their former Soviet counterparts, will need considerable creativity to manage auditable performance favorably in the face of objective decline. New pressure points, in the form of control agents and audit departments, will be created at great cost to manage these contradictory forces. In the case of the UK research assessment exercise, the explosion of journals as homes for the research output of academics is well known, but it is far from clear that the substance of research has really improved (Various, 1999). Forcing individuals whose comparative advantages lie elsewhere to produce research, or feel that they should, is hardly an optimal use of resources. In this way a system with the legitimate objective of making academics accountable for the quality of research, and which is designed to measure and evaluate research quality, ends up affecting the field adversely, even to the extent of creating a systemically sub-optimal transfer market.

Teaching and medicine are in a similar position; newly established systems of auditing may have damaged local cultures of first order practice. Certain activities, which are valued locally, are not represented by official systems or are lost in some general concept of 'goodwill'. Official auditable indicators, in the form of, say, exam results and waiting times, have strange effects on the incentive structure of individuals in organisations.² If auditing processes get decoupled from core organizational activities, these effects may be minimal and the audit process becomes an expensive but harmless ritual, which is important for external legitimacy. Where performance measures and systems developed for audit do eventually force changes in organizational habits, these effects need to be systematically documented and fed back into the design process. In short, there is a need for more research on the effects of making agents in organisations accountable in terms of auditable measures of performance.

The audit society reflects the growing influence of auditors themselves as they move into areas of wider influence and service provision. In particular, auditors are de facto major interpreters of political mandates; accountability is concretely realised in the audit process. While there is considerable discussion about the constitutional position of the NAO and Audit Commission (White and Hollingsworth, 1999) ideals of policy neutrality contrast with operational realities where jurisdictions are blurred and where the distinction between audit and policy is unclear. The UK Audit Commission has come to be an explicit agent of change by promoting the systems which make auditing possible (Henkel, 1991; Thatcher, 1999)

Organizations must be changed internally to be audited, and in many cases this may be desirable. It is not denied that it may be a good thing to require teachers to think seriously about their objectives (Gray and Berry, 2000) or to make the private world of hospital consultants more transparent. Nor does the idea of the audit society assume a homogenous process of transformation across all fields. The key issue is to draw attention to the fact that audits do not operate neutrally and have effects on the auditee. The audit explosion has been insensitive to whether these intended changes have been successful, and what unintended changes may have resulted. But to say all this is to leave much of the empirical work to be done in exploring the consequences of the growth of auditing and views of these consequences will undoubtedly differ, as the essays in this volume demonstrate.

CRITIQUE

Because the concept of the audit society was invented in advance of detailed empirical work, there remain many unresolved issues and problems. Two will be addressed below.

1. It has been argued that the use of the word 'audit' is not significant. Auditing practices are varied, and evaluation and inspection are different again. (Bowerman et al., 2000; Humphrey and Owen, 2000). A great deal of time and effort has been invested in defining and distinguishing meanings of audit, especially in emergent areas such as environmental and clinical auditing. There are also ongoing discussions about the nature of VFM auditing and the

difference between performance or effectiveness auditing and financial auditing (Pollitt et al 1999). Add to this discussions about evaluations and assessments which do not have a verifiable assertion, claimed as one of defining characteristics of audit, as their object and it begins to seem as if the 'audit society' concept has no clear reference point.

It is difficult to deny the reality of this diversity, especially when this is reflected in text books and official accounts. Despite a reasonable attempt (Power, 1999, chapter 6), the relation between auditing, evaluation and inspection remains far from clear. However, two points must be made. First, despite all these attempts at definition and distinction, the vague idea of audit has been an important reference point in policy; this vagueness can be *observed* and analysed. From this point of view, *The Audit Society* is as interested in understanding the power of the word 'audit' as it is in defining it. The idea of audit (and auditors) consists of general and highly idealised elements, and is appealed to and used in a wide variety of policy contexts. The rise of auditing is also as much about the cultural and economic authority granted to people who call themselves auditors as it is about what *exactly* these people do. Indeed, we know that the people we call auditors (and inspectors) actually do many different things.

To call something an 'audit' places it within a field of social and economic relations which would be different if it was called an 'assessment' or 'evaluation'. Labelling activities as audits makes it possible for them to acquire the idealised characteristics of audit over time. For example, the label 'clinical auditing' was used to rename idiosyncratic research activity. Once this collection of ad hoc practices came to be called 'auditing', it also became possible for it to acquire a new public accountability role. In short, against critics of *The Audit Society*, the argument is that vagueness is an essential part of the phenomenon. Once practices can be appropriated by the discourse of audit they can begin to acquire similarities and shared operational templates. In the audit society definitions of auditing are dependent variables.

2. A second unresolved problem is the relation between auditing, organizational democracy and transparency. Being made to be accountable, being required to account and having this

account audited, are not the same as being made more transparent or publicly accessible (Bowerman et al., 2000). One might argue that some audit processes discharge a certain style of accountability precisely to *avoid* transparency. In other words, that an audit is done can be more important than what is done and to whom any report is made; being audited *per se* is a badge of legitimacy. Indeed, what seems to be important is less the disclosure to stakeholders promised by the rhetorics of accountability, which lit the fuse for the audit explosion, and more the private discipline of information gathering and control which the audit process imposes.

