

# Malaysia's External Auditing: The Case of the Better Tool for Analysis

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## Abstract

Various rationales for external auditing appear to have limited application in the context of Malaysia where the auditors exist in an environment marked by little publicity and little public clamour for needed changes although the same environment is tarnished by numerous cases of corporate illegality, unaccountability and the use of questionable business practices. This situation is in marked contrast to that confronted by auditors in Anglo-Saxon countries and their counterparts from other developing countries in Asia such as India, South Korea and Singapore. Therefore, to appreciate "how" the social role of auditors is determined or "why" audit is executed in Malaysia, it is necessary to situate the interaction between "society" and the audit function within a proper "context" that includes history and environmental factors. It is accordingly suggested that a research conducted by applying the political economic theory - introduced by Tinker (1980) and refined by Cooper & Sherer (1984) to explain accounting experiences - driving an enlarged exogenous analytical framework of processual change analysis - developed by Smith (1973) and adapted to accounting by McKinnon (1986) - which in turn is supported by the qualitative case study research strategy that stresses the use of oral and documented evidence should be the more appropriate vehicle.

**Keywords:** Malaysia, Accounting History, Politic, Auditing

## 1. Introduction

Research into the desired, potential and actual roles served by auditing, conducted over a considerable period and in many different environments, has raised issues concerning the degree of correspondence between audit practice and expectations of the audit and the significance of professional structures in developing the contribution of auditing in particular contexts.

Rationales for auditing have typically been developed with reference to these restricted contexts; however, these resultant explanations have often been taken as valid across different localities and points in history. In the discussion which follows, the state of Malaysia's external auditing is reviewed briefly. This discussion should provide the picture that almost all of the various rationales for auditing that are summarily pointed out right after have little application in most cases in the context of Malaysia over the years. Thus, there appears to be a need for an alternative approach to provide the explanation for the question of "Why audit in Malaysia?"

## 2. Selective features of Malaysia's contemporary audit experience

Financial statements audit in the country is characterised by little publicity, little public clamour for needed changes and what appear to be no court cases where the auditors have to defend themselves from plaintiffs who sue them for damages. (Note 1) Even though company auditors make millions of ringgit annually as audit fees (*Malaysian Business*, 16 Aug. 1988, pp. 13-14), their work have attracted the attention of hardly anyone.

During economic recessions in the 1980s, when many businesses were forced to close down and cases of financial improprieties by directors and top management were disclosed, Malaysian auditors avoided being taken to court. The then Finance Minister Tun Daim Zainuddin was quoted as saying that "... it is a miracle that no member of the public or any interested party has sued auditors for being professionally negligent taking into account the various "swindle" cases recently ...." (*NST*, 12 Sept. 1987).

This picture is considerably different from that experienced by auditors in countries such as the United States, Britain, Canada and Australia. They are often criticised for the business failures and a number have had to pay large damages or settle out of court with plaintiffs accusing them of committing audit failures.

In the United States, accounting firms faced around 4000 lawsuits with claims amounting to US\$30 billion (*The Economist*, 17 Oct. 1992, p. 22). Maloo (1993, p. 76) noted that as of 1 May 1993, in the United States, the federal banking regulators alone had 32 lawsuits pending against accounting firms, seeking US\$2.5 billion for damages to government insurance funds from accounting malpractice.

In Britain, between 1982/3 and 1992/3, the number of annual claims against the six biggest audit firms together with BDO Binder Hamlyn and Grant Thornton increased from three to 210 (*Accountancy Age*, 3 March 1994, p. 10). By 1994, over 600 claims were still outstanding. In Australia, during 1992 alone, ten major claims against accounting firms totalled A\$2.8 billion (*World Accounting Report*, Nov. 1992, p. 2). In Canada, Coopers & Lybrand faced in 1993, 12 different claims valued at more than C\$500 million over its audits of Castor Holdings which collapsed in 1992 with debts amounting to more than C\$1 billion (*The Accountant*, Jan. 1994, p. 12).

Besides the court, regulatory agencies and other groups have also played their part in demanding that the profession move in an expeditious fashion to meet its responsibilities as perceived by the public. In these countries even when external economic factors force businesses into liquidation and there is little proof of auditors' failure to conduct audit properly, the auditors nonetheless become implicated in the failure. Flint (1983, pp. 10-11) cites many remarks made by parties ranging from Department of Trade and Industry (1979) in the UK to that of the Cohen Commission (American Institute of Certified Public Accountants, 1978) in the US and the Adams Committee (Canadian Institute of Chartered Accountants, 1978) in Canada which show that audit needs to match wider societal expectations (see also Bruce, 1988; Humphrey et al., 1992; and Jacob, 1992).

Even when Malaysia's auditing experience is compared to others in Asia, the situation in Malaysia is a source of surprise. For example, in South Korea, in December 1991, alleged failure of the auditors to uncover significant liabilities of now bankrupt companies had led to the investors filing the first ever lawsuit against the auditors (*International Accounting Bulletin*, Feb. 1992, p. 3). Furthermore, in 1993, the country's Securities Supervisory Board (SSB), which regulates the nation's audit practice, issued warnings to seven of South Korea's audit firms for their alleged audit negligence (*International Accounting Bulletin*, 17 Jan. 1994, p. 4). This warning took place after SSB conducted a quality review of auditing practice of selected firms. Out of the seven firms warned, four were affiliates of the Big Six.

In Hong Kong, Deloitte Touche Tohmatsu was criticised by a Hong Kong inspector over audits it conducted for a group of companies which were under criminal investigation (*International Accounting Bulletin*, 8 Nov 1993, p. 1). The firm was alleged to have committed audit failure leading to the publication of misleading financial statements.

In India, as a result of the loss of US\$1.5 billion through a securities fraud involving banks and mutual funds, the auditors were criticised by a Joint Parliamentary Committee (JPC) set up by the Parliament to investigate the case (*International Accounting Bulletin*, 14 March 1994, p. 3). Not surprisingly, the Reserve Bank of India (RBI) in 1993 dropped from its list of auditors for 1992/3 about 20 audit firms which acted as auditors for the institutions involved during the 1991/2 fiscal year (*International Accounting Bulletin*, 21 June 1993, p. 2). These firms which included all the Big Six were ordered to take a one year "period of rest".

Closer to home, in Singapore, the collapse of Pan-El, a property, salvage and hotel group, resulted in an unprecedented three-day closure of the Kuala Lumpur and Singapore stock exchanges in December 1985, the demise of six broking firms and the trial of three key figures in the Pan-El Group on charges ranging from criminal breach of trust to share forgery (*NST*, 6 June 1988). The uproar over the alleged failure of the auditors to conduct proper audit was brought to public attention in late 1986 when the Singapore Minister of Finance mentioned in his speech in Parliament that there was "an inexplicable audit failure" in the Pan-El affair.

In 1988 the former shareholders of Pan-El sued its group auditor, Coopers & Lybrand, for US\$105 million. Early on in December 1987, a former partner of another accounting firm, acting as auditor for a number of Pan-El's subsidiaries, pleaded guilty to a criminal charge brought against him for issuing a misleading audit report. He was sentenced to two months in jail and fined for S\$10,000. In 1987, the investigation undertaken by the Singapore Society of Accountants (SSA) culminated with Coopers & Lybrand publicly faulted for the quality of its audit work.

In Malaysia, there may be a few lone voices asking the auditors to do a better job, but that seems to be where the "story" ends. Thus, a senior partner of the Malaysian Coopers and Lybrand, Oh Chong Peng (1989, p. 5) mentioned that "[t]he Malaysian investing public's attitude towards corporate financial performance has so far largely been one of apathy and indifference .... [t]he press too, have not placed emphasis on the contents of the auditor's report, even a qualified one".

Indeed, if there is any profession or group of people in the country which seems to be able to operate with little challenge to its practices, it is the so-called external auditors. Teachers/lecturers, government servants, politicians,

Malay rulers, nurses have all lately entered the limelight of adverse publicity. Other professionals, such as physicians and lawyers have also in recent years been confronted with adverse public scrutiny. (Note 2)

All this takes place in an environment when over a decade ago (July 1983), an (internal) auditor of the Bank Bumiputra Malaysia Bhd was found strangled to death in Hong Kong. The late Jalil at the time of his death was busy investigating the scandalous affairs of Bumiputra Malaysia Finance (BMF), the Bank Bumiputra's Hong Kong subsidiary, which had lent over two billion ringgits to the EDA and Carrian property groups. The scandal nearly brought down the Bank Bumiputra, the second biggest bank in the country. It did not collapse because another government enterprise, Petronas, bailed it out.

When the country was experiencing economic recessions in the 1980s, it appeared that nothing happened to the auditors, and for most of the last decade, the nation's economy has been strong which has meant that the auditors have experienced little pressure for change. It appears that there will continue to be voices of dissatisfaction with the auditor - but nothing more.

