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TABLE OF CONTENTS

Letter from the president of the Polish Agency for Audit Oversight <i>Jacek Gdański</i>	7
Foreword <i>Anna Karmańska</i>	9
Model for Changes in Fees for Audits of Financial Statements during the Pandemic Period <i>Agnieszka Baklarz</i>	11
Managing the Risk of Entering into a Toxic Business Relationship from the Perspective of Anti-Money Laundering Legislation <i>Michał Kaczmarzki</i>	35
The Imperatives of Corporate Governance <i>Anna Karmańska</i>	65
The Place of Conducting the Audit of Financial Statements versus the Location of the Head Office of Audit Firms in Poland <i>Marcin Kreis</i>	99
Internal Audit versus Ethics Programmes <i>Lukasz Małecki-Tepicht</i>	141
Cost of Equity under the Circumstances of Uncertainty – the Example of the US Market <i>Marcin Pęksyk, Karol Śledzik, Bogusław Bławat</i>	163
The Auditor’s Professional Skepticism in Times of Economic Uncertainty <i>Beata Zyznarska-Dworczak</i>	181

REVIEWS – RECOMMENDATIONS – – RESUMES – TESTIMONIALS

A few words about the book: <i>Application of Machine Learning Techniques and Artificial Intelligence to Detect Financial Irregularities in Commercial Companies</i> <i>Marek Masztalerz</i>	209
---	-----

Briefly on the publication: <i>Thermodynamic Approach to the Discount Rate and Discounted Cash Flow Method</i> <i>Bogusław Bławat</i>	211
Report Resume: <i>Back to Earth. Landing Real-World Impact in Research Evaluation</i> <i>Radosław Różycki</i>	213
Conference Coverage: <i>Security of Economic Trade, Responsibility of Institutions, Responsibility of Business</i> <i>Mateusz Dziób</i>	217

ENGLISH SUMMARIES OF ARTICLES

Model for Changes in Fees for Audits of Financial Statements during the Pandemic Period <i>Agnieszka Baklarz</i>	225
Managing the risk of entering into a Toxic Business Relationship from the Perspective of Anti-Money Laundering Legislation <i>Michał Kaczmarski</i>	227
The Imperatives of Corporate Governance <i>Anna Karmańska</i>	229
The Place of Conducting the Audit of Financial Statements vs. the Location of the Head Office of Audit Firms in Poland <i>Marcin Kreis</i>	231
Internal Audit versus Ethics Programmes <i>Lukasz Małecki-Tepicht</i>	233
Cost of Equity under the Circumstances of Uncertainty – an example of the US market <i>Marcin Pęksyk, Karol Śledzik, Bogusław Bławat</i>	235
The Auditor's Professional Skepticism in Times of Economic Uncertainty <i>Beata Zyznarska-Dworczak</i>	237

LADIES AND GENTLEMEN,

I am delighted to present the first issue of “The Annual Journal of Audit and Accounting”, a magazine founded with the objective of fostering closer collaboration and knowledge exchange between academia and the business world. After all, one cannot view theory and practice as two distinct and separate fields, and for the Polish Agency for Audit Oversight to be able to successfully carry out its mission of enforcing the public interest, it is essential for many institutions, organisations and communities to collaborate and work together in a close and effective manner.

The magazine features articles and papers on varied topics, in line with the broad nature of the duties of a statutory auditor, as well as the diverse knowledge required of those who work in the field. The audit is facing numerous challenges as it moves towards the future. These concern not only identifying risks and impacts of economic transitions and upheavals in the world on companies’ operations and results, but also sustainability and the required reporting, as well as changes brought about by the dynamic growth of artificial intelligence and its ever-increasing impact on our economic life.

This magazine would never exist without the involvement and the work of its authors, as well as reviewers, who were guided by their commitment to the reliability of financial information, which is indispensable to the entire system, whose objective is to effectively ensure the public interest and economic activity. Without their willingness to share their knowledge, this issue would have never been completed. I would like to thank all of them for all the efforts and commitment.

I hope that “The Annual Journal of Audit and Accounting” will help our readers broaden their horizons, discover new issues and see ongoing challenges in a new light.

Jacek Gdański
President of the Polish Agency
for Audit Oversight



FOREWORD

DEAR ALL,

I would like to present you with the first edition of *The Annual Journal of Audit and Accounting*, an academic journal which was born as an initiative of the Polish Agency for Audit Oversight in 2023. At the same time, I hope that it becomes a recognisable platform for sharing knowledge, research results and concepts, which, in different ways, with different strengths and speeds, and to a different extent, may contribute to shaping systemic solutions that provide for the security of economic trade in which auditors and accounting professionals play an important role.

The journal and its mission need to be seen in the context of the needs of the environment, whose professionalism requires constant attention to changes that may occur in the areas which are often only seemingly distant from its fields of interest, but which may be of significant importance for recognition of contexts relevant to judgments, formation of professional attitudes or reinforcement of competencies that are relevant for the activities carried out.

In *The Annual Journal of Audit and Accounting* (2023) you will find seven articles of a research or popular science nature. Their spectrum varies and we wish to maintain this approach in future editions of the Annual. This is because we consider it important to discuss environmentally important issues, which are undertaken in the areas of various scientific disciplines, including in particular economics, finance, management and law.

Each article describes the purpose behind addressing the issue it concerns, the research or analytical methodology applied and the key findings and their cognitive value as well as research limitations. Owing to this, the Annual provides you with a concise view on the key issues tackled and of particular interest to the authors hereof in a given year, and simultaneously adheres to the set of rules applicable to publications of an academic nature.

In this issue you will also find a short review of a book that is worth reading, a recommendation to read an article on a problem analysed in an interesting manner, as well as information on the results of an empirical study on a thorny problem of the

value of scientific research, and also a report on the conference disputes held under the aegis of the Polish Agency for Audit Oversight.

To conclude, I would like to express my two hopes. Firstly, I hope that you will find this Annual indicative of this journal's development potential in the future. And secondly, I hope that you will have your unique share in this development, which I warmly encourage you to do on behalf of the entire Editorial Team and the Programme Council of the *Annual*.

The next issue of *The Annual Journal of Audit and Accounting* (2024) is ahead us. Let's create it together, using the following communication channel: www.pana.gov.pl/czasopismo/ and e-mail: czasopismo@pana.gov.pl.

With kind regards.

Professor Anna Karmańska, PhD
Editor-in-chief
*The Annual Journal
of Audit and Accounting*

29 December 2023

Model for Changes in Fees for Audits of Financial Statements during the Pandemic Period

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Summary

Purpose: The aim for undertaking of the title issue is the intention to examine – for audit firms outside the largest audit firms (TOP11 or TOP12 for 2022) – the developments in fees for the audit of the financial statements of entities other than public interest entities during the pandemic period. An additional objective was to approach answering the question: whether the pandemic, forcing a shift to remote auditing of these statements, has changed audit firms' behaviour in the practice of selecting clients from further distances.

Methodology/research approach: It was possible to fulfil the objective assumed by presenting a proposal for the author's model (function) of salary changes, which takes into account the specific nature of the pandemic period. When constructing and using this model, data resulting from the Database of Annual Reports of Audit Firms for 2020–2022, created at the Polish Agency for Audit Oversight at its inception in 2020, were used. The analysis of the data available in this database, at the same time those that coincided with the period of the Covid-19 pandemic and were appropriately extended for the needs of the analysis, consisted in diagnosing the peculiarities of the studied sample and establishing the characteristics of the explaining variables, as a result of which a proposal was formulated for modelling the issue undertaken.

Results: The article confirms the existence of a dependence of the remuneration for statutory audit services on the type of the financial statement audited, the 'high' or 'low' season of rendering these services, and the distance between the audit firm and the entity audited. In addition, it focuses on a deeper understanding of the sign of the coefficient appearing in the model with the variable indicating the season. The



study has also indicated a trend of undertaking financial statement audit assignments from entities relatively more distant from the audit firm.

Research limitations/implications: The primary limitation is the identification of the actual location of the audit firm's registered office at which the services were rendered. For this reason, the largest audit firms with multiple branches have been eliminated from the database. Another limitation (however, affecting the results only insignificantly) is the method used for measuring the distance. The distance was calculated as the distance in a straight line between the audited entity's registered office and the audit firm's registered office. Manual recalculation of a few examples indicates that the distance measurement error may be at a level of no more than several kilometres.

Originality/value: The author notes the lack of published research in the area assumed and identifies a research gap. The article partly complements it by contributing to the understanding of the functioning of the process of measuring revenue in audit firms earned from the provision of audit services provided to entities other than public interest entities. The conclusions presented can provide an incentive for further research and development of the model for post-pandemic periods, taking into account the distinctive features specific to that period.

Keywords: auditor, statutory auditor, audit, audit fees, pandemic

Introduction

The pandemic caused by the SARS-CoV 2 coronavirus (known as the COVID-19 pandemic) has become a global catalyst that triggered particularly strong increases in the volume of work performed using electronic means of communication (Mierzejewska, Dziurski, 2021). In the first lock-down periods, in particular, during weeks or even months, employees (including auditors and audit teams) had to communicate and perform work remotely.

Traditionally, financial statements are audited at a company's location. In the face of health safety restrictions, remote auditing has become an important alternative, and sometimes a necessity. However, this means of communication had already been used by larger audit firms on a regular basis, but it was not so straightforward for small practices because of technical and intellectual resources they had.

Based on the study by Sharma et al. (Sharma, 2022), India was eager to incorporate new technologies into the auditing practices adopted. On the other hand, in their 2023 study (Jarva, Zeitler, 2023), Jarva and Zeitler concluded that as far as internal auditing is concerned, the pandemic had no effect on technological changes in the entities covered by the empirical study. This may indicate that audit firms use technology for the purposes of auditing financial statements in a way different from that in which they use technology for the purposes of internal auditing. According to the study conducted by Haddad et al. (Haddad H., Al-Bawab A., Ahmad M., 2023), the pandemic has prompted companies to accelerate their digital transformation processes, including auditing. In the article titled *The Impact of Covid-19 Pandemic on the Auditing Profession*, it is highlighted that the economy, including the profession of auditor, has been significantly affected by the Covid-19 pandemic. Revenues of audit firms have declined and the productivity and the number of customer visits have dropped. The results of the study indicate that effective strategies for mitigating an adverse impact of crises on the profession of an auditor and maintaining its financial stability and performance need to be further researched and explored. The review of literature shows that it is likely that during the pandemic medium and small audit firms should commence to adapt and to adjust to the changing conditions of remote work. It is therefore interesting to verify whether this happened indeed during the pandemic.

The Polish Agency for Audit Oversight started operating at the beginning of 2020. This fact also coincided with the beginning of the COVID-19 pandemic. The Agency thus began to collect data on the services provided by all Polish audit firms and by statutory auditors acting on their behalf in the period concerned. During the three-year pandemic period (2020–2022), a unique database was created with information on audits conducted by audit firms. The detailed scope of information kept in the database is indicated in the Regulation of the Minister of Finance, Funds and Regional Policy of 18 January 2021 on the annual reporting of audit firms (Regulation, 2021) and includes, among other things, the indication of the type of services (statutory or voluntary auditing), the provision date of the services, the indication of the beginning and end of the financial year for which the audited financial statements are prepared as well as information about the entity to which the services were provided and the price for the audit conducted.

Owing to this database, a detailed analysis of the number of services rendered in each pandemic year was carried out and presented on the Agency's website.

And, thus:

- The audits conducted in 2020 were as follows: 28,697 audits of financial statements and 1,644 audits of consolidated financial statements (Baklarz, Kreis, 2021);

- The audits conducted in 2021 were as follows: 28,012 statutory audits of financial statements and 1,617 audits of consolidated financial statements (Baklarz, Kreis, 2022);
- The audits conducted in 2022 were as follows: 29,085 statutory audits of financial statements and 1,650 audits of consolidated financial statements (Baklarz, Kreis, 2023).

In this way, approximately 90,000 records of audits conducted by audit firms entered in the list kept by the Polish Agency for Audit Oversight in Poland were collected.

Due to such an extensive database and to a lack of analysis of factors other than those specified in Article 80 para. 2 of the Act on Statutory Auditors, according to which *'audit fees received by audit firms, statutory auditors and subcontractors acting on their behalf and for their benefit may not depend on any condition, including the results of the audit conducted'* (Law, 2017), the author hereof decided to carry out an in-depth analysis of changes in audit fees paid to audit firms during the pandemic period and their dependence on the distance between the auditor's registered office and that of the entity audited. Taking into account the duration of the pandemic period, a hypothesis was formulated that audit firms were more likely to conduct audits of the entities located farther away from their registered offices, which was made possible owing to an increased number of procedures carried out remotely.

As a result of the pandemic, the provisions of the Accounting Act, according to which financial statements are to be prepared within a 3-month period of the balance sheet date and then audited and approved in the following three months, were amended to such a way that such periods were extended (six months for the preparation of financial statements and another three months for their audit and approval). The author also analysed the impact of the aforementioned amendments on audit fees.

The analyses carried out included, in particular, the distance between the registered office of the entity analysed and the registered office of the audit firm.

However, the largest audit firms (TOP11 for 2020–2021¹ and TOP12

¹ TOP11 – audit firms from groups A and B of the list of audit firms conducting statutory audits in public interest entities in 2020–2021 (the list of firms in this scope has not changed); these are firms that provide more than 1% of services (in relation to the fees of all audit firms auditing public interest entities). The TOP11 group included the following companies: KPMG Audyt spółka z ograniczoną odpowiedzialnością spółka komandytowa, PricewaterhouseCoopers Polska spółka z ograniczoną odpowiedzialnością, Audyt spółka komandytowa, BDO spółka z ograniczoną odpowiedzialnością spółka komandytowa, Deloitte Audyt spółka z ograniczoną odpowiedzialnością spółka komandytowa, Ernst & Young Audyt Polska spółka z ograniczoną odpowiedzialnością spółka komandytowa, Grant Thornton Polska spółka z ograniczoną odpowiedzialnością spółka komandytowa, Mazars Audyt

for 2022²), were excluded from the analyses, as these firms often have branches across the country, and the annual reporting of audit firms does not specify which branch is responsible for auditing particular financial statements. In addition, the scope of the analyses carried out did not cover audits of financial statements of public interest entities, which were conducted in accordance with extended audit procedures resulting, among others, from EU requirements (Regulation, 2014), extended provisions resulting from auditing standards, or the applicable code of ethics for statutory auditors.

Finally, the analyses carried out concerned 21,916 audits conducted in 2020, 22,384 audits conducted in 2021 and 21,926 audits conducted in 2022, for a total of 66,226 audits.

1. Specific nature of the sample analysed – seasonality of audit services

When analysing audit fees in conjunction with the aforementioned factors (the distance, the seasonality and the type of the financial statements audited), it is worth noting that audit services are of a seasonal nature and that it is necessary to clarify the understanding of the distance between the entity audited and the audit firm.

The analysis of data concerning the seasonality of services rendered by audit firms demonstrates that if the services were rendered regularly throughout the year, the audits conducted monthly would constitute 8.33% of all the audits conducted throughout the year. However, Figure 1 illustrates a strong seasonal volatility of the monthly number of audits. It should be pointed out that in the different years of the period analysed, the number of financial audits conducted in particularly critical months (March, June and September), slightly changed its distribution. At this point it may be recalled that in 2020–2022 (i.e., the pandemic period) the time limit for preparing financial statements has been extended to the end of June (i.e., up to 6 months instead of the legally required time limit of 3 months after the end of the financial year). As demonstrated, in 2020, in spite of difficult conditions, companies sought to maintain the original time limit and only some of the audits were shifted to September. This may have been due to

spółka z ograniczoną odpowiedzialnością, PKF Consult spółka z ograniczoną odpowiedzialnością spółka komandytowa, UHY ECA Audyt spółka z ograniczoną odpowiedzialnością spółka komandytowa, Związek Rewizyjny Banków Spółdzielczych im. Franciszka Stefczyka in Warsaw, Związek Rewizyjny Banków Spółdzielczych w Poznań.

² TOP12 – audit firms from groups A and B of the list of audit firms conducting statutory audits in public interest entities in 2022. As far as TOP11 is concerned, the group was increased by POL-TAX 2 Limited Liability Company.

the obvious will of both parties to comply with the contractual terms. According to Article 66 para. 5 of the Accounting Law (Accounting Law, 1994), contracts for the provision of audit services shall be concluded in such a way as to allow for statutory auditors to participate in the stocktaking. In practice, this means that it should be done even before the end of the financial year audited. Taking into account that a financial year is in practice predominantly the calendar year, it can be assumed that contracts for the provision of audit services for 2019, which are de facto provided in 2020, should already be concluded in 2019, the year preceding the pandemic. In 2021 and 2022, however, the organisation of work changed and the provision of audit services shifted significantly from March to September. This was particularly true in 2022, when the proportion between the number of audits conducted in March and September reversed.

