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HOW DO AUDITORS FOLLOW RULES?

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Abstract:

Motivated by concerns about whether rules and regulations capture the rich complexity of auditing and auditors follow rules and regulations to the extent of compromising judgment, this paper provides a synthesis of the literature in the field of auditing and psychology to better understand how auditors follow rules in exercising judgment. Five testable propositions are derived. A model of rules compliance is also developed to better understand auditors' practices and performance. The model sheds light on how auditors comply or conform to rules given the nature of audit tasks, ranging from well-structured to ill-structured. While the model is developed in the context of audit judgment, the model is also applicable in other similar judgmental settings with a range of well and ill-structured tasks. The propositions and model developed in this study serve as a platform for future empirical research in auditing as well as other similar domains of expertise.

Keywords:

Rules Compliance, Rules Conformance, Audit Judgment, Structured Tasks, Ill-Structured Tasks

Introduction

Rules ensure "global order in the modern world"; rules facilitate "co-ordination and co-operation on a global scale" and are considered "instruments of control" (Brunsson and Jacobsson, 2000, p. 1). A survey that involves 688 organizations revealed that majority have formalized rules and procedures: 80 percent have procedure manuals, 78 percent have rules related to fringe benefits, 74 percent have written job descriptions, 74 percent have rules on safety and hygiene, 67 percent have hiring and firing procedures, and 67 percent have rules on personnel evaluations (Marsden et al., 1994).

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More formalized rules and procedures are in place to govern highly regulated professional practices in disciplines like auditing, law and medicine. The auditing profession has been criticized for being overwhelmed by formalized rules and procedures to the extent of jeopardizing auditing as a hermeneutical practice where auditors may lose their capacity for critical reasoning (Francis, 1994). Empirical findings also suggest auditors' lack of critical thinking and deficiencies in audit work especially when complex accounting estimates are involved (Bucaro, 2019; Glover et al., forth. Accounting standard setters and regulators are concerned that auditors follow rules to the extent of becoming reluctant to exercise judgment (Millman, 2005; FASB, 2004; Weil, 2002). Rules and procedures bring about global order, coordination and cooperation, while promoting legitimacy and control, but inadvertently breed complacency and reduced vigilance due to the less need for informed intelligence and judgment (Weil, 2002), which can erode auditors' expertise in exercising professional judgment.

Whether auditors follow rules and procedures to the extent of compromising audit judgment is indeterminate as extant literature provides mixed evidence. On one hand, auditors have been found to follow audit procedures that have been routinized in the past too strictly to the extent of compromising their performance in detecting fraud (Glover et al., 2003; Zimbelman, 1997). On the other hand, auditors have also been found to be capable of arriving at a judgment through interactions with members of the audit team, rather than based on effortful and systematic search and analyses of audit evidence as per formalized rules and procedures (Pentland, 1993). Auditors even manage to incorporate unrecorded audit evidence into their judgment (Grout et al., 1994). There are also concerns about auditors' manipulation of rules to exercise judgment biased towards audit clients' demands (Moore et al., 2006; Moore and Loewenstein, 2004; Bazerman et al., 2002).

Various audit methodologies and decision aids—such as big data and audit analytics, audit risk model and fraud risk assessment—have been introduced over the years to facilitate audit judgment, but each has been found to have its respective limitations and does not necessarily enable auditors to make better decisions (e.g. Moffitt et al., 2018; Brown-Liburd et al., 2015; Curtis and Turley, 2007; Knechel, 2006; Houston et al, 1999; Zimbelman, 1997). Studies investigating the effects of regulatory reforms have similar findings where deemed better rules, regulations and standards do not necessarily ensure improved financial reporting quality (e.g. Agoglia et al., 2011; Chen and Zhang, 2010; Jamal and Tan, 2010). Auditing is a complex process that varies across clients, business environment and jurisdictions, which makes it challenging for auditors to maintain and improve their judgment performance (DeFond and Zhang, 2014; Knechel et al., 2013). Much is to be learned about how auditors apply rules and procedures to facilitate judgment.

