

THE MORALITY OF LAW IN AUDITING

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Abstract

The aim of the present research is to emphasise the boundaries of law in the absence of morality especially in the field of auditing. In ordinary speech, the word law is contrasted with even so close a cousin as the word justice. We are used to thinking of justice as something that can be hard to define; we do not delight in the open admission that its boundaries may be shadowy and uncertain. The word law, on the other hand, contains a built-in bias toward black and white.

By using a hand-collected data on the framework of the increased number of financial crimes in auditing and by questioning an amount of 80 professionals from the Chamber of Financial Auditors from Romania (CAFR), I provide evidence about the limited effects of the legislation and that the laws should have the basis in morality, in the consciousness of the human beings. Overall, this research documents that the legislative framework is not enough to fade the number of financial crimes in auditing.

Keywords: justice, law, auditing, morality, financial crimes.

1. Introduction

Over the last decade, the quality of audit services has been debated due to the high number of economic frauds. The discrepancy behind the unsmoothed legislation related to the national oversight systems depresses the appearance of an increased number of ethical dilemmas. The lack of supra-national efforts of achieving harmonisation obliges the Committee of European Auditing Oversight Bodies (CEAOB) to sustain the minimum requirements through the European Directive 2014/56/EU and the Regulation 537/2014. The national laws mandate specific EU settings but also allow a considerable liveness in their implementation. No more minimum requirements through national laws which should augment the transparent vision about the auditing mission.

If we could come to accept what might broadly be called an interactional view of law, many things would become clear that are now obscured by the prevailing conception of law as a one-way projection of authority. It would become clear, for example, that a failure to observe the principles of legality may harm the institution of law itself, even if no immediate harm is done to any individual. This point, along with others, is ignored in a rhetorical question posed by Dworkin in rejecting my suggestion that legal morality embraces a principle against contradictory laws: "A legislature adopts a statute with an overlooked inconsistency so fundamental that it makes status a goal. form. Where is the immorality or decay of the moral ideal"¹.

In the following section, I provide a consistent overview of the legal institutional setting in auditing and the relevant literature. In Section 3, I analyse the effect of the limited requirements of POB national laws at the EU level and I emphasise the empirical findings. Section 4 presents the conclusions and the personal interpretations.

2. Literature review

The implementation of the inspections program by POBs represents the key reform which has improved the relationship between financial audit under ISA and financial reporting under IFRS. There are also critics who are questioned the expertise and the adequacy of inspections by POBs². Despite all the discussions, the introduction of POB is one of the main reforms aimed at improving audit quality. Concerning the impact of PCAOB, the emerging literature³ argues that its effect on audit quality remains a consistent empirical question. Most specialised studies that analyse the effects of POB inspections focus on the US PCAOB authority. Lamoreux

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¹ I. K. Khurana, N.G. Lundstrom, K.K. Raman, *PCAOB inspections and the differential audit quality effect for Big 4 and non-Big 4 US auditors*, Contemporary accounting research, 38(1), 2021, p. 376-411.

² C. Lennox, J. Pittman, *Auditing the auditors: Evidence on the recent reforms to the external monitoring of audit firms*, Journal of Accounting and Economics, 49(1-2), 2010, p. 84-103; M.L. DeFond, C.W. Park, *The reversal of abnormal accruals and the market valuation of earnings surprises*, The accounting review, 76(3), 2001, p. 375-404; B.K. Church, L.B. Shefchik, *PCAOB inspections and large accounting firms*, Accounting Horizons, 26(1), 2012, p. 43-63; M. E. Peecher, I. Solomon, K.T. Trotman, *An accountability framework for financial statement auditors and related research questions*, Accounting, Organizations and Society, 38(8), 2013, p. 596-620.

³ D. Aobdia, N. Shroff, *Regulatory oversight and auditor market share*, Journal of Accounting and Economics, 63(2), 2017, p. 262-287; T.L. Johnson, E.C. So, *A simple multimarket measure of information asymmetry*, Management Science, 64(3), 2018, p. 1055-1080.

shows the direct effects of PCAOB inspectors of the US companies on audit quality as measured by less earnings management and more reported material weaknesses with higher predilection to issue going concern overview. There is little evidence on the impact of POBs on audit quality, regarding the European countries. As an example, Carson⁴ find a positive effect of POBs' inspections on the quality of auditing. However, there is no systematic documentation concerning the effect of inspections commence, inspection characteristics and disclosing the results of national inspections.