Newspaper headlines on the subject of adequate disclosure in companies' annual reports will no doubt continue to appear. They will only show that "something" is not quite right - that is at least with regard to what the auditors could probably have done to correct the situation. Examples of such headlines include "Act Responsibly, KLSE Firms Told" (*NST*, 3 Oct. 1990); "Accounts Review Finds Weaknesses" (*NST*, 21 Dec. 1991); "Need for More Voluntary Disclosures" (*NST*, 9 Aug. 1993); "Don't Withhold Info, Companies Warned" (*NST*, 20 Aug. 1993); "Annual Report Should Provide More Details" (*The Star*, 27 Sept. 1993); and "67,000 Companies Fail to Submit Annual Reports" (*NST*, 2 Jan. 1994).

It is not the intention here to advocate that greater court action against auditors should be encouraged in Malaysia. Rather the point is that given that the auditors seem never to have been made to answer hard questions during problems in corporations it is relevant to ask what sort of contribution is being assumed or sought from auditing in corporate life.

Why is it that auditors appear to be largely absolved of responsibilities? Whatever the answer may be, it appears that audit in Malaysia is a profession that has quietly grown from strength to strength through the years, (Note 3) seemingly unaffected by corporate illegality, unaccountability and the use of questionable business practices. Thus, another more basic question may be raised: Why audit in Malaysia? In seeking to answer this question it is appropriate first to refer to established rationales in the auditing literature which can inform the approach taken to researching Malaysian auditing development. (Note 4)

### **3. 0Audit rationales from the literature**

The activity of auditing intervenes between the preparation of financial and non-financial information relating to a particular entity by management and the use by many different groups of users of this audited information.

A number of reasons for auditing have been put forward over the years. Thus it is not surprising to find Lee (1993, p. 4) noting that there is no one role played by the complex and technical function of company audit. Instead, there is a "composite" role where the social, economic, psychic and political roles all come together to produce the present form of company audit. The apparent roles played by audit include acting as a legitimating institution (Richardson, 1987), as a director of power flows (Hickson et al., 1971), as a source of control (Covaleski and Dirsmith, 1983) and as ritual (Gambling, 1987).

Sikka et al. (1989) argue that audit may be nothing more than a complex device by the accounting profession to maintain power relations in the name of the public interest. This explains why, they argue, the auditors have tolerated flexible accounting practices which management are very happy to select and apply in preparing financial statements. For the same reason they argue that the accountancy profession is inclined to inflate the importance of accounting or its contribution to national well-being and prosperity.

Wallace (1980), in her insurance hypothesis, in contrast to the above argument by Sikka et al. (1989) says that the auditor may also play the part of a "victim". She points out that the auditor has a role to play in society since shareholders/creditors and politicians need the auditors to provide protection from business risk and public criticism, respectively. Thus, the auditor is considered as having deep pockets to compensate aggrieved third parties such as shareholders when they lose money whether or not there is an audit failure. As for the politicians, the auditor could be used as a convenient scapegoat to bear the blame when businesses collapse or financial scandals erupt.

In addition to all these views, Jensen and Meckling (1976) stress that both owners (principals) and management (agents) need the auditor to lessen the possibility for the undervaluing of the firm by market as a result of information asymmetry and goal incongruence between the two parties. Information asymmetry takes place because a company's management has access to and controls all of the information regarding the company. As for the goal

incongruence, it emerges since the owners have the aim of increasing their investment value, while managers their pecuniary and non-pecuniary benefits. Though audit cannot be expected to eliminate information asymmetry and goal incongruence, it can diminish their adverse impact on a firm's value.

McMickle (1978, p. 135) identifies two reasons creating a need for external auditing. First, what he calls the auditant (the party who is the beneficiary of the audit work) is unable to do the audit him/herself directly for reasons which he calls "organisational distance". The second reason is the set of benefits that auditing can provide to the auditant. These are the confirmative, preventative and enhanceive benefits.

Finally, still in the 1970s, the Committee on Basic Auditing Concepts of the AAA (1973) says that there exist four conditions - conflict of interest, consequences, complexity and remoteness - requiring the existence of auditing. It stresses that auditing provides added value to the management prepared financial reports. With the involvement of auditors who are free from any conflict of interest, the reports' users such as investors can have confidence in the quality of the data presented for their decision making.

The AICPA (1973) however separates the objectives of financial statements into the "economic" (related to management's effectiveness and efficiency) and the "legalistic" (related to the issue of custodianship, safeguarding or maintenance) roles of audited statements. In the former role, the audited statements are intended to provide reliable information that is needed for the well-functioning of the securities market. In this regard, Stamp and Marley (1970, pp. 168-9) argue that the role of the auditor in lending credibility to the financial statements is vital in establishing and maintaining confidence in the capital markets. They claim that without such confidence the whole basis of the capitalist system would be destroyed.

Wallace (1980) appears to link this view of the economic role of the audited statements to the information hypothesis: audit takes place with the investors being the causal agents of the demand for the audit. Audit is thus viewed as providing added value by enhancing the quality of financial information.

As for the legalistic role played by audited statements forwarded by the AICPA above, Wallace (1980) terms this the stewardship hypothesis: audit takes place with management acting as the causal agent due to the separation of ownership and control in a business entity. This entails the need for management to be voluntarily monitored with the benefits of doing so on the part of the management exceed costs.

The state comes into the process of formalising the audit function because the revenue and thus the stability of the nation depend on the economic performance of the audited companies. Lee (1993, p. 42) points out that audit plays the role of a political instrument of the government regulators and political executives who are acting as guardians of public interest. In other words, audit, in ensuring credible reporting by management, is a means of protection for members of society by the state.

Although the basis and legitimacy of auditing discourse and practice appear neat in theory, the practice is less straightforward. (Note 5) That however is not the focus of this study at this stage. What needs to be said at this time is that the agency theory, under which much of what was discussed above comes, basically says that individuals are motivated by profits.

This view however may not be valid in a society where greater weight is placed on the welfare of the group and not the individual and where non-wealth concerns have a greater influence over people's attitudes and behaviour, or when it is not quite a "liberal democratic society" that one is concerned with. Miller (1994, p. 29) makes the following interesting remark:

The growth and deployment of accounting, that is to say, can be understood in relation to the emergence of particular political systems, and particular ways of seeking to govern the conduct of individuals. For accounting is one of the key ways in which attempts have been made to exert influence on individuals through indirect means. Such modes of government can be regarded as characteristics of *liberal democratic societies*. In so far as such societies mark out the economy as a distinct sphere with its own laws and regularities, and make the individual a fundamental locus of responsibility, accounting has a central place. Understood as a mode of government of economic life, accounting can be appealed to as a way of seeking to act upon the conduct of individuals to remedy deficits of rationality and responsibility. (Emphasis added.)

While the kind of society one refers to is perhaps a crucial factor in understanding what type of auditing is in operation, the agency theory, founded on the assumption of an "arms-length" relationship between corporate managers as agents and shareholders and bondholders as principals has appeared also significant in portraying what is really going on in a certain society when this assumption does *not* hold true - at least when one gets down below the superficial and surface accounts of the so-called "business" transactions.

In other words, the economic based stewardship and information hypotheses and other auxiliary ones such as bonus compensation, debt covenants and political visibility (size) that agency theorists posit to have led to demands for external auditing may not be valid in socio-economic contexts different from those in Anglo-Saxon countries when the economic actors are rather inseparable in substance though they may appear on surface different in form. There are no real differences among these parties whose activities may very well be taking place in a choking political economy where the economic and political power are rested in the hands of the very few.

Therefore, although different societies may exhibit similarities in audit infrastructure comprising among others the various actors i.e. auditors, regulators, users and preparers and mechanisms such as Companies Act and Generally Accepted Auditing Standards, the fact that the audit operates within different environmental influences over time and space may well ensure that its operation differs.

Accordingly, in order to appreciate "how" the social role of auditors is determined or "why" audit is executed in a place such as Malaysia, it is necessary to situate the interaction between "society" and the audit function within a proper "context" that includes history and environmental factors. (Note 6) The "context" where auditing is taking place, as pointed out by Tinker et al. (1991) in discussing the environment of auditing, is both complex and conflict-based. Willmott (1990) in particular claims that economic factors and market relationships have to be considered together with other elements in the social context such as political programmes and the state-auditor relationship.

In addition, Kirkham (1992) writes that the environment of auditing involves a multiplicity of factors which cannot be collapsed into a few sets of economic variables. She also mentions (p. 312) that the interactions among the players in the audit environment are in a fluid state "as they are constituted and reconstituted in broader social context". (Note 7)

In the end, perhaps, it will be seen that auditors, regulators, users and preparers and other parties involved in the external audit process in Malaysia (and perhaps elsewhere too) are historical actors whose interests and associated actions are continuously defined, organised and aligned rather than "externally given" either to themselves or other parties. Giddens (1984) has described it well by saying that instead of taking the preferences of the actors as given, it is necessary to consider how they have been and continue to be constituted by historical conditions which their actions serve to reproduce or transform.

