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Management Accounting Research 16 (2005) 340–370

Management Accounting Research

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Management control in audit firms—Partners' perspectives

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Received 19 April 2004; accepted 23 June 2005

Abstract

Previous studies have consistently reported high levels of quality threatening behaviours in response to traditional budgetary controls at audit trainee levels in Big Four audit firms. Partners simultaneously occupy positions as owners and members of top management, and their perspectives on these behaviours and control procedures that may mitigate potential consequences are therefore important. These perceptions, which have been missing from prior research, were investigated using semi-structured interviews with 12 audit partners from three of the Big Four firms. The findings suggest the existence of previously unidentified controls at partner level that become embedded in the procedures and routines through which potential cost-quality conflicts are managed. At the same time as cost-quality conflicts created by the formal budgetary control system are increasingly being seen by partners to be pushed up the hierarchy, changes in audit methodology and operating procedures are perceived to facilitate a strengthening of the impact of other less formal controls at lower levels. Many of these constitute examples of clan controls and include the influence of partners' experience and intuition over a wide range of organisational activities, informal communication and signalling both within the partnership and between partners and staff, and the management of internal and external relationships. The study highlights the importance of these controls in achieving a balance between trust-building and additional monitoring.

Keywords: Audit quality threatening behaviours; Audit partner clan controls

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doi:10.1016/j.mar.2005.06.008

1. Introduction

Control systems in audit firms have been the subject of many research studies, almost all of which have involved relatively junior audit staff as survey respondents or non-auditors as experiment subjects (for example, Pany et al., 1989; Pierce and Sweeney, 2004). These studies have consistently reported high levels of apparently dysfunctional behaviour in response to pressures created by the formal control system. Given the rapid pace of change in the audit environment and the increased public scrutiny of auditors, the need for research into audit firms' control procedures and issues of cost-quality conflict from a top management/owners' perspective is arguably greater than ever. However, the sensitivity of issues such as cost-quality conflict (McNair, 1991) and the difficulty of conducting field study research in auditing (Gendron, 2000) have resulted in little in-depth research on the topic. The need for in-depth research on management control systems (Chenhall, 2003) and on the complex back stage of the audit process (Power, 2003) has been highlighted in previous studies.

The purpose of this study, therefore, was to conduct an in-depth examination of Big Four audit partners' perspectives on the firms' control systems. Although Macintosh (1985) identified clan controls as being particularly applicable to the audit environment, no study to date has provided empirical evidence of how those controls are perceived to operate in practice. The next section sets out the background literature organised around management control theory and its application to audit firms. The research objective is then developed, followed by details of data collection and analysis. The findings are presented in Section 4, followed by discussion and conclusion.

2. Background literature

2.1. Management control literature

Ouchi (1979) presented a framework based on market, bureaucracy and clan controls and argued that in situations where there is low ability to measure output and imperfect knowledge of the transformation system, the traditional control measures of output and behaviour are no longer sufficient. In situations such as these, clan control characterised by rituals and ceremonies is all that remains. Clan controls require stability of membership and a strong social memory (Ouchi, 1984). The selection process is a key element of these controls, as ensuring the correct person-job fit increases the likelihood that individuals will internalise the objectives of the organisation (Ouchi, 1979). Furthermore, it is difficult in reality to get a perfect person-job fit and organisations rely on training to instil in individuals a commitment to the organisation's objectives. Performance evaluation tends to be more informal in this environment, and involves 'a subtle reading of signals' (Ouchi, 1980, p. 137).

Simons (2000) referred to diagnostic and interactive control systems, a distinction that relates to how the information is used by managers rather than the actual content of the control information. He defined diagnostic control systems as 'formal information systems that managers use to monitor organisational outcomes and correct deviations from preset standards of performance' (p. 209) and interactive control systems as 'formal information systems that managers use to personally involve themselves in the decision activities of subordinates' (p. 216). With diagnostic control systems, the performance of lower level employees is controlled by monitoring deviations from target on a number of defined criteria. This system is appropriate where performance standards can be preset, outputs can be measured and action can be