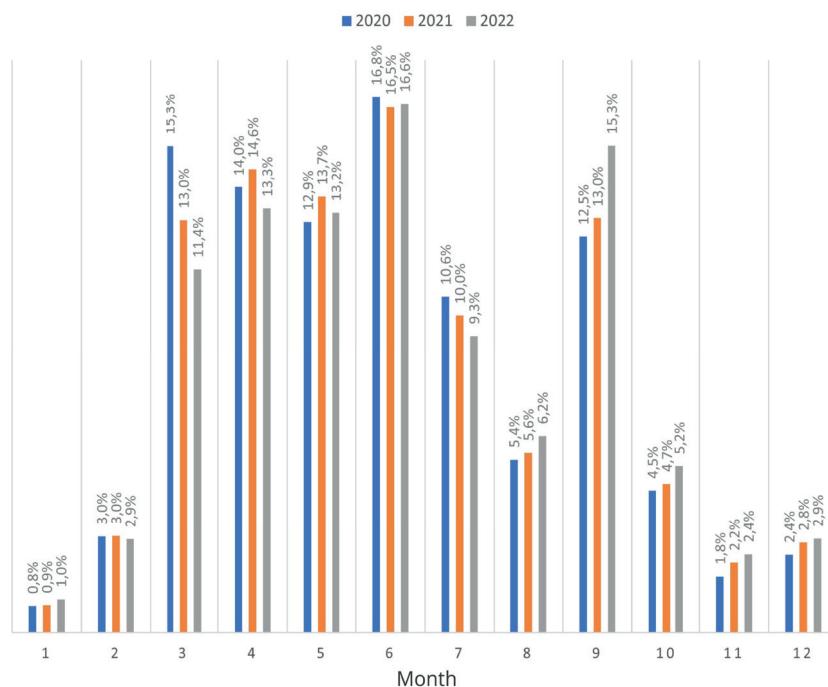


Figure 1. Share of the number of audit services provided on a monthly basis in the total number of audit services rendered in the years 2020–2022

Source: Own study based on the data available from: PANA – Database of Annual Reports of Audit Firms, 2020–2022.

The analysis of the monthly number of audits conducted (Figure 1) shows that the pandemic period in the audit industry had its 'high season' (a high intensity of audits), which included March, April, May, June, July and September, and its 'low season' (a low intensity of audits), which included August and the autumn and winter months. Taking the foregoing in consideration, a logical variable of high season was added to the model applied in order to identify services that are provided in the months of increased workload.

2. Specific nature of the sample analysed – a distance between the entity audited and the audit firm

In order to analyse an impact of the distance between the audited entity and the audit firm on fees, it was necessary to add contact details to information derived from the annual reports of audit firms available in the PANA database. Contact details of the audit firms were derived from the list of audit firms. Contact details of the audited entities were obtained from the annual GUS database, based on their tax identification numbers. Based on these contact details, the geographic coordinates of each entity were determined using the API (*Application Programming Interface*) provided by Google. The distance in kilometres between the audited entity and the audit firm was calculated based on the arc distance formula, using the formula presented as Equation 1 (assuming that the Earth is a perfect sphere).

Equation 1

$$Distance = \arccos(\cos(latitude1) \times \cos(latitude2) \times \cos(longitude1 - longitude2) + \sin(latitude1) \times \sin(latitude2)) \times 10000 \div \arccos(0)$$

where:

latitude1, latitude2: latitude of the 1st and 2nd point respectively, longitude1, longitude2: longitude of the 1st and 2nd point respectively.

The calculation resulted in the distances being set in kilometres as straight-line distances, i.e., without taking into account the actual shape of a route between the audit firm and the audited entity. Figure 2. illustrates the number of audits in relation to the distance (up to 310 km) between the audit firm and the audited entity, and Table 1 presents information concerning distances between the audited entity and the audit firm in each year of the audited period.

As can be seen, the median distance between the audit firm and the audited entity has been gradually increasing (a ten-percent increase between 2020 and 2022). The average distance between entities has also been increasing (here: 2.5% in the period concerned). The area of Poland has a limited spread, and this is why the increase

in the average distance has been naturally limited and grows more slowly than the median. Nevertheless, changes in the median have not been significant, and may lead one to conclude that audit firms acted in various ways during the pandemic. A gradual increase in the median distance in subsequent years may result from an increase in the number of audit procedures carried out remotely.

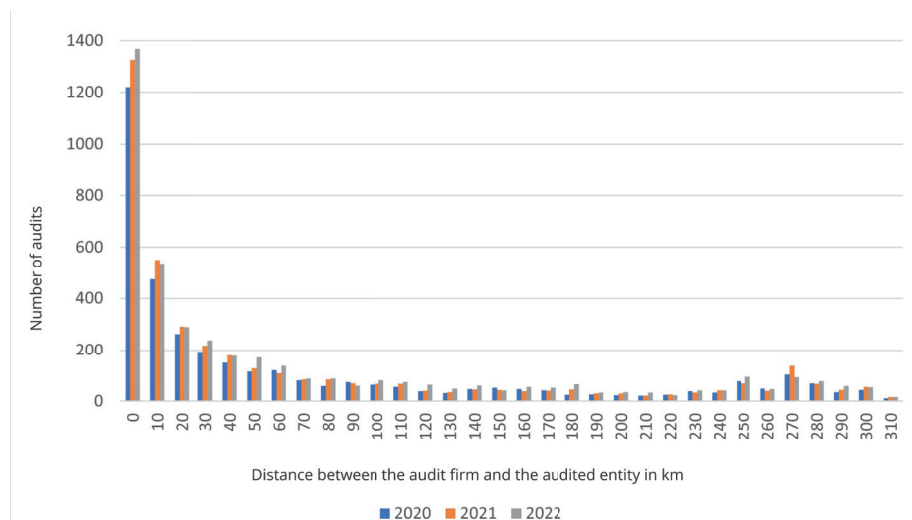


Figure 2. Number of the audits conducted as a function of the distance between the audit firm and the audited entity in 2020–2022

Source: Own study based on the data available from: PANA – Database of Annual Reports of Audit Firms, 2020–2022

Table 1. Basic information on the spread of data about the distance between the audit firm and the audited entity in 2020–2022

Descriptive characteristics of the distance	Year		
	2020	2021	2022
Average distance (km)	82.138	82.824	84.221
Median distance (km)	29.094	30.206	32.235
Minimum distance (km)	0.000	0.000	0.000
Maximum distance (km)	665.010	665.010	665.010

Source: Own study based on the data available from: PANA – Database of Annual Reports of Audit Firms, 2020–2022.

3. Specific nature of the sample analysed – types of financial statements audited each year

Audit fees may be affected by the types of financial statements audited. This is due to the fact that the tasks performed during the audit of consolidated financial statements differ slightly (National Auditing Standard 600, 2019) from those performed when auditing separate financial statements. Taking this into consideration, it is assumed that the type of financial statements to be audited affects the pricing of the audit services rendered.

Table 2 presents the number of audits conducted during the period analysed, but takes into account the dissimilarity of the standards applied: the logical variable for audits of consolidated financial statements is 1 and the logical variable for audits of separate financial statements is 0.

Table 2. The populations analysed by type of financial statements in 2020–2022

Type of the financial statements audited	Year		
	2020	2021	2022
Separate financial statements	21.068	21.285	21.090
Consolidated financial statements	848	1.099	836
Total	21.916	22.384	21.926

Source: Own study based on the data available from: PANA – Database of Annual Reports of Audit Firms, 2020–2022

4. Model proposed for assessing the impact of selected factors on audit fees in the pandemic period

When developing a dedicated model, it was assumed that an audit fee (revenue of the audit firm, Audit Revenue) was a linear function specific to a year in which audit services were rendered and dependent on a distance between the audited entity and the audit firm (Distance) and on the type of the financial statements audited (SSF, which was 1 for consolidated financial statements and 0 for separate financial statements), and on whether the audit was conducted in high season (High Season, which was 1 for March, April, May, June, July and September, and 0 for the remaining months). This interrelation is described by Equation 2.

Equation 2.*Audit Revenue*

$$= Const + a \times (Year-2019) + b \times High\ Season + c \times Distance + d \times SSF$$

First, the model is verified for the entire database, including all the three years. Next, the model is verified for each year separately in order to determine whether the parameters for each year are within an acceptable error of the multi-year model parameters. This helps identify whether any other additional, unknown factors become apparent which would have an impact on changes in audit fees. This analytical procedure allows for a model picture of changes in audit fees to be obtained for the years of the outbreak, duration and extinction of the pandemic and for the full pandemic period.

4.1. Determination of parameters for the audit fee volatility model – MODEL FOR THE FULL PANDEMIC PERIOD

In determining parameters that define the impact of related factors (variables) on audit fees in the full pandemic period, regardless of the specific nature of individual pandemic years, year 2020 is described as Year 1. The year 2021 is designated as Year 2 and the year 2022 as Year 3. The confidence level is 95%, and the significance level is 1%. This model (as well as other models described further herein) is tested using Gretl software, an open source statistical package.

Table 3. Model for the full pandemic period Least-squares estimation

Dependent variable (Y): Audit Revenue

Coefficient	Value of coefficient	Standard error	Student's t-test	p-value
<i>Const</i>	10,872.3	147.49	73.72	<0.0001
<i>Relative Year (year – 2019)</i>	1,152.92	51.89	22.22	<0.0001
<i>High Season</i>	-870.58	107.19	-8.122	<0.0001
<i>Distance (km)</i>	12.55	0.39	31.95	<0.0001

Coefficient	Value of coefficient	Standard error	Student's t-test	p-value
<i>SSF</i>	-1,553.20	209.89	-7.400	<0.0001
Test for normal distribution of residuals Null hypothesis: a random element has a normal distribution Test statistic: Chi-square(2) = 83,169.4 with p-value = 0				

Source: Own calculations based on the data available from PANA – Database of Annual Reports of Audit Firms, 2020–2022, using the Gretl statistical package

The above calculations allow for the model for the full pandemic period to be presented in the form of the following formula (Equation 3):

Equation 3.

$$\begin{aligned}
 \text{Audit Revenue} = & 10,872.30 + 1,152.92 \times (\text{Year}-2019) - 870.58 \\
 & \times \text{High Season} + 12.5471 \times \text{Distance} - 1553.20 \times \text{SSF}
 \end{aligned}$$

Table 4 below presents values of coefficients (parameters in the model) at the assumed 95% confidence level.

Table 4. Parameters in the model for the full pandemic period, along with the limits for the 95% confidence interval
 Dependent variable (Y): Audit Revenue

Coefficient	Value of coefficient for the full pandemic period (2020–2022)	Confidence interval of 95%
<i>Const</i>	10,872.30	[10,583.2, 11,161.4]
<i>Relative Year (year – 2019)</i>	1,152.92	[1,051.22, 1,254.61]
<i>High Season</i>	-870.580	[-1,080.68, -660.48]
<i>Distance (km)</i>	12.55	[11.78, 13.33]
<i>SSF</i>	-1,553.20	[-1,964.59, -1,141.82]

Source: Own calculations based on the data available from: PANA – Database of Annual Reports of Audit Firms, 2020–2022, made with the use of the Gretl statistical package

Analysing the results obtained relating to the size of the constant – the value of 10,872.30 is the expected audit fee in the period other than the high season in close proximity (up to 10 km) in 2019. The parameter related to the *Year* factor informs that in each subsequent year the revenue will grow on average by about PLN 1,152 per year. This will be verified by creating analogous models for each year of the pandemic period separately. However, at this point, it is worth pointing out that information included in the studies presented on the website of the Polish Agency for Audit Oversight for the years 2020–2022 shows that the annual growth in audit fees is likely to be linked to an increase in inflation (Baklarz, Kreis, 2021; 2022; 2023). The model also shows that *Audit Revenue* is weakly dependent on the distance between the audited entity and the audit firm. This is because the increase in revenue is not significant, as it is only about PLN 12 per each kilometre of distance. Interestingly (and unexpectedly), the high season price is PLN 870 less than the low-season price. (An overview of possible interpretations of this finding is presented later herein.) Equally interesting (although expected in the context of information contained in publications made available on the PANA website), the price for auditing consolidated statements is PLN 1,553 less than the price for auditing financial statements.

In the next section, analogous models for each of the pandemic years are presented in order to verify whether their parameters fall within the ranges indicated.

4.2. Determination of parameters for the audit fee volatility model – MODEL FOR THE FIRST YEAR OF THE PANDEMIC

The model for the first year of the pandemic is based on the following characteristics of the audit services rendered in that period:

- a) the audit fee (dependent variable: *Audit Revenue*),
- b) the month(s) of high or low season in which services are provided (independent variable: *High Season*, which is 1 for March, April, May, June, July and September and 0 for the remaining months),
- c) the distance in km between the audited entity and the audit firm (independent variable: *Distance*),
- d) the type of the financial statements audited (independent variable: *SSF*, which is 1 for consolidated financial statements and 0 for individual financial statements).

The function described by the aforementioned variables for the first year of the pandemic is presented as Equation 4 below.

The confidence level adopted is 95% and the significance level is 1%. The model was also tested using the Gretl software, an open source statistical package.

Equation 4.

$$\text{Audit Revenue} = \text{Const} + b \times \text{High Season} + c \times \text{Distance} + d \times \text{SSF}$$

The results of model testing (Table 5) indicate the high probability of a match between the model and the data.

Table 5. Model for the first year of the pandemic Least-squares estimation
Dependent variable (Y): Audit Revenue

Coefficient	Value of coefficient	Standard error	Student's t-test	p-value
<i>Const</i>	11,945.70	175.72	67.98	<0.0001
<i>High Season</i>	-621.40	183.14	-3.393	0.0007
<i>Distance (km)</i>	13.46	0.65	20.63	<0.0001
<i>SSF</i>	-2,136.67	362.36	-5.897	<0.0001
Test for normal distribution of residuals Null hypothesis: a random element has a normal distribution Test statistic: Chi-square(2) = 36004.9 with p-value = 0				

Source: Own calculations based on the data available from PANA – Database of Annual Reports of Audit Firms, 2020–2022, using the Gretl statistical package

Transforming Equation 3, for the year 2020, we arrive at Equation 5.

Equation 5.

$$\begin{aligned} \text{Audit Revenue} \\ = 10,872.30 + 1,152.92 \times (2020-2019) - 870.58 \times \text{High Season} \\ + 12.5471 \times \text{Distance} - 1,553.20 \times \text{SSF} = 12,025.22 - 870.58 \\ \times \text{High Season} + 12.5471 \times \text{Distance} - 1,553.20 \times \text{SSF} \end{aligned}$$

Table 6 presents the ranges of coefficients (model parameters) at the confidence level of 95%.

It should be noted that each of the parameters calculated for 2020 using Equation 3 falls within the aforementioned confidence intervals. This demonstrates that the two models are coherent.

Table 6. Parameters in the model for the first year of the pandemic, along with the limits for the confidence interval of 95%, as compared to the parameters in the three-year model

Coefficient	Value of coefficient for the first year of the pandemic (2020)	Confidence interval of 95%	Values of coefficient calculated for the 3-year model
<i>Const</i>	11,945,70	[11,601.30, 12,290.20]	12,025.22
<i>High Season</i>	-621.40	[-980.36 -262.43]	-870.58
<i>Distance</i>	13.46	[12.18, 14.74]	12.55
<i>SSF</i>	-2,136.67	[-2,846.93, -1,426.42]	-1,553.20

Source: Own calculations based on the data available from PANA – Database of Annual Reports of Audit Firms, 2020–2022, using the Gretl statistical package

4.3. Determination of parameters for the audit fee volatility model – MODEL FOR THE SECOND PANDEMIC YEAR

The model for the second year of the pandemic is based on the following characteristics of the audit services rendered in that period:

- the audit fee (dependent variable: *Audit Revenue*),
- the month(s) of high or low season in which services are provided (independent variable: *High Season*, which is 1 for March, April, May, June, July and September and 0 for the remaining months),
- the distance in km between the audited entity and the audit firm (independent variable: *Distance*),
- the type of the financial statements audited (independent variable: *SSF*, which is 1 for consolidated financial statements and 0 for individual financial statements).

The function described by the variables is presented as Equation 4 above.

The confidence level adopted is 95% and the significance level is 1%. The model was also tested using the Gretl software, an open source statistical package. Again, the results of model testing indicate the high probability of a match between the model and the data (Table 7).

Table 7. Model for the second year of the pandemic Least-squares estimation.
Dependent variable (Y): *Audit Revenue*

Coefficient	Value of coefficient	Standard error	Student's t-test	p-value
<i>Const</i>	12,665.00	172.35	73.48	<0.0001
<i>High Season</i>	-583.09	180.33	-3.234	0.0012
<i>Distance (km)</i>	11,47	0.66	17.40	<0.0001
<i>SSF</i>	-1,094.40	327.52	-3.341	0.0008
Test for normal distribution of residuals Null hypothesis: a random element has a normal distribution Test statistic: Chi-square(2) = 22636.6 with p-value = 0				

Source: Own calculations based on the data available from PANA – Database of Annual Reports of Audit Firms, 2020–2022, using the Gretl statistical package

Transforming Equation 3, for the year 2021, we arrive at Equation 6.