Brunsson and Jacobson (2000) share a similar view where the influence of rules in the society, though important, is a much neglected and under-researched area in social science. Rules and procedures have a history as a double-edged sword. Rules and procedures provide guidance, clarify responsibilities and reduce role stress, but at the same time can stifle creativity, foster dissatisfaction and demotivate employees (Adler and Borys, 1996). Even within the same organization, the same set of rules and procedures can have different effects on different individuals performing different tasks; for example, while scientists and engineers dislike being overwhelmed by formalized rules and procedures, they welcome rules and procedures that facilitate more routine parts of their tasks, which enhance their effectiveness and self-efficacy

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(Bandura, 1977). Much is still to be learned about how one can capitalize on the benefits of rules and procedures despite their shortcomings.

This study examines how rules and procedures are applied in a judgmental context like auditing from the psychology perspective. Audit judgment provides a rich setting to better understand the influence of rules. Formalized rules and procedures predominate in the auditing environment due to the increasing demand for legitimate and transparent forms of standardized audit practice for control purposes (Power, 2003). Drawing on prior auditing and psychology research on human cognition, five propositions and a model are developed to provide insights into how auditors follow rules and procedures.

The remainder of this paper is organized as follows. The second section discusses the benefits of rules. The third section discusses the feasibility to strictly follow rules. The four section discusses the extent to which auditors follow rules. The fifth section develops a model to explain how auditors follow rules. The final section summarizes and concludes the discussions. (TNR, 12, single spacing, justify)

The Benefits of Rules

Codification of what skilled auditors know to serve as rules in the form of manuals, training courses, standardized audit techniques and decision aids is not uncommon and practiced not only in audit firms. As rules promote coordination and coherence of practices, empirical evidence suggests that codification of knowledge to serve as rules brings about several benefits ranging from greater judgment consensus in audit reports, greater control over audit team members, less role stress and role conflict, to greater leverage of expertise through deployment of inexperienced audit staff, and greater cost-savings as an audit firm can be formed with only a handful of experts (e.g. Burns and Scapens, 2000; Morris and Empson, 1998; Dirsmith and Haskins, 1991). In short, the practice of having formalized rules and procedures in place has gained widespread acceptance not only in the auditing profession. Having formalized rules and procedures in place has become an institutionalized business practice.

Auditors are expected to comply with various explicit and implicit rules pertaining to not only their day-to-day audit tasks, but also to their attire, social demeanor and even choice of lunch, which constitute part of the professional code of conduct (DeFond and Zhang, 2014; Spence and Carter, 2014; Power, 2003; Pentland, 1993). In addition to promoting legitimacy, formalized audit practices also serve as a platform for marketing audit services as more than mere credibility assessment but also for business advisory and risk management. Auditing is a business. Formalized audit practices facilitate a more cost as well as revenue effective way of doing audit.

Evidence of auditors' desire for rules and standardized practices is traceable in both academic as well as practitioners' literature even back to the 1970s. In the absence of formalized audit rules and procedures, past audit practices serve as a substitute. For instance, Tipgos (1978) lamented that auditors rely heavily on prior years' working papers in audit planning, to the extent of either limiting the scope of audit to that of prior years' or doing a little more. Similarly, Fischer (1996) provided evidence of auditors' adherence to past audit approaches to the extent of becoming reluctant to adopt new audit technologies and better audit approaches.

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While formalized audit rules and procedures provide structure, facilitate automation of certain audit procedures and promote legitimacy via transparent, standardized audit practices, improved quality of auditing services does not necessarily follow (e.g. Moffitt et al., 2018; Brown-Liburd et al., 2015; Manson, 2001; Pincus, 1989; Johnson and Kaplan, 1996). Auditors face a tradeoff between the need to reduce audit costs versus enhance the quality of auditing services (Fischer, 1996). Between cost reduction and quality enhancement, quality enhancement is at the losing end for two major reasons. First, the debate on what constitutes audit quality is still unresolved (see DeFond and Zhang, 2014; Knechel et al., 2013). Audit quality is subjective, intangible and cannot be directly observed and therefore measured. Hence, audit quality is a matter of perception (Knechel et al., 2013; Power, 2003; Pentland, 1993). Second, cost reduction is more tangible and more attainable by following established rules and procedures.

