Exploring Changing Requirements of Financial Statement Audit Reports via a Morphogenetic Approach

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Keywords
Morphogenetic approach; auditing; accountability; transparency; social agents

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Exploring Changing Requirements of Financial Statement Audit Reports via a Morphogenetic Approach

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Abstract

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JEL classification: M40, M41

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INTRODUCTION

This concept paper has been prepared to address the growing concern with the quality of audit reports issued by registered public accounting firms related to the financial statements of public companies (PCAOB, 2009). The Public Accounting Oversight Board\(^4\) (“PCAOB” or “Board”) released a concept paper in July 2009 which included discussion on the requirement for financial audit engagement partners to sign the financial audit reports with the purpose to improve the accountability of engagement partners as well as enhance the perceived transparency of the audit report and the associated financial statements. In 2011 and 2013 the PCAOB released follow up documents to further improve the transparency of audits reports along with supplemental requests for comment on the proposed changed requirements on the disclosures of audit participants. (PCAOB, 2015). One of the changes was a requirement for the completion and submission of a new PCAOB form, Auditor Reporting of Certain Audit Participants (Form AP), which requires the name of the engagement partner and additional information about the other participants in the audit to be disclosed in the audit report rather than just the disclosure of generic audit firm details. While the aim of this review of audit regulation was to both improve and promote a higher level of transparency and accountability (PCAOB, 2009) through improved audit reports and audit reporting requirements it does appear to be more focused on auditors simply disclosing their names and including their signature on the audit report rather than addressing other important features of transparency and accountability, such as the disclosure of an audit opinion.

A growing number of empirical studies (see Carcello and Li, 2013; Gul, Wu and Yang, 2013; Wang, Wang, Yu, Zhao and Zhang 2015; Liu, 2017) have started to explore the topic and undertake analysis on the impact on the inclusion of the engagement partner’s name on the quality of financial reporting and audit quality. Carcello and Li (2013) investigated some of the impacts in the United Kingdom (UK) context finding there is a significant decline in abnormal accruals indicating improved audit quality in the post-signature period. However, explanation of the reasons for the causal relationships between the proxies of audit quality, such as the abnormal accruals and audit fees, with the requirement of the engagement partner’s signature to be included are not confirmed or clarified, and nor how audit exactly quality has improved. Carcello and Li (2013) and Liu (2017) undertook additional analysis on the effect of requiring the audit engagement partner to sign the audit report when examining the financial analysts' information environment in the United Kingdom (U.K.) by using a control compromising a sample of listed firms from France, Germany, and Netherlands. Liu (2017) identified that the disclosure requirement of the engagement partner’s signature improved the financial analysts’ information environment and therefore, provides useful information to financial statement users. A number of quantitative studies turned their attention to the engagement partner’s signature requirement with the aim to connect the audit quality with the audit partners’ experience and within a unique cultural context such as China (see Gul, Wu and Yang, 2013; Wang, Wang, Yu, Zhao and Zhang 2015). However, whether the requirement of the engagement partners to sign the audit report is an effective way to

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\(^4\) July 2009, PCAOB released a concept paper on requiring the engagement partner to sign the audit report. October 2011, PCAOB released a paper on improving the transparency of audits with proposed amendments to auditing standards. December 2013, another paper released on improving the transparency of audits through the disclosure in the auditor’s report of participants in the audit. June 2015, supplemental request for comment on the rules to require disclosure of audit participants. December 2015, another document released on improving the transparency of audits and discussion related to amendments to auditing standards.
provide, let alone improve, accountability to investors relying on the financial information to make informed decisions is questionable.

The question of and around accountability being provided is the core of this paper. There is a conflation of roles of various social agents involved in the financial report preparation, approval and assurance processes which contributes to and impacts on the accountability discharged through these financial statements. The social agents need to be understood independently, *inter alia* the auditors and accountants, since the professional roles and stance they take with respect to the financial reporting and engagement with clients by each profession are vastly different. As a consequence, this may give rise to the creation of a social reality which may confuse the investors (Archer, 1995). This leads to the central debate on the interplay between structure and agency (Archer, 2007, 2010; Modell, 2015a, 2017), especially when the process of the agential elaboration is minimised. Structures are associated with socio-cultural powers, while they also reflect pre-existent social conditions through directing the practice and mediation of social agents. From a morphogenetic perspective, the structural influences (accounting / auditing regulations) provides the environment for agents (accountants / auditors) to differentiate themselves through the mediatory process, a process of how social agents respond, perceive and react to the social influences. At any given time, they are also performing their activities influenced by past interactions with other social agents.

