

# When the client is a former auditor

## How auditees facilitate and influence the audit engagement

*Bertrand Malsch and Laurence Daoust on Audit Quality and Independence*

### The Essentials

CPAs who leave their positions as auditors to become accountants in private industry often find themselves on the other side of the audit engagement as auditees. Here, they have the power to shape the engagement in ways that jeopardize audit independence. This study of 36 auditees with former experience as auditors found that they are able to draw on the expert knowledge and social capital they earned as auditors to actively facilitate and influence the audit engagement in six ways: information filtering, bonding, teaching, coaching, questioning, and monitoring. In light of the current regulatory ambiguity around this specific form of bias, we propose that accounting firms and clients alike should develop their own internal methods for curbing such bias. The first step is growing awareness among their audit teams about the potential of these interactions to reduce audit quality and independence.

The transition from auditor in a large accounting firm to auditee in a private organization is a well-trod career path for the CPAs of today. And why not? The expertise they accumulate from years of working with a diverse group of businesses makes them invaluable players for their new companies and the opportunity to apply their knowledge in a new way is a welcome challenge for the accountants themselves. No doubt their keen understanding of the audit process is equally appreciated by auditors who find a common language with their client.

Of course, the dynamic of an audit engagement in which auditors are sitting on both sides of the table also raises concerns about auditor independence. Indeed, a great deal of research and regulatory frameworks have been designed to interrogate and monitor the “revolving door” of auditors who become auditees, and how this impacts the judgement of the auditors who eventually work with them as clients. The same levels of inquiry and scrutiny have not, however, been applied to the behavior of the *auditee*.

When public accountants leave their auditing roles to join private organizations, whether they are former clients or not, they bring with them “insider” knowledge and expertise, but also social capital – the status, relationships, and prestige of their auditing careers. These resources are not trivial. Past research has found that the judgement of managers and partners alike can be jeopardized by any number of affinities between their firms: clients’ affiliation with audit firms, clients’ prior professional background, and clients’ social ties with the auditors.

It follows that ex-auditors who are hired as accountants in private companies can bias operational decisions in ways that impact on the audit engagement. And yet, a thorough understanding of how actively auditees influence this process is limited by the tendency of researchers and regulators to focus elsewhere. The current understanding of the relationship between auditors and clients is largely based on studies that focus on high-level negotiations between audit partners and executives with little attention paid to the negotiations taking place at street level. The influence of auditees on staff auditors’ work matters because if staff auditors do not collect the necessary inputs or make biased judgments, the information will not be documented in the audit file properly, and thus not reviewed by more experienced auditors.

In line with the mission of the CPA Centre Governance & Accountability to improve corporate governance, our study aims to capture the street-level view of the experiences and actions of the auditor-turned-auditee to assess their role in the audit engagement. We conducted interviews with 36 ex-auditors who, in their capacity as the chief accountants, controllers, or financial analysts in their accounting departments, acted as auditees—the primary contacts for junior and senior auditors on the field during audit engagements.

In discussing their past work in public accounting firms, their transition to private industry, their experiences with audit engagements, and their identities as CPAs, the auditees in our study demonstrated how they purposefully leverage the knowledge and social capital earned from their auditing tenures during an audit engagement. We find that auditees then use these resources to facilitate and influence the audit engagement through three distinct strategies.

The actions of the auditees in our study reveal a blind-spot in our understanding of auditees as active players in the audit engagement. They also highlight the regulatory

ambiguity of the actions of auditees, of which regulators and practitioners on both sides of the table should be aware.

## **Strategy 1: Setting the Ground**

### *How auditees can facilitate the engagement*

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#### *The Action: Filtering*

Auditees can exhibit influence before the audit engagement even takes place by filtering the information auditors see. Our participants felt empowered to control audit information by a sense of their own authority and knowledge advantage over the auditors in two domains. As internal actors in the client organization, auditees had a far better understanding of the business activities, operational realities, and risks than outsiders ever could. Furthermore, from a technical standpoint, they possessed a stronger command of the client's accounting information system and they knew the right internal people to ask for specific information.

From their past auditing experience, auditees also felt very confident in their technical comprehension of auditing processes. Some even said that their transition to private industry showed them how little ground-level auditors know. "I had more experience as an auditor than the senior in charge of the file. I understood better what I was talking about," one participant told us.

Auditees use this knowledge to be proactive, anticipate future issues, and engage with auditors prior to the audit engagement so as to avoid "highlights" or "surprises." In one example, an auditee explained, "Let's say we have a new type of transaction. We record it, and then, we send it to our auditors: 'This is what we did, this is the transaction, this is how we analysed it, and this is our conclusion. If you don't agree, tell me now. We will change it before the quarter end, and it won't even be noted as an unadjusted difference.'"