The ambiguity surrounding what constitutes audit quality has made the institutionalized principle of having formalized rules and procedures in place even more important. Difficulties in observing and measuring audit quality have diverted attention to the audit process (Power, 2003). Formalized audit rules that enable automation of audit procedures—via big data and audit analytics, robotic audit automation, statistical sampling—project an image of audit efficiency and effectiveness (Moffitt et al., 2018; Brown-Liburd et al., 2015; Power, 2003; Manson, 2001; Power, 1995; Carpenter and Dirsmith, 1993). Informal rules and procedures that are typical in big audit firms, such as long working hours with short breaks, the discipline of charging for time and dress codes, project an image of diligence and professionalism (DeFond and Zhang, 2014; Spence and Carter, 2014; Power, 2003; Pentland, 1993).

The first proposition is as follows.

> Proposition 1: Formal and informal rules portray an image of professionalism and competence in audit work.

Besides portraying an image of professionalism and competence, rules and procedures facilitate top-down control over audit team members in two major ways. First, rules and procedures, both formal and informal, motivate less experienced auditors to perform better due to increased understanding on performance expectations and how to perform tasks assigned (Miller et al., 2006). Indeed, less experienced auditors demand for established rules and procedures (Knechel, 2006). Second, working papers prepared in accordance with standardized format and content promotes familiarity and therefore facilitates review from the top (Rich et al., 1997a).

Tasks that are routine and predictable in form and content across client firms where the most efficient and effective ways of completing such tasks are already identified and prescribed in the form of formalized rules and procedures are excellent candidates for automation (e.g. Moffitt et al., 2018). Conventional wisdom suggests that conscious deliberation based on a set of predetermined standards enhances efficiency and effectiveness (e.g. Dijksterhuis et al., 2009; Dijksterhuis et al., 2006; Dijksterhuis and van Olden, 2006; Agor, 1989). Even in the context of purchasing a painting at an art auction for instance, Dijksterhuis and van Olden (2006) explained that people tend to think thoroughly what they like and dislike, and if possible, use a balance sheet to systematically assign each painting pluses and minuses for different attributes with the belief that a such a strategy leads to a wiser decision.

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The second proposition is as follows.

> Proposition 2: Formal and informal rules provide structure to facilitate coordination, control and automation of routine audit tasks for better efficiency and effectiveness.

While auditors are expected to comply with formalized rules and procedures in line with conventional wisdom, auditors are also expected to provide evidence of compliance through the production of working papers, which is particularly important in the event of litigations (Power, 2003). Any deviation from formalized rules and procedures, even in terms of cosmetic standards for working paper formats, can be used by plaintiff attorneys against auditors in a court of law as evidence of negligence (Rich et al., 1997a).

The third proposition is as follows.

> Proposition 3: Formal and informal rules enable auditors to defend that their duties have been performed in a competent and professional manner, particularly in the event of litigations.

The Feasibility to Strictly Follow Rules

Judgment is inevitable in auditing. Accounting numbers and standards are subject to a myriad of interpretations (Lau, 2008; Bazerman et al., 2002). Auditors are merely in a position to provide reasonable assurance—not absolute assurance—on whether financial statements are fairly presented. Audit report merely conveys an opinion, which is judgmental. An audit opinion is a conclusion made based on arguments contained in audit files and is subject to the limitations of accounting and auditing standards in providing measurements of wealth and income reported in the audited financial statements (DeFond and Zhang, 2014; Smieliauskas et al., 2008).

While formalized rules and procedures provides structure, enables automation and facilitate control and coordination particularly over performance of more routine, structured tasks delegated to junior members in the audit team, such rules and procedures are insufficient to accommodate for the rich complexity of auditing for two major reasons. First, formalized rules and procedures are incomplete. Some kinds of knowledge, i.e. tacit knowledge, are not easily articulated and thus not laid down as rules and procedures (Brunsson and Jacobsson, 2000). Further, certain audit tasks, such as fraud detection, occur infrequently and tend to be variable in their form and content, which constrain development of the knowledge required to perform such tasks in the first place (Johnson et. al, 1993), let alone development of formalized rules and procedures. Second, formalized rules and procedures are developed more at a distance (Brunsson and Jacobsson, 2000) and may not be suitable to audit tasks at hand.