Equation 6.

Audit Revenue

$$\begin{aligned}
 &= 10.872,30 + 1.152,92 \times (2021-2019) - 870,58 \times \textit{High Season} \\
 &+ 12,5471 \times \textit{Distance} - 1.553,20 \times \textit{SSF} = 13.178,14 - 870,58 \\
 &\times \textit{High Season} + 12,5471 \times \textit{Distance} - 1.553,20 \times \textit{SSF}
 \end{aligned}$$

Table 8 presents the ranges of coefficients (model parameters) at the confidence level of 95%.

Table 8. Parameters in the model for the second year of the pandemic, along with the limits for the confidence interval of 95%, as compared to the parameters in the three-year model

Coefficient	Value of coefficient for the second year of the pandemic (2021)	Confidence interval of 95%	Values of coefficient calculated for the 3-year model
<i>Const</i>	12,665.00	[12,327.20, 13,002.80]	13,178.14
<i>High Season</i>	-583.10	[-936.55, -229.64]	-870.58
<i>Distance</i>	11.47	[10.17, 12.76]	12.55
<i>SSF</i>	-1,094.40	[-1,736.36, -452.430]	-1,553.20

Source: Own calculations based on the data available from PANA – Database of Annual Reports of Audit Firms, 2020–2022, using the Gretl statistical package

It should be noted that the variables of High Season, Distance and SSF calculated for 2020 using Equation 3 fall within the aforementioned confidence intervals. However, the value of the constant falls outside the confidence interval. This may indicate that the constant value is somehow dependent on the parameter based on other factors.

4.4. Determination of parameters for the audit fee volatility model – MODEL FOR THE FINAL PANDEMIC YEAR

Again, the model for the final pandemic year is based on the following characteristics of the audit services rendered in that period:

- a) the audit fee (dependent variable: *Audit Revenue*);
- b) the month(s) of high or low season in which services are provided (independent variable: *High Season*, which is 1 for March, April, May, June, July and September and 0 for the remaining months),
- c) the distance in km between the audited entity and the audit firm (independent variable: *Distance*),
- d) the type of the financial statements audited (independent variable: *SSF*, which is 1 for consolidated financial statements and 0 for individual financial statements).

The function described by the variables is presented as Equation 5 above.

The confidence level adopted is 95% and the significance level is 1%. Again, the model was tested using the Gretl software, an open source statistical package. And

again, the results of model testing indicate the high probability of a match between the model and the data.

Table 9. Model for the third year of the pandemic Least-squares estimation

Dependent variable (Y): Audit Revenue

Coefficient	Value of coefficient	Standard error	Student's t-test	p-value
<i>Const</i>	14,880.90	183.18	81.24	<0.0001
<i>High Season</i>	-1,367.73	192.69	-7.098	<0.0001
<i>Distance (km)</i>	12.76	0.73	17.56	<0.0001
<i>SSF</i>	-1,475.47	406.72	-3.628	0.0003
Test for normal distribution of residuals Null hypothesis: a random element has a normal distribution Test statistic: Chi-square(2) = 31134.5 with p-value = 0				

Source: Own calculations based on the data available from PANA – Database of Annual Reports of Audit Firms, 2020–2022, using the Gretl statistical package

Transforming Equation 3, for the year 2022, we arrive at Equation 7.

Equation 7.

$$\begin{aligned}
 \text{Audit Revenue} = & 10\,872,30 + 1152,92 \times (2022-2019) - 870,58 \times \\
 & \text{High Season} + 12,5471 \times \text{Odległość} - 1553,20 \times \text{SSF} = 14\,331,06 \\
 & - 870,58 \times \text{High Season} + 12,5471 \times \text{Distance} - 1553,20 \times \text{SSF}
 \end{aligned}$$

Table 10 presents the ranges of coefficients (model parameters) at the confidence level of 95%.

It should be noted that the variables of *Distance* and *SSF* calculated for 2022 using Equation 3 fall within the aforementioned confidence intervals. However, the value of the constant and the value of the coefficient for *High Season* fall outside the confidence interval. This confirms the discrepancy identified with the use of the model for 2021 that the constant (which is the expected price for auditing services rendered outside the high season in close proximity (up to 10 km)) is somehow dependent on a parameter derived from other factors, and may indicate that a dependence on another parameter concerning the variable of *High Season* also exists.

Table 10. Parameters in the model for the third year of the pandemic, along with the limits for the confidence interval of 95%, as compared to the parameters in the three-year model

Coefficient	Value of coefficient for the third year of the pandemic (2022)	Confidence interval of 95%	Values of coefficient calculated for the 3-year model
<i>Const</i>	14,880.90	[14,521.90, 15,239.90]	14,331,06
<i>High Season</i>	-1,367.73	[-1,745.41, -990.05]	-870,58
<i>Distance</i>	12.76	[11.34, 14.19]	12.5471
<i>SSF</i>	-1,475.47	[-2,272.68, -678.27]	-1,553.20

Source: Own calculations based on the data available from PANA – Database of Annual Reports of Audit Firms, 2020–2022, using the Gretl statistical package

5. Potential interpretations of the negative value of the parameter set for the variable of *High Season*

As has already been mentioned, the negative sign next to the variable of *High Season* indicates that audit firms are paid higher fees outside the high season. This is an interesting reflection, especially since it may point to several potential reasons. Unfortunately, due to the specific and, in this case, inadequate information structure of the *Database of Annual Reports of Audit Firms, 2020–2022*, they cannot be fully confirmed.

In order to deepen the understanding of the negative value of the variable of *High Season*, an analysis of the audit duration was carried out. Since less than 4% of the financial statements in the database analysed relate to the shifted balance sheet date (i.e., other than that of 31 December), the author hereof analysed the number of days between the balance sheet date and the date of the audit report. The results of the analysis have been presented in Figure 3 over a period limited to 370 days (rounded up to 10 days).

In analysing (Figure 3) changes in the number of days between the balance sheet date and the audit report date (rounded to the nearest 10 days), it can be noticed that their distribution varied from year to year. In 2020, despite lockdown, companies seemed to comply with the obligation to have their financial statements audited within 3 months after the end of the financial year, without

major difficulties. However, in the following years the conduct of audits lost on its efficiency as a result of the time limit up having been extended up to 9 months from the balance sheet date.

The distribution of the audits completed in the high season (Figure 4) is very similar to that presented above. However, the distribution of the audits completed outside the high season is very different (Figure 5).

The audits completed outside the high season (Figure 5) can be divided into three groups:

- 1) audits completed within 2 months of the balance sheet date – a potential reason for an increase in remuneration may therefore be the intensification of work performed by the audit team;
- 2) audits completed within 7–8 months of the balance sheet date – a potential reason for an increase in remuneration may therefore be re-examination of the financial statements audited after each adjustment thereto, additionally carried out procedures, tasks performed during the holiday season;
- 3) audits completed within 9 and more months of the balance sheet date – a potential reason for an increase in remuneration may therefore be re-examination of the financial statements audited after each adjustment thereto, additionally carried out procedures (e.g., because the lapse of time after the balance sheet date, the need to verify events after the balance sheet date in the relevant period), intensification of tasks for entities that forgot to have their financial statements audited.

Thus, without prejudging the accuracy of the reasons for the negative value of the coefficient for the variable of *High Season*, it can be concluded that there are three main reasons for which this value is negative. They are presented in detail below.

Reason 1: Audit firms typically contract new audits between August and December of the preceding year in an effort to first secure a pool of audits up to their break-even point. That is, even having their own price lists set, they can gently compete on price (approx. 5–7% of the price) so as to ensure that they can operate in the times of high occupancy. Subsequent audits that are in excess of the break-even point are priced at higher rates as more heavily burdening, and thus they are also measured by a lost benefit in the form of a loss of free time by those carrying out the audits.

Reason 2: The post-season audits are usually conducted for entities that contract such services late and cannot find potential contractors. Consequently, competition is low and an audit firm can discount the lost benefit in the form of a loss of vacation time or other time which would otherwise be spent on doing other activities.

Reason 3: The post-season audits are often characterised by a higher risk. For example, entities want to contract auditing services too late for a statutory auditor to participate in the stocktaking and additional procedures have to be carried out which increases the audit fee.

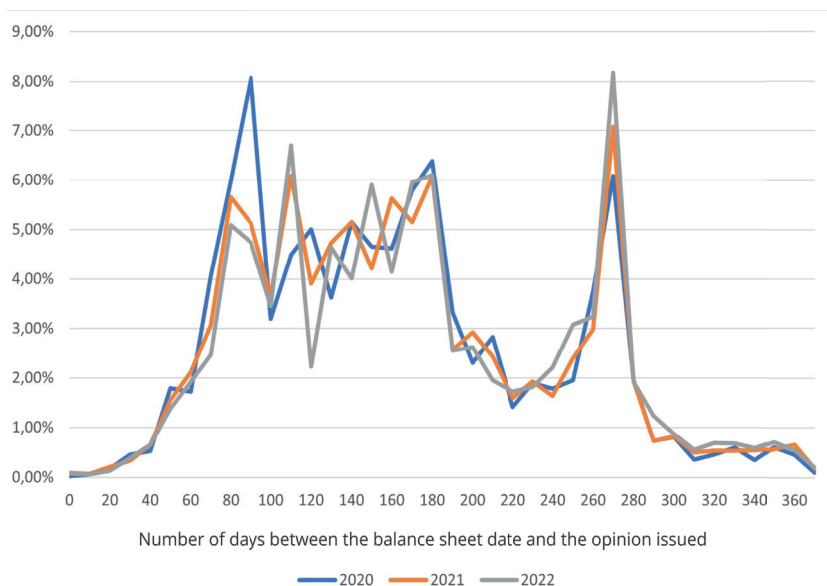


Figure 3. Percentage distribution of audits conducted in 2020–2022, by number of days between the balance sheet date and the opinion issued on the audit of financial statements

Source: Own calculations based on: PANA – Database of Annual Reports of Audit Firms, 2020–2022

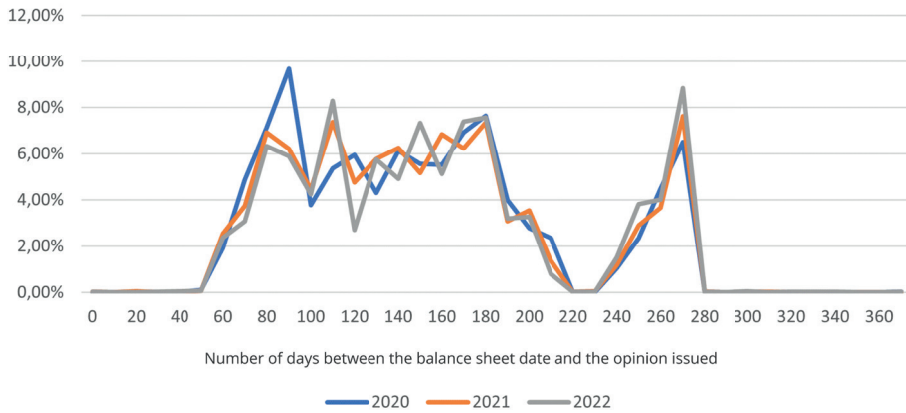


Figure 4. Percentage distribution of the period between the balance sheet date and the audit opinion issued in 2020–2022 for audits completed in the high season

Source: Own calculations based on: PANA – Database of Annual Reports of Audit Firms, 2020–2022

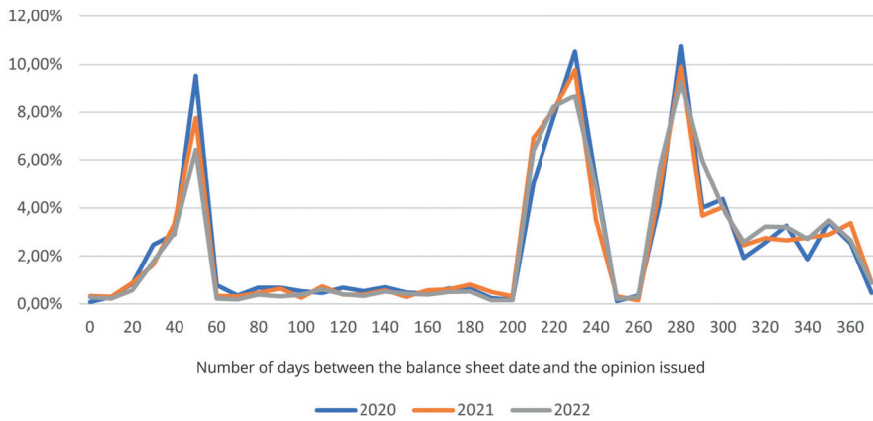


Figure 5. Percentage distribution of the period between the balance sheet date and the audit opinion issued in 2020–2022 for audits completed outside the high season

Source: Own calculations based on: PANA – Database of Annual Reports of Audit Firms, 2020–2022

Summary

The analyses carried out confirmed that the following factors had a real impact on the audit fees paid to audit firms for services provided to entities other than public interest entities during the pandemic:

- a) the year (of the pandemic period) in which the services were provided, with fees earned outside the high season being comparatively cheaper by about PLN 870 each year,
- b) the distance (measured in km in a straight line) between the audited entity and the audit firm,
- c) the type of the financial statements audited, with audits of consolidated financial statements being cheaper by about PLN 1,500 than audits of separate financial statements.

In conclusion, it can be stated that the aforementioned interrelation between the audit fees and the identified factors is described well by the general formula and by the ranges of parameters

Audit Revenue =

$$\text{Const} + a \times (\text{Year}-2019) + b \times \text{High Season} + c \times \text{Distance} + d \times \text{SSF}$$

where:

- *Const is between PLN 10.583 and PLN 11.161,*
- the coefficient *a* is between 1.051 and 1.254,
- the factor *b* is between -1.080 and -660,
- the factor *c* is between 11.777 and 13.317,
- the factor *d* is between -1.964 and -1.141.

However, it should be clearly pointed out here that the value of *Const* should be subjected to further verification in terms of dependence on macroeconomic factors. Additional analyses have also made it possible to note that:

- a) the pandemic on had an impact on the month in which the audit of the financial statements was completed; this is indicated by an increasing postponement of the completion of the audit, i.e., until the cut-off time in a given year, applicable in accordance with the provisions of law;
- b) the distance between the audit firm and the audited entity changed in the pandemic period, and in particular that changes in the median distance were not significant, but were constantly increasing, and could possibly reflect changes which the audit firms made to their mode of operations (remote) in response to the pandemic circumstances;

- c) the audits of financial statements were characterised by seasonality which had an impact on that audit fees.

The analysis carried out has not been exhaustive of all the factors that may be relevant to the audit fees for audits conducted during the pandemic period. Pandemic conditions in Poland were far more complex than those whose characteristics have been made available in the *Database of Annual Reports of Audit Firms for 2020–2022*, created at the Polish Agency for Audit Oversight. As a result of the foregoing, the reasoning presented and the resulting model can be further developed, supplemented with factors and interrelated macroeconomic parameters that characterised the Polish economy during the pandemic. Such an analysis can also serve as an inducement to conduct comparative analysis at a global scale, and to create (unfortunately, due to the global scope of the pandemic) – a cultural picture of the problem taken up.

In expressing hope that the situation does not repeat, the modelling done can nevertheless be viewed as cognitive in terms of the audit firms' response to the health pandemic crisis contributing to a change in approach and greater use of IT tools in auditing.

The author believes that the study of factors affecting audit fees should be extended beyond the pandemic period in order to gain the understanding of the processes initiated in the period concerned.

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Managing the Risk of Entering into a Toxic Business Relationship from the Perspective of Anti-Money Laundering Legislation

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Abstract

Purpose: The aim of this article is to provide an introduction to the issue of risk management and the standard of due diligence within the establishment of a business relationship with a client by members of the public trust profession, in particular statutory auditors, in the context of anti-money laundering legislation.

Methodology/research approach: Literature research and review of national and European legislation relating to issues of counteracting money laundering and the statutory auditor profession.

Results: Based on the review of literature and the content of legal regulations relating to counteracting money laundering and the exercise of the statutory auditor profession, key risk areas and legal requirements for managing the risk of exposure to money laundering involvement were identified. The analysis performed made it possible to propose a number of recommendations in the scope of limiting the exposure to the conscious or unconscious involvement of a statutory auditor in unlawful activities in the context of legal obligations in the area of counteracting money laundering.

Research limitations/implications: The literature research and the review of legal regulations only covered documents selected by the author which he considered crucial from the perspective of the purpose of the analysis. The text is



therefore not an exhaustive overview of all content relevant to the issues of counteracting money laundering issues available in the public domain.

Originality/value: Gathering in one place the knowledge of the risks that surround the practice of the statutory auditor profession in the context of regulatory requirements in the area of counteracting money laundering and exposure to the risk of the statutory auditor's involvement in money laundering.