This study is based on the application of Archer’s (1995) morphogenetic approach in the exploration of the interplay of the structures and social agents, and the conflated problems of the audit’s regulatory objectives of accountability and transparency of auditing practices between the auditing regulations and auditors. Of necessity, this paper begins with unpacking the notion of the morphogenetic approach, that is the explanatory program consisting of a three-stage model: social conditioning, social interaction, and social elaboration, to address the long-standing problem on the inseparability of structure and agency (Modell, 2017). The paper will then explore how the PCAOB regulation change has influenced the qualities of audit regulation and the auditor whose perspectives deserved to be noticed from the dominant constituencies structured by the four propositions of a morphogenetic analysis (Archer, 1995). The study will revisit the regulatory emergent properties of the financial report auditor and discuss the morphogenetic cycle of the auditor in response to the implications and guidance of accounting regulation. One of the key contributions of this study is the demonstration of the application of the morphogenetic approach in identifying the theoretical pluralism in the critical sociology arena (Gendron, 2018). Indeed, the second-order of emergent properties, which are discussed later in this paper, are inherent at the institutional level with related situational qualities of objects which vary with time and space. These qualities are used to limit the practices facilitated by the auditors (engagement partner) in the context of changes to auditing regulation.

**THEORETICAL UNDERPINNINGS – MORPHOGENETIC APPROACH**

Social reality, a form of social structuring, “is unlike any other because of its human constitution” (Archer, 1995, p.1). According to Archer (1995), it is a vexatious task to understand the ambivalent reality of society. Social reality is a social process that is shaped and re-shaped by a continuous process of human activities (Chua, 1986) and demonstrates that the pivotal ability of society to change and interact with human agents, *inter alia* society is activity-dependent. Social ontology endorses that society and human constituent are different strata, the structure and agent,
are characterised by their *sui generis* emergent properties (Archer 1995). These emergent properties with real powers are irreducible unlike the collectivists’ claim that the interplay between society and human constituents, structure and agency are traditionally aggregated in social science (Weber, 1964); nor is the individualist moulded in the complete monopoly over the causal powers of individuals (Archer, 2010).

To promote the adequacy of social theorising, and inspired by Lockwood (1964), the morphogenetic approach is used to perform the task in relation to the interplay between structure and agency and provide linkage to non-conflationary theorising. According to Archer, “the use of morphogenesis to describe the process of social structuring; ‘morpho’ indicating shape, and ‘genesis’ signalling that the shaping is the product of social relations” (1995, p.166). The imperatives of morphogenetic analysis are categorised and defined in three-part cycles: *structural conditioning*, *social interaction* and *structural elaboration*. Within these cycles, the structure and agency operate in different time periods when a given structure provides the pre-existing conditions. Although the social interaction seems to be conditioned with the given set of complex relations among the agents, the agents are the mediators with the causal influences and results in emergent properties quintessentially the object of their activities. These emergent properties are not structurally limited by pre-existing conditions. Throughout the time periods, the component elements of agency are consequentially elaborated into structural conditions and modify the previous structural condition.

The basis of morphogenetic approach is analytical dualism, which demonstrates an analogical method of seeing the emergent properties from both the structure and agent by distinguishing the component elements involved with the analysed objects subject to different time periods. There are four basic propositions considered in the application of the morphogenetic analysis

1. there are internal and necessary relations within and between social structures (SS);
2. causal influences are exerted by social structures (SS) on social interactions (SI);
3. there are causal relationships between groups and individuals at the level of social interaction (SI); and
4. social interaction (SI) elaborates upon the composition of social structures (SS) by modifying current internal and necessary structural relationships and introducing new ones where morphogenesis is concerned. Alternatively, social interaction reproduces existing internal and necessary structural relations when morphostasis applies (Archer, 1995, pp.168-169).