In summary, it is challenging, if not impossible, for formalized rules and procedures to comprehensively capture the rich complexity of auditing. Though believed to be able to achieve economies of scale, robotic audit automation is only applicable to predictable and recurring tasks where rules can be clearly defined (Moffitt et al., 2018). Robots need precise instructions, but it is impossible to develop precise instructions for the entire audit process. Similarly, the traditional audit risk model has been criticized for being simplistic and inadequate as each audit engagement is unique (Houston's et al., 1999; Francis, 1994). Hence, the very nature of

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auditing is not conducive for auditors to strictly follow rules and refrain from exercising judgment altogether.

The discussion in this section yields the fourth proposition, as follows.

> Proposition 4: It is not feasible for auditors to strictly follow rules and refrain from exercising judgment, especially when coping with the complex and ill-structured nature of auditing.

The Extent to Which Auditors Follow Rules

Being well-versed in the accounting standards, rules and regulations is important to complete the routine, technical part of the audit process, which every beginner in the auditing profession aspires to master. However, such technical competence only allows auditors to progress up to the director level but not the partner level (Spence and Carter, 2014; Carter and Spencer, 2014). Partners lead the audit team, make the ultimate decision and sign the audit report. More experienced partners are found to be associated with improved audit quality and garnered a premium audit fee (Cahan and Sun, 2015). Yet, partners, who were once technically competent with the accounting standards, rules and regulations in the earlier part of their career, admitted being reliant on their subordinates for technical advice to minimize legal risks (Spence and Carter, 2014; Carter and Spencer, 2014). How do partners arrive at a judgment?

Early studies suggest that auditors at all levels use emotional language to describe how they work and spend substantial amount of time interacting with members of the audit team rather than reading working papers or searching dispassionately for audit evidence (Pentland, 1993). According to Dane and Pratt (2007), it is the very nature of intuitive judgment to be made in a non-conscious, automatic, rapid and effortless manner, rather than based on conscious and thorough analyses of information. Yet, judgment is reached with a feeling of certitude. While auditors are not strict followers of formalized rules and procedures who make judgment based on conscious evaluation of audit evidence, auditors are found to be comfortable with the numbers (Pentland, 1993), which is consistent to what Hayashi (2001, p. 60) called a "feeling of knowing", i.e. feeling of certitude. In essence, auditors are certain and confident with their judgment, which suggests that judgment is not made in a haphazard manner despite the lack of systematic, step-by-step analyses of working papers, but has a firm basis though not readily accessible to auditors' conscious mind, i.e. tacit knowledge.

Further, auditors have been claimed to be able to take into consideration unrecorded audit evidence (Grout et al., 1994), which reflects the all-encompassing, holistic nature of unconscious processing; all pertinent audit evidence regardless of whether they are formally recorded are taken into consideration. Being able to account for unrecorded audit evidence indicates that audit judgment is, again, not based on conscious, step-by-step deliberation and analyses of working papers; unrecorded audit evidence is not in the working papers in the first place. Auditors have also been claimed to rely less on written communications, but more on verbal communications and therefore decreases working-paper details (Rich et al., 1997a). The trend towards more verbal communications and less written communications as well as decreased working-paper details further makes conscious deliberation and thorough analyses of working papers less feasible. Indeed, conscious and deliberate adherence to rules and procedures to search and account for audit evidence impede intuitive judgment, which is most effective when made in a non-conscious and rapid manner (Dane and Pratt, 2007). In the

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domain of psychology, the non-conscious, rapid nature of intuitive judgment has been found to be superior in processing and integrating information in a holistic manner, particularly when the capacity of unconscious processing is virtually unlimited (Dijksterhuis et al., 2009; Dijksterhuis et al., 2006; Dijksterhuis and Meurs, 2006; Dijksterhuis and Nordgren, 2006; Dijksterhuis and van Olden, 2006; Dijksterhuis, 2004).