Keywords: money laundering, counteracting money laundering, AML, economic crime, financial crime, fraud risk management, due diligence, compliance.

Introduction

Money laundering is a serious crime, the essence of which is to give the appearance of legitimacy to assets derived from the commission of other crimes. Organising the logistics of money laundering is often the domain of organised crime groups, which this way hide their proceeds from law enforcement authorities and simultaneously make sure that they are able to continue their criminal activities. Criminal groups attempt sometimes to make use of public officials to launder money, most often in the capacity of so-called *gatekeepers*, i.e., people who facilitate access to various services, in particular financial services, which would be impossible or significantly more difficult to secure without their participation. Because of the risks associated with public officials' exposure to money laundering, they have been included in the group of 'obliged institutions' within the meaning of the anti-money laundering regulations.

This text introduces readers to the issue of managing the risk of entering into a toxic business relationship from the perspective of anti-money laundering legislation and of a statutory auditor, as an obliged institution, focusing on the problem of due diligence in establishing business relationships with clients in professional economic trade.

In the era of the global risk economy (WHO, 2023), diligence in selecting business partners is of considerable importance to companies. The risks associated with establishing a new business relationship or continuing an existing one are various, and include, among many, a risk of violating economic sanctions or anti-money-laundering regulations if a relationship is established with a client who attempts to use our credibility as a springboard for committing fraud.

This paper focuses only on the risk of entering into a relationship with an entity that, in the course of its business, may commit acts described in Article 299 para.

1 of the Criminal Code (Journal of Laws of 2022, item 1138, as amended), i.e., the offence of money laundering. In addition, the subject matter of considerations has been narrowed to a particular group of the 'obliged institutions' within the meaning of Article 2 para. 1 of the Act on Counteracting Money Laundering and Terrorism Financing (Journal of Laws of 2023, item 1124), i.e., non-financial obliged institutions, and further to public officials with knowledge of accounting, i.e., statutory auditors

Diligence in establishing a business relationship with a client is of particular importance from the perspective of personal liability of statutory auditors or audit firms they represent, not only at the stage of establishing a business relationship, but also during the performance of contracts concluded with clients.

In business relations, the general rule for assessing diligence in establishing business relations with counterparties is introduced by the provisions of Article 355 para. 2 of the Civil Code (Journal of Laws of 2022, item 1360, as amended), according to which '*due diligence in business activities shall be determined taking into account the professional nature of such activities.*' This provision is interpreted as a duty of special care on the part of professional economic trade participants. In its decisions and resolutions, the Supreme Court leaves no doubt in this context, pointing out that '*in the doctrine (of the application of law) and judicial decisions (of courts) it has been accepted that due diligence is determined by objective and abstract considerations, i.e. independent of the individual characteristics of the perpetrator of damage*' (OSNC 1991, No. 1, item 3), and adding that '*embedded in the essence of business activity is the requirement to possess the necessary expertise, which includes not only purely formal qualifications, but also experience resulting from professional practice and customary established standards (e.g., good practices and codes of ethics)*' (IV CK 100/05, LEX No. 187120).

Statutory auditors, while practising their profession, are obliged, in particular, to '*continuously improve their professional qualifications, in particular, by way of receiving mandatory professional training in each calendar year*', which is subject to documentation and verification by the National Chamber of Statutory Auditors (Journal of Laws of 2023, item 1015, Article 9),

Statutory auditors, in performing their tasks, act under what is known as a reciprocal agreement, within the meaning of Article 487 para. 2 of the Civil Code (Journal of Laws of 2022, item 1360, as amended): '*when both parties undertake in such a way that the performance of one of them is to be equivalent to the performance of the other*'. The essence of the performance of statutory auditors or audit firms they represent will be, within the framework of a reciprocal contractual relationship, in particular, the provision of auditing services within the meaning of Article 3 in conjunction with Article 2, para. 7 of the Act on Statutory Auditors (Journal of Laws of 2023, item 1015). The customer's consideration, on the other hand, will be the payment of remuneration for the work performed. Under a reciprocal agreement,

both parties are creditors and debtors to each other. At the same time, the scope of the statutory auditor's duties derives not only from the content of the contract with the client itself, but also, in particular, from the provisions of laws, including the Law on Statutory Auditors (Journal of Laws of 2023, item 1015) and the Act on Counteracting Money Laundering and Terrorism Financing (Journal of Laws of 2023, item 1124). The aforementioned regulations supplement the concept of diligence within the meaning of the aforementioned Article 355 para. 2 of the Civil Code, following Article 56 of the Civil Code (Journal of Laws of 2022, item 1360, as amended), which stipulates that *'a legal action (e.g., the conclusion of a contract) produces not only effects expressed therein, but also those arising from the law, rules of social intercourse and established customs.'*

Given that the title of this paper refers to the perspective of anti-money laundering regulations, the remaining part hereof focuses on the content of the statutory auditor's obligations under the aforementioned laws and established customs that is good market practices. The latter are discussed in the context of a study published in June 2023 by the Association of Certified Fraud Examiners, hereafter referred to as the ACFE) and by Thomson Reuters, titled *'Combating Business-to-Business Fraud: Benchmarking Report'* (ACFE and Thomson Reuters, 2023).

There are a number of risks associated with entering into a business relationship with an entity involved in money laundering, the key of which appears to be the issue of criminal and administrative liability, both on the part of a statutory auditor and the audit firm itself, as well as a reputational risk, although the list of potential risks is certainly not limited to these two elements.

A detailed description of risks related to entering into cooperation with an entity involved in money laundering and of obligations imposed on statutory auditors in this regard by the Act on Counteracting Money Laundering and Terrorism Financing (Journal of Laws of 2023, item 1124), along with the context of the ACFE and Thomson Reuters analysis results, has been presented below (ACFE and Thomson Reuters, 2023).

1. Money laundering as a criminal act and the context of obliged institutions

Money laundering is a criminal act, the essence of which is to give the appearance of legitimacy to gains derived from the commission of any other criminal act, the so-called underlying act. The national statutory definition of money laundering can be found, as has already been mentioned in the introduction, in Article 299 para. 1 of the Criminal Code, according to which, *'whoever receives, holds, uses, transfers or transports abroad, conceals, transfers or converts, or assists in transfer of title or possession of legal tenders, financial instruments, securities, or other foreign currencies*

values, property rights or other real estate or movable property derived from the benefits relating to the commission of an offence, or takes any other actions which can prevent, or make significantly more difficult, determination of their criminal origin or place of deposition, detection or forfeiture, shall be subject to the penalty of deprivation of liberty(Journal of Laws of 2020, item 1138, as amended).

In Poland, penalties for money laundering are imposed on the basis of intentional guilt. A person who commits the crime of money laundering, e.g., conceals movable or immovable property derived from the commission of another criminal act, is subject to criminal liability if they act with knowledge that their activity or omission to act amounts to a criminal act under Article 299 para. 1 of the Criminal Code. The burden of proof for demonstrating guilt, i.e., that knowledge that a certain activity or omission to act amounts to a criminal act, rests with a public prosecutor, in accordance with the principle that:

- *'the accused is considered innocent until their guilt is proven and established by a final judgment'* (Journal of Laws of 2022, item 1375, as amended, Article 5),
- *'any doubt that cannot be cleared up shall be resolved in favour of the accused'* (Journal of Laws of 2022, item 1375, as amended, Article 5), and,
- *'the prosecuting body shall be obliged to initiate and carry out preparatory proceedings, and the public prosecutor shall also be obliged to initiate and support a prosecution for any act prosecuted ex officio', and that 'except in cases specified in national or international law, no person can be released from liable for a crime committed'*. (Journal of Laws of 2022, item 1375, as amended, Article 10).

It is perhaps worth pointing out that in many countries, for example in Great Britain, liability for money laundering can also arise in cases of unintentional guilt, i.e., for example, if a perpetrator takes possession of assets in exchange for a price significantly lower than their market value. (UK Proceeds of Crime Act 2002, Article 329). Liability under the *UK Proceeds of Crime Act 2002* is therefore similar to that regulated by the (Polish) national legislation and concerning liability for unintentional handling of stolen goods, resulting from Article 292 of the Criminal Code, according to which, *'whoever acquires or assists in disposing of an item which, based on the accompanying circumstances, should and may be presumed to have been obtained as a result of a prohibited act, or accepts or assists in concealing such an item, shall be subject to a fine, custody or imprisonment* (Journal of Laws of 2022, item 1138, as amended)'.

The provisions of the *UK Proceeds of Crime Act 2002*, moreover, implement the recommendation of Article 9(3) of the Council of Europe Convention of 16 May 2005 on counteracting money laundering, signed in Warsaw, according to which, *'any party may assume that in order to be considered a money laundering activity, it is sufficient*

that the perpetrator suspected that the property taken into possession came from the commission of a criminal act or should have assumed that the property came from the commission of another criminal act based on the accompanying circumstances (Council of Europe, CETS No. 198, 2005)'.

For the purpose of summarising the argument on the premises of liability for money laundering, it is worth mentioning that auditors are a professional group that has entered the ranks of obliged institutions within the meaning of the Act on Counteracting Money Laundering and Terrorism Financing (Journal of Laws of 2023, item 1124), in relation with the foregoing and in the context of Article 355 para. 2 of the Civil Code, already referred to in the introduction (Journal of Laws of 2022, item 1360, as amended), and are expected to exercise a superior standard of diligence in establishing business relationships with clients. In this context, it is also worth recalling the severe criminal liability referred to in Article 156 para. 1 of the Act on Counteracting Money Laundering and Terrorism Financing, according to which, *'whoever, acting for or on behalf of an obliged institution, fails to comply with the obligation to notify the General Inspector of Financial Information of circumstances that may indicate a suspicion that a money laundering or terrorism financing crime has been committed, or with the obligation to notify the General Inspector of Financial Information of a reasonable suspicion having been raised that a certain transaction or assets subject to the transaction may be related to money laundering or terrorism financing, shall be subject to a penalty of imprisonment from 3 months to 5 years.'* (Journal of Laws of 2023, item 1124). More information on the obligations of statutory auditors as an obliged institution has been presented further herein.

The imposition of special obligations with regard to establishing business relationships with clients, on statutory auditors and also on other public officials such as attorneys, legal advisers, notaries public and tax advisers, did not come out of nowhere. In this context it is worth recalling that the Financial Action Task Force (FATF) established in 1989 by G7 members, has drawn attention to the role of gatekeepers, i.e., public officials instrumentally used by criminals for the purposes of concealing the source of criminal assets, as early as in the 1990s of the previous century. The 2019 FATF report entitled *FATF Guidance for a Risk-Based Approach for the Accounting Profession* (which replaced its previous version issued in 2008, which in turn replaced earlier FATF considerations) identifies the following areas of increased risk of involvement in money laundering, faced by the accounting professionals, including statutory auditors and audit firms (FATF, 2019, p. 11):

- financial and tax advice – criminals may impersonate legitimate companies and seek the support of professionals in raising funds, managing the capital under their control, or in optimising taxes. Although in many

cases such advice will concern legitimate revenues, where the source of assets is related, directly or indirectly, to the commission of crimes, any assistance in managing and potentially concealing the source of the funds used may be treated as complicity or aiding and abetting money laundering;

- support in the establishment of companies and trusts – criminals may attempt to mask the links between assets under their control and their source by way of creating corporate structures that distance or eliminate personal links visible to third parties between the capital and its real beneficiary;
- brokerage in the acquisition or disposal of assets or an organised part of an enterprise – criminals may use asset ownership transfers as a way of distancing the crime scene from the place of use of proceeds from the crime committed. This makes it difficult to both subjectively and objectively link assets to criminal acts. Using the assistance and reputation of professional intermediaries and advisers to act as the aforementioned gatekeepers may also serve to lull the vigilance of law enforcement authorities and other obliged institutions such as banks, which will often rely on the credibility and diligence of statutory auditors and audit firms in selecting business partners;
- making financial transactions for or on behalf of a client – criminals may use accounting professionals to make such transactions in order to make the rationale of the economic purpose of the financial operation plausible;
- gaining access to financial institutions – criminals can use accounting professionals as intermediaries to manage relationships with financial institutions, thus in this way avoiding direct exposure to potentially uncomfortable questions.

It is also worth remembering that although the primary task of audit firms and statutory auditors who function within their structures is to *'provide auditing services'* Article 47 para. 1 of the Act on Statutory Auditors (Journal of Laws of 2023, item 1015); however, in keeping with Article 47 para. 2 of the Act on Statutory Auditors (Journal of 2023, item 1015), an audit firm may also provide the following services:

- bookkeeping and taxation services;
- tax consultancy;
- conducting bankruptcy or liquidation proceedings;
- publishing or training activities in the area of accounting, auditing and taxation;
- preparation of expert reports or economic and financial opinions;

- consultancy or management services that require knowledge of accounting, auditing, tax law, and business organisation and operations;
- provision of attestation services other than auditing services, other than those reserved for statutory auditors;
- provision of related services;
- provision of other services reserved by separate legal regulations for statutory auditors (Journal of Laws of 2023, item 1015).

In comparing the scope of services provided by statutory auditors and audit firms in accordance with the Act on Statutory Auditors, Audit Firms and Public Supervision (Journal of Laws of 2023, item 1015) with the FATF-indicated areas of higher risk of money laundering exposure for statutory auditors and accountants (FATF, 2019, p. 11), it is easy to see many potential points of contact between the areas of the risk of money laundering and the scope of activities reserved by law for statutory auditors and audit firms.

In the course of providing auditing services, a statutory auditor may come across traces of transactions and other business events that do not have an obvious business rationale and may raise questions in terms of a potential connection to money laundering. For example, an audit firm's client company acquires a new shareholder whose ownership structure does not allow for the parties that control the entity to be identified, and simultaneously the shareholder's registered office is located in a country with a high corruption perception index, and with the acquisition of the shareholder, new entities appear as the company's partners that generate high turnover, both revenues and expenses, although the transactions made with these entities seem to have no economic sense. In addition, such operations with new partners do not generate profits, despite their very high turnover, and furthermore, they are for goods stored in the warehouse area of a third party (which is also a new supplier of the warehouse space, despite the fact that the client has its own warehouse resources, some of which are unused).

The client has no accounting evidence of the actual flow of goods to which the financial flows allegedly relate. There is a risk of fictitious commodity trading, masking the true economic sense of financial flows.

Having a status of an obliged institution and being required to comply with a superior standard of diligence in their operations under the provisions of the Civil Code (Journal of Laws of 2022, item 1360, as amended) and of the Act on Statutory Auditors (Journal of Laws of 2023, item 1015), statutory auditors and the audit firms they represent cannot remain apathetic to red flags and risks linked to clients' participation in unlawful activities.

The audit firm's liability, at least the indirect one, for fulfilling its obligations under the Act on Counteracting Money Laundering and Terrorism Financing (Journal of Laws of 2023, item 1124), results from the fact that, pursuant to Article 3(2) of the

Act on Statutory Auditors and their Self-Regulatory Body, Audit Firms and Public Supervision (Journal of Laws of 2023, item 1015), statutory auditors may act as:

- an individual carrying out business activities in their own name and for his own account, or
- as a partner in an audit firm, or
- an individual in an employment relationship with an audit firm, or
- an individual, including a self-employed person, who has made a civil law contract with an audit firm.

However, whenever a statutory auditor acts within the structures of an audit firm, they are acting on behalf of such an audit firm.

Therefore, it is in the interest of an audit firm to ensure that all statutory auditors acting within its framework perform their duties with due diligence. A cautious analogy can be made here to the need to develop a group procedure, as provided for in Article 51 of the Act on Counteracting Money Laundering and Terrorism Financing (Journal of Laws of 2023, item 1124).

At this point it is worth mentioning that according to Article 2(1)(3)(a) of Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorism financing, amending Regulation (EU) No. 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (Directive (EU) 2015/849) *‘This Directive shall apply to (...) the following natural or legal persons acting in the exercise of their professional activities: auditors.’* The directive refers explicitly to natural and legal persons acting as auditors, and therefore also to audit firms. Unfortunately, the implementation of this provision to Article 2, para. 1, pt. 15 of the applicable Act on Counteracting Money Laundering and Terrorism Financing (Journal of Laws of 2023, item 1124) remains non-obvious, and a recourse to an extensive interpretation would be, in the context of imposing obligations on entrepreneurs, inconsistent with Article 22 of the Constitution of the Republic of Poland: *‘freedom to conduct a business may only be restricted by law and only for reasons of important public interest’* (Journal of Laws No. 78, item 483, as amended) and with Article 8 of the Act on Entrepreneur Law, *‘an entrepreneur can only be obliged to act in a certain way in keeping with the provisions of law’* (Journal of Laws of 2023, item 221, as amended). However, it is worth clarifying this issue, as even the Polish Chamber of Statutory Auditors, by letter of 30 January 2020, made an inquiry to the Inspector General of Financial Information, asking it whether *‘the obliged institution is a statutory auditor or an audit firm’* (PIBR, AML for Statutory Auditors). As of the date hereof, an official answer to this question has not been made publicly known. However, irrespective of this answer, audit firms should always exercise due diligence, both in terms of the risk of establishing a toxic business relationship

and, at the very least, mitigating the risk of potential criminal liability for collective entities (Journal of Laws of 2023, item 659).