The morphogenetic approach does not provide a rejection on critical realism (Bhaskar, 1989) rather it complements Bhaskar’s central argument on social theorising by recognising the emancipatory power of human agency which exists in each socio-cultural group and their ability to participate, modify and mediate the change in each time fragment. When exercising activities in the conceptualised social forms that highlight the emergent properties which are attached with the pre-existing structural and/or cultural conditions these pre-existing conditions do intervene or constrain the ability to make changes. Subject to the connections between structural conditions, individuals tend to place themselves in the socially structured positions because of *vested interests*.

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5 *Sui generis* properties are used understand the unique tripartite link between the ontology, methodology and practical social theory.
While individuals and societies are inherently reflexive (Archer, 2010) the social systems are open so, rather than exerting direct influence on the social systems, people are capable of “resisting, repudiating, suspending and circumventing” the structures or social systems in which they existed (Archer, 1995, p.195). Given the freedom of structure and agency, the indeterminate quality of both may give rise to the conditional influence of opportunity costs. The differentials of the opportunity costs may result in variations in the course of actions (Mutch, 2007) and consequently lead to a social change, the two-way reflexive process of social interaction when linking the social conditioning and social elaborations of human agents. The social conditioning assigns different prices and premiums for the human agents to choose from, because of the risks involved with different courses of action due to interpretive volatility and acting opportunistically and strategically. Accordingly, this process will eventually give rise to the relational properties of social structure and agency.

Morphogenesis of agency and Emergent properties

Human constitution is the central interest of the morphogenetic perspective. The role of social agency is not isolated from social structures nor the social interaction. However, due to the nature of human agency, the notion to “people” or human beings intensifies the contrasting positions on the view of social agency such as Durkheim’s (1962) one-dimensional view on there are no human beings but social agents, whilst the ‘model of man’ constitutes the meanings of social structure. The morphogenetic perspective of agency is important to bring the attention to the tripartite distinction on the agency: ‘human beings’, ‘social agent’ and ‘social actor’. According to Archer (1995), people are often regarded as the ‘indeterminate material’ and directionally guided by pre-existing social conditions of vested interest groups.

The emergent properties give rise to the conditioning environment of structure and culture which allows the social agents to innovate (Elder-Vass, 2007). Simultaneously, the social agents interact in the socio-cultural conditioning (social interaction), which eventually transforms itself and contributes to the social stability. However, human agents are unpredictable and future social conditions may lead to unintended consequences which were not predicted and are irreducible in the process of social interaction.

The first-order emergent properties are the result of past interactions. Since the first-order and second-order emergent properties are results at the institutional level these properties may have influence on the agency behaviour directionally and strategically, such as accounting students are institutionalised in the accounting discipline. The first-order of emergent properties are directed to the accounting students via the educational institutions such as universities and professional accounting bodies, as they play a part in strategic directional guidance affecting the professional actions in their future social interactions.

The four second-order emergent properties of agents are identified as necessary complementarities, necessary incompatibilities; contingent incompatibilities; and contingent compatibilities (Archer, 1995). These properties indicate the situational logics when agents are placed in different circumstances. The situational logic provides good reasons to understand the systemic features of different courses of actions when there are positive or negative results upon

6 “… the principle of human agents making problematic choices among alternative courses of action” (Knepper 2007, p.29).
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the vested interests. It also indicates the different forms of strategic action that the agents choose to act upon and interact with members from other social groups.

Necessary Complementarities, according to Archer (1995), demonstrate the internal qualities of social structures which are necessarily useful and attractive to be maintained and reinforced by protective practices in order to retain and sustain vested interests. Protective practices are constructed at the institutional level, and then delegated to reinforce its monopoly of practices. The situational logic created as defensive is to ensure that every participant interacts within the given structural influences aiming to foster the gain in the current stable conditions, otherwise losses may result because of disruptions or negative feedback. Due to the structural pressures protective practices are generated for collective interests whereas innovation and diversification are considered as negative and disruptive towards vested interests.

When this complementary configuration is missing from the necessary features of structural conditioning, the necessary incompatibilities may become of the indicators of the social system. Necessary incompatibilities promote a state of contradiction assuming that there are the contradictory internal dynamics of institutions and situations. A process of comparing gains and losses is undertaken to ensure that actions to be taken depend upon a cautious mind. Where there are penalties assumed to be incurred, action of compromise is encouraged. Both necessary complementarities and incompatibilities indicate the social pressures in a top to bottom manner. No social change or disruptions are to incur which may damage the vested interests which have been preserved in the prevailing systems.