In auditing and other professional domains like taxation, law and medicine, the need to be an all-rounder is required to progress to the top echelon, i.e. partner (see Carter and Spence, 2014; Spence and Carter, 2014). Partners' role encompasses more than just making the ultimate decision for every audit engagement and signing the audit report. Partners are leaders who need to have a long-term, holistic view as they set the rules, decide the right course of actions, develop and maintain good rapport with colleagues, subordinates as well as clients, while cross-selling a range of services. Technical competence merely facilitates deemed second-order activities like deliberate search for audit evidence and systematic compilation of working papers that are delegated to the deemed specialists, i.e. directors. Technical competence promotes a mechanistic mentality, which is conducive in following predetermined procedures as prescribed in formal as well as informal rules but is insufficient to cope with the complex and uncertain audit environment (Bucharo, 2018). Therefore, only directors who manage to reinvent themselves and become all-rounders move to the top echelon to become partners. Having a long-term, holistic approach in their conduct and judgment enables partners to cope with their diverse roles as well as exercise intuitive judgment in the complex and uncertain audit environment where not all pertinent audit evidence is readily available and thus compiled in working papers. Partners' broad, holistic focus of attention enables them to incorporate incidentally available audit evidence, acquired formally as well as informally while interacting with clients, colleagues and subordinates, into their judgment (Griffith et al., 2015).

Having transcended the specialist stereotype and diverted away from the narrow focus of consciously abiding by formalized rules and codes of conduct, partners can still be in conformance with rules. Dijksterhuis and Nordgren (2006 p. 101) illustrated that "an apple conforms to gravity by falling down rather than up, but it does not actively follow a rule in doing so." Similarly, partners adopt a long-term, holistic approach and exercise intuitive judgment rather than mechanistically follow rules in a step-by-step manner. Nevertheless, subsequent search for audit evidence and production of working papers that are typically delegated to the specialists, i.e. directors, are still expected to ensure that auditing is conducted professionally in compliance with formalized rules and procedures; partners conform to rules.

The discussion in this section leads to the fifth proposition, as follows.

> Proposition 5: Audit partners exercise intuitive judgment in a manner that conforms to rules.

Discussions

It is most important especially for junior members of the audit team to consciously follow rules in a precise manner while executing well-structured tasks to facilitate top-down control and demonstrate that auditors have performed their duties in a competent and professional manner, which is pertinent particularly in the event of litigations. However, it is not as suitable to consciously follow rules when performing ill-structured tasks such as forming an audit opinion and detecting fraud. Rules and procedures are often incomplete to guide performance of ill-

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structured tasks. It is the very nature of ill-structured tasks to be variable in their form and content, where precise application of tried-and-tested rules and procedures is often inadequate. Further, conscious processing does not facilitate a holistic approach in judgment (Dijksterhuis et al., 2009; Dijksterhuis et al., 2006; Dijksterhuis and Nordgren, 2006; Dijksterhuis and van Olden, 2006; Dijksterhuis, 2004).

> "Whereas conscious thought stays firmly under the search light, unconscious thought ventures out to the dark and dusty nooks and crannies of the mind" (Dijksterhuis and Meurs, 2006, p. 138).

Model of Rules Compliance

Figure 1 depicts the model of rules compliance given a range of task structure. The x-axis represents the degree of rules compliance, from low (i.e. unconsciously conforming to rules) to high (i.e. consciously following rules in a strict manner). The y-axis represents the extent to which tasks are structured, from low (i.e. ill-structured) to high (i.e. well-structured). A high degree of rules compliance is suitable when performing tasks with a high degree of structure. Conscious processing ensures that rules are followed in a careful and precise manner when performing well-structured tasks. However, the limited capacity of conscious processing tend to undermine performance of tasks with a lower degree of structure, i.e. ill-structured tasks; either only a subset of information is considered or disproportionate weight being assigned to a subset of information resulting in the inability give due consideration to the various possible solutions to the tasks in an unbiased manner (Dijksterhuis et al., 2009; Dijksterhuis et al., 2006; Dijksterhuis and Nordgren, 2006; Dijksterhuis and van Olden, 2006; Dijksterhuis, 2004). When performing tasks with a lower degree of structure, i.e. ill-structured, it is more appropriate to unconsciously conform to rules rather than consciously follow rules in a strict manner. Unconscious processing, which enables information to be considered in an all-encompassing, holistic manner due to its virtually unlimited capacity, is in a better position to ensure that the various alternative solutions to the tasks are given due consideration. On the other hand, unconscious processing offers little assistance when performing tasks with a higher degree of structure, i.e. well-structured, due to its inability to follow rules in a precise manner.