Further on herein, an attempt is made to explain how to ensure compliance with law and why inactivity is not the best approach, as well as how to reduce exposure to the risk of toxic business relationships.

2. Legal consequences of establishing a toxic business relationship in the context of money laundering exposure

'Toxic business relationships' within the meaning of a dictionary of the Polish language (PWN, SJP, n.d.) and for the purposes hereof, can be defined as those, the establishment of which results in adverse consequences for one of the parties. In the event that a statutory auditor or audit firm enters into a relationship with a business entity involved in money laundering operations referred to in the title hereof, adverse consequences can potentially be very severe, both in terms of liability of statutory auditors as individuals and of audit firms themselves as collective entities.

In the context of national legislation on criminal liability of collective entities (Journal of Laws of 2023, item 659), the regime of liability for acts committed by employees and subcontractors implies that in order to bring criminal charges against a collective entity, the following three qualifying conditions for such liability must be met together:

- firstly, a 'prejudication' [prejudykat] is required, i.e., a situation in which the fact that a criminal act has been committed by a person acting on behalf of or for a collective entity has been confirmed by a final court judgment convicting that person (the exception is an environmental offence, in the case of which prejudication is not required);
- secondly, an act committed by a person acting on behalf of or for the benefit of a collective entity constitutes a catalogue offence [przestępstwo katalogowe] under Article 16 of the Act on the Liability of Collective Entities, (Journal of Laws of 2023, item 659); catalogue offences include, in particular, an offence referred to in Article 299 of the Criminal Code, i.e., participation in money laundering (Journal of Laws of 2022, item 1138, as amended);
- finally, the behaviour of the perpetrator brought or could have brought a collective entity an advantage, albeit a non-pecuniary one (this could be, for example, an audit fee specified in a contract with a client).

A collective entity bears criminal liability if the trial authority proves in criminal proceedings the above three prerequisites for liability towards an individual, and additionally demonstrates that the collective entity failed to exercise due diligence in:

- election of its representative or employee,

- supervision over that person, and
- organisation of activities; here in the context of money laundering, the following aspects are of particular significance: internal procedures, employee training, designation of a person responsible for counteracting money laundering, and documented monitoring of the implementation of obligations under internal procedures and counteracting money laundering and terrorism financing regulations (Journal of Laws of 2023, item 1124).

Potential sanctions, in the event of a final conviction, are extremely severe, as the catalogue of penalties provided for by the Act on the Liability of Collective Entities (Journal of Laws of 2023, item 659) includes, in particular:

- financial penalties in the amount of between PLN 1,000 and PLN 5,000,000, but no more than 3% of the revenue generated in the fiscal year in which the criminal act giving rise to the liability of the collective entity is committed;
- mandatory forfeiture of financial gains derived, even if indirectly, from the commission of a criminal act;
- ban on promoting or advertising the activities carried out (for up to 5 years);;
- ban on using grants, subsidies or other forms of financial support with public funds (for up to 5 years);
- ban on bidding for public contracts (for up to 5 years), and finally
- making a criminal judgment public.

In addition, criminal liability of audit firms and statutory auditors may also arise from the provisions of the Act on Counteracting Money Laundering and Terrorism Financing, as well as from Article 299 of the Criminal Code (at this point it is worth reminding of liability only for intentional acts or omissions).

Criminal provisions and administrative penalties provided for in sections 13 and 14 of the Act on Counteracting Money Laundering and Terrorism Financing include, in particular:

- a financial penalty imposed up to twice the amount of the benefit gained or loss avoided by the obliged institution as a result of a breach or, if it is not possible to determine the amount of that benefit or loss, up to the equivalent of EUR 1,000,000 (higher financial penalty thresholds are naturally applicable to financial institutions);
- publication of information on the obliged institution and the scope of a breach of the Act by this institution in the Public Information Bulletin on the website of the authority providing services to the minister responsible for public finance;
- an order to make the obliged institution cease conducting certain activities
- withdrawal of a license or authorisation or deletion from the register of regulated activities;

- a ban against any person who holds a managerial position and who is held responsible for a breach of the Act by the obliged institution, for a maximum period of one year;
- a penalty of imprisonment of up to 5 years for any person who *'fails to comply with the obligation to notify the General Inspector of Financial Information of circumstances that may indicate a suspicion that a money laundering or terrorism financing crime has been committed, or with the obligation to notify the General Inspector of Financial Information of a reasonable suspicion having been raised that a certain transaction or assets subject to the transaction may be related to money laundering or terrorism financing'* (Journal of Laws of 2023, item 1124).

In addition, criminal liability is without prejudice to the rights to make civil claims against auditors (depending on the configuration of criminal liability and culpability, both of a statutory auditor and an audit firm itself). This is because a claim for damages can be made by stakeholders who find that they have suffered damages due to a lack of anti-money laundering diligence on the part of an auditor of the financial statements. For example, statutory auditors examine financial statements of a joint-stock company, but they fail to raise objections in their auditor's report on the audit of financial statements, although during the reporting period the client engaged in money laundering, which affected the integrity and reliability of the client's financial statements. In the meantime, the audited company issues new shares or bonds, which are acquired by investors relying on the statutory auditor's lack of objections to the proper presentation of the issuer's financial condition. Then it turns out that the issuer was involved in crimes against its clients or was used to launder money, and the statutory auditors did not exercise due diligence in assessing the consequences of this illegal activities, although they should have asked the 'troubling' questions concerning some of the entries in the financial statements before the client's improper operations became known to the public. As a consequence, investors suffer damage as a result of a misguided investment and have trouble retrieving the amounts due from the issuer, for example, because the prosecutor's office has initiated preparatory proceedings. Therefore, they claim damages against the audit firm, claiming that its auditor's report misled them and that it was a direct cause for the adverse disposition of property, i.e., the erroneous investment that led to a damage being incurred by the investors.

This is a scenario that should never be overlooked, or that should always be considered (i.e., the so-called front-page test). In the most pessimistic scenario, if it is proven that the audit firm bears criminal liability, by virtue of lack of diligence in supervision, selection and organisation of work, against an employee who in complicity with the audit firm's client committed a money laundering crime, this may lead to a loss by the audit firm involved of insurance coverage against claims relating to the

consequences of the participation in the commission of a money laundering crime under Article 299 of the Criminal Code. This very adverse scenario which, although highly unlikely, is not impossible.

At this point, it is possibly worth adding that the finding of a statutory auditor guilty or an audit firm culpable for the lack of due diligence in a criminal trial makes it easier to pursue claims on the part of a claimant in a civil trial. According to the provisions of Article 11 of the Code of Civil Procedure, *'The findings of a final judgement of conviction in criminal proceedings as to the commission of a crime are binding on the court in civil proceedings'* (Journal of Laws of 2021, item 1805, as amended). Meanwhile, any conviction also confirms that the culpable act or omission was committed by the convicted person, since guilt, along with the unlawfulness and social harmfulness of the act, is one of the three necessary prerequisites for criminal liability. Pursuant to Article 1 of the Criminal Code (Journal of Laws of 2022, item 1138, as amended):

- criminal liability is incurred only by those who commit an act prohibited under penalty in accordance with laws in force at the time of commission,
- a criminal act whose social harm is insignificant does not constitute a crime,
- a perpetrator of a criminal act does not commit a crime if guilt cannot be attributed to them at the time of the act being committed.

In accordance with the provisions of Article 413 para. 1 pt. 5 of the Code of Criminal Procedure (Journal of Laws of 2022, item 1375, as amended), *'every (criminal court) judicial decision should include (...) a justification'*, which in practice *'takes the form of finding the defendant guilty of the crime concerned'* (Stefański, Zablocki, 2021). However, in the judicial decisions issued by criminal courts, there is no doubt that *'the omission therein of the phrase confirming that defendants are found guilty of the act alleged is a procedural defect'* (II AKa 30/99, Wokanda 2000, No. 2, item 43). Thus, a civil court is obliged to consider the final criminal judgment as a sufficient premise confirming the culpability and description of the act from the operative part of the criminal judgment, since *'the findings of a criminal conviction issued in criminal proceedings bind the civil court as to all the factual circumstances necessary for the existence of the crime for which the perpetrator is convicted, and in particular all the circumstances that form part of the subjective and objective parts'* (Manowska, LEX/el. 2022, Article 11), which indeed makes it easier to demonstrate the causal link between the culpable act and the effect, in the form of compensation sought in the criminal proceedings for the damage caused.

On the other hand, according to Article 415 of the Civil Code, *'Whoever, through their own fault, caused damage to another, is obliged to make good any such damage caused'* (Journal of Laws of 2022, item 1360, as amended). Furthermore, Article 430 of the Civil Code introduces the concept of liability for subordinates, indicating that, *'whoever, on their own account, entrusts the performance of a task*

to a person who, in the performance of that task, is subject to their management and is obliged to comply with their instructions, such a person is liable for damage caused through the fault of that person in the performance of the task entrusted (Journal of Laws of 2022, item 1360, as amended).

The scope of liability for damages, however, is indicated by Article 361 of the Civil Code, according to which, *the liable party bears liability only for normal consequences of the act performed or of any omission to act which caused the damage incurred, and the making good of the damage caused consists in covering losses incurred by the party concerned and in providing benefits that the party concerned would have gained, were damage not caused* (Journal of Laws of 2022, item 1360, as amended).

3. Managing the risk of exposure to money laundering

Given the severe penalties for establishing relationships with entities involved in money laundering, and, in the context of the provisions of the Act on Counteracting Money Laundering and Terrorism Financing (Journal of Laws of 2023, item 1124), the liability for failing to implement procedures and preventive controls provided for in this Act, it is extremely important that statutory auditors and audit firms manage the risk of entering into toxic relationships with clients.

Just for the sake of argument, let's summarise that the risk means the measurable probability of damage, (Wikipedia, Risk) and therefore, in keeping with Article 361 para. 2 of the Civil Code, *the loss incurred by the injured party and the benefit that they could have been provided with, were damage not caused* (Journal of Laws of 2022, item 1360, as amended).

Furthermore, the society we live in nowadays is a global risk society, and the 21st century is a risk globalisation century, in which nothing that happens is just a local event, and all significant risks have become global risks (Beck, 2012). In this context, we must view relationships with clients not only from a national perspective, but also in an international context. In translating the foregoing into the area of money laundering, the underlying act, within the meaning of Article 299 of the Criminal Code, is very often committed at a considerable distance from the place of money laundering, i.e., abroad, while the proceeds gained end up in Poland.

On the other hand, risk management is defined as *'coordinated activities relating to the direction and supervision of an organisation with respect to risks'* (PKN, Risk Management) and such activities include *'risk identification, analysis, and subsequent evaluation'* (PKN, Risk Management).

In translating the aforementioned definition, made available on the website of the Polish Committee for Standardisation (Polski Komitet Normalizacyjny, PKN) into the language of business, it relates to:

- diagnosing the probability of damage being incurred by an organisation and measuring this potential damage (if a risk materialises in the form of an event causing damage), i.e., determining a potential impact, measured in money, of the materialisation of risk on the organisation's performance and indicating the probability of this materialisation (inherent risks);
- adjusting the diagnosis against inherent risks based on the controls identified in business processes, leading to reduction in the impact of risks on the organisation (in terms of the probability or value of potential damage); the result of the adjustment made is the determination of a residual risk,
- determining the organisation's risk appetite, i.e., determining of whether the residual risk falls within the range of the organisation's acceptable risk levels, and of whether the monitoring of changes in the level of probability and in the value of potential damage forms a sufficient measure of monitoring the risk levels. However, if the risk appetite is lower than the exposure to residual risks, it is necessary to develop a strategy and plan for reducing the risk exposure in order to bring it closer to the level acceptable to the company's management.

The foundations of risk management methodology are obviously not significantly different from the general management theory understood as '*A set of activities including planning, decision-making, organising and leading, directed at the organisation's resources (human, financial, physical and information) and carried out with an intention to make the organisation achieve goals in an efficient and effective manner*' (Kisielnicki, 2008, p. 14).

The most up-to-date and available in the public domain National Risk Assessment of Money Laundering and Terrorism Financing was prepared by the Ministry of Finance (Financial Information Department) in 2019 (Department of Financial Information, National Risk Assessment, 2019, pp. 148–149). According to the document, in 2017 the Financial Information Department at the Ministry of Finance addressed a survey to obliged institutions and cooperating units, asking them to identify five properties of entities participating in business transactions or of products or services available in the financial market, which are or may be the most frequently used for the purposes of money laundering. The survey included a list of potential risk areas, and in particular an area of money laundering risk designated as '*services provided by auditors*'.

According to the survey, the highest money laundering risk was associated with:

- cryptocurrency trading operations;
- cross-border physical transportation of money, securities and other highly valuable assets (including works of art, jewellery, precious stones, gold and luxury goods);
- clients registered in tax and financial havens;

- slot machine games and exchange of chips in gambling casinos;;
- purchases/ sales.

With regard to statutory auditors and audit firms, information on the above risk areas may be of significance at the stage of assessing the risk of entering into a relationship with a client engaged in one of the above activities. In addition, *Krajowa ocena ryzyka prania pieniędzy oraz finansowania terroryzmu* [lit. *National Risk Assessment for Money Laundering and Terrorism Financing*] includes, among other, risk scenarios relating to public officials, in particular, statutory auditors. These scenarios are available in Annex No. 2 to the aforementioned national assessment, entitled *Scenariusze ryzyka prania pieniędzy* [lit. *Money Laundering Risk Scenarios*] (Department of Financial Information, Annex No. 2 to the National Risk Assessment, 2019, p. 35) [accessed:27/07/2023]. The aforementioned scenario relating to statutory auditors and audit firms, reads as follows: *‘assisting criminals (often without awareness of the real purpose) in carrying out transactions for the purchase of real estate and high-value goods, establishing and operating business entities, foundations and trusts, and carrying out financial transactions by lending their bank accounts’*.

Although the aforementioned scenario does not seem to apply to the core activity of a statutory auditor, i.e., to auditing, however, the *‘assisting’* in the *‘establishing and operating business entities’* can be interpreted differently in specific factual situations, but obviously, in the final conclusion, the scope of potential criminal liability for *‘assisting’* depends on the demonstration of intentional guilt on the part of the perpetrator (statutory auditor) charged with the allegation of money laundering or of assisting in such operations. Auxiliary services referred to in Article 47 para. 2 of the Act on Statutory Auditors and their Self-Regulatory Body, Audit Firms and Public Supervision (Journal of Laws of 2023, item 1015), may also include the aforementioned money laundering risk scenario.

In *Krajowa ocena ryzyka prania pieniędzy oraz finansowania terroryzmu* [lit. *National Risk Assessment for Money Laundering and Terrorism Financing*] (Department of Financial Information, National Risk Assessment, 2019) it has been highlighted by the Department of Financial Information that with regard to public officials, *‘a money laundering operation within the scope of the analysed scenarios is highly likely to be detected, and then the perpetrators will be charged and convicted as a result of the investigation carried out’* (Department of Financial Information, Annex No. 2 to the National Risk Assessment, 2019, p. 35). It has been pointed out, however, that *‘entities providing such services are the obliged institutions [within the meaning of the Act on Counteracting Money Laundering and Terrorism Financing] and have some awareness of their obligations in the area of counteracting money laundering. However, they provide no information or relatively little information on suspicious transactions/activities’*

to the Department' (Department of Financial Information, Annex No. 2 to the National Risk Assessment, 2019, p. 35).

According to the Department of Financial Information, *'the use of third-party intermediaries to transfer and legitimise funds from illegal sources poses a very high risk of money laundering'* (Department of Financial Information, Annex No. 2 to the National Risk Assessment, 2019, p. 35). At the same time the Department of Financial Information *'has a limited ability to collect and analyse information'* (Department of Financial Information, Annex No. 2 to the National Risk Assessment, 2019, p. 35) arguably due to a low level of the suspicious transactions reported, coupled with an insignificant amount of data concerning clients of public officials that the Department can analyse in an automated manner, which, by the way, results from the nature of *'public officials'*.

Thus, it can be concluded that statutory auditors and audit firms are subject to obligations under anti-money laundering regulations, and a risk of *'using their intermediation to legitimise funds from illegal sources triggers a very high risk of money laundering'* (Department of Financial Information, Annex No. 2 to the National Risk Assessment, 2019, p. 35), and this in turn leads to the conclusion that the requirement for diligence on the part of statutory auditors and audit firms is a must. This is because the only way to defend against criminal charges or administrative penalties under the regulations is to demonstrate due diligence counteracting money laundering regulations. The ability to demonstrate due diligence is of particular relevance in view of the opinion of the Ministry of Finance's Department of Financial Information that *'a money laundering operation is highly likely to be detected, and then the perpetrators will be charged and convicted as a result of the investigation carried out'* (Department of Financial Information, Annex No. 2 to the National Risk Assessment, 2019, p. 35).