Contingent incompatibilities may arise when the system is open or when social structures are particularly resilient. When there are contingent damages or differences which conflict with institutional or personal gains, the action of elimination of the option associated with losses or penalties will be chosen by agents to preserve the vested interests.

Similarly, contingent compatibilities are assumed to exist in an open system with no effective barrier, however, compatibilities are attached with the nature of scarcity of resources which may cause uneven distribution of materials. Gains are to be generated due to sacrifice of resources (costs). Therefore, participating agents may opportunistically interpret the conditions and make alternate decisions.

Morphogenesis and audit reporting

Audit Partner Signature Requirement Background

The value of the audit report of listed companies is based on the dissemination of informative and useful information to the users of the audited financial reports. The clauses and items required of an audit report are proposed, passed, and imposed as a legislative requirement on financial reporting as a means to contribute to the transparency and accountability of financial information, inter alia, the audit quality. Since audit activities involves significant amount of professional judgement and professional scepticism during the engagement process and the report produced by the registered audit firm is the main document, along with the financial statements, that can be accessed and evaluated by users of the financial reports to make informed decisions, the signatures on the audit report should provide a meaningful indication on the quality of the audit work undertaken and the final audit report. The debate on audit quality and how it can be conveyed via the audit report has been ongoing for the last few decades while an apparent action to indicate
improved audit quality, the requirement to include the engagement partner’s name and signature on the audit report, has been debated since 2005. Those who support the inclusion of the engagement partner’s name and signature on the audit report recognise the importance of auditor performance in the demonstrating transparency and improved accountability of the financial information presented in an organisation’s financial statements (ICAEW, 2005; ACAP, 2008; PCAOB, 2009). The inclusion of the engagement partner’s signature was anticipated by other researchers to result in more conservative audit reporting which would result in a reduced risk of litigation (Carcello and Santore, 2011). While others suggested that the engagement partner would be motivated to be more accountable due to concerns on loss of reputation, professional embarrassment and potential criticisms from the media and public if negative consequences of the financial data are blamed due to audit failure (DeZoort, Harrison and Taylor, 2006; PCAOB, 2009). Ernst and Young (2009) argue that a large amount of accountability mechanisms have already been in use to ensure the accountability of auditor performance, and further, the requirement on disclosing the engagement partner name and signature may reduce the incentives of other members in the engagement team to identify or report material restatements causing reduced accountability of audit procedure. McGladrey & Pullen (2009) suggest that the effective regime to improve transparency and accountability is to consider the effectiveness of the audit committee who have access to both internal and external audit information. In addition, increasing audit fees to perform more complicated audit procedures may reduce the risk of audit failures however it may also damage the clientele of audit firms, and eventually lead to inefficient audit performance (DeZoort et al., 2006).

The research approach applied in this study to explore the changes in financial audit reporting is based on the social realist theory, morphogenetic approach. This approach presents two key challenges. The first challenge relates to the debate on the problem of structure and agency that auditing regulation (structure) has limited the causal powers generated by the auditor (agency) simply by conflating its unintended consequences with the ends of regulation (transparency and accountability). The change to include the engagement partner’s signatures on the audit report seems to reduce the properties of auditors into the responsibilities that the regulation affords and the ends it wants to achieve.

The second challenge is that the quintessential features of the auditor (agency) are viewed as powerless, unidimensional and “contingent stratification rather than being necessary” (Archer, 1995). This study explores the emancipatory power of auditor to investigate the factors which could be linked to the improvement of audit and audit reporting quality. The analysis starts with the identification of the propositions based on morphogenetic analysis (Archer, 1995) to recognise the conditioning environment within which financial report auditors interact. This is then followed by the application of the morphogenetic cycle of agency to explain the emergent properties of an auditor.