#### **4. Suggested solution**

The works referred earlier appear to show that the auditor has functions to play in society. In the context of Malaysia, the utilisation of, in particular, the neo-economic model which the agency theory comes under appears to be inadequate to describe exactly what function is played out by its auditors.

Therefore, to find out what is really going on, it is herein suggested that a research conducted by applying the political economic theory driving an enlarged exogenous analytical framework which in turn is supported by the qualitative case study research strategy that stresses the use of oral and documented evidence should be the more appropriate vehicle.

##### *4.1 Political Economic Theory*

The proposed political economic theory is that introduced by Tinker (1980) and refined by Cooper and Sherer (1984) to explain accounting experiences. Tinker (1980) introduces a classical political economic approach to financial reporting. (Note 8) He proposes that the social relations of production work together with the economic forces of production as two related dimensions of capital shaping the social and economic life of a nation. He points out that in any society the coming together of the two modes of production is discernible in the particular socio-political and economic institutional forms and arrangements. Qualitative discussion of the social-political institutional forms and arrangements can be found in nation-specific sociological literature while quantitative economic discussion is found in the related macroeconomics literature.

The use of political economic theory that recognises the presence of social relations makes it less cumbersome to understand the economic forces of production that are operating at any particular time period and in any society. Tinker explains that such relations are reflected through a set of institutional forms and arrangements that are constructed to interact with economic relations (i.e. the type of economy). Therefore, in order to understand what is going on in the economic sphere, which may include the external audit function, researchers need to identify the related socio-economic and institutional environment. Interpretation of a nation's specific economic features will be less adequate if insufficient attention is given to the surrounding social and political processes. (Note 9)

In regard to accounting activity in particular, Cooper and Sherer (1984) point out that a political economy of accounting is useful for understanding how the accounting process interacts with its social, economic and political environment. They write (p. 208):

*... the objectives of and for accounting are fundamentally contested, arises out of recognition that any accounting contains a representation of a specific social and political context. Not only is accounting policy essentially political in that it derives from the political struggle in society as a whole but also the outcomes of accounting policy are essentially political in that they operate for the benefit of some groups in society and to the detriment of others.*

Thus, it is assumed that there exists no basic harmony of interests in current society. Accounting practice is viewed as favouring specific dominant interests in society and disadvantaging others. This view of accounting embedded in interests and conflicts points towards the need to supplement the marginalistic analysis of competitive markets with political and social concepts in order to gain real understanding of the functioning of audit in Malaysian society.

As noted by Cooper and Sherer (1984, p. 208), a political economy of accounting focuses on the institutional environment which supports the existing system of corporate reporting. In other words, it looks at the accounting function within the broader structural and institutional environment in which it operates. It stresses that political issues cannot be divorced from economic analysis in relation to social choices. It revolves around power and whose interests predominate in society which inevitably impact upon auditing.

Cooper and Sherer specifically identify the presence of three key variables which they claim affect the value of financial accounting reports: power-play in society, historical specificity and human agency. On the first variable of power-play, they argue that social-relations of power and conflict determine accounting's significance, which in turn affects such relationships. (Note 10) Instead of assuming a basic harmony of interests in society where power is widely diffused and which results with the unproblematic view of the social value of accounting reports, the political economy approach supports the following contrasting views: either that society is seen clearly controlled by a well defined elite or that there is a continuing conflict in society between antagonistic classes. Both views of elitist domination and pluralist anarchy signify the contested value of the accounting reports and practices. Thus, accounting reports are hardly impartial and objective, nor is the accountant in the position of a disinterested and innocuous historian.

Dye (1986) argues that a cohesive "power elite" exercise authority over a variety of institutions. This elite is comprised of a small group of dominant, authoritative individuals or entities. The elite functions through, among other things, interlocking directorships, interlocking institutional experiences and similar social backgrounds. However, instead of a single power elite, Dye says that a society may have different groups of individuals or entities which exercise power in its various sectors. Thus, leadership or authority is dispersed. More importantly perhaps it is not unusual for these elites to be in conflict with each other.

The second variable of historical specificity stresses the importance of the specific historical and institutional environment comprising the social and political structures and cultural values of the society that provide the context for the delivering of the accounting reports. There is recognition that "disequilibrium is a standard feature of the economy" as proven by the presence of a few large corporations dominating the economy and that the state plays paramount roles in various fields including that of intervening in the determination of accounting policies. The historical focus in particular should assist efforts to understand the changing roles of accounting practice and emphasises the importance of historical specificity for a fair assessment of the social value of these roles.

The final variable on human agency acknowledges the potential of people and accounting to change and reflect differing interests and concerns. In contrast to the neo-classical view of accounting as a passive function which responds to, rather than changes, the environment in which it operates, the political economy approach stresses the viable role of accounting in changing society. As noted by Lowe et al. (1991, p. 154), under the political economy approach, accounting has "no necessary class belongingness". Therefore, accounting practitioners and researchers can have legitimate concerns for the effects of accounting work on the surroundings where it operates. Acceptance of current institutions and practices ("status quo") is now changed towards being sensitive to the need for appropriate changes in things which are crucial to the work of accountants. (Note 11)

The political economy perspective provides an excellent format for studying the external auditing activity of a nation due to the fact that it is interested in giving deeper understanding of how the story has unfolded. This can result from directing attention to the power relationships within the society and stressing the specific historical antecedents and the socio-economic environment. In addition, it recognises both explicit and implicit purposes of auditing over the years. The explicit structural purpose provides the "right" functionalist kind of impression, while the implicit social relations purpose protects an underlying power arrangement in order to maintain the status quo. There is thus a difference in what the elite say and do and perhaps also what is in their mind in the matter of auditing and similar functions.

Overall, under the political economy approach, it is assumed that the implicit purpose modifies the structural objective. For the purposes of this study, it suggests that the environment and the related socio-economic and political institutions impinge on the development of an audit process viewed as an open, dynamic social system. The understanding viewed to be the result of this study may be said to be the outcome of focusing made not on separate and overt elements of the audit infrastructure and its technical outputs but through a more comprehensive and in-depth study of these and other items considered crucial to such an understanding under the enlarged exogenous interpretive framework. It is however recognised that the "story" told is most probable only one of many.

In summary, political economy approach recognises both apparent and hidden purposes underlying audit process taking place in a specific locale and time period. The apparent, structural purpose reflects the proclaimed needs of a society. The more hidden underlying purpose associated with social relations on the other hand ensures the maintenance of the status quo. In getting a clear understanding of an audit process a focus on the social relations purpose should be given greater importance, for it is assumed that in any locality and a specific time period the social relation goal is always successful in modifying the structural purpose.

#### *4.2 The Enlarged Exogeneous Interpretive Framework*

This manner of interpreting data collected in this study of auditing experience in Malaysia is developed by Smith (1973, 1976) and adapted to accounting by McKinnon (1986) who traced the historical development of the Japanese corporate reporting regulation and its present operational form. The enlarged exogenous framework provides a structure for applying the idea of political economy of accounting, particularly the social relations dimension, which views the social, economic and political environments and related institutions as having impacted upon the audit process and accordingly the audit needs to be considered not as a distinct and separable part of the total social system but as an integrated aspect of a unified social whole. The enlarged exogenous framework assists the analysis of the nature, structure and functioning of auditing in its socio-economic context.

This interpretative framework has its origin in social systems research (McKinnon, 1986, p. 6). McKinnon mentions that this research views social systems as open, complex and dynamic. Also, under the framework, the past is viewed to be as important as the present in analysing the shifting patterns of intra-system and trans-systems activity and in the continual interactions of systems with their environment over time. Utilising a longitudinal approach is intended to help answer questions of "how" and "why" a phenomenon exists in time (temporal dimension) and space (spatial dimension) in relation to its aspects of continuity and change. In other words, the social system research is about "change" experienced by a social system.

Smith (1973, 1976) describes two approaches in analysing social system change: "pure" endogenous and exogenous approaches. His "enlarged" exogenous framework compensates the exogenous approach by taking into consideration variables other than intrusive events in order to understand a process of change experienced by the object under study. These variables comprise the process investigated, its neighbouring systems and their surrounding environment. Smith explains that these three aspects interact, each influencing the other. Therefore, each has the potential to introduce process changes. To understand a process of change, an analysis of the interrelationships is crucial.

Smith's framework thus combines "exogenous premise" and "endogenous inputs" resulting in four interrelated components to be used as the basis for system analysis - the environment, intrusive events, trans-systems activity and intra-system activity - and views "change" in a social system to involve three phases: source, diffusion and reaction. A "change" is defined as the transformation (replacement or modification) of the pre-existing pattern in the system through the occurrence of a succession of historical events over time in the system. (Note 12) The components and terminology of the analytical framework are described below.