A related puzzle or paradox of the audit society concerns the nature and periodicity of audit and inspection reports and the extent to which such reports support deliberative processes. Where audit reports are not designed to continue stakeholder dialogue then it is necessary to trust the auditors and their independence becomes an important benchmark of trust. Quality kitemarks and financial audit reports are like this. They are intended simply to indicate the quality of systems, products or services. In contrast National Audit Office VFM audit reports are in narrative form. And social audits, which seem messy and diverse, may worry much less about independent audit reporting and more about stakeholder involvement (Cotton et al. 2000). Here the hypothesis is intriguing: greater stakeholder involvement in auditing, of whatever kind, may alleviate anxieties about auditor independence and may support less standardised reporting.

In *The Audit Explosion* I suggested that the audit society is a less trusting society. However, it was pointed out that audit may in certain circumstances be essential to restore trust between parties and to support institutions, such as capital markets (Hatherly, 1995). This needs further investigation since many teachers and doctors claim that evaluation processes have achieved precisely the opposite by eroding informal goodwill and by making individuals develop new incentives around crude performance measures. There is some work on these effects and more is needed, but it is unlikely that issues of trust in the audit society are as self-evident as *The Audit Society* suggests.

Research is also needed to address and evaluate the implications of new auditing and inspection institutions for the audit society

thesis. For example, the National Institute for Clinical Excellence (NICE) will set clinical standards and the Commission for Health Improvement (CHI) will enforce them and oversee local clinical auditing activity. A super regulator for OFTEL, OFSTED and other regulators has been proposed. Where do these processes of 'control of control' end? I have suggested that the audit society threatens an infinite regress to the *n*th auditor as further layers of regulatory influence are created. But such a theoretical regress must in practice stop somewhere, and further work is needed to document and explain the patterns of 'control of control' in different fields.

CONCLUSION: RECONSTRUCTING AUDIT

The primary critical intention of *The Audit Society* remains relevant despite its weaknesses as an empirical set of arguments; the book is simply a plea for greater understanding of the consequences of checking and monitoring for industries, organizations and individuals. Some forms of audit and inspection need to be radically redesigned with greater sensitivity to their consequences and without slavish adherence to performance measures which serve the audit process and little else. But there is no general critical argument here, and each area needs to be looked at on its own merits. The prospects of a light, self directed audit process, which harnesses productive learning and self-help to regulatory compliance, is an attractive ideal. Defensive auditing is the antithesis of this ideal.

An important and relatively under-researched development is the rise of the internal audit function. This was suggested in an ICAS report (McInnes, 1993) and is now more evident as auditing is being redesigned with a risk management emphasis (Selim and McNamee 1999a; 1999b). Depending on how one looks at the phenomenon, there has been an 'internal control explosion' (Maijoor, 2000) or an audit *implosion* (Power, 2000). In *The Audit Society* it was argued that the internal control system was becoming the primary auditable object. Recent developments in corporate governance and the corresponding increase in significance of the internal auditor confirm this view and may in turn lead to a systematic re-balancing of the

relation between internal and external checking (ICAEW, 1999). Once society overcomes its concerns about *formal* auditor independence, it will become clear that expertise, *operational* independence and proximity to real time cultures of control are desirable. The Institute of Internal Auditors in the UK and USA sense the professional opportunities and external financial auditors will face increasing competition.

The audit implosion thesis is consistent with a more 'responsive' regulatory philosophy (Ayres and Braithwaite 1992) and there is a potential both for the worst excesses of the audit society to be realized and for something more relevant, effective and sensitive to be created. As audit processes are re-designed to reflect risk management ideals, the distinction between audit and consulting becomes increasingly blurred (Jeppeson 1998), and this may not be to the taste of regulators like the SEC. But a form of anticipatory and integrated risk management, overseen by the auditor/risk specialist may represent the best opportunity to align public policy and corporate objectives. The motif of 'control of control' is likely to remain relevant and useful in characterising a regulatory system with a greater accent on internal self-inspection. This is especially evident from recent developments in financial services regulation (Goodhart et al., 1998)

Finally, the 'audit society' can be understood as a label for a loss of confidence in the central steering institutions of society, particularly politics. So it may be that a loss of faith in intellectual, political and economic leadership has led to the creation of industries of checking which satisfy a demand for signals of order. In the UK auditing and inspection will be set to work in the name of 'best value' and 'joined-up' government, but we may be forced to understand auditing as part of a general language of decline which attempts to bridge the widening gulf between plans and achievements. One might even see auditing as an elaborate form of confession and periodic purification of organizational order. The interpretations can become ever more exotic but the critical point is clear: a great deal of audit activity has had little to do with efficiency, and few large companies believe the stories of value added that financial auditors promote. The audit explosion is not simply a functional response to complexity and to increasing risk in different areas of society. And

yet equally there is a need for more sensitive and more efficient technologies of checking and assurance because of the manufactured dangers that we now face. The essays in this special issue of the *International Journal of Auditing* have made an important start in providing a more systematic understanding of the consequences of audit.

NOTES

1. This paper was originally presented at the Seventh National Auditing Conference, Cranfield School of Management, Cranfield University, March 21-2 1997 and at the ESRC / CIMA New Public Sector workshop, London School of Economics and Political Science, April 28-9, 1997.
2. In the private sector it might be assumed that auditable performance measures are fully integrated into the core of corporate life. However, here there have also been extensive discussions about the limitations of financial indicators and there is currently much interest in the reporting of non-financial information (ICAEW, 1999). Experimentation in the UK with the Operating and Financial Review is an attempt to pluralise corporate reporting, but the doubtful auditability of qualitative information is regarded as a serious constraint on developments.

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