The system of professions

Proposition 1: The audit profession and regulatory regime (social structures) do have internal and necessary relations within and between their structures. (Social conditioning)

In addition to the accounting firms in which they work auditors are guided by the accounting regulation and the professional bodies, such as those represent chartered and certifies practicing accountant, which set up rigorous professional rules and processes for admittance so as to become part of the system of professions (Westermann, Cohen, and Trompeter, 2019). Establishment of
PCAOB in 2003 indicated the closure of self-regulation in the audit profession (Ernst & Young, 2012) resulting in the solidarity of the audit profession to protect public interest by ensuring the provision of financial information is accurate and informative to stakeholders. The primary functions of PCAOB involves the registration, standard-setting, assurance procedures, and enforcement aiming to ensure the auditors are independent so as to improve audit quality (DeFond & Lennox, 2011). The PCAOB, has far-reaching impact and influence on financial audit procedures, client importance and maintenance of the public interest (Sharma, Sharma, Ananthanarayanan, 2011). Furthermore, Westermann et al. (2019) investigated the inspection process of PCAOB with the purpose to rejuvenate the professionalism in audit profession, finding that the inspectors are a powerful group and are perceived as “judge” and “jury” by auditors even though “all PCAOB inspectors are former auditors” (Archer, 1995; p.6). This creates a level of conflict as the PCAOB inspectors share the identity with the auditors on who they make judgements. The unintended consequence of the inspection regime is that auditors perceive the power exerted on the well-designed set of audit tasks, auditor roles and responsibilities has characterised the salient feature of auditors as trustworthy to the external world (Freidson, 2001). The objective of the production of an audit report is the advancement in science and practices in the audit profession to protect public interest (Arbernathy, Barnes, and Stefaniak, 2013). The regulatory bodies and expectations from the public have exerted collective pressures on the audit profession which is perceived as a ritual power by the auditors who are actively working to become the qualified members of this social group.

Drawing attention to Archer’s (1995) work of structural conditioning of the morphogenetic cycle, the circumstances confronted in the audit regulation, the profession and by individuals results in auditors being socialised to the system of the audit profession and regulatory bodies which outline the requirements for which guide the professional activities of auditors. The conditions generated in the structures that are activity-dependent in the past give the situations for the current practices to be grouped and re-grouped. The selected inspectors in Westermann et al. (2019) study were auditors who had extensive industry experience and were associated with the regulatory and professional bodies. The inspection processes were designed to detect loopholes and risks of fraud and to potentially shape the current auditors’ ideologies when they design their engagement with the clients and the audit procedures to be undertaken. Due to the pre-existents in the audit profession, the auditors who are acting as “investigator” or “judge” and those who are tying themselves to the role as “watchdog” were consistently and continuously shaping themselves to meet the regulations so as to avoid the risk in not identifying material errors in the financial reports. At this end, the agents (auditors) are the mediators to the objective influence inherent in the social structures (laws and constraints), they understand and re-shape the structures by their actions with strategic directional guidance. In the following section, the actions of agents in material and ideational structures are discussed.

Proposition 2: Causal powers are exerted by the social structures on the social interaction.

The causal powers are considered to be exerted on the social interactions through the distribution of material resources. The human agents are facing choices when there is an imbalance of distribution. These choices may be embedded in the institutions or in particular roles that are voluntarily intervening people’s lives. Human agents are born with the power in both free and constrained nature with the ability to confront or extricate themselves from social conditioning. They may voluntarily bury themselves in the institutions they are associated with or roles with their agential power, yet, they also involuntarily place themselves into the social conditioning with
a degree of unwillingness due to having no choice but to do so. The structures provide the conditions, positions, roles and situations for the agents to mould with voluntarily. The agents also exert their influence on the structure which results in modifications of structure and eventually may lead to problems causing agents to mediate the situations by confronting the situational interest while exercising their powers to make strategic decisions. These strategic decisions do result in intended, and sometimes unintended consequences.