##### *4.2.1 Historical Events*

Not all events are of interest. The events viewed as relevant under the framework are those associated with a turning point or which mark a transition from one pattern to a new or modified pattern in the system. These events are divided into two types: intrusive and response events. (Note 13)

Response events could only be the results of the interactions within the elements of the system studied (intra-system activity) or between this focus system and neighbouring systems (trans-systems activity). Response events are proof of pattern transformations made possible by the occurrence of intrusive events. In other words, they provide the visible evidence of change and need to be identified before change can be analysed. Several response events may constitute a particular change. They are also the essence of the social relations dimension or implicit purpose of the social system.

A change consists of a series of response events normally clustered in time and space around what are known as central response events. The identification of these significant events and their use as "insight stimulating examples"

(Selltiz et al., 1976) allow examination to be made as to how and why change occurs. This examination leads to the identification of intrusive events to provide the starting points from which the spatial and temporal analysis of change can proceed. The examination would also help in finding out the common elements underlying the series of changes which have transformed the system over time and which may be inferred to underlie future transformation of the system.

Intrusive events are known as diffusions and defined by Smith (1973) as including the following five types: migration, missionary activities, invasion including conquest and extermination, trade and technological exchange and the spread of ideas and institutions. McKinnon (1986, p. 47) adds economic depression and inflation to the list of intrusive events, arguing that in a processual study of change they should be viewed not as environmental conditions but as at the same level as war or technological advance or exchanges.

McKinnon (1986) summarises what makes an event intrusive as either it is generated through trans-systems activity or it appears from the international environment. Also it has the ability to disrupt the pre-existing pattern in the focus system and neighbouring systems. In short, intrusive events activate changes in the focus system and come from external sources. (Note 14)

Finally an intrusive event takes place in the source phase though it can also occur during the reaction phase to either intensify or modify the transformation process. Since the span of the source and diffusion phase may overlap and the fact that intrusive events are frequently continuous in nature, the intrusive events may persist into and throughout the diffusion phase.

Harrison and McKinnon (1986, p. 239) note that the impact of intrusive events on the focus system is frequently indirect. That is, the impact would occur often through disruption to other systems with which the focus system interacts. Also they say that intrusive events explain why the system undergoes change. These events however are not able to explain the system-specific response to their stimuli. The explanation in this case should come from environmental influences.

#### 4.2.2 Systems' Activities

The trans-systems activity, besides taking place between a neighbouring system and focus system, could also occur when two or more neighbouring systems interact. This activity embodies environmental influence which is conveyed to the focus system through the interaction between neighbouring systems and focus system.

Intra-system activity which is of a primary concern of this work takes place, as mentioned earlier, within the focus system. That is, the response events come about through interaction among the groups and individuals which comprise the structural elements of the focus system. The collective and individual responses of focus system components towards intrusive events are circumscribed by the interactions between the focus system and neighbouring systems. Therefore, the kinds of response events taking place within the focus system are influenced by the environment through the presence of the trans-systems activity which embodies this environmental influence.

#### 4.2.3 The Phases

As mentioned earlier, the process of change is divided into three phases: a source phase where intrusive events play their part in activating the system towards transformation; a diffusion phase with its response events which accommodate and transfuse the intrusive events within the system; and a reaction phase which may comprise both intrusive and response events. The occurrence of these events in the reaction phase may be a direct result of what takes place earlier in the diffusion phase or as an intensification or moderation of intrusive events that take place in the source phase. Change is considered incomplete until all the necessary events in the reaction phase have taken place. In sum, under the enlarged exogenous framework, system change is the product of both intrusive events taking place in the source phase and the continuous trans-systems and intra-system activity taking place in the other two phases.

The kind of change taking place in the social system is shown in the response events generated through all these activities. This form of change is directed by, and therefore reveals, the environmental influences upon the system itself.

#### 4.2.4 The Environment

The environment provides the spatial context within which all this activity takes place. It is the set of conditions which surrounds the focus system and all other systems within the nation and which is subject to only gradual change over time. In contrast to the various activities within the focus system and between systems, it does not generate events as data for change analysis. It instead serves to constrain or facilitate change through its influence on the nature of interactivity between and within systems. In other words, it sets parameters as to the extent of



interactions within and between systems. Indeed, what kind of environment is present is reflected by what is taking place between and within the social systems.

The environmental influence is also embodied in the interactions among the neighbouring systems and is conveyed to the focus system through neighbouring system interactivity with this system. This influence may be suppressed by the occurrence of certain intrusive events but would normally be apparent later on (McKinnon, 1986, Chapter Eight). Finally, by looking at the environment, one may see what form of change that has taken place in the focus system.

#### 4.2.5 Central Response Events

The analysis requires the selection of the outcome of interactions both within the audit system and between the audit system and neighbouring systems known as central response events. These are the response events that point to the direction of the significant differences existing across different time periods and localities. In short, they are used as "insight stimulating examples" in the historical and environmental analysis of the Malaysia audit system. The determination of these events is made through examination of various documents and interviews with various parties.

In summary, the enlarged exogenous framework adopted in this study has the following characteristics: system's change flows in three phases of source, diffusion and reaction and four components - intrusive events, intra-system activity, trans-systems activity and the environment - need to be considered at the same time in analysing that change. The utilisation of the enlarged exogenous framework of processual change would provide not just a structured interpretation against which the historical development stressed by a political economic theory could be examined, but also a manner of understanding the interaction between the environment and audit process in a society. This in contrasts with mainstream studies of audit practice which have proceeded on implicit prior assumptions about the motivation and behaviour of corporate managers, auditors, shareholders and other users of audited statements, regulators and other parties, and on the premise of an "arms-length" relationship among these parties. These studies give little regard to the specific environmental influences over audit practice.

#### 4.3 A Qualitative Case Study Research Strategy

The qualitative case study method is chosen as the research strategy since the aim is to have a deep understanding on the impact of the environment and other factors on the audit process. Patton (1990, p. 54) mentions that case studies are particularly useful when the need is to understand a subject of interest in "great depth" and in context.

Yin (1994, p. 13) in his well-received work on case study methods has the following definition for a case study: "... an empirical enquiry that investigates a contemporary phenomenon within its real-life context, especially when the boundaries between phenomenon and context are not clearly evident". Miles and Huberman (1994, p. 25) mention a case as "... a phenomenon of some sort occurring in a bounded context." They say a case is the researcher's unit of analysis. For the present study, the case referred to is the audit practice occurring over a forty-year period covering the history of Malaysia from independence in 1957 to 1997.

Yin (1994) has also clearly mentioned several other pertinent points in his introductory chapter which are applicable to the present research. All of them are concerned with the question of when it is appropriate to use a case study as the research strategy: first, when the "how" and "why" questions are the research questions being posed; second, when there are "many more variables of interest than data points" as a result of including the context of the subject as part of the study; third, when the research relies on multiple sources of evidence; and finally when the efforts in data collection and analysis are being guided by some theoretical framework.

Besides Yin (1994), numerous other works are available on the subject of case study research (see for example: Miles and Huberman, 1994; Ryan et al., 1992; Patton, 1990; and Scapens, 1990). Overall, these works agree that case study research is appropriate where the predominant research questions are those of "why" and "how", allowing the incorporation of a range of materials which may suggest different stories and the collection of data right away without already having determined the answer or even the form of the answer. (Note 15)

Utilising a case study approach involves collection of qualitative data. The data comes in the form of "words", "phrases", "sentences" and "narrations" which can provide a more complete portrayal of this subject under study than "numbers". Blumer (1978) describes "words" and similar data as being capable of providing the "rich", "full" and "real" story, rather than the thin abstraction produced by "numbers". Indeed, these are the data considered appropriate in explaining social aspects which cannot be quantified in a universal manner (Ryan et al., 1992).

For the present study, the data are to be gathered from primary and secondary source materials and from semi-structured, open-ended interviews of selected participants. (Note 16) During the interviews, limited participant observation is also to be executed to some extent. (Note 17) All these approaches towards data

collection are intended to put into practice the concept of triangulation to reduce systematic bias in research work. (Note 18) The literature refers to these various efforts as qualitative methods. (Note 19) Merino (1988, p. 188) stresses the significance of gathering data through these various ways:

*... [historical] facts must be interpreted in light of the conditioning environment of the period and human agents' perception of the alternatives available to them and the resources available to them. This determination must be made by thorough examination of available evidence, including an evaluation of the credibility of the testimony of participant sources.*

The importance of the interviews in particular is expressed well by Merino (1988, p. 188) as follows: "If historians are to provide valid explanations, then we must examine all available evidence, including the testimony of participant sources, to substantiate posited motives and causes" (see also Collins and Bloom, 1991 and Hammond and Sikka, 1996).

Filstead (1970, p. 4) says that the qualitative research approach in no way suggests that the researcher lacks the ability to be scientific while collecting the data. On the contrary, it merely specifies that for validity - and, consequently, for reliability - it is important to try to picture the empirical social world as it actually exists to those under investigation, rather than as the researcher imagines it to be.