The issue of the correct implementation of procedures for counteracting money laundering by statutory auditors and audit firms is an area of supervision, on the part of both the Polish Agency for Audit Oversight, in accordance with Article 88 et seq. of the Act on Statutory Auditors and their Self-Regulatory Body, Audit Firms and Public Supervision (Journal of Laws of 2023, item 1015), and the General Inspector of Financial Information, pursuant to Article 130 of the Act on Counteracting Money Laundering and Terrorism Financing (Journal of Laws of 2023, item 1124). Nevertheless, having a procedure is only part of an effective programme for counteracting money laundering. The second important element is its dynamic application. A dynamic one, as it may in certain situations lead to a refusal to enter into a contract with a client, or to a termination of the contract signed and notification of the General Inspector of Financial Information, or to the reporting of information about the client's suspicious behaviour by a client (*SAR* or *Suspicious Activity Report*). All of this, of course, may lead to the resignation

from some of the revenues, and this is inevitably related to a conflict of interest and mechanisms known as the ‘*Cressey triangle*’ (also known as the ‘*fraud triangle*’) (Wikipedia, Donald Cressey).

The issues of counteracting money laundering also remain a current and priority problem on the agenda of not only national (PANA), but also European audit oversight bodies, as evidenced by the contents of the *2023 Law Enforcement Report. Report on the 2023 CEAOB Enforcement Questionnaire*, (PANA, 2023) prepared by the Investigation Subgroup forming part of the Committee of European Auditing Oversight Bodies (CEAOB). The report informs that gaps in the counteracting money laundering controls have been the subject of administrative proceedings and of responses by both non-financial (in many EU countries) and financial (in Sweden) oversight bodies for many entities that do not comply with the counteracting money laundering regulations.

In order to avoid inconveniences of participating in administrative and criminal proceedings concerning violations of the provisions of the Act on Counteracting Money Laundering and Financing of Terrorism (Journal of Laws of 2023, item 1124), it is worth taking a look at the scope of obligations that the aforementioned Act imposes on the obliged institutions, within the area of combating the use of the national financial system for money laundering and terrorism financing, and indirectly also for complying with economic sanctions directed against Russia in connection with the armed aggression against Ukraine (Consilium Europe, EU, Summary).

The obligations of the obliged institutions under the Act on Counteracting Money Laundering and Financing of Terrorism (Journal of Laws of 2023, item 1124) have been detailed in its sections 4, 5, 7, 8, 9 and 10. As far as statutory auditors are concerned, these obligations concern the issues specified below.

- 1) Assessing the risk of exposure to money laundering, taking into account the business profile (services provided) and risk factors regarding clients, countries or geographic areas, transactions or their supply channels.

The risk assessment must be documented and updated at least every two years. *Krajowa ocena ryzyka prania pieniędzy [National Risk Assessment for Money Laundering]* (Department of Financial Information, National Risk Assessment, 2019) prepared by the General Inspector of Financial Information, and an assessment for the EU territory prepared at the request of the European Commission, e.g., for the financial sector by the European Banking Authority (EBA), (EBA, 2021).

- 2) Identifying and verifying the identity of:
 - a) the client, i.e., the other party to a contract with a statutory auditor or audit firm,

- b) the client's beneficial owner, i.e., a natural person who directly or indirectly controls the client through the powers they possess as a result of legal or factual circumstances, enabling them to exercise decisive influence over the client's acts or activities.

If the client is either a legal entity or an organisational unit, or a trust, it is necessary to determine the ownership and control structure of the client (what helps in practice is a graphic presentation in the form of a flow chart).

If the client itself is a company or is controlled by a company whose securities are admitted to trading on a regulated market, subject to disclosure requirements under the EU legislation or corresponding laws of third countries, it may be considered a beneficial owner of the client. A valuable source of information on beneficial owners of collective entities registered in Poland is the Central Register of Beneficial Owners (Central Register of Beneficial Owners, CRBR), the operation of which is regulated by the Act on Counteracting Money Laundering and Terrorism Financing (Journal of Laws of 2023, item 1124).

However, pursuant to the Act on Counteracting Money Laundering and Terrorism Financing, the identity of beneficial owners may not be verified solely against information from the Central Register of Beneficial Owners or a corresponding register in another country (in practice: it is worth requesting that clients provide corporate documents confirming the identity of the beneficial owner, for example, in the form of a copy of the company's share book or articles of association, or information entered in the National Court Register or a similar register). If this is difficult, what can be of help is to consult information entered in one of the commercial databases or, in case of doubt as to whether the documents provided by the client are reliable, ask a business intelligence service for assistance. In addition, if during verification of the beneficial owner's the identity it turns out that there are discrepancies between the contents of the Central Register of Beneficial Owners and the data received from the client or concerning the client obtained from other sources, the obliged institution shall determine the discrepancies between information in the register and information about the client's beneficial owner and shall take steps to clarify the discrepancies found. If the discrepancies are confirmed, the obliged institution shall provide the minister responsible for public finance with updated information on the discrepancies, together with justification and documentation concerning the discrepancies found;

- c) the person representing the client for the purposes of signing the contract and submitting declarations of intent on behalf of the client

(in practice: a power of attorney or an authorisation to represent the client resulting from the National Court Register (KRS, n.d.) [accessed: 27/07/2023] or other company register, e.g., the UK Companies House. (UK Companies House).

- 3) If it is not possible to identify and verify the identity of the client, beneficial owner or person representing the client, the obliged institution may not establish a business relationship with the client, and furthermore it should consider notifying the Ministry of Finance's Department of Financial Information of the suspected money laundering (if may be indicated by the factual circumstances).
- 4) Ongoing monitoring of the client's economic relationships. As a general rule, statutory auditors and audit firms will be able to monitor the clients' economic relationships in practice during the provision of services to clients, and this will involve maintaining a critical approach towards the statements and documents provided by clients in the course of providing services, but also based on other circumstances in relationships with clients such as the client's use of a bank account held by a bank or country considered to be a high-risk location, without reasonable justification for such action.
- 5) Documentation of the financial security measures applied, so that at the request of the authorised authorities, the obliged institutions are able to demonstrate that, taking into account the level of the identified risk of money laundering and terrorism financing associated with the business relationship or occasional transaction in question, they have applied appropriate financial security measures. Documentation related to the identification and verification of the identity should be kept on an ongoing basis and retained for a 5-year period starting from the termination of business relationships with the client. In turn, the results of regular analyses of business relationships should be kept each time for a 5-year period starting from the date of their carrying out.
- 6) Informing clients prior to the establishment of a business relationship about the processing of their personal data, and in particular, about obligations of the obliged institution under the personal data processing laws (in practice: such a statement legitimises our questions about information and data, and additionally indicates the legal basis for the processing of personal data within the meaning of the GDPR (Regulation (EU) 2016/679).
- 7) In the case of higher-risk customers, due to the politically exposed status or higher-risk geographic location, or to information on adverse media, additional actions are required on the part of the obliged institution, such as an approval by senior management to establish a relationship with the customer, or more frequent monitoring of a business relationship, including

a lower threshold on the reliability of the client's statements on its business activities, requirement of additional documentation to support these statements, as well as greater inquisitiveness with regard to determining the source of the client's assets.

- 8) Introduction of an internal procedure for counteracting money laundering and terrorism financing, hereinafter referred to as the '*internal procedure of the obliged institution*'. Obligated institutions that form part of a capital group (group of companies) shall implement a group procedure for counteracting money laundering and terrorism financing, hereinafter referred to as the '*group procedure*', in order to fulfil the obligations of the capital group and its members set forth in anti-money laundering legislation.
- 9) The procedure for counteracting money laundering must set out rules for anonymous reporting by employees of factual and potential violations of counteracting money laundering regulations (whistleblowing procedure).
- 10) Provision of training on counteracting money laundering regulations (what is worth doing in practice is to document this training, as part of the due diligence audit procedure).
- 11) Notification of the General Inspector of Financial Information of circumstances that may be indicative of a suspected money laundering or terrorism financing crime. The notification shall be made immediately, but no later than within two working days of confirmation of the suspicion by the obliged institution. The obliged institution may not inform the client of the notification made to the General Inspector of Financial Information. Violation of this prohibition results in financial penalties being imposed on the obliged institution.
- 12) For the purposes of counteracting terrorism and terrorism financing, obliged institutions also apply specific restrictive measures against persons and entities on terrorism lists (both national ones and those used by the UN Security Council). In practice, there are also EU sanctions and the US list maintained by the Office of Foreign Assets Control (OFAC).

At this point, it is also worth mentioning sanctions against Russia as a result of the Russian aggression against Ukraine, under which, in addition to the Act on Counteracting Money Laundering and Terrorism Financing, restrictions have been imposed on the establishment of relationships with sanctioned entities. For example, as of 4 June 2022, it is prohibited to provide, directly or indirectly, accounting and auditing services, including audits, bookkeeping and tax consulting, as well as business and management consulting or public relations services to state institutions and companies and other legal entities registered on Russian territory (Consilium, Europe, EU).

In practice, specific restrictive measures and other economic sanctions require ongoing verification of whether clients, their beneficial owners or client representatives are not entered in sanction lists, which are subject to updates on an ongoing basis. For larger audit firms, such verification is practically impossible without the use of technology to support verification (if only in the context of various records of foreign names) and the support of commercial tools that provide data on current sanction lists and solutions that automate ongoing (regular/cyclical) verification of clients against up-to-date sanction lists.

In the case of the obliged institutions that carry out one-man operations, the tasks related to the fulfilment of the counteracting money laundering obligations are performed by the person carrying out such activities. In other cases, the obliged institutions shall designate senior management responsible for carrying out the duties set forth in the Act, and also an employee in a managerial position responsible for ensuring that the activities of the obliged institution and its employees and other persons performing activities on behalf of the obliged institution comply with the anti-money laundering and terrorism financing regulations. The scope of obligations of the obliged institutions under the Act is intended to be, as a rule, proportional to the profile of activities of the obliged institution, and valuable support for its application can be found in the Communications of the General Inspector of Financial Information made available on the website of the Ministry of Finance's Department of Financial Information, in the Communications [Komunikaty] section (General Inspector of Financial Information, Communications).

Failure to apply financial security measures, on the other hand, results, as mentioned above, in severe penalties being imposed – Chapter 13 and 14 of the Act (Journal of Laws of 2023, item 1124).

An interesting point of reference for solutions used by businesses around the world in risk management at the stage of establishing a relationship with a counterparty is the report entitled '*Combating Business-to-Business Fraud: Benchmarking Report*', published in June 2023 by the Association of Certified Fraud Examiners (ACFE) and Thomson Reuters (ACFE and Thomson Reuters, 2023). In keeping with the report, regardless of the status of the obliged institution, the most significant areas of risk analysed when establishing a relationship with clients are as follows:

- a risk that the client, its body member or authorised representative, or the client's beneficial owner are on the list of international sanctions (both anti-terrorist and economic, as in the case of Russia) – 75% of respondents considered this risk to be crucial;

- a risk of cooperation with a high-risk industry or a client from a high-risk country (corruption, economic sanctions, etc.) – respectively 65% and 63% of respondents;
- a risk of politically exposed person (PEP) status and of the presence on criminal records or involvement in media legal disputes – respectively 61% and 60% of respondents;
- other risks such as a risk of the client’s beneficiary owner being located in a high-risk country or a risk of adverse media, however other than that related to criminal liability or high-profile civil proceedings – respectively 55% and 48% of respondents.

It is not surprising that the risk areas already referred to in the Act on Counteracting Money Laundering and Terrorism Financing (Journal of Laws of 2023, item 1124) reappeared as part of the ACFE and Thomson Reuters survey on the overall management of a toxic counterparty relationship risk (ACFE and Thomson Reuters, 2023). This is the result of the aforementioned global risk society syndrome (Beck, 2012) and the globalisation of risk as part of the overall trend of globalisation and colonisation of the economy by risk (WHO, 2023).

The ACFE and Thomson Reuters report also indicates that two key aspects of evaluation when establishing a relationship with new customers among respondents are as follows:

- identification and verification of the identity of the beneficiary owners, and
- screening against sanctions.

However, the most popular source of information on the beneficiary owner is information provided directly by the client (81% of respondents). Other typical methods for obtaining knowledge about a real beneficiary include using a third-party data provider (71%) or conducting an open-source internet research (OSiNT) – 59% (ACFE and Thomson Reuters, 2023, p. 16).

In addition, procedures that are currently the most commonly used by the majority of organisations for the purposes of monitoring a business relationship on an ongoing basis, once it has been established, include the following:

- monitoring adverse media on clients; and
- automated periodic verification of sanction lists.

Moreover, the two areas with the greatest potential for use in the ongoing monitoring of relationships with clients are:

- the use of artificial intelligence/machine learning; and
- the use of data collected as part of the consortium of companies.

Although the majority of organisations are not yet using these solutions, more than 40% of those surveyed expect to do so in the near future (ACFE and Thomson Reuters, 2023, p. 19).

At this point it may be worth mentioning that an initiative for such a consortium in data exchange has been launched in Poland by the Union of Polish Banks (Związek Banków Polskich, ZBP) and the National Clearing House (Krajowa Izba Rozliczeniowa, KIR) as part of the Sector Centre for AML Services for Financial Institutions Sector (SCU AML) initiative.

According to the project's authors, the Sector Centre for AML service *'is a partnership venture between the KIR and the ZBP and banks established to prepare and make available a catalogue of services to support AML/CFT processes. The goal of the SCU AML is to improve the quality of AML/CFT processes through the exchange and sharing of information in the banking sector, and to reduce the cost of the process by standardising and centralising certain activities. SCU AML provides banks with information that a bank is unable to identify. The results obtained from the analyses carried out on sector data are absolutely unique and impossible for a single bank to obtain on its own'* (KIR, SCU AML).

To conclude the argument on managing the risk of exposure to money laundering and on due diligence in that respect, it is worth mentioning again the Cressey triangle referred to above. Donald Cressey devoted his life to researching organised crime and occupational fraud from a psychological and forensic perspective. As a result of his research on occupational fraud, he developed the theory of the fraud triangle, often referred to as the Cressey triangle (Wikipedia, Fraud Triangle). In keeping with this theory, the necessary conditions for fraud to occur are:

- opportunity, i.e., information on gaps in the company's control mechanisms that allow for fraud to occur;
- pressure, i.e., the causal imperative (it can be of a corrupting nature, involving a reward in return for an action or omission to act that is not in accordance with procedures or laws; alternatively, it can result from a subjective need to address a financial need or a strong need to belong, due to which one gives in to pressure for fear of exclusion);
- rationalisation, i.e., a set of principles adhered to by a fraud perpetrator, which subjectively downplay the reprehensibility of the fraud committed, or justify the perpetrator's action or omission to act in the name of some greater good. In other words, perpetrators have an internal imperative to create a subjectively positive evaluation of their objectively adverse behaviour. In practice, the perpetrator's rationalisation is derived from the organisational culture and lack of proactive promotion and reward of positive behaviour patterns.

At this point, it is worth mentioning that the US Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) in their guidelines on compliance with the American FCPA (Resource Guide to the U.S. Foreign Corrupt Practices Act, Second Edition) (SEC and DOJ, 2020) point to the value of

creating a positive culture of integrity by creating incentives for and rewarding ethics-based behaviour. According to the guidelines, *'DOJ and SEC recognise that positive motivation through incentives for ethics-based behaviour can lead to the promotion of compliance-based behaviour. Incentives can take many forms, such as regular evaluations and staff promotions, rewards for improving and developing the company's compliance programme, as well as rewards for ethics- and compliance-based leadership'* (SEC and DOJ, 2020, p. 61).

Summary

In the context of effective management of the risk of exposure to toxic business relationships in light of anti-money laundering regulations, Donald Cressey's fraud triangle points out to the way to self-improvement.

This is because there are no organisations that are completely immune to fraud, including money laundering, because fraud is committed by people who either deliberately do not follow procedures, or do not know them, or know that there is a loophole in procedures and exploit that loophole in an instrumental way.

The combating of money laundering therefore requires not only procedures and training, but also management of unjustified and excessive pressure as well as positive rationalisation associated with promoting and rewarding ethical behaviour.

In this context, it is worth remembering the seventeen (17) UN sustainable development priorities (goals) outlined in the 2030 Outlook (SDGs, or *Sustainable Development Goals*) (UN, SDGs). In keeping with the sixteenth (16th) priority titled *Peace, Justice and Strong Institutions*, for the purpose of creating a better environment for socio-economic growth of future generations, it is necessary to *'significantly reduce illicit financial flows and combat all forms of organised crime'*.

Organised crime cannot be combated effectively if criminals are permitted to benefit from proceeds of criminal acts. The proceeds of crime, on the other hand, cannot be enjoyed without money laundering.