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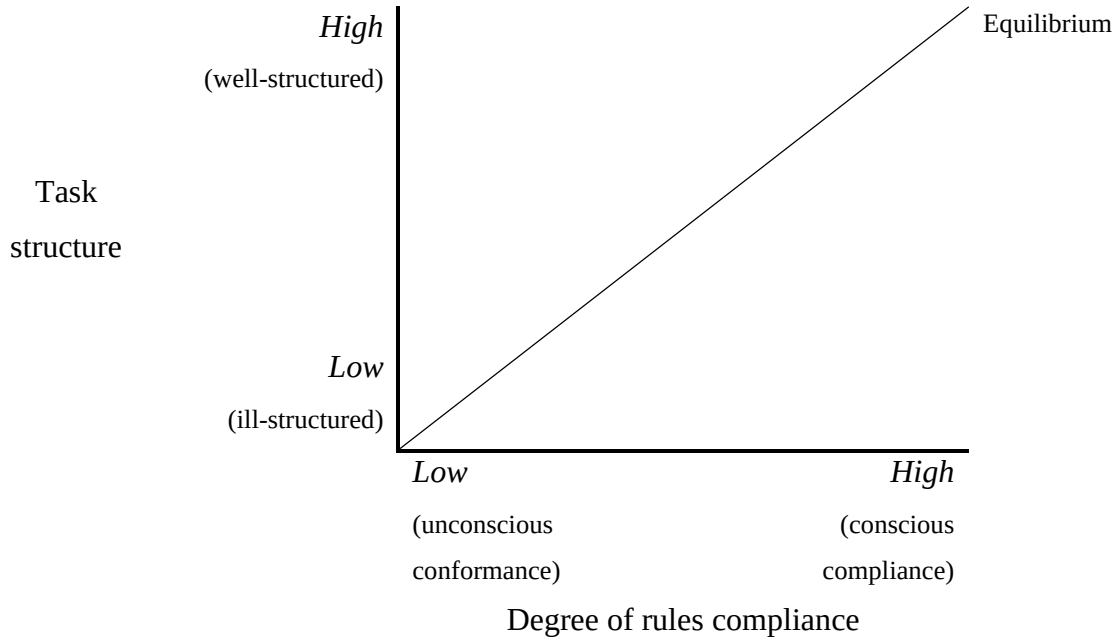

Figure 1: Model Of Rules Compliance For A Range Of Task Structure

Auditors are compelled to follow rules and procedures in a precise manner in light of litigation risks. While auditors are forced to routinize the habit of consciously following rules in a precise manner, auditors are also blamed for being too inclined to follow rules (FASB, 2004; Weil, 2002), particularly when auditors fail to disengage from the habit of following rules and procedures in a strict manner even when tasks at hand are ill-structured. In other words, auditors are compelled to operate on the right side of Figure 1 where auditors are inadvertently forced to operate below the diagonal line when working on the ill-structured component of the audit process. When performing tasks with a lower degree of structure, auditors require some leeway in deciding how rules and procedures should be implemented, especially when rules and procedures are often inadequate to accommodate for ill-structured tasks. Having found how best to conform to rules given the ill-structured nature of tasks at hand, auditors return to the diagonal line again on the bottom left of Figure 1.

Ideally, auditors should operate along the diagonal line. Auditors are in equilibrium when operating along the diagonal line. Tasks with a higher degree of structure require more conscious processing to ensure a strict degree of rules compliance. On the other hand, tasks with a lower degree of structure require the use of more unconscious processing to apply intuitive judgment and identify the most appropriate solution that conforms most to rules. Litigation risks and demand for legitimacy serve as external mechanism while auditors' ability to find leeway in implementing rules serves as internal mechanism that facilitate attainment of equilibrium; i.e. consciously follow rules in a precise manner when performing tasks with a high degree of structure and unconsciously applying intuitive judgment to reach the most appropriate solution that conforms most to rules when performing tasks with a lower degree of structure.

How the two external and internal mechanisms operate to enable auditors to attain and remain in equilibrium is further discussed in the next subsection.