Despite the real benefits of POBs, the public oversight of the auditing profession is still the subject of scepticism⁵ for the limited expertise and insufficient transparency of procedures⁶. More, the inspection program is claimed being largely ineffective⁷ and non-representative for the entire client portfolio⁸. Certainly, the uncontested advantages of public oversight argue the further academic research on this subject. Early studies ensure descriptive evidence on the effects of PCAOB inspections and audit quality. Lamoreaux argues the positive association between PCAOB inspections and audit quality, measured by less earnings management and more reported material weaknesses. Specialised literature⁹ attest the previous findings related to the association between PCAOB inspections and audit quality.

Concerning the public oversight of the European countries, there is very little written about the effect of POBs on audit quality. Some exceptions¹⁰ documents the public oversight of the audit regulation in the context of audit quality and auditor independence. In the same context, they document about the number and frequency of inspections by POBs influence the inspection feedback of the analysed auditors. Florou and Shuai¹¹ find that the audit costs grow for clients of inspected auditors if the national inspections are independent, rigorous and complex.

A written constitution may provide that no law shall become law until it has been given some form of publication. It might be supposed that the principle of condemning retroactive laws could also very easily be formalised into a simple rule that no such law should ever be enacted, or should be valid if enacted. Such a rule would, however, be frustrated by legality. Curiosity, one of the most obvious requirements of legality - that a rule passed today should govern what happens tomorrow, not what happened yesterday - turns out to present some of the most difficult problems of all the internal morality of law. As for the requirements of legality other than promulgation, then the most we can expect from constitutions and courts is that they will rescue us from the abyss; they cannot be expected to lay down very many binding steps to a truly meaningful achievement. Most theories of law either explicitly state or tacitly assume that a distinction of law consists in the use of coercive force. A social norm is legal if its neglect or violation is regularly carried out, in threat or in fact, by the application of physical force by an individual or group who has the socially recognized privilege to act in this way.

In a society of angels there would be no need for law. But it depends on the angels. If angels can live together and perform their good deeds without any rule, then of course they need no law. Nor would they need law if the rules by which they acted were tacit, informal, and intuitively perceived. But if, in order to perform their heavenly functions effectively, angels need "made" rules, rules brought into being by some explicit decision, then they need law, as law is viewed in these essays¹².

The 1933 Congressional testimony of Colonel Carter on the proposed legislation (the Securities Act) may give us some incentives about the human subjectivity in the legislative interpretation. The transcript of the

⁴ E. Carson, R. Simnett, U. Thuerheimer, A. Vanstraelen, *The effect of national inspection regimes on audit quality*, 2017, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3049828.

⁵ K. D. Westermann, J. Cohen, G. Trompeter, *PCAOB inspections: Public accounting firms on trial*, *Contemporary Accounting Research*, 36(2), 2019, p. 694-731.

⁶ S.M. Glover, D.F. Prawitt, M.H. Taylor, *Audit standard setting and inspection for US public companies: A critical assessment and recommendations for fundamental change*, *Accounting Horizons*, 23(2), 2009, p. 221-237.

⁷ D.W. Johnson, R.T. Johnson, *Cooperative learning and social interdependence theory*, *Theory and research on small groups*, Springer, Boston, MA, 2002, p. 9-35.

⁸ M.L. de Fond, *Earnings quality research: Advances, challenges and future research*, *Journal of Accounting and Economics*, 50(2), 2010, p. 402-409.

⁹ R. Ball, L. Shivakumar, *Earnings quality in UK private firms: comparative loss recognition timeliness*, *Journal of accounting and economics*, 39(1), 2005, p. 83-128; R. Ball, A. Robin, J. Wu, *Incentives versus standards: properties of accounting income in four East Asian countries*, *Journal of Accounting and Economics*, 36(1), 2003, p. 235-270; D. Burgstahler, I. Dichev, *Earnings management to avoid earnings decreases and losses*, *Journal of accounting and economics*, 24(1), 1997, p. 99-126; V. Capkun, D. Collins, T. Jeanjean, *The effect of IAS/IFRS adoption on earnings management (smoothing): A closer look at competing explanations*, *Journal of Accounting and Public Policy*, 35(4), 2016, p. 352-394.