In the accounting field, numerous scholars argue that qualitative research methods provide rich descriptions of the social world, particularly the meanings attached to actions in the language of actors. In short, they argue that qualitative methods help in understanding how accounting meanings are socially generated and sustained. To mention just a few, these scholars include Humphrey and Scapens (1996), Ryan et al. (1992), Ansari and Bell (1991), Scapens (1990), Covalleski and Dirsmith (1990), Smith et al. (1988), Kaplan (1983, 1984, 1986), Hopper and Powell (1985) and Hopwood (1983).

For the present study, the chosen enlarged exogenous interpretive framework to be described fully in the next chapter leads to the view of audit as a social system that is open to its environment and has the qualities of complexity and dynamism. A social system is a functionally differentiated group, composed of interactive entities. The process of auditing interacts with many social systems involving varying degrees of influence. Complexity lies in the multiple interactions which occur within the audit system and between the audit system and other relevant systems and in the continuous interactions of various social systems with their environment. As for the dynamism of the systems, it is reflected in the different patterns of interactions occurring over the different time periods.

Given complexity and dynamism providing the essence and reality of the subject under study, quantitative data collection is considered inappropriate due to its cross-sectional nature which entails the simplification of the system to a number of abstract variables which would give only a superficial version of the system. In other words, if the quantitative data collection is still used, it will divert attention from the essential basic or operational form of the system. One will end up getting to know merely the system's structural form and have little or no understanding of the flows of events and continuous interactions among the relevant constituencies. (Note 20)

To recapitulate, for a retrospective investigation of the audit process, viewed as a complex and dynamic system shaped by historical events and environmental factors, quantitative evidence collection and statistical data analysis are deemed inappropriate. This is due to their tendency to require abstraction to a degree which hinders the emergence of the very essence of the phenomenon that this research focuses on. Instead, qualitative data collection is to be used to capture the essence of the system.

Specifically, the collection of primary and secondary source materials yielding excerpts, quotations or entire passages and the in-depth interviews asking open-ended questions to allow participants to describe matters freely on their own terms resulting in direct quotations, form the basic sources of raw data. Thus, what people said is a major source of qualitative inquiry, whether what they said is obtained verbally through an interview or in written form through a document analysis.

The use of individual quotes deriving from the interviews and various documents to enrich the analysis may allow the possibility that meanings may be ascribed to words out of their context. This however appears unavoidable in the process of abstraction for such interpretive work. Rest assured, however, that a triangulation strategy is utilised to ensure that only quotes supported by other interviewees and/or documents have been chosen. Those which are not supported by other sources of evidence are to still be presented in some cases when they are considered appropriate to show the very complicated side of the subject under study.

In conclusion, the study of a complex phenomenon such as auditing in its historical and environmental contexts demands in-depth and detailed research work in and out of field. The decision to adopt the qualitative case study format fits with the everyday reality of human life marked by various complications, struggle and whatever other specifics that are part and parcel of the Malaysian life during the last forty years.

## 5. The importance of context and the subjectivity of historical approach

Both the political economy and enlarged exogenous analytical framework stress the need to take into account the context of the subject under study and the use of historical approach. Related to the former, Lehman (1985, Chapter 3) outlines two views on the manner in which knowledge of accounting is enhanced: the first views accounting with what Lehman (p. 59) calls "illusory concepts" such as "value free", "objective" and "fact"; (Note 21) the second considers the field as social practice imbedded in a socio-historical context.

Under this latter approach, accounting, the discipline and its research, is socially constituted. Illustrative of this approach, Burchell et al. (1980, p. 12) propose that accounting and reporting are "outgrowths of institutional processes .... shaped by the pressures which give rise to accounting innovation rather than any essence of the accounting mission". That is, there exist various forces that shape and direct accounting practice under different social regimes. In short, accounting is not a natural phenomenon that is independent of human beings, rather it is a man-made system that is continuously changing within its environment.

Of relevant to the present work, Burchell et al. also say (1980, p. 12): "The technical components of accounting regulation and specification [must] be seen as being embodied within a complex pattern of institutional and other influences and the search for technical solutions [should be] complemented by a search for institutional and political support". A similar view on the importance of context is raised by Puxty et al. (1987) who lament the lack of emphasis on social context in studying accounting.

Puxty et al. (1987, p. 273) argue that a concern with the social context is important if accountants are to understand their position and roles in society and if the significance of accountancy is to be assessed. They point out that the roles of accountancy in regulating economic and social activities in society and the manner in which the institutions of accountancy are themselves regulated are intertwined. They further claim appropriately that the institutions and processes of accounting in different nation-states cannot be understood independently of the historical and political-economic contexts of their emergence and development.

Other works in this genre include Tinker (1980), Cooper and Sherer (1984), Armstrong (1985, 1987), Burchell et al. (1985), Hopwood (1985), Berry et al. (1985), Miller and O'Leary (1987), Loft (1986), Hoskin and Macve (1986) and Lehman and Tinker (1987). By contextualising accounting in its various aspects, they show accounting to be socially and historically specific.

By examining its social, economic and political environments together with developments within auditing itself, it is hoped that the original, present and potential functions of auditing in Malaysia will be disclosed fairly - perhaps in the spirit of the following remark by Burchell et al. (1980, p.13): "... accounting, it would appear, is made to be purposive rather than being inherently purposeful."

The need to consider the right context is stressed throughout the study. In addition, the study is also historical in approach - that is, reconstructing the past by a process of sifting through the layers of time to discover how the present could have emerged from the past. The stress throughout is that in order to provide explanations and an understanding of the changing role of auditing, it must be examined in its historical and environmental contexts. Also, in order to understand the present auditing, there is a need to place the past auditing in its historical and environmental contexts.

In regard to the stress on historical approach, Bircher (1991, p. 30) mentions that any non-trivial history which tries to understand actions and practices *in situ* (rather than reading back interpretations from the present) goes beyond simple recording and becomes involved with analysis and interpretation. Thus, there is a need in the explanation of historical events and change for the guiding theoretical structure. Individual studies have used different theoretical tools to help such analysis and interpretations. The use of different theoretical perspectives to inform the interpretation of the past, however, suggests that there can be different histories, different interpretations. Therefore, history is radically and viciously subjective. There cannot be any histories which are absolutely objective. In fact, there may be different histories for the same events. The theory of political economy and the enlarged exogenous interpretive framework provide the needed theoretical perspectives for the chosen research approach.

## 6. Clarifying the alternative approach

The political economy of accounting theory is applied through an enlarged exogenous framework to describe and analyse audit process in Malaysia over a period of four decades. The enlarged exogenous framework emphasises the environmental influence upon interactions within and between systems that are placed under it. Thus, the focus for a study utilising such a view of the world is in interpreting and explaining what has gone on.

Under the political economy approach, the focus on social relations leads to the proposition that certain parties possess special interests that often influence the audit process. That is, what transpires in the audit process would be

in accord with their expectations or goals. A political economy approach attributes audit activities to the distribution of power in society and the social, political and institutional structure that mirrors that distribution of power. To understand the functioning of audit, there should be a focus on political, economic and social variables.

Thus, this approach attempts to show not only the manner that audit activities have taken place, but also tries to explain how these activities occurred as a result of institutional and social forces. In other words, the study by applying the enlarged exogenous interpretive framework attempts to link the nation's audit history with its social, economic and political history. A change analysis of the historical data is used to illustrate the link between the two.

The research approach adopted to study auditing in Malaysian environment as discussed above is an initial attempt to understand how political, economic and social conditions and related institutions have impacted the functioning of audit in Malaysia. In other words, auditing in Malaysia is understood here to be interrelated with the dynamics of the wider sociopolitical and economic context of which it is an integral part. Auditing in this respect is not understood as "technical" - a neutral set of practices - but as an integral to the sociopolitical structure of society. Auditing here is considered to be a mutable phenomenon, interacting with a dynamic, mutable context (Hopwood, 1987).

As a malleable phenomenon with potential consequences, auditing is interpreted as political in character and not as a (potentially) neutral device. It is a man-made system that is based on socially constructed reality and shaped by its different socio-political and economic environment. It is constantly changing and evolving within its dynamic environment (Hopwood, 1983; Chua, 1986; Hines, 1988; Morgan, 1988; Dillard, 1991; and Samuels and Oliga, 1982 mention this for accounting). In short, it is postulated that the Malaysian audit process is changing within a set of contextual conditions which may be expected to affect its development.

The above distinctive assumptions upheld in this research inquiry concerning the audit process in Malaysian society may be viewed to come under what is generally termed the interpretive research paradigm. Burrell and Morgan (1979) claim that all social scientists approach their subject through assumptions about social science and the nature of society.

Assumptions about social science or the study of human society can be thought of in terms of the subjective-objective dimension covering the four areas of ontology, epistemology, human nature and methodology. As for assumptions concerning the nature of society, they create another dimension comprised of concerns about the maintenance of social order with regulation and the need for radical change due to deep-seated structural contradictions in society.