Advanced International Journal of Banking, Accounting, and Finance
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Equilibrium: Operation of External and Internal Mechanism

The fact that audits are traditionally performed in teams facilitates operation of both the external and internal mechanism in a manner that ensures auditors attain and remain in equilibrium in two major ways. First, working in teams enable division of labor and specialization based on the experience and expertise of each member (e.g. Spence and Carter, 2014; Carter and Spencer, 2014; Rich et al., 1997a; Rich et al., 1997b; Ramsay, 1994; Libby and Trotman, 1993). Junior auditors with less experience specialize in more structured tasks whereas senior auditors review the work of junior auditors. Being assigned with more structured tasks encourages junior auditors to operate along the diagonal line on the top right of Figure 1, i.e. consciously follow rules and procedures in a precise manner. Senior auditors who review these junior auditors' work ensure that these juniors remain operating in equilibrium. Second, while senior auditors are in a position to find leeway in implementing rules and exercise judgment to cope with tasks with a lower degree of structure, their work is still reviewed by other colleagues. Having colleagues to review one's work helps to reduce individual biases and encourage operating along the diagonal on the bottom left of Figure 1.

Each review, performed by auditors at more senior levels, weeds out deficiencies in the audit work until a consensus is reached with regards to the audit procedures implemented, and audit evidence documented is able to defend the audit opinion, particularly in the event of litigation (e.g. Rich et al., 1997a; Rich et al., 1997b; Ramsay, 1994; Libby and Trotman, 1993). In other words, working in teams ensures that leeway in implementing rules in light of the ill-structured nature of auditing is not taken advantage of or misused, but used in line with the demand for legitimacy, which enables auditors to defend their judgment, i.e. audit opinion, particularly in the court of law. Being able to review and validate each other's work ensures that auditors remain in equilibrium, i.e. conform to rules when it is not feasible for auditors to strictly follow rules.

Regardless of the review process, auditors have every incentive to either strictly comply or conform to rules when strict compliance is not feasible. The extent to which audit judgment reached is in line with formalized rules and procedures and is defensible in the event of litigation affect auditors' reputation. To be perceived as competent is required and desired for auditors to grow and expand their business (DeFond and Zhang, 2014; Rich et al., 1997b). Failure to demonstrate that audit work is conducted in line with formalized rules and regulations in the event of litigation can result in not only loss of reputation as auditors also risk being sentenced to prison. In light of reputation and litigation risks, it is in auditors' best interest to remain in equilibrium.

However, auditors do not operate in the vacuum but in a complex and uncertain environment. In the face of complexity and uncertainty, differences in opinion on how accounting standards should be interpreted and what constitutes sufficient audit evidence are not uncommon (Glover et al., 2019). Drawing an example from Rich's et al. (1997b) paper, having detected an unexpected ratio fluctuation and with the intention to enhance his/her reputation for completing work within budgeted time, the auditor can make an inquiry of audit client's management, who is highly likely to provide a non-error explanation for the fluctuation, and document the explanation in the working papers. Alternatively, the auditor may perceive his/her reputation is enhanced by first making an inquiry of audit client's management, then gather evidence with an attempt to disconfirm the client's non-error explanation prior to documenting the information in the working papers. Despite the auditor's best effort to either strictly follow or

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conform to rules, these two alternatives may lead to significantly different audit evidence being documented and potentially support different conclusions. Colleagues who review the auditor's work may not have the same opinion that the auditor's choice of what and how audit evidence is gathered is in close compliance or conformance to rules and procedures. Having to reach a consensus over which alternative comply or conform most to rules and procedures in the presence of time and budget constraints is no easy task.

Concluding Remarks

This paper sheds light on how auditors follow rules and procedures while completing a range of audit tasks, from well-structured to ill-structured tasks. In brief, as a highly regulated professional practice that is subject to litigation risks and increasing demand for legitimacy has encouraged auditors to consciously follow rules in a strict manner. However, the very nature of auditing does not enable auditors to strictly follow rules at all times particularly when performing ill-structured tasks where existing rules and procedures are incomplete in the first place. When it is not feasible to consciously follow rules in a strict manner, auditors find leeway in implementing rules and procedures that enable them to conform to rules instead. Auditors are in equilibrium when they consciously follow rules while performing well-structured tasks and unconsciously conform to rules while performing ill-structured tasks.