¹⁰ C. de Fuentes, R. Porcuna, *Predicting audit failure: evidence from auditing enforcement releases*, *Spanish Journal of Finance and Accounting*, 48(3), 2019, p. 274-305.

¹¹ A. Florou, Y. Shuai, *The costs of public audit oversight: Evidence from the EU*, 2020, <https://ssrn.com/abstract=3595454> or <http://dx.doi.org/10.2139/ssrn.3595454>.

¹² M. Tache, M., *Auditing the auditors through POB inspections*, ASE Publishing House, 2023; M. Tache, *Ethical dilemmas between the moral and the legal or The art of being moral in auditing*, ASE Publishing House, 2024.

dialogue between Colonel Carter and the Senator Barkley was reread in the AAA (American Accounting Association) on the Annual Meeting on the 14th August, 1996:

Senator Barkley: Is there any relationship between your [...] and the organisation of the controllers here yesterday [...] ?

Colonel Carter: Not at all. We audit the controllers.

Senator Barkley: You audit the controllers?

Colonel Carter: Yes; the public accountant audits the accounts.

Senator Barkley: Who audits you?

Colonel Carter: Our conscience.

Senator Barkley: I am wondering whether after all a controller is not for all practical purposes the same as an auditor, and must he not know something about auditing?

Colonel Carter: He is in the employ of the company. He is to the orders of his superiors.

Senator Barkley: I understand. But he has got to know about auditing?

Colonel Carter: Yes.

Senator Barkley: Has he got to know something about bookkeeping?

Colonel Carter: But he is not independent.

3. Research analysis and findings

With the help of CAFR, this questionnaire was completed by 80 auditors, starting from September 2023 and managing to collect the answers at the end of the previous year. Therefore, even if the total number of auditors questioned is not surprisingly high, we consider that the answers received, which we will nuance at the level of the next subchapter, are feasible and confirm the qualitative research developed at the level of the first chapter related to this research paper. In this case, we affirm that this study is an exploratory research at this moment.

Even though this questionnaire was designed in such a way that the respondents feel comfortable when they have to share with us some sensitive data about ethics and morals in the field of auditing, the low number of responses received even when maximum anonymity was ensured can be observed. From the results collected, with the help of Google Forms, we noticed that, for the first seven general questions, the information that is the majority is:

- the average age of the respondents is between 30 and 60 years (66.3%);
- most respondents are female (55%);
- the profession targeted by the majority is that of auditor (93.8%);
- the position of the majority of the respondents is management (81.3%);
- the average monthly net income is between 5,000 and 10,000 lei (48.8%) respectively >10,000 lei (41.3%);
- the last form of education completed in the majority is the master's degree (48.8%).

The question *Would an ethicist/moralist profession be useful as a guarantor in compliance with the Code of Ethics, within audit services?*, had the role of observing the auditors' awareness of the existence of a guarantor in compliance with the Code of ethics. Figure 1 shows that although the majority of respondents (53.8%) consider it necessary to implement a new ethicist/moralist profession regarding compliance with the Code of Ethics, the opponents' responses seem to persist vehemently (46.3%).

Figure 1. Q.1

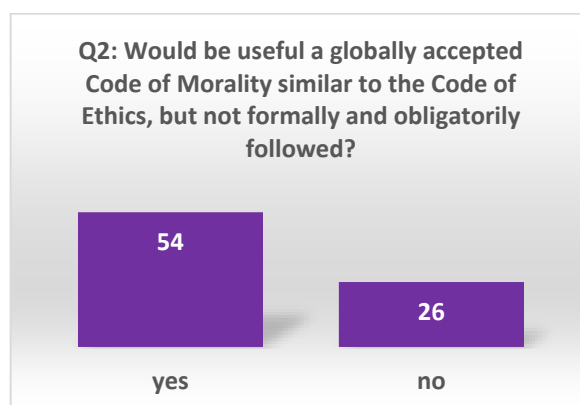


Source: Tache, 2024

Figure 2 shows that the majority (67.5%) believe that the provisions related to the Code of Ethics are

respected out of obligation and at the formal level. Thus, a number of 54 auditors out of the total number of 80 agree with the implementation by law of a globally accepted Code of Morals, similar to the Code of Ethics.