Another auditee told us, "I think we have a better understanding of auditors' work. We understand what they're trying to find. So, we build our files accordingly. Everything is already referenced, everything is ready for them when they arrive." Anticipating what the auditors will want in this way, they organize their documentation and supporting data in advance of the audit.

Being "proactive" and "transparent" is not just about improving the efficiency of the engagement and the relationship with the auditors. By anticipating as much as possible what auditors want to see in terms of documentation and the work that they will perform, auditees also inevitably direct the auditors' attention, limit their questions, and accelerate the process. One participant told us that a well-structured file reduces questions from auditors. Another discussed the economic benefits: "I prepare the files with all the back-up in the right order, well numbered, checked. We do the tests at the firm, the pricing tests, the sales tests, you know, it helps. All my tests and all the back-up are ready. So, they just have to verify them and flip the pages. Just doing that saves a lot of audit fees."

While facilitating auditors' lives, auditees also actively bias the engagement by betting on the fact that the auditors won't ask for more or different information than what their official protocols require them to do, thereby excluding potential accounting issues to be raised and discussed.

#### *The Action: Bonding*

Auditees also shape the engagement through their social connection to the audit team. Many auditees look forward to the audit as an opportunity to reconnect with their professional past. One participant said, "When I was an auditor, clients' controllers weren't always nice. They made life difficult for me. Rather the opposite, I know now that the annual audit is going to be my best two weeks of the year. I love it. It's really cool. I feel like I'm back with my buddies."

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What's more, auditees feel a strong sense of empathy and professional solidarity toward the auditors as part of this reconnection. They empathize with the time pressure auditors face, the informational disadvantage they have, and with the frustration they can experience if they have to wait for the client to deliver the right information. Remembering what it was like to be an auditor and to deal with a difficult or a disobliging client, auditees are willing to reciprocate clients' best practices now that they find themselves on the other side of the fence. This often manifests in friendly, respectful behavior during the audit engagement, as one auditee described:

"Collaboration matters because we work as a team. It's important for us to have good audited financial statements. We understand the auditors' work, we respect it. They help us a lot during the year when we face issues. So, when they arrive, we are always happy, it's relevant, it's straight to the point, it's not too long, they respect our deadlines. We maintain a good relationship."

Auditees' sense of affiliation leads to consequences in their own professional duties. Their feelings of solidarity for the auditors can blur their sense of organizational accountability as they are torn between their allegiance to their current employer and their social attachment to their former firm. For instance, one auditee described worrying about the consequences of his work as a client on his reputation at his former firm, even though he was no longer working there.

Another described how "one evening, I had to work late at the company. And three girls from the audit team also had to stay. They told me, 'Come with us. We'll have dinner and then we'll work separately.' It was OK but it was also weird being in the same room as the girls. Three months ago, I was still working with them. I was really trying to put some barriers in my mind, 'OK, now I am part of the company. I am no longer an auditor.'"

Specific accounts from participants of the socializing between auditees and auditors during the engagement illustrate how integrating and enacting various roles as friends, ex-colleagues, or auditees can create complex identity conflicts. Juggling with contradictory demands, auditees can be hesitant about which identity to mobilize and /or to compromise when acting with the auditors. The desire of auditees to help auditors can easily become a desire to please them at the expense of their professional duties.

## **Strategy 2: Training**

*How auditees can influence the engagement through knowledge transfer*

### *The Action: Teaching*

When the engagement begins and the interactions with auditors intensify, the auditees find themselves on the winning side of a knowledge gap. Their extensive technical knowledge of specific audit processes combined with their knowledge of the client put them into a "teaching" role between the client and audit team, as one auditee's experience shows:

"My boss is a CMA. It's a manufacturing company. Cost accounting is crucial. That's what interests him. He hates everything about financial accounting. That's why he wanted to hire a CA. He told me, 'I don't talk audits.' Sometimes, I have to translate what he wants me to say. You know, he wants to ask something to the auditors, but he doesn't use terms that we are used to as auditors."

Because systems, methods, and objectives can differ between firms, several participants specified that when the audit firm hired was their former firm, they were chosen over other colleagues to manage the engagement. But auditees' familiarity with auditors'

<sup>1</sup> CMA is the legacy designation in Canada for professional accountants specialized in management accounting.

<sup>2</sup> CA is the legacy designation in Canada for professionals who obtained their public accounting permit.

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specific practices and thinking is not just an asset for the client. It can also be valued and leveraged by the audit team who can delegate some of their standard tasks to auditees to reduce their work load.

One auditee told us, “[The auditors] wanted me to get involved as if I was the senior in charge of the file. In my head, I was like, ‘No, no, no. The line has to be drawn, I am the client now, so I do my job as a client. I am going to help you, I’ll give you the documents you want, but I won’t do the analyses for you! I won’t do the calculation for you!’ We fight with them every year because they try to give us more work, especially because we are alumni.”