Auditing standards, transparency and accountability

To understand the causal powers exerted by the social structures, the influences of PCAOB is considered due to its authority on the audit profession. This consideration will also help to form an understanding on the prior conception of audit reporting. The influences of PCAOB are objectively real not only because its functions in enforcement but also due to its ability to identify market deficiencies and provide justified rules to penalise the unadjusted behaviours (Daugherty, Dickins, & Tervo, 2011). The accounting standards, requirements on audit reporting and rules from professional bodies have set up the conditioning environment as the objectified facts in which the agents (auditors) are required to follow. Simplified but complicated functions, registration, standard-setting, inspections and enforcement, are planned out to exert far-reaching implications onto the audit procedures to be carried out (Abernathy et al., 2013). The audit reports that the auditors prepare include discrete considerations because of the rewarding or sanction consequences flowing from the audit reports. The audit report required and produced by auditors not only gives a formality on evaluating the financial information but is also perceived as a channel to disseminate information on the levels of risk and types of potential frauds. The potential consequences of enforcement actions and subsequent penalties may be considered by auditors while they undertake audit engagements and prepare the final audit report. The activities and processes of the PCAOB provides the conditioning for auditors to interpret and adhere to, such as to require the engagement partner to sign the audit report, that may be detrimental or beneficial to auditors. These conditions are considered as means to confer and advocate the transparency, accountability and improved audit quality. Referring to the ideologies of morphogenesis, the structure conditioning is formed subjectively due to past interaction, however, it is objectively real to the existing agents to understand and make decisions dependent upon the unintended consequences. This results in the laws and regulations stated in the jurisdictions that existing auditors are required to learn and follow in their social structures along with their own, unique, innovative causal powers. The accounting firms, auditors and users who intend to use information disclosed in the audit report to assist their decision-making are therefore grouped accordingly due to the causal powers inherited from the social or structuring conditioning. These causal powers are exerted by the jurisdiction of auditing.

Proposition 3: There are causal relationships between groups and individuals at the level of social interaction.

The next episode of this study focuses on gaining an understanding of the causal powers of agents, the vested interest which may give rise to the causal relationships of groups and individuals. The groups and individuals are working towards achieving the same type of interests and are accordingly grouped together. The agents, through a mediatory process, are continuously producing, reproducing and socialising themselves into the social conditioning through social interaction. Yet, the agents are socialising accordingly to the divergent interests of the organisations or institutions virtually as per structural influences. What is distinguished in the
morphogenetic cycle is that the social conditioning or structural influences which existed in society for the social agents to consider is objective for the social agents to work upon. The vested interests universally exist in any type of structured condition. The agents subjectively interact with the objective features of their situations, and this leads to various courses of actions to the life choices. The other crucial assumption underlying the morphogenetic cycle is that the agents’ motive to reproduce or transform their agential power is the determination of interest to be vested. The interest is vested when it is associated with social positions and its carrying cost that may later vary the distribution of material resources.

The causal relationships between the groups and individuals are relational in nature rather an absolute however, what are the motives underlying the agents’ behaviour to be situated in the vested interests? In the morphogenetic cycle, the opportunity cost associated with life choices may explain the reasons of how conditional influences on agents’ choices. When there are opportunity costs involved in vested interests, there are differences between the structural influences. The agents need to make decisions on which way they should direct their attention to generate the maximum amount of interests. In this process, the new rules have been formed, new goals are oriented and a new morphogenetic cycle starts.

Vested interests are the objective features embedded in the regulatory system (groups) for the individuals (auditors) to identify, operate and transform (social interaction), and therefore, causal relationships arise due to the choices made involuntarily. The question to consider is what are the vested interests that exist between the audit regulation and auditors since auditors are continuously interpreting and acting upon the regulatory schemes and make involuntary choices. Given the structural influences are real and with frustrating and rewarding situations, the auditors’ choices may be varied along with the changing state of vested interests in relation to the change of positions. The requirement of the disclosure of the engagement partner name promoted by PCAOB (2009) and certain investors and banking regulators involved (see CalPERS, 2009; Council of Institutional Investors, 2009; Federal Housing Finance Agency, 2001; Muddy Waters Research, 2011), results in audit firms having reduced performance risk, and the potential for improved clientele relations, better professional reputation and greater levels of information of financial performance for investors (DeFond, Wong and Li, 1999). There is also the risk that some clients will exit their contracts with their current auditors due to the increased audit fees associated with the increased complexity of audit procedures (Carcello and Li, 2013). This could lead to the risk of clients overly relying on external expert advice or internal audit which may be heavily biased towards other interests other than financial stakeholders (Asare, Fitzgerald, Graham, Joe, Negangard and Wolfe, 2013). Due to the relational nature of properties arisen from motives along with vested interests, auditors may strategically vary their choices when they are placed in a positive situation, as demonstrated by Archer (1995). The discretionary judgement of auditors will be considered in next section.