Money laundering may also be combated by avoiding toxic business relationships and managing the risk of exposure to such relationships by public officials, in particular by statutory auditors. Owing to the application of financial security measures, two benefits can be achieved simultaneously. The first is to reduce the risk of a statutory auditor or audit firm being involved in the process of money laundering, and the second is to reduce the risk of exposure of statutory auditors and audit firms to any fraud, far beyond the set of activities defined as money laundering.

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The Imperatives of Corporate Governance

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Abstract

Purpose: The aim of the following text is essentially to highlight: The purpose of the text presented below is essentially to emphasise: (1) the developments and direction of the evolution of corporate governance principles as a guideline for the introduction of the global order in this area, (2) the importance of corporate governance for the sustainable development of economic operators, and (3) the related reporting standard which, as a conceptual framework for the presentation of corporate governance reporting information of economic organisations across the European Union, constitutes an important element of their policies.

Methodology/research approach: The presentation is based on the analysis of the official announcements and guidelines posted on the OECD website (and other cited institutions), which are collectively used here to provide a picture of the corporate governance framework/principles in global terms, followed by a confrontation with the legal regulation outlining the standard of corporate governance reporting in the European Union space.

Results: This text indicates the need to verify the operation of corporate governance in practice, simultaneously at two levels: macroeconomic and microeconomic. It identifies the sustainable development imperative as a key premise. It presents six directional recommendations for improving organisational practice and corporate governance reporting from a microeconomic perspective.

Research limitations/implications: Due to the pace of change in global corporate governance guidelines, on the one hand, and EU law relating to sustainability reporting, on the other, this text focuses on the need to recognise the current shape of principles and rules occurring on both levels. This is because it will only be possible to study their impact on various areas of business organisations and carry out



different comparative (and other) analyses in the future (from 2025 onwards), as they are implemented in practice.

Originality/value: The value of this study can be identified in the structuring of knowledge in the title area, in the presentation – through a historical outline – of the global (OECD) approach and the institutional environment relevant to the formulation of the corporate governance framework. Its usefulness is supported by the provision of recommendations that can be considered as a guideline in reviewing – at the level of the business organisation – current practices in this area.

Keywords: corporate governance, OECD, reporting, sustainable development, epidemic, Covid-19, ESG

Introduction

Corporate governance¹ is a concept that is often invoked in various contexts, but is just as often understood in different ways or not at all. Meanwhile, ‘corporate governance’ is of importance for several reasons, among many, first and foremost, for the security of economic transactions (in the sense of transparency and reliability of information on the activities of business entities, important in the decisions of various stakeholder groups) and institutional stability (in the sense of the functioning of corporate bodies, ensuring the ability to achieve corporate goals). In the latter case, corporate governance is to ‘pin down’ various interests and goals of those involved in the functioning of a company in such a way as to ensure that its operations are consistent and focused on its long-term goals.

Owing to various crisis-triggered global events, corporate governance is now in the spotlight. Forms of leadership, both in private business organisations and in public institutions, have become an object of attention for researchers inquiring into relationships between various attributes of business activity and corporate governance. The focus was not only on internal control systems and risk management. There has also been a turn toward regulatory authorities which have focused on increasing disclosure requirements related to corporate governance.

¹ In Polish literature, it is difficult to find a widely accepted translation of the term corporate governance, as well as an interpretation of the meaning thereof. The most common translations include: kontrola w korporacji [corporate control]; ład korporacyjny [corporate governance]; nadzór właścicielski [corporate governance]; nadzór korporacyjny [corporate supervision]; władztwo korporacyjne [corporate authority]. (Herdan, Stuss, Krasodomska, 2009, 13).

The focus on the foregoing is justified by the already widespread orientation (sensitivity) to issues of sustainable development of various stakeholder groups of the activities of business organisations, which go beyond the economic field in their idea and require that economic, social and environmental goals are harmonised.

Corporate governance includes mandatory laws and regulations forming part of legal acts (e.g., the Commercial Companies Code, Banking Law, industry regulations, etc.) and recommendations of a voluntary nature. ‘The concept of *corporate governance* was introduced to economics by A. Smith, who in his 1776 work entitled *The Wealth of Nations*, was the first to draw attention to the separation of ownership and control function in corporations at the time. “The concept was introduced into modern economic theory in the first half of the 1930s by A. Berle and G. Means. They analysed the functioning of American corporations, and in particular, relationships between ownership, corporate governance, and business performance” (Herdan, Stuss, Krasodomska, 2009, 14–15).

A review of the *corporate governance* definitions by Mirela Oana and Melinda Timea (Oana, Timea, 2015, 9–14) and Agnieszka Herdan et al. (Herdan, Stuss, Krasodomska, 2009, 13) made it possible to conclude that all of them are based, more or less, on specific assumptions as to its essence, and that they depend both on the areas of science in which their authors function, and on the cultural, national conditions of the organisation’s business activities in the countries from which researchers with a significant influence on the way of studying and describing the ‘phenomenon’ of corporate governance originate.

Corporate governance is the subject of scientific research in various aspects and contexts, and is being treated with an increasing intensity in different parts of the globe, which in addition points to the importance of the problem. At this point, only a few are cited here to illustrate the current research trends. And, thus, for example: Farooq et al. (2015) pointed out that determinants of good corporate governance practices and a relationship between corporate governance and company performance are frequent objects of academic research. They indicate that a relationship between corporate governance and corporate social responsibility remains unrecognised, but companies with strong internal corporate governance are willing to invest more in activities that strengthen this aspect of their operations. Ibrahim and Zulkafli (2016) verified the existence of a relationship between corporate governance practices implemented by companies and types of HR management practices adopted. Murtaza et al. (2016) in turn, when analysing through a prism of market share, diagnosed a relationship between ownership and management attributes and the company performance. Pinillos et al. (2020) examined the extent to which the issue of corporate governance along with environmental and social criteria is taken into account by the most prominent indexes relating to sustainability. Iglesias et al. (2022) carried out a research to answer

the question of whether corporate governance features such as management compensation, board composition, ownership structure and control are somehow inter-related and interdependent on the performance of business organisations. Havel et al. (2023) present the development of company law after 1989 against the background of a gradual change in the private law and its paradigms. In doing so, they note that the lack of practical development of certain aspects of corporate governance or corporate social responsibility does not result from the inadequacy of legal regulations, but is rather a result of overestimating the personal qualities of entrepreneurs, their reluctance to introduce complex governance structures.

This synthetic overview points to the potential of research which, when undertaken in relation to corporate governance, can enrich knowledge of its role and quality. Given the significant, and at the same time global in scope, changes in corporate governance guidelines, it is expected that academic research on corporate governance will grow significantly. This is because its practice does not remain indifferent to its helpful revised guidelines, which take into account difficult pandemic experiences and the directional necessity of sustainable development. For this reason, it is agreed here that recognising the most current developments, guidance and responsibilities in this area is paramount to establishing research niches and to verifying or updating the results of scientific research conducted to date.

Taking the foregoing into account, the development of corporate governance principles has been presented first (in a synthetic historical) from the OECD perspective, followed by a closer look at the European Union's sustainability reporting standard for corporate governance. This somewhat educational idea serves to present two levels of corporate governance: the organisation of corporate governance in practice and the reporting of corporate governance to its stakeholders. As a result of the characteristics presented, it is concluded that the confrontation of the guidelines for corporate governance with the reporting standard may be an interesting area of investigation. This finding leads the author to make several recommendations for organisational and reporting practices in that respect.

1. 1999–2020 corporate governance imperatives from the perspective of the OECD

The guardian of the principles of corporate governance, promoted globally by the OECD and set forth in the document titled *G20/OECD Principles of Corporate Governance*, is the *OECD Corporate Governance Committee*². Since the first

² The OECD Corporate Governance Committee coordinates and manages the Organisation's works on corporate governance, oversees the implementation of the G20/OECD Corporate Governance

publication (in 1999) of the principles compiled in a document titled *OECD Principles of Corporate Governance* (OECD, 1999), the principles have become an international reference for decision-makers, investors, corporations and other stakeholders around the world. This fact was further reinforced by the inclusion of the OECD-developed corporate governance principles in the *Financial Stability Board's Key Standards for Sound Financial Systems (About the FSB, n.d.)*. In addition, they provide a point of reference in the area of corporate governance and in the preparation by the World Bank and the International Monetary Fund (World Bank, International Monetary Fund) of reports known as the *ROSCs (Reports on the Observance of Standards and Codes – ROSCs³)*, which summarise the extent to which countries adhere to certain internationally recognised standards and codes. These principles also form the basis for a number of sector documents on corporate governance, including the *Basel Committee on Banking Supervision's Corporate Governance Principles for Banks*, the OECD's *Guidelines for Pension Fund Governance*, and the *International Association of Insurance Supervisors' Principles on Corporate Governance of Insurers*.

The *Principles*, promulgated in 1999, were revised as early as in 2002, in response to, among many, corporate scandals that strongly focused the attention of governments on the need to improve corporate governance practices. The OECD's observation that decision-makers have been increasingly aware of the importance of good corporate governance in ensuring the stability of financial markets, investments and economic growth is also very important, and at a microeconomic level it has been noted that the understanding of corporate governance and the implementation of its principles contribute to the competitiveness of a business organisation. It has also been recognised that the issue of corporate governance has also been gaining on importance to a growing group of stakeholders, including collective investment institutions and pension funds acting in a fiduciary capacity. Seeking to increase the value of its investments, the group plays an important role in ensuring good corporate

Principles and the OECD Guidelines on Corporate Governance in State-Owned Enterprises, and directs and supports the OECD's dialogue with the economies of various countries in this area.

³ ROSC summarise the extent to which countries adhere to certain internationally recognised standards and codes. *The International Monetary Fund* (IMF) has recognised 12 areas and related standards as useful for the operations of the Fund and the World Bank. These include accounting, auditing, anti-money laundering and countering the financing of terrorism (AML/CFT), banking supervision, corporate governance, data dissemination, fiscal transparency, insolvency and creditors' rights, insurance supervision, monetary and financial policy transparency, payment systems and securities regulations. Reports summarising the countries' compliance with these standards are prepared and published at the request of member states. Short updates are compiled on a regular basis, and new reports are produced every few years. See: (*Reports on the Observance*, n.d.).

governance practices. Nor could the OECD be indifferent to the fact that in today's economies, interest in corporate governance goes beyond shareholder interest in the performance of individual companies. Indeed, good corporate governance has been increasingly important to various growing segments of society (OECD, 2004, p. 4).

The revision of the principles commenced in 2002 was completed in 2004 and described in document entitled the OECD *Principles of Corporate Governance* (OECD, 2004), which – to ensure that the principles are up-to-date and relevant to the dynamically changing environment – underwent another revision. This resulted in another set of G20/OECD *Principles of Corporate Governance* guidelines (OECD, 2015). This time, the review involved undertaking expert and empirical and analytical research that primarily addressed significant changes in both the corporate and financial sectors (OECD, 2015, pp. 3–4).

A comparison of the literal wording of the OECD's corporate governance imperatives specified in the aforementioned three documents (OECD, 1999), (OECD, 2004), (OECD, 2015) may lead to an observation that the changes made were cosmetic in nature. However, this observation led to an analysis of the detailed development/description/commentary of each of the key principles.

Guided by the primary purpose of this text, a generalised characterisation of the 2015 *Principles* is presented here, as immediately preceding the version of the *Principles* currently in effect, as will be discussed later herein.

A review of the G20/OECD *Principles of Corporate Governance* (2015) yields several conundrums, most of which – understandably given the OECD's mission – place the burden more on providing general guidance of a more macro-than micro-economic nature. The OECD justifies this at the introduction to the *Principles* by stating that they are not intended to present detailed regulation which would be translatable directly into national legislation. They are rather conceived as a point of reference recommended for use by national decision-makers and by market participants when developing legal frameworks and other regulatory arrangements relating to corporate governance, which reflect, however, their own economic, social, legal and cultural circumstances.

As far as the synthetic presentation of the contents of the 2015 *Principles* is concerned, the following can be concluded (in keeping with: OECD, 2015). Firstly, the *Principles* emphasise more strongly the synergy between macroeconomic policies and corporate governance that encompasses a set of relationships between the company's management, shareholders and other stakeholders, and that is one of the key elements in improving growth and ensuring integrity and financial stability of the market. Secondly, the *Principles* are formulated in such a way as to help assess and improve legal, institutional and regulatory frameworks that affect corporate governance and provide guidelines to stock exchanges, investors, corporations and other entities that play an important role in developing good

standards and practices in this area. Thirdly, the *Principles* indicate that corporate governance provides organisational arrangements that establish goals for the company's operations, the ways to achieve them and monitor performance, as well as an incentive system associated with them. Fourthly, the *Principles* emphasise that while they focus on listed companies, both financial and non-financial, they can also be a useful tool for improving corporate governance in non-commercial companies. Fifthly, they point to the need for institutional arrangements that provide the basis for an effective corporate governance framework, including appropriate supervisory, regulatory and enforcement institutions. And finally, the *Principles* also define the role of stakeholders in corporate governance and set forth (in a manner based on a set of six directional guidelines) conditions necessary to ensure that they are provided in a timely and accurate manner with information on all key issues affecting the company. They also determine what is needed to ensure that the company is run in a strategic manner and that management is monitored effectively.

2. 2020 – the new face of uncertainty triggered by COVID-19 and revision of corporate governance imperatives

An immediate rationale for the next revision of corporate governance principles, as further discussed below, has become the new face of uncertainty that emerged with COVID-19. The impact of the crisis conditions caused by the pandemic is still being felt in many aspects of business operations, and it was shocking to the world during the pandemic. The pandemic challenged the basic assumptions of the governance model based on the agency theory, which is one of the theoretical concepts of corporate governance, the essence of which is related to the primacy of shareholders (owners).⁴ The pandemic has shown that every stakeholder group matters to the operation of a company and that satisfying the expectations of multiple parties simultaneously is a major challenge. In the context of the COVID-19's impact on corporate governance, the issue was analysed in detail by Lynn Sharp Paine (Harvard Business School), who presented her observations in the document entitled *Covid-19 is Rewriting the Rules of Corporate Governance*. Following her lead, it can be highlighted at this point that meeting the challenges that the new 'uncertainty' has triggered requires that (Paine, 2020):

- 1) more attention be paid to the impact of business on society and that social problems be addressed and resolved efficiently, and that systemic

⁴ Agency theory depicts a company as a network of contacts ('agency relationships') occurring between shareholders, other providers of finance (lenders) and managers.

solutions be introduced in this regard; this is because the responsibility associated with this and such actions are becoming the rule;

- 2) closer attention be drawn to remuneration and its incentive nature when an unexpected downturn makes business goals a secondary concern;
- 3) decisions be made in a more thoughtful manner, because ‘maximising shareholder value’ loses its meaning if unprecedented problems have to be remedied and investments in personal health care equipment have to be made or the company’s business profile has to be changed to one that serves society in these difficult conditions better than the existing one;
- 4) more attention be paid to the composition of management boards, including in terms of their gender diversity;
- 5) works be carried out that are increasingly demanding for management, given the need to permanently track and discuss developments, update current plans and strategies, as well as apply various risk mitigation tools.

The COVID-19 issue has also been reflected in the conclusions made in the two 2021 OECD reports: *The Future of Corporate Governance in Capital Markets Following the COVID-19 Crisis* (The Future, 2021) and *OECD Corporate Governance Factbook* (Corporate, 2021). These in turn led the *OECD Corporate Governance Committee* to revise the 2015 *Corporate Governance Principles*.

3. 2023 – Kolejna rewizja imperatywów ładu korporacyjnego promowanych przez OECD

A review of the principles (G20/OECD *Principles of Corporate Governance*, 2015) began in November 2021 (*Review*, n.d.) The principles were revised by the OECD, G20 and FSB, as well as other countries (in a round-table format, from Asia, Latin America and the Middle East). A clear goal was set before this exercise: to update the corporate governance principles to a form that would be appropriate for the environment shaped by COVID-19. Changes involved strengthening the focus on risk management and improving the companies’ access to financing.

The *OECD Corporate Governance Committee* identified (and presented in February 2022 in a report concerning the review) 10 priority areas on which the review was focused. They have been defined as follows (*OECD Secretary*, 2022):

- 1) managing climate change and other environmental, social and governance (ESG) risks,
- 2) corporate ownership trends and increased concentration,
- 3) the role of institutional investors and *stewardship*,
- 4) the development of new digital technologies and emerging opportunities and threats,

- 5) crisis and risk management,
- 6) excessive risk-taking in the non-financial corporate sector,
- 7) the role and rights of debtors in corporate governance,
- 8) management remuneration,
- 9) the role of audit committees,
- 10) diversity of management boards and senior management.

This document stresses several times the importance of internal and external audits, the quality of which is a prerequisite for the confidence of various stakeholder groups in both financial and non-financial information presented by companies (OECD Secretary, 2022, pp. 7, 9, 36, 42).