At a more fundamental level, auditors begin to see the experienced auditees as sources of information and experiential knowledge that they can tap. Thus, auditees have no choice but to play a non-trivial role in auditors’ learning curve by addressing their questions and teaching them auditing procedures, and sometimes basic accounting notions, during the engagement. “A lot of times they ask you questions,” one auditee said. “These are not bad questions, but you can see pretty quickly that they don’t understand what they’re doing. Sometimes you have to explain to them why they are doing that procedure and what they should be looking for. You actually have to teach them.”

“Inevitably, I explain to them, I want them to understand,” one participant said of his tendency to teach the auditors. “But I don’t work for the firm. I work for my employer. We clear up a lot of things for them, but at the end of the day, they have to make it on their own.”

Ultimately, such a knowledge asymmetry between auditees and auditors raises the question of auditors’ independence and auditees’ organizational allegiance. In one regard, auditees’ familiarity with the auditing practice facilitates the communication with the audit team and the execution of their work. However, when auditors are literally being taught by the client, they are not only informationally dependent on the auditees, but intellectually dependent, making their mission to carry out audits independent of auditee behavior quite impossible.

On the other hand, auditees are also confronted with a certain dilemma about the nature and scope of their educational involvement. When do they start working for the auditing firm and stop working for their employer?

#### *The Action: Coaching*

Knowledge sharing from auditee to auditor can affect the audit engagement on a social bonding level when it evolves into a coaching-style relationship. Unlike teaching, coaching involves a more intense dialogue between the coach and the coachee during which the coach observes the coachee performing skills and offers hints and feedback. Several participants mentioned that they kept acting as coaches after leaving their firms.

“I’d like to keep playing the role I had within the firm, like I said, some kind of coaching,” one such participant said. “Even with the juniors from [name of old firm], I used to like telling them, you know, give them some tips, tell them, ‘OK but you’ve now asked me that question twice, three times, but if you go there, you’ll see it’s like much simpler.’ We become more efficient and effective that way.”

One participant who was in charge of the audit before joining the client, agreed with the partner that he would keep training the new senior replacing him on the file. By focusing on the improvement of the auditor’s professional skills, the auditee was acting much more as the auditor’s coach than as the client.

In some cases, the coaching relationship pre-dated the audit engagement to entrench the roles of coach and coachee. Another participant told us about his experience of being audited by two auditors whom he had coached when they were reporting to him at his former firm. “When they were not going in the right direction, I would say, ‘Don’t go there, you don’t need to go there, you’re wasting your time. You should proceed this way

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*"I already knew what position my former accounting firm had, and our way of thinking. I knew everything. I had all the cards in my hands. It's like if you are playing cards, but with everybody showing their hand"*

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instead," he said. Because he personally knew the auditors, what they were looking for, and what they were doing, he felt he was helping to make the audit "more efficient."

Auditees' coaching was not sub-conscious but a proactive use of their knowledge and social status as experienced auditors. They felt almost personally responsible for anticipating issues for the auditors and detecting deficient reasoning in order to offer appropriate guidance. One participant said, "I realize that I have a strong tendency to want to do the work for them. I have a strong desire to train them. There is even one [auditor] that came to see me [and said], 'Listen, I am not one hundred percent sure. Why am I doing this test?'"

As with bonding, coaching can blur the lines between the identities assumed by the auditees and auditors and open the door for either party to bias the audit.

### **Strategy 3: Regulating**

*How auditees can influence the engagement by controlling the process*

#### *The Action: Questioning*

Sometimes auditees find that their calculated efforts to direct auditors' attention and to train them in their own way are not sufficient to control the engagement. When the knowledge gaps stopped being useful, our participants' mindsets became more confrontational. They had to be more persuasive in demonstrating the rightness of their opinion and this usually manifested in auditees questioning the decisions or methods of the auditors.

One auditee said because of her audit experience, "I am less inclined to answer all their requests immediately and do what they want me to do. If they come to us with requests that make no sense, I might just say, 'Here is the information that you have in hand already, if you do this procedure instead, it would give you the exact same result but you would save time. And I would also save time.'"

Another told us, "We have vigorous discussions on accounting treatments, especially when auditors ask us to do things that are irrelevant and way too time-consuming for us, and when they should use other procedures instead to verify something which is not necessarily risky. For example, the way we bill our clients here is very simple. We make one invoice per week and per client. Their audit procedures and their audit strategy get them to test 100% of our revenues. But you have to use your judgment at some point!"

They are empowered to question auditors by their own knowledge of the audit process. As one participant explained, her colleagues who did not have experience as auditors "don't know that they can say 'No' to the auditors or 'Why don't you do it that way instead?'"

In addition to challenging procedures, auditees' comprehension of the clients' business and auditing methods allows them to express skepticism and dispute the auditors' assessments. For instance, two participants described an episode where they managed to find the right argument to convince the auditors to change their calculations and projections of an accounting misstatement.