The placing of these two sets of dimensions together result in four separate views of social theory, one of which is the interpretive approach. (Note 22)The interpretive paradigm is characterised by the intersection of subjective and regulatory dimensions and uses the notion of "understanding" as the method to study human world by reliving the experience of others. (Note 23) As Hopper and Powell (1985, p. 89) put it, "[t]he focus is on individual meaning and people's perceptions of "reality" rather than any independent "reality" that might exist external to them."

Thus, in a study of human society, the relevant ontological assumption that may be upheld ranges from the presence of complete objective world to that of totally subjective one creating realism-nominalism differences. The realists believe that there exists an objective world external to people where knowledge is considered hard, real and tangible. This results in a positivistic search for universal laws and generalisable relations believed to be the determining factor for human actions. They favour microscopic, narrowly defined research characterised by the hypothetico-deductive element and known as functionalist in approach. On the other hand, for the nominalists, reality is subjective - based upon personal experience and insight - and socially constructed. Thus, they seek to understand and explain human actions viewed as the result of free will. They tend to favour the holistic-inductive approach to research known as the interpretive paradigm.

Yanow (1994) explains that instead of the discovery of objective facts, the interpretist aims to understand human actions and interactions in their context due to his/her view that social institutions, policies, agencies, etc. are human creations, not objects independent of the humans. Also, she explains that the study of human meanings entails the discovery of multiple meanings or varieties of interpretations (by "situated knowers") of the subject of interest ("situated knowns"). The focus accordingly is on the carriers of meanings (known as the artifactual symbols) that come in the forms of symbolic objects, symbolic language and symbolic acts.

Chua (1986) points out that an interpretist considers "knowledge" to have the following qualities: a high degree of clarity and compatibility with the principles of logic, plausible or common sense meaning derived from parties involved in knowledge creation and consensually agreed upon by the actors concerned. The last two qualities show that the interpretist perspective recognises diverse understandings and the presence of societal relations entailing the

need to attain relevant parties' definitions of situations and analyse how such awareness is intermingled with a wider social, economic and political structure.

Thus, the perspective recognises the presence of a relative reality affected by changing social, economic and political environments. It is also concerned with actors' plausible or common sense views woven into a wider environmental context. A theory developed is assessed to be adequate when actors concur with the explanation of their intentions.

The interpretive approach is most appropriate in examining a nation's auditing practice because it recognises auditing as a socially constituted product, not a natural phenomenon. It also gives the opportunity to the researcher to provide a rich description of the audit experience and at the same time explain why such experience takes place and how it has all come to be the case.

Chua (1986) notes that case studies are among those strategies which fit with the utilisation of an interpretive research paradigm in order to obtain knowledge about the "everyday world of actors". She states that ideographic methods rather than hypothetic-deductive methods are needed to re-enact the actors' definition of the problem. This is reasonable due to the fact that in-depth study is needed, and this could very well be provided by the case study research strategy. For the present research, the case study format is accordingly chosen emphasising the gathering of qualitative data from personal interviews and relevant documents and literature.

With interpretivism and not functionalism as the line of inquiry, human activity is seen as "text" consisting of a collection of symbols which expresses layers of meaning. (Note 24) The theory of political economy applied in the context of the audit function in Malaysia is thus considered to provide such an avenue and is applied in the present study.

### **7. The relevance of the alternative approach**

The neo-classical view of accounting applied in much research in accounting to date and which has strongly influenced accounting outputs may be viewed as a means of sustaining and legitimising the current social, economic and political arrangements (Cooper, 1980, p. 164). The status quo in consequence is maintained, for it is regarded as desirable or, in some other cases, as the only arrangement possible. In short, this influential view has prevented a good understanding of what society is like and the possibility of changing it.

What could stop this view from continuing its reign over accounting research and practice and thus give one point of relevance for the alternative approach is to have more and more conscientious accounting practitioners and researchers to adopt a more holistic approach to their work emphasising the interpretive as opposed to the supposedly "objective" aspects of the discipline to help broaden and deepen the accountants' contributions to economic and social life.

Another point of relevance of this research approach is that by enhancing understanding of the existing ("below the surface" rather than overt) audit functioning, perhaps some rough estimation can be made as to the direction of environmental influence over audit. Parties concerned may want to check whether they would really like to have the prediction to come true or to act swiftly and be proactive to ensure that instead of "events" influencing them it should be the other way around.

This view, that some kind of prediction could be made in regard to audit functioning, is based among others on remarks such as the following: "The traces of dynamic process at given points in time should be interpreted as the result of a complex interplay of historical development" (Hagg and Hedlund, 1979, p. 138). And as Fusfeld (1972, p. 1) has succinctly put it: "The processes of change are rooted in the past, operate in the present, and thrust into the future .... Social scientists have to develop a triple vision; they must look backward to the world we came from, analyse the world in which we live, and try to discern the future". Fusfeld (1977, p. 777) has also mentioned that the present is not totally isolated from the past: "If we think of the present as a point in space and time, we can examine the past in terms of how a variety of processes and forces contributed to produce the present situation" (see also Carnegie and Napier, 1996).

Thus, the present state of audit functioning is viewed as the current episode in a continuous process of change when earlier on it might well have been viewed as the future state as of that point in time. Needless to say, the present is also going to be viewed as the past of the future audit functioning. Perhaps by looking now to the future, pro-active arrangements could be made to have that future be less surprising or intimidating considering the fact that as much as the past has influenced the present, the present whenever that is is never the same as the past.

Still another point of relevance of the research approach is related to the remark made by Willmott (1991, p. 109) that the study of auditing "has been seriously neglected and marginalised, even as evidence of "failures" mounts and

doubts about the independence of auditors grow". He also mentions (footnote 1, p. 119) that the interest in auditing among scholars as a social phenomenon was limited to a few mavericks and moralists.

It is thus hoped that the utilisation of this approach will be able to contribute in some small way towards enriching this very important area whereby the emphasis is on the perceptions and explanations of the actors themselves. (Note 25) By applying this approach too, it is hoped that the profile of auditing is raised in Malaysia to direct the attention of more influential parties (e.g. politicians and journalists) to ask probing questions about the operation and adequacy of the existing audit regulatory arrangements (Sikka et al., 1989; Willmott, 1985) with the focus also on other systems neighbouring to the audit practice.

The final point of relevance for this research approach concerns the lack of accounting studies in developing countries where accounting is regarded as a part of the wider socio-economic and political context. (Note 26) Although there have been numerous studies such as those by Enthoven (1977, 1973) on the role of accounting in economic development and others such as the effect of international transfer of accounting skills (Seidler, 1967; Needles, 1976), accounting is constantly seen as a technical activity which provides financial information for economic development. The scholarly works are invariably normative and are deemed located in the functionalist paradigm. Thus, they fail to examine how accounting is very much a reflection of the society it is located in. There appears always to be a lack of attention to developing countries' socio-economic factors which impact upon accounting resulting in suggestions that the transfer of western accounting technologies and ideas would be unproblematic and undeniably and automatically beneficial to these countries - though experience time and again appears to prove otherwise.

Therefore, the adopted approach is an attempt to help in rectifying such efforts. Specifically, it may be viewed as satisfying a need for research in financial reporting in developing countries where the supposedly technical tool of auditing is seen to intermingle with the various factors in the environment. Accordingly, it should lead to a broader if not an alternative conception of auditing compared to that written from a functionalist perspective in a normative manner. The expanding view of "auditing in action" may perhaps also encourage other researchers to do similar kind of work seeing perhaps how much more relevant such work is to the socio-economic environment of the developing countries.

## **8. Conclusion**

There are at least two paths to better understanding of the auditor's role in society. One is the neo-classical conception of economic activity that appears to have had greater influence upon the beliefs, values and vocabulary of many generations of economists, politicians, policy makers, students and academics. In regard to most accounting research, Ahmed (1992, p. 163) notes that traditional microeconomic thought has influenced accounting to the point that it virtually ignores the purposive nature of human conduct and behaviour and hence the meaning and context of actions including the production and processing of knowledge (see also Baker and Bettner, 1997).

Ahmed claims that by accepting the objective and abstract form of knowledge and viewing accounting as merely a technical and natural service activity, accounting researchers have isolated the domain of accounting thought and inquiry from many issues of wider social and organisational significance. In other words, though its rhetoric and ideology may match the power of logic and mathematics, the conception of social reality by mainstream accounting is debatable.

The alternative path adopted in this study concerns the interrelation of the audit function with its environment viewed in an historical and social manner. This is in the very manner stated by Burchell et al. (1985, p. 382) who lament the neglect by accounting researchers of the intermingling of the accounting and the social: "... little is known of how the technical practices of accounting are tethered to the social, of how wider social forces can impinge upon and change accounting, and of how accounting itself functions in the realm of the social, influencing as well as merely reacting to it".