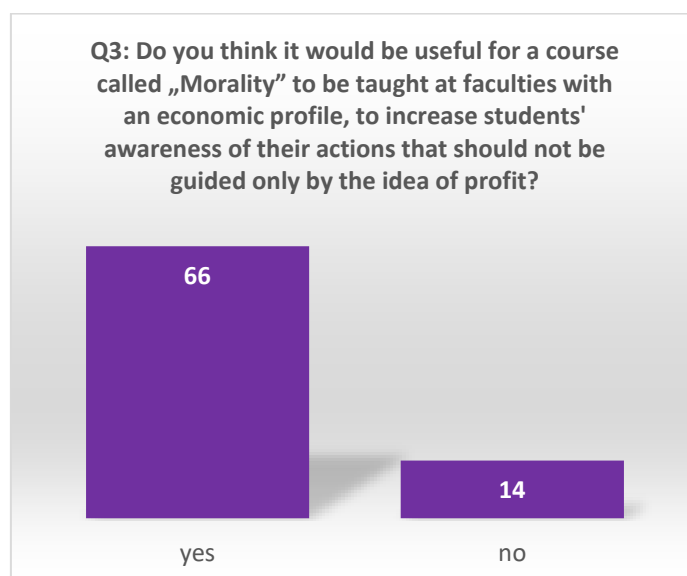
Figure 2. Q.2



Source: Tache, 2024

Figure 3 points out that a majority of 82.5% of the total auditors surveyed believe that, in addition to the central idea of profit, including knowledge of morality, students should be taught.

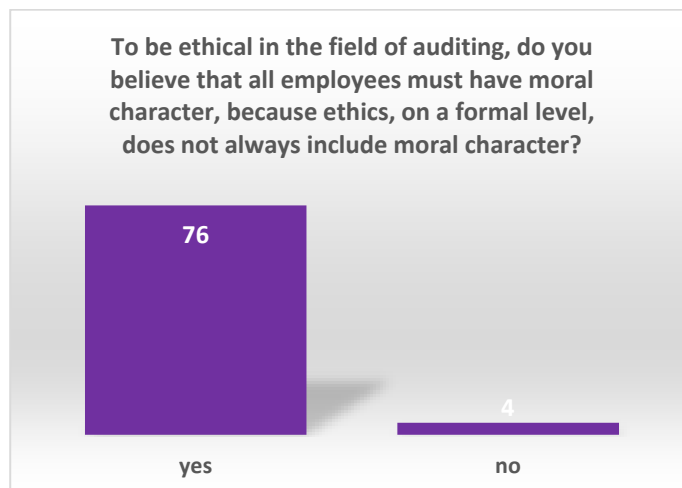
Figure 3. Q.3



Source: Tache, 2024

Figure 4 shows us that 76 of the 80 auditors who responded to our questions agree that, at a formal level, ethics does not always include a moral character of the auditor. Therefore, the second research hypothesis is validated through the four questions detailed above.

Figure 4. Q.4



Source: Tache, 2024

We can see that the professionals questioned are aware of the fact that the issues encountered in the field of auditing cannot be resolved only at the form-ethics level, which is found at the level of the Code of ethics and various other documents, but the moral background is also necessary, which is found in the conscience of each individual.

4. Conclusions

The lack of standardised reports by POBs leads to a deficiency of information across countries. Moreover, the harmonisation of the annual reports by POBs represents the main clue in comparing the results of national inspections across different oversight bodies. Overall, the scope of national inspections appears to be unaccomplished in some countries due to the unstandardized annual reports by POBs.

The bounded legal part of auditing should be diminished due to (i) the harmonisation of the minimum requirements of national laws through the disclosure of the POBs' annual activity and their inspections' results and, and (ii) augmenting the mission of CEOAB through the periodic and mandatory review of POBs annual activities.

Perhaps we should not overlook the conclusion that morality should become a mandatory discipline at universities with an economic profile, in order to be able to edify the ethical dilemmas that seem endless including in scientific research. The saying inscribed on the frontispiece of the temple at Delphi *Know thyself* is perhaps the best solution for solving ethical dilemmas at the individual level.

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