**Proposition 4:** The current internal and necessary structural relationships are modified, elaborated and transformed into a new morphogenetic cycle.

In relation to internal and structural relationships different groups experience different degrees of freedom to retain their benefits of choices or eradicate the difficulties either knowingly or unknowingly. When there are reverse rewards or frustrations, vested interests may be reversed and transformed with necessary or contingent compatibilities of agents attached. The consequence may lead to a modification or transformation into a new morphogenetic cycle which also refers to the
discretionary judgements of agency. The discretionary judgements contain the breaks or continuous reasoning derived from the reflexive power of agency when weighing up the opportunity costs for actions. Archer (1995) argues that structure conditioning should not be conflated with the autonomous power of agents, but to respect the reasons for the agency to be reflexive, purposive and innovative. The agents have the freedom to interpret the different course of actions in different circumstances. The costs and benefits associated with the choices are objective, distributed for interpretation and action. Agents have their innovative power to recognise the rewards along with the risks if they oppose, and vice versa, therefore, the agential power, to some extent, encourages the strategic or opportunist guidance to make informed decisions for themselves.

In the previous proposition, the aim was to understand the constraints which are conditioned with real structural influences. Rewarding or frustrating situations may exist as to objectify the situations for agents to weight up the associated benefits and costs situated in each scenario. However, consideration on the reproducing and transforming power of agents is also required. There is a vast amount of detailed work required during the audit process from assessing risk, identifying appropriate samples, levels of materiality as well as collecting and analysing the material upon which the audit opinion is to be based.

The auditors may selectively make judgements on the discretionary disclosure when there are opportunity costs associated with different course of actions. While there is uneven distribution of material resources (premiums or penalties), agents may tend to oppose risks that may have detrimental impacts on their vested interests and accordingly act opportunistically (strategically) to address these risks.

Emergent properties of agents (auditors)

When Archer proposes the second-order emergent properties, she generally relates to the internal necessities of social structures (institutions). Since the human constituents are influenced by their pre-existents and social structures are constructed from the past there are also causal powers inherited from the emergent properties that are later transformed and reproduced by the agency in their practices with their innovative and emancipatory nature. In this section, a modification of the structural conditioning of strategic action model was discussed, and used to unpack the second-order emergent properties attached to the social agency (auditors) and how the situational logic underlying in the auditors’ practices

Emergent property – Necessary complementarities (protective)

The audit profession is quite different from other activities in the accounting discipline. Auditors are required to provide discretion views and judgements when evaluating accounts and their associated transactions while they also perform tests of control over the financial reporting and report. Auditors are required to be reflective on the financial transactions which occurred during the reporting period and any clauses stated on the financial statements to determine whether they are the faithfully presented in the financial reports. However, this is not to infer that auditors are the ‘bloodhound’, but more act as the watchdog or investigators (Everett, Friesen and Neu, 2018) in the accounting discipline. The nature and responsibilities of auditors pre-assumed from the society and constrained by the auditing standards and regulations which are constantly interpreted by the existing auditors in the industry have given, the ‘prestigious status’ of auditors. This privileged position inherited from the prevailing social structures, somehow, guarantee the gains
from social practices if the stability of the audit profession does not break down. The engagement partner (auditor/agent), who acts in the role of supervisor of the other auditors in the engagement team throughout the audit engagement may have the protective action to preserve the authority of the audit profession and the vested interests (Sikka, 2009) that are necessary to ensure the continuous operations of audit firms.

Emergent property – Necessary incompatibilities – (compromise)

Accounting standards are continuously updated and modified (Smith-Lacroix, Durocher and Gendron, 2012), and these changes are often seen as breakthroughs in the financial market’s aim to provide useful information to investors (PCAOB 2019). This may, in the beginning, be seen as the necessary conditions for which the auditors are to comply with, however, it becomes increasingly difficult to integrate and involve themselves with their subjective values. When auditors are facing the negative consequences, such as loss of reputation and/or litigation risk, by not following the regulations, auditors tend to behave mildly to ensure the audit process is congruent with the accounting/auditing regulations and become ‘participative in existing relations of power’ (Editors – Critical Perspectives of Accounting, 2015). Subject to these variations on the vested interests, the management of audit firms may choose to comprise themselves in this ‘game’ in order to preserve the gain.