In order to place emphasis on the context of the audit function, an interpretive research approach is adopted in this study. This interpretive orientation is consistent with the socially constituted view of accounting. This research approach also influences the collection of data, although when it comes to data analysis, it is augmented with the use of an enlarged exogenous model and the related critical theory of the political economy of accounting.

The interpretive framework aided by qualitative data is most appropriate for examining a nation's audit practice because it recognises that audit is a cultural product, not a natural phenomenon. To understand audit in action, the perspective emphasises putting audit in its particular historical and environmental context. This would lead towards not only rich description of the audit practice in Malaysia, but also to explain and interpret why such practice exist and how it emerged.

To understand the structure, meaning and significance of the nation's audit practice it is necessary to probe the various components of the social, economic and political environments that surround auditing together with the actors of user, regulator, preparer and auditor who are closely involved with audit practice. The political economy of accounting theory utilised in the study drives an enlarged exogenous framework to describe and analyse auditing in Malaysia across a period of forty years. The framework attributes primacy to audit development in the unfolding of history. Audit development is viewed as located in society and is therefore related to changes in society. By focusing on audit practice situated in concrete social conditions, audit change can be understood dialectically, rather than as a mere outcome of mechanical determination by the market.

Therefore, this study on the rationale for external audit in Malaysia is inter-disciplinary. To isolate the economic study of audit practice from the sociological treatment of social class and racial conflict and from political science's attention to the state is to restrict artificially the depth and scope of social investigation and analysis. By identifying a variety of related factors which comprise the processual change of audit practice, the significance of societal specificity and historical sequence in social change is also underscored. Hence what is being attempted here is a historical case approach.

In particular, this approach analyses how general concepts - audit, state, companies - take on concrete social and historical meaning over time. The major variables of culture, market, state and organisation - to mention a few - bear differential explanatory weight through time, as a different balance of factors comes into play in different time periods.

Every country or economy or time period (of a country) has companies. Every country or economy or time period (of a country) has government. Every country or economy or time period (of a country) has auditors. It is only when all these and other elements are considered in interactive relationships with each other that a coherent and consistent pattern is found - to lead towards the emergence of an appropriate understanding. It is this collective patterning of variables, not the individual fragments of reality, that is being considered here.

Concentrating on the dominant units of auditing in action helps to overcome some of the problems of comparative accounting system analysis and forces one to consider how these particular kinds of units developed and become established in different kinds of ways over time. The factors said to be influential, such as the state's control of businesses, distinctive economic institutions such as banks and stock markets, are not singular in nature, universal in character and unambiguous in practice. They all reflect their spatial and temporal location. Moreover, these highly complex factors do not exert their influence in a vacuum, apart from other, equally complex factors such as the country's national attributes. As a result, all these factors do not interact in the same way in different locations and time periods.

To recapitulate, the objective of this study is to answer the question of "Why audit in Malaysia?" through tracing the historical development of the audit function since independence in 1957 and analysing the environmental influences on this development. Thus, the subject of the study is auditing and auditors generally, and auditing change particularly. The emphasis will be on discovering rationales for past and present auditing. Finally, by interpreting the past, the present may be understood in order to help in charting the future. The main and specific assumption held throughout is that the audit activities taking place within a certain length of time are associated with a unique configuration of social, economic and political conditions. The study in all probability provides the first comprehensive analysis of audit practice in post-independence Malaysia, utilising an analytical framework which employs a process orientation, recognition of environmental influences and a historical perspective.

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## Notes

Note 1. Noted Ooi Soon Kiam and Chuah Soon Guah (1989, p. 4): "To date there is no record of legal liability suit involving the work of auditors in Malaysia". From the field work conducted recently in Malaysia, it has been found that these views are incorrect. There is one case and it took place in the early 1960s.

Note 2. For example, the doctors recently have been bombarded by one negligence suit after another. Noted Malaysian Medical Council chairman Professor Datuk Dr Mahmood Mohd Noor, "[t]he number of medical negligence or malpractice suits in Malaysia is relatively few but the cases filed over the last two years were more

than the average for the previous five years" (*NST*, 29 Dec. 1994). As a result, it is reported that the Law Ministry is now looking into ways to introduce limits on the amount of money a plaintiff can claim (*NST*, 29 Dec. 1993).

Note 3. In 1993, there were over 800 audit firms in the country with over 250,000 companies demanding auditing yearly (*Akauntan Nasional*, Apr. 1993, p. 25). There were also 2,000 external auditors working in those 800 audit firms (*Akauntan Nasional*, Apr. 1994, p. 29). In 1991, the then MACPA president stated that of the 700 audit firms in Malaysia, 88 percent were small practices with fewer than 50 staff each (*Business Times*, 19 Oct. 1991). The larger firms are known to provide a wide-range of services besides auditing and all these services are bought by not only registered companies but also by others such as individuals, multi-national corporations, government departments and statutory bodies. The services offered besides auditing include tax consultancy, accounting, management advice, company secretarial services, receiverships and liquidations, mergers and acquisitions and executive recruitment. As for the small audit firms, see Adrian Yeo (1993), who in his 1990 study found that small firms defined as those with a maximum of 4 partners or a fee income up to RM 1.5 million, had as the main sources of their income the following: auditing (52 percent), taxation (19 percent), bookkeeping (10 percent) and secretarial work (10 percent). (However, with only 21 respondents, or a 16 percent response rate, and that from only small firms in four selected cities in Malaysia, his findings need to be treated with caution.) The big audit firms have tie-up with overseas firms. The link up takes place as the former can now benefit from transfer of expertise and technology and thus enhance their services. The tie-up is also considered to bring benefits to both sides since in exchange for a contribution to the overseas audit firms for joint expenses such as advertising, product development and liability insurance, the local big firms can gain instant credibility and access to multinational clients. Examples of link-ups include Jaffar Hussein with Price Waterhouse, Kassim Chan & Co with Deloitte, Haskins and Sells, Desa Megat & Co with KPMG Peat Marwick, A. Samad & Co, Hanafiah Raslan & Mohamad with Arthur Andersen, Lim Ali & Co and Larry Seow and Co with Arthur Young International, Mustapha Law with Touche Ross International and Nordin Hanifah & Co with Ernst & Whinney. For 15 years up to 1988, Hanafiah Raslan & Mohamad (HRM) was linked with Touche Ross International. Following the merger overseas between DHS and Touche Ross (and Tohmatsu Awoki & Sanwa), their local counterparts - Kassim Chan and Mustapha Law, respectively - also merged. The same also took place with their local counterparts when Ernst and Whinney merged with Arthur Young in July 1990 creating a total of 23 partners and almost 1,000 employees in 12 offices in Malaysia (*NST*, 16 July 1990). The MIA noted that these two mergers had saved the firms overheads on a smaller number of offices (*Akauntan Nasional*, Apr. 1993, p. 25). In 1989, it was estimated that the biggest eight firms then accounted for 90 percent of the audit fees of the KLSE listed companies (*NST*, 2 Sept. 1989). In 1988, Patrick Pillai reported that the experienced auditors he contacted estimated that the total cost of audit fees for the entire local corporate sector could be around RM 140-150 million (*Malaysian Business*, 16 Aug 1988, pp. 13-14). A major proportion - RM 120 million - went to the then big eight audit firms which had cornered more than 90 percent of the audit market for multinational and Malaysian listed companies. The non-big eight audit firms were left to cater to the needs of thousands of smaller companies. Among the big firms, in 1990, the three biggest in terms of number of professional staff were Price Waterhouse, Arthur Andersen/Hanafiah Raslan & Mohamad and Ernst and Young with 800, 886 and 900 employees, respectively (*The Accountant*, Aug. 1991, p. 17). Each also had 8, 17 and 13 offices, and 18, 20 and 22 partners, respectively. Another big audit firm in the country is Coopers & Lybrand which started operations in 1960 with a staff of 70. In 1976 it was "Malaysianised" and in 1990 it had a staff strength of 600 (*NST*, 27 June 1990). With more merging expected to take place, the MIA on 11 Feb. 1993 applied to the Registrar of Companies to lift the then limit of 20 partners to an unlimited number so that all the advantages of a merger and the opening up of branches could actually be realised (*Akauntan Nasional*, Apr. 1993, p. 24). In making the application, the MIA noted that the merging between firms had forced many partners to leave the enlarged firms and that since the public accounting profession in the country was expanding very fast the firms now had to open up branch offices all over the country. The opening up of branches demanded the placement of partners. Four years after these remarks were made, the *NST* (23 Apr. 1997) reported that legal and accountancy firms could now have more than 20 partners following the latest amendments to the Companies Act 1965 following amendments to Section 14(3)(a) of the Act that was gazetted on 17 Apr. 1997.

Note 4. The term "development" as it is used here, unless it is noted to the contrary, does not relate to evolutionary perspective of the functionalists. Instead, it relates solely to the historical development of the social system.