Findings of this study have a number of implications. The first and most immediate implication is the model of rules compliance proposed in this study. The model clarifies concerns about auditors following rules to the extent of becoming incompetent in exercising professional judgment (Millman, 2005; FASB, 2004; Weil, 2002; Francis, 1994), and getting around rules to exercise biased judgment (Moore et al., 2006; Moore and Loewenstein, 2004; Bazerman et al., 2002). The model also offers explanations to better understand why certain guiding principles, audit methodologies and reforms to accounting and auditing standards do not necessarily bring about the desired results.

Based on the model, being inclined to follow rules too strictly to a certain extent is problematic, particularly when the very nature of auditing is complex, and each audit engagement is unique. However, auditors are capable of finding leeway in implementing rules where they conform to rules rather than strictly follow rules. While audit judgment can be compromised as a result of auditors' inclination to follow rules too strictly, i.e. when tasks at hand are ill-structured and trial-and-tested rules are incomplete, such a phenomenon—compromised judgment due to having followed rules too strictly—is transient as auditors will eventually attain equilibrium, i.e. find leeway in implementing rules and conform to rules to cope with the ill-structured nature of auditing.

Secondly, findings of this study are consistent with proponents of voluntary, self-regulation where inspections, validations, sanctions, penalties and any form of deterrence and punishment are believed to be demoralizing, inadequate and subject to abuse (e.g. Parker, 2000; Shapiro, 1987). The model of rules compliance suggests that auditors are capable of voluntary, self-regulation. Regulators, standard-setters and the public at large need not be unduly concerned when reforms to accounting and auditing standards fail to bring the desired results, or audit judgment is compromised or biased. Auditors are professionally trained, and governed by code of ethics, professional standards and regulatory requirements, and are conscious of the high reputation and litigation risks. Auditors' occasional malpractices and underperformance reflect the difficulties auditors experience in coping with uncertainties in the audit environment.

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AIJBAF
EISSN: 2682-8537
Volume 3 Issue 6 (March 2021) PP. 13-27
DOI 10.35631/AIJBAF.36002

Auditors have every incentive to demonstrate competence and professionalism, i.e. auditors will eventually return to equilibrium. Similarly, in other highly regulated professional disciplines that are subject to high reputation and litigation risks, where there are similar concerns—occasional malpractices and underperformance of medical doctors and lawyers for instance—these professionals experience difficulties in coping with the complex and uncertain work environment. These professionals have every incentive to be perceived as competent and law-abiding; they will eventually return to equilibrium.

Thirdly, this study provides insights into audit judgment from the psychology perspective. Such insights, especially the pros and cons of conscious and unconscious processing, serve as a guide for professionals to capitalize on the strengths of each processing method. For instance, gathering of audit evidence, which is primarily delegated to junior auditors, is best conducted by consciously abiding by rules and procedures to ensure that audit judgment is not made based on incomplete audit evidence. Senior auditors, especially partners, who integrate audit evidence gathered by other members of the audit team should exercise intuitive judgment. Having consciously attended to the audit evidence, partners also need to spend some time "sleeping on" the information to facilitate extensive and holistic unconscious thought prior to reaching a judgment, i.e. forming an audit opinion. It is when one is not consciously thinking about the audit evidence—i.e. "sleeping on" or putting the task aside—that one is able to integrate information in a holistic and unbiased manner, and may even find a better way to reach an audit judgment, beyond existing tried-and-tested rules and procedures. In fact, Dijksterhuis and Nordgren (2006, p. 107) called use of both conscious and unconscious processing in this manner "best of both worlds hypothesis" where "complex decisions are best made when the information is encoded thoroughly and consciously, and the later thought process is delegated to the unconscious".

Finally, the five propositions and model of rules compliance serve as a platform for future empirical research. There is a paucity of field studies in auditing, in comparison with experimental and analytical economics studies. Field studies are risky (Power, 2003). The five propositions and model provide field researchers with a sense of direction and reduce risk of getting lost in the field. Field data can be used to test and validate the propositions and model as well as ascertain how best to facilitate auditors to attain and remain in equilibrium; i.e. reduce instances of compromised audit judgment as a result of having followed rules too strictly and biased judgment due to failure in conform to code of ethics. Further, human capability in unconscious thought is under researched even in the domain of cognitive science and psychology (Reber, 1992). Future research can consider exploring how best to facilitate the use of unconscious processing which ensures a more all-encompassing and holistic approach in reaching a judgment, to compensate for the limited capacity of conscious thought in auditing and other professional practices.

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