Emergent property – Contingent incompatibilities – (elimination)

Auditors and audit firms are often in a reflexive role on the selection of clients and decisions on the appropriateness of audit procedures. Many studies on audit procedures focus on auditor rotation and firms’ choice (Bowlin, Hobson and Piercey, 2015), however, what has not been fully explored is the risk assessment done by the auditors on assessment of contingencies of clients. When there are contingencies involved, the increasing likelihood of litigation risk may result in an unexpected amount of legal costs due to the lawsuits (Frost and Pownall, 1994), and therefore result in a higher level of audit risk in the auditor’s assessment (Seetharaman, Gul and Lynn, 2002). When the risk of contingent incompatibilities is material, the auditor firm, may remove the client from their portfolio.

Emergent property – Contingent compatibilities – (opportunism)

Contingent compatibilities mix the scenarios of the extreme cases, however, a mediatory activity (Archer, 1995; Mutch 2007; Archer, 2010) is practiced by the agents (auditors) while they are weighting up the costs and benefits of any proposed client engagement. The praxis of auditors is to actively evaluate the outcomes of any risk (potential penalty) which is associated with potential premiums. Auditors or groups of auditors (audit firms) are often tempted by the auditor tenure, reputation and client importance to the auditor’s/firm’s client portfolio (Chen, Sun and Wu, 2010). Since there is an open system for auditors to act, interact, and evaluate, the costs are to the extent analysed opportunistically, such as in relation to auditor rotation, audit effort, amount of restatements, abnormal accruals and litigation fees.

CONCLUDING REMARKS

This paper has sketched the contours on Archer’s (1995) morphogenesis analysis so as to unpack the causal powers of structure (accounting/auditing regulation) and agency (auditors). This focus on morphogenesis firstly lies in the arguments on the change in the accounting regulations to include the engagement partner’s signature on the audit report (PCAOB, 2009) which may not be
the most effective regime to achieve the ends of improved transparency and accountability of financial reporting. The accounting regulation seems to complicate and conflate the ends of regulation with the characteristics of auditors which are the quintessential features to the improvements in the audit quality. The qualities or causal powers of auditors are buried in the jurisdictional ramifications (Smith-Lacroix et al., 2012) and accordingly it has been argued that the stratified nature of structure (accounting regulation) and agency (agency) could be considered using the morphogenetic approach developed by Archer (1995). Four propositions of analytical dualism of the morphogenesis analysis were used to identify emergent properties. Consideration of these propositions contributed to the examination of the interplay between the standard-setting institutions and the auditors by providing the temporal relation between social conditioning, social interaction and social elaboration. It is argued that the regulatory regime is activity-dependent, but with objectified features which exert powers on the social agents through involuntary placement. The social agents or auditors in this context have innovative and purposive power to release themselves from social structures and make them be able to interact with the accounting standards through vested interests. The social agents with emancipatory power elaborate, produce, reproduce and transform the social or structural conditions with their choices (strategically), such as to be protective, compromise, eliminate and act opportunistically, in relation to the judgements on the opportunistic costs associated with each decision, and therefore start a new cycle of morphogenesis. The directional guidance is influenced by the emergent properties of the accounting/auditing regulatory regime. In addition, this study confirms the view of Archer (1995) that the nascent 'social science' is needed to confront the transcendental reality of social structures since society is activity-dependent of human components, is transformative through human interactions and the human agents are reflexive on the social reality in which social agents live and by efforts to elaborate and transform.. The work of using morphogenesis analysis imbuing the critical realist view allows the contribution on response to the calls on the conflation problem between auditing standards and the auditors. The analysis produced by this study recommends auditors and regulators pay more explicit attention on the pre-existing and objective realities of accounting regulatory system and how can they enhance significant changes that are durable and immutable. Future research could be undertaken in the critical realism arena, especially in the provision of analysis based on double and triple morphogenesis of the social agency (practitioners) in the accounting discipline, such as to critically examine how the auditors behave surrounding the changes of audit fees, for the purpose to consider the impact should their activities be conflated or reduced into the propaganda of mainstream of accounting research.
References