Note 5. See the reality of audit as dissected by Willmott (1991, p. 113). See also Kirkham (1992). And note what is pointed out by Okike (1994), Akathaporn et al. (1993), Soong Hyun Park (1990) and McKinnon (1984) in regard to audit practice in Nigeria, Thailand, South Korea and Japan, respectively.

Note 6. Kirkham (1992) mentions that appeal for this type of work has been made in the extant auditing literature and that a small growing body of researchers has embarked on such pursuit. She lists 16 relevant works.

Note 7. See the excellent writings by Briloff (1993) and Mitchell and Sikka (1993) which capture well these very interactions in the current audit environment in US and UK, respectively.

Note 8. Hudack (1989, pp. 16-17) mentions that Tinker's political economy is actually a re-birth of Ricardian economic thought in the early nineteenth century.

Note 9. Ahmed (1992, p. 191) writes that the neo-classical economists would consider factors such as political lobbying, political interest in a government policy and institutions of power and authority protecting and legitimating certain economic practices as rigidities or imperfections in the pursuit of optimal efficiency and rational decision-making. Thus, they would treat them as external factors which decision-makers are told to either ignore or work on reducing their impacts. See also Veblen (1984, pp. 174-175).

Note 10. Dahl (1967) defines power and conflict as the ability to impose one's will upon another and the existence of more than one interest, respectively.

Note 11. The focus for research on corporate accounting report now is on its impact on the welfare of the society as a whole. There is no more bias toward the shareholder and manager classes in society as in research based on neo-classical marginal economics related to the assessment of the usefulness of accounting reports for users.

Note 12. See Smith (1976, pp. 16-18) who discusses how a study of change may be differentiated into three types.

Note 13. Note that it is McKinnon (1986) and not Smith (1973, 1976) who suggests this division of events. See footnote five in Chapter Three of McKinnon (1986) for more.

Note 14. In Harrison and McKinnon (1986, p. 239), they however note that though the intrusive events "typically" originate from without the system, "they may have their origins within the system". They further write: "Thus, the potential of individuals and groups within the system to act in innovative, proactive way, or to seek to redefine their roles or influence within the system, may be regarded and examined as intrusive events in respect of the system as a whole"

Note 15. Scapens (1990) delineates the six steps to be followed in executing case studies.

Note 16. A purposive sampling approach is to be used rather than a simple random selection to locate interviewees. When the desired elements of the sampled population do not equally and universally exist in all units of the target population, when inclusion of exceptional and special units in the sampled population is essential for the completeness of the research, or when the universe includes a relatively small number of sampling units, a simple random selection may miss the more important elements and is therefore rejected (Foroughi, 1981, p. 222). Another manner of looking at this approach is that it signifies that the conduct of interviews is not to prove or refute a hypothesis. Also, there is no intention at all to say that the views of individuals who were finally interviewed represent any other group of people or institutions. Instead, the whole aim is to attain information-rich interviews which will illuminate the questions under study. In regard to the open-ended quality of the questions asked, the intention is to enable interviewees to express their own understanding in their own words. The interviewer never supplied and predetermined the phrases or categories that must be used by respondents to express themselves. The focus is on learning interviewees' viewpoints by recording their terminology and judgements and capturing the complexities of individual perceptions and experiences. As Patton (1990, p. 278) notes succinctly, the purpose thus is to allow the interviewer to enter into the participants' perspective using the assumption that the perspective of others is meaningful, knowable and able to be made explicit. In general, the interview guide used in the field work as a basic checklist of subject areas to ensure that all relevant topics were covered during the interview. It presumed that there was common information that should be obtained from each person interviewed, but no set of standardised questions was prepared in advance. The wording and the sequence of questions were also adapted to specific participants in the context of the actual interview (See Patton, 1990, p. 283 and Kvale, 1996, Chapter Seven). In short, the interview schedule used during interviews is actually put to use with a considerable degree of flexibility. That is, if an interviewee showed great interest in an issue and wished to develop it further, he or she is encouraged to do so. If on the other hand, he or she is not comfortable to say much or to claim to have little knowledge of the issue forwarded, the question is thus dropped. This led to the possibility that more information would be collected from some people than from others. Patton (1990, p. 286) mentions that for basic research such as the present one where the aim is to understand the holistic overview of a group of people, it is not necessary to collect the same information from each person. Not having a structured interview format is viewed to be a more effective way of establishing a better understanding of auditing within its historical and environmental contexts, due, among other things, to the implicit assumption behind the use of structured interviews that questions and responses are taking place in a context-free framework. Utilising structured interviews would also prevent participants from posing their own questions and introducing lines of inquiry not envisaged by the researchers. Nevertheless, there are limitations with semi-structured interviews. This is because of the tendency of certain individuals (even when it is agreed that they are not going to be directly identified in the report for views they expressed) to exhibit opinions that

are "politically acceptable" to others. Moreover, these types of interview do not negate the possibility that participants adopting a manipulative stance and, deliberately or otherwise, feed information for power-related or political purposes to the researcher. See Van Maanen (1979) for more. Also see Douglas (1976) who discusses various intervening steps that an interviewer could undertake in facing people in field sites who nearly always have reasons for omitting, selecting or distorting data and for deceiving the field worker (not to mention deceiving themselves). Note also that Miles and Huberman (1994) provide an extensive discussion on enhancing the validity and reliability of field data.

Note 17. This data gathering technique is to be utilised with no intention at all that the field work is turned into an ethnographic study. It is done everytime however due to two reasons. First, the researcher is there in the company of the interviewees who provide various postures in interacting with the former. Second, it allows the responses of the interviewees to be interpreted within their contexts. Note also that numerous informal talks with a number of people who are at the peripheries of the subject under study to avoid the so-called the "elite bias" (talking only to high-status interviewees) need to take place too.

Note 18. Patton (1990, p. 470) defines triangulation in research as a process by which the researcher can guard against the accusation that a study's findings are simply an artefact of a single method, a single source, or a single investigator's biases. Miles and Huberman (1994, p. 266) however mention that "[s]tripped to its basic, triangulation is supposed to support a finding by showing that independent measures of it agree with it or at least, do not contradict it." They also say that triangulation as defined by Denzin (1978) is a way to get to the finding in the first place. Neuman (1991, pp. 329-30) has interestingly suggested that triangulation is not only to increase the "sophisticated rigor" of the data collection and analysis, but also to help disclose the "richness" of social settings for a qualitative inquiry. He mentions that quantitative researchers would consider the inconsistent picture derived from data on the same social event collected by different methods, different researchers or at different times as "bias" or "error". This he says would not be the case for the qualitative researcher. He writes (p. 330): "But for a qualitative researcher such differences are anticipated and are a valuable source of information about social life. They are themselves an aspect of social life to be analysed". See also the very interesting work by Kvale (1996, Chapter 12) on this very subject. Note also in this regard what Kvale (1996, p. 14) says in regard to interview data in particular: "The aim of the qualitative research interview is not to end up with unequivocal and unquantifiable meanings on the themes in focus. What matters is rather to describe precisely the possibly ambiguous and contradictory meanings expressed by the interviewee. The contradictions of interviewees may not merely be due to faulty communication in the interview situation, nor to their personality structures, but may in fact be adequate reflections of objective contradictions in the world in which they live."

Note 19. See for example Van Maanen (1979, p. 520).

Note 20. This is not to deny however that the quantitative method could be utilised as a "useful adjunct" to the study of social system change which stresses on qualitative rather than quantitative features of the system. This is as shown by McKinnon (1986).

Note 21. Their view is associated with the method of inquiry called the "scientific method" that comes under the philosophical school of logical positivists. See Abdel-Khalik and Ajinkya (1979). See also Williams (1988, Part V) who claims that the accounting's "scientific method" is not quite scientific and should be renamed "logico-mathematical method" or more aptly "pseudo-scientific method"!

Note 22. The other three are radical humanist, radical structuralist and functionalist. See Burrell and Morgan (1979) for more who in coming out with these four mutually exclusive research paradigms create a dichotomy between the subjective and objective approaches. Hopper and Powell (1985) disagree with the dichotomy and view subjective-objective dimension as a continuous with radical humanist and radical structuralist combined to create the radical paradigm.

Note 23. See Belkaoui (1987, pp. 56-8) and Patton (1990, Chapter Three) who describe various forms of qualitative inquiry. See also Hopper and Powell (1985, p. 88).

Note 24. "Meanings" people place on the events, processes and structures of their lives are defined by van Manen (1977) as people's "perceptions, assumptions, prejudgements, presuppositions".

Note 25. See Colville (1981), Otley (1978) and Tomkins and Grove (1983) who support this manner of studying a research subject. Hopper and Powell (1985, p. 91) appear to agree that the interpretive research method to study how accounting meanings are socially generated and sustained could result in better understanding of accounting.

Note 26. In other words, in the very notion of accounting propagated by Burchell et al. (1985). That is, the accounting processes and institutions are not so much influenced by the wider social, economic and political environments as "inter-twined" with them, and thus, as proposed by Hopper and Powell (1985, p. 93), need to be studied together.