Of course, auditees don't necessarily always win their arguments. But understanding what both parties need and how both parties think can still constitute quite a competitive edge, as one participant's experience shows. "I already knew the file, so it helps. I already knew the positions," he said. "Because often auditors don't say what they think to clients, you know. I already knew what position [my former accounting firm] had, and our way of thinking. I knew how [my previous boss] thought. So, I was able to deal with this. I knew everything. I had all the cards in my hands. It's like if you are playing cards, but with everybody showing their hand."

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*The status that auditees attain from hierarchical positions in their previous firms follows them into their new position*

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#### *The Action: Monitoring*

Auditees can also use their social capital in a very different way to monitor and discipline auditors' professional conduct. Although generally supportive of auditors and willing to help, auditees' expectations are also relatively high in terms of professional attitudes. Having worked for an accounting firm, they have a pretty clear understanding of the limits between acceptable and unacceptable behaviors. "We don't hear anything for a week and bang! They come back to us and they keep asking questions. This is a nightmare. You follow up on the file, you agree that everything is fine, and they come back with issues that you thought were resolved," one auditee explained.

The disappointment or irritation they feel regarding auditors' breach of conduct can be all the more significant when they keep identifying themselves with the profession. Auditors' misconduct reflects on the entire professional community, including themselves. As one auditee said, "We give documents to auditors in a certain order, and when they give them back to us it's a mess! They leave trash in the room. They are too familiar. I know I have high expectations, but these are the basics. You remove your post-its, you don't put pencil marks on originals."

Not only did our participants expect the same standard of professionalism as what they used to experience as auditors, but they also reasoned from the clients' perspective, which was aimed at saving time and costs. As a result, auditees appear to be quite good at tracking and reporting auditors' lack of productivity. As one participant said, "That's it, they don't really have excuses. We know how it works. We do follow-ups almost every day with the senior. We want to know where they are at, what's missing, what we can do on our side to help. At this stage, we know what they have to do and we know what they have in hand."

Because of their background in auditing, their experience at the client's company, and more generally their social seniority, most of our participants displayed a sense of intellectual and professional superiority when recounting how they tend to challenge auditors' professional judgments. When auditors "make requests that don't make any sense" or "don't want to adjust their audit procedures to the company's reality," auditees don't waste their time. Our participants quickly ask to discuss the matter with someone higher up in the hierarchy. Several of them described a scenario like this one:

"When a junior auditor comes to see me and asks for something stupid, I will tell him, 'Listen, I don't think you need this. I think you'd be better off with this instead. Go talk to your manager and come back to see me. If your manager wants something else, tell him to call me.' The manager actually called me and he apologized."

Auditees tend to see themselves in a peer-to-peer relationship only with managers, while giving little consideration to the arguments of lower-level auditors. The status that auditees attain from hierarchical positions in their previous firms follows them into their new position.

### **Toward greater auditor independence**

By shifting the focus from the auditors' attitudes and behaviors to the auditees' actions, we can see more clearly the role of auditees in actively affecting auditor independence. Arguably, the impacts of auditees with auditing experience on auditors completely escape the current regulatory macro-structure aimed at protecting auditor independence. From that perspective, our study raises regulatory concerns about the lack of guidance regarding auditees' behaviors during audit engagements.

In response, we propose that accounting firms develop their own methodologies for addressing this dynamic on their audit teams. Although more research is needed to understand the best forms of training that can mitigate undue influence on the audit engagement, creating awareness about the micro-strategies in play (filtering, bonding, teaching, coaching, questioning, and monitoring) is a first step. Accounting firms would

do well to revisit and enhance their practical training and mentorship programs that their auditors will be less dependent on, and vulnerable to, the input of experienced auditees during the engagement. More experienced auditors could also be interacting with auditees to a greater extent on these engagements, therefore reducing staff auditors' inquiries. Furthermore, auditors could seek to diversify the sources of information by mobilizing other employees in accounting departments, who may not possess the same level of auditing knowledge than former auditors. Distributing responsibilities and limiting junior auditors' interactions could reduce auditees' influence on audit engagements.

Overall, the experiences of the auditees in our investigation paint a rich picture of the audit engagement and the complexity of the interaction between auditors and clients when they share a certain level of knowledge and professional symmetry. The micro-strategies they employed defy overly simplistic characterizations of auditees' motivations and objectives, and open the door to questions about how we manage the intellectual experience of the audit engagement toward higher degrees of auditor independence and audit quality.

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The CPA Centre for Governance & Accountability is an initiative funded by Chartered Professional Accountants of Ontario. The goal is to improve corporate governance in Canada through a variety of research and teaching programs. The Centre is the first in Canada to have as its primary mission, research in the area of governance.



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