The review was conducted by the OECD Corporate Governance Committee between November 2021 and March 2023, and as a result of this 18-month works the revised corporate governance principles were approved at the G20 Summit held on 9–10 September 2023 (*Review*, n.d.). Thus, the *G20/OECD Principles of Corporate Governance* (2023) is now the most up-to-date international corporate governance standard.

Their primary goal is to help decision-makers create a legal, regulatory and institutional framework for corporate governance that will effectively promote economic efficiency, sustainable growth and financial stability. The principles outlined in this document reflect recent developments in capital markets and corporate governance practices. They introduce many new and updated recommendations. They concern shareholder rights, the role of institutional investors, corporate disclosure and reporting, the responsibilities of supervisory boards and, for the first time, sustainability (OECD, 2023, p. 3). According to Mathias Cormann, OECD Secretary-General, the *G20/OECD Corporate Governance Principles* (2023) are [still – AK note] a major international point of reference for good corporate governance. They are global in scope, and while they reflect experiences and ambitions of many different jurisdictions, with different legal systems and at different stages of development, they ‘*reflect the strong desire of all the OECD and G20 members for the Principles to provide guidance on corporate sustainability and resilience, and to help companies manage environmental and social risks, support disclosure of information that is important to shareholders and other stakeholders, and to define in detail responsibilities of the company boards*’ (OECD, 2023, p. 3).

The *G20/OECD Corporate Governance Principles* are designed to help decision-makers assess and improve the legal, regulatory and institutional framework for corporate governance. This is because they identify the key components of a sound corporate governance framework and offer practical guidance for its implementation at the national level. The *Principles* also provide guidance to stock exchanges, investors, corporations and others who play a role in the development of good corporate governance (OECD, 2023, p. 51).

The *G20/OECD Corporate Governance Principles* (2023) include, similarly to those in *G20/OECD* (2015), six imperatives, the current wording of which, including a synthesised elaboration, is presented in Table 1.

Table 1. Organisational imperatives of corporate governance according to the *G20/OECD Corporate Governance Principles* (2023)

The imperative blocks of corporate governance	Synthetic characteristics
<p style="text-align: center;">BLOCK I</p> <p style="text-align: center;">ENSURING THE BASIS FOR AN EFFECTIVE CORPORATE GOVERNANCE FRAMEWORK</p> <p>The corporate governance framework should promote transparent and fair markets, and efficient allocation of resources. It should be consistent with the rule of law and support effective supervision and enforcement..</p>	<ul style="list-style-type: none"> • <i>The corporate governance framework should be developed with a view to its impact on corporate access to finance, overall economic performance and financial stability, the sustainability and resilience of corporations, market integrity, and the incentives it creates for market participants and the promotion of transparent and well-functioning markets.</i> • <i>The legal and regulatory requirements that affect corporate governance practices should be consistent with the rule of law, transparent and enforceable. Corporate governance codes may offer a complementary mechanism to support the development and evolution of companies' best practices, provided that their status is duly defined.</i> • <i>The division of responsibilities among different authorities and self-regulatory bodies should be clearly articulated and designed to serve the public interest.</i> • <i>Stock market regulations should support effective corporate governance.</i> • <i>Supervisory, regulatory and enforcement authorities should have the authority, autonomy, integrity, resources and capacity to fulfil their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained.</i> • <i>Digital technologies can enhance the supervision and implementation of corporate governance requirements, but supervisory and regulatory authorities should give due attention to the management of associated risks.</i> • <i>Cross-border co-operation should be enhanced, including through bilateral and multilateral arrangements for exchange of information.</i> • <i>Clear regulatory frameworks should ensure the effective oversight of publicly traded companies within company groups.</i>

<p>The imperative blocks of corporate governance</p>	<p>Synthetic characteristics</p>
<p style="text-align: center;">BLOCK II</p> <p style="text-align: center;">THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND KEY OWNERSHIP FUNCTIONS</p> <p>The corporate governance framework should protect and facilitate the exercise of shareholders' rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders.</p>	<ul style="list-style-type: none"> • <i>Basic shareholder rights should include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant and material information on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect and remove members of the board; 6) share in the profits of the corporation; and 7) elect, appoint or approve the external auditor.</i> • <i>Shareholders should be sufficiently informed about, and have the right to approve or participate in decisions concerning fundamental corporate changes such as: 1) amendments to the statutes, articles of incorporation or similar governing documents of the company; 2) the authorisation of additional shares; and 3) extraordinary transactions, including the transfer of corporate assets that in effect result in the sale of the company.</i> • <i>Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings, and should be informed of the rules, including voting procedures, that govern general shareholder meetings.</i> • <i>Shareholders, including institutional shareholders, should be able to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent fraud.</i> • <i>All shareholders of the same series of a class should be treated equally. All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any changes in economic or voting rights should be subject to approval by those classes of shares which are negatively affected.</i> • <i>Related party transactions should be approved and conducted in a manner that ensures proper management of conflicts of interest and protects the interests of the company and its shareholders.</i> • <i>Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress. Abusive self-dealing should be prohibited.</i> • <i>Markets for corporate control should be allowed to function in an efficient and transparent manner.</i>

The imperative blocks of corporate governance	Synthetic characteristics
<p style="text-align: center;">BLOCK III</p> <p style="text-align: center;">INSTITUTIONAL INVESTORS, STOCK MARKETS AND OTHER INTERMEDIARIES</p> <p>The corporate governance framework should provide sound incentives throughout the investment chain and provide for stock markets to function in a way that contributes to good corporate governance.</p>	<ul style="list-style-type: none"> • <i>The corporate governance framework should facilitate and support institutional investors' engagement with their investee companies. Institutional investors acting in a fiduciary capacity should disclose their policies for corporate governance and voting with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights. Stewardship codes may offer a complementary mechanism to encourage such engagement.</i> • <i>Votes should be cast by custodians or nominees in line with the directions of the beneficial owner of the shares.</i> • <i>Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.</i> • <i>The corporate governance framework should require that entities and professionals that provide analysis or advice relevant to decisions by investors, such as proxy advisers, analysts, brokers, ESG rating and data providers, credit rating agencies and index providers, where regulated, disclose and minimise conflicts of interest that might compromise the integrity of their analysis or advice. The methodologies used by ESG rating and data providers, credit rating agencies, index providers and proxy advisers should be transparent and publicly available.</i> • <i>Insider trading and market manipulation should be prohibited and the applicable rules enforced.</i> • <i>For companies who are listed in a jurisdiction other than their jurisdiction of incorporation, the applicable corporate governance laws and regulations should be clearly disclosed.</i> • <i>Stock markets should provide fair and efficient price discovery as a means to help promote effective corporate governance.</i>

The imperative blocks of corporate governance	Synthetic characteristics
<p style="text-align: center;">BLOCK IV</p> <p style="text-align: center;">DISCLOSURE AND TRANSPARENCY</p> <p>The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, sustainability, ownership, and governance of the company.</p>	<ul style="list-style-type: none"> • <i>Disclosure should include, but not be limited to, material information on: the financial and operating results of the company, company objectives and sustainability-related information, capital structures, group structures and their control arrangements, major share ownership, including beneficial owners, and voting rights, information about the composition of the board and its members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board, remuneration of members of the board and key executives, related party transactions, foreseeable risk factors, governance structures and policies, including the extent of compliance with national corporate governance codes or policies and the process by which they are implemented, debt contracts, including the risk of non-compliance with covenants.</i> • <i>Information should be prepared and disclosed in accordance with internationally recognised accounting and disclosure standards.</i> • <i>An annual external audit should be conducted by an independent, competent and qualified auditor in accordance with internationally recognised auditing, ethical and independence standards in order to provide reasonable assurance to the board and shareholders on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.</i> • <i>External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit in the public interest.</i> • <i>Channels for disseminating information should provide for equal, timely and cost-efficient access to relevant information by users.</i>

The imperative blocks of corporate governance	Synthetic characteristics
<p style="text-align: center;">BLOCK V</p> <p style="text-align: center;">THE RESPONSIBILITIES OF THE BOARD</p> <p>The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.</p>	<ul style="list-style-type: none"> • <i>Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders, taking into account the interests of stakeholders.</i> • <i>Board members should be protected against litigation if a decision was made in good faith with due diligence.</i> • <i>Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.</i> • <i>The board should apply high ethical standards.</i> • <i>The board should fulfil certain key functions, including: reviewing and guiding corporate strategy, major plans of action, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures; reviewing and assessing risk management policies and procedures; monitoring the effectiveness of the company's governance practices and making changes as needed; selecting, overseeing and monitoring the performance of key executives, and, when necessary, replacing them and overseeing succession planning; aligning key executive and board remuneration with the longer term interests of the company and its shareholders; ensuring a formal and transparent board nomination and election process; monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and fraud in related party transactions; ensuring the integrity of the corporation's accounting and reporting systems for disclosure, including the independent external audit, and that appropriate control systems are in place, in compliance with the law and relevant standards; overseeing the process of disclosure and communications.</i> • <i>The board should be able to exercise objective independent judgement on corporate affairs.</i> • <i>In order to fulfil their responsibilities, board members should have access to accurate, relevant and timely information.</i> • <i>When employee representation on the board is mandated, mechanisms should be developed to facilitate access to information and training for employee representatives, so that this representation is exercised effectively and best contributes to the enhancement of board skills, information and independence.</i>

The imperative blocks of corporate governance	Synthetic characteristics
<p style="text-align: center;">BLOCK VI</p> <p style="text-align: center;">SUSTAINABILITY AND RESILIENCE</p> <p>The corporate governance framework should provide incentives for companies and their investors to make decisions and manage their risks, in a way that contributes to the sustainability and resilience of the corporation.</p>	<ul style="list-style-type: none"> • <i>Sustainability-related disclosure should be consistent, comparable and reliable, and include retrospective and forward-looking material information that a reasonable investor would consider important in making an investment or voting decision.</i> • <i>Corporate governance frameworks should allow for dialogue between a company, its shareholders and stakeholders to exchange views on sustainability matters as relevant for the company's business strategy and its assessment of what matters ought to be considered material.</i> • <i>The corporate governance framework should ensure that boards adequately consider material sustainability risks and opportunities when fulfilling their key functions in reviewing, monitoring and guiding governance practices, disclosure, strategy, risk management and internal control systems, including with respect to climate-related physical and transition risks.</i> • <i>The corporate governance framework should consider the rights, roles and interests of stakeholders and encourage active co-operation between companies, shareholders and stakeholders in creating value, quality jobs, and sustainable and resilient companies.</i> • <i>Mechanisms for employee participation should be permitted to develop.</i> • <i>Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis.</i> • <i>Stakeholders, including individual workers and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and/or to the competent public authorities, and their rights should not be compromised for doing this.</i> • <i>The exercise of the rights of bondholders of publicly traded companies should be facilitated.</i> • <i>The corporate governance framework should be complemented by an effective and efficient insolvency framework and by effective enforcement of creditor rights.</i>

Source: based on G20/OECD Corporate Governance Principles (2023)

The structure of the 2023 *Principles* has changed as compared to their 2015 version. The wording of some of the guidelines and specific recommendations on how to apply them provided for in the *G20/OECD Corporate Governance Principles* (2023) have also been amended. It is easy to see that a strong emphasis has been placed on the issues of risk management and sustainability, and thus on the key issues discussed herein.

At this point, in order to highlight the global role of the *G20/OECD Principles of Corporate Governance* (2023) in promoting good practices in this scope, it is still necessary to state, following the clarifications provided for therein (by the way, analogous to those made available also in each of the previous versions of the *Principles*), that: *‘The Principles are non-binding and do not aim to provide detailed prescriptions for national legislation. The Principles are not a substitute for nor should they be considered to override domestic law and regulations. Rather, they seek to identify objectives and suggest various means for achieving them, typically involving elements of legislation, regulation, listing rules, self-regulatory arrangements, contractual undertakings, voluntary commitments and business practices. A jurisdiction’s implementation of the Principles will depend on its national legal and regulatory context. The Principles aim to provide a robust but flexible reference for policy makers and market participants to develop their own frameworks for corporate governance. To remain competitive in a changing world, corporations must innovate and adapt their corporate governance practices to meet new demands and grasp new opportunities. Taking into account the costs and benefits of regulation, governments have an important responsibility for shaping an effective regulatory framework that provides for sufficient flexibility to allow markets to function effectively and to respond to new expectations of shareholders and stakeholders* (OECD, 2023, p. 6).’

4. Significance of corporate governance in terms of sustainability reporting

Following the events and initiatives undertaken globally and relating to the issue of corporate governance, entwined with sustainability reporting, it is hard not to get the impression that the *G-Governance* (corporate Governance) used in this context should be equated with the operating completion of the ideas behind the *E-Environmental* (Ecology) and *S-Social* (Social responsibility) slogans. This leads to the next conclusion that the standardisation of management efforts and corporate governance activities relating to *E-Environmental* and *S-Social* is a complex issue, due in no small part to the fact that the modus operandi may vary in the practice of different entities, even if this is to occur within a certain – legally defined – framework. This means difficulty in standardising how corporate

governance works. Simultaneously, however, this prompts the stakeholders of entities to report the need for transparent presentation of information on the conduct of business, respecting the principles of sound management and management of assets that are not their own, and which should be carried out in accordance with rules based on fairness towards not only the owners of such assets, but also to other stakeholder groups. Disseminated guidelines for transparent reporting on the corporate governance of an economic organisation can thus be, especially in view of the fact of strongly growing uncertainty, a valuable guideline in assessing achievements and potential of an organisation.

Various international institutions make efforts to develop appropriate reporting guidelines. They are all the greater as the standardisation attempts come with the premise of developing guidelines that are either global in scope or smaller, but still multi-state scale⁵. Unsurprisingly, the process of agreeing on standard

⁵ The first area of change and opportunity important for reporting by business organisations is related to the announcement on 3 November 2021 of the *International Financial Reporting Standards (IFRS Foundation)* by the *International Sustainability Standards Board (ISSB)* (Sustainability, n.d.), which took place in Glasgow, during the *UN Climate Change Conference, Conference of the Parties – COP26*. (*COP26 (Conference of the Parties)*) refers to the ‘conference of the parties’ at the UN Climate Change Convention held between 31 October and 13 November 2021 in Glasgow. At the convention, the parties reviewed their commitments in pursuit of the goal of keeping an increase in the global average temperature well below 2 °C in relation to its pre-industrial levels, and continuing efforts to limit an increase in the temperature to 1.5 °C). The ISSB’s declaration to develop a globally unified approach to reporting ESG factors, made by Erkki Liikanen, head of the IFRS Foundation, is perceived as an outcome of COP26, with which it can be hoped that the diversity of approaches commonly found around the world and of disadvantageous comparabilities be sorted. See: (*How?*, n.d.). This declaration has been followed by an announcement made on 3 November 2021 by the *IFRS Foundation*, according to which it intends to join the most prominent centres for developing methodologies and guidelines for ESG reporting: *Climate Disclosure Standards Board – CDSB*, which is an initiative under the *Carbon Disclosure Project – CDP* and the *Value Reporting Foundation – VRF*. See: (*IFRS Foundation announces*, n.d.). *Carbon Disclosure Project – CDP* is a non-profit charitable organisation that manages a global disclosure system for investors, companies, cities, states and regions for the purposes of managing their environmental impact. The global economy views the *CDP* as the gold standard for environmental reporting with the richest and most comprehensive collection of data on corporate and municipal operations. See: (*Who we are*, n.d.). *Value Reporting Foundation – VRF* is a global non-profit organisation that offers a comprehensive set of resources designed to help companies and investors develop a common comprehension of the enterprise value, i.e., how it is created, preserved and lost. *Value Reporting Foundation* is the result of joining forces of: the *International Integrated Reporting Council – IIRC* and the *Sustainability Accounting Standards Board – SASB*. See: (*The Value*, n.d.). At this point,

solutions requires that procedures be simultaneously politically appropriate and legitimate in terms of quality and contents⁶. Business practice, on the other hand, in coping with uncertainty and ongoing economic circumstances in its area, must be prepared to meet an obligation whose framework emerges on many levels, becoming a truly difficult accounting and reporting challenge to which corporate governance cannot remain indifferent (*Exposure Draft*, 2022).

Evaluating compliance of the entities' operations with the sustainability imperative and its reporting (ESG) has serious consequences, as it affects the company's market value, its perception by various stakeholder groups, among which are investors and creditors, counterparties and customers. When deciding on whether to invest in a company, to make commercial contracts, or to provide a source of financing, these stakeholders evaluate non-financial characteristics along with financial indicators. In this assessment, it is important how the entity addresses the impact of climate change on its operations and its activities on the environment, what steps it takes to improve working conditions for employees, and whether management operating

the author welcomes the fact that participants in the global accounting policy has found the will to cooperate in the development of a single non-financial reporting model instead of many different ones. The issue of complexity, the multiplicity of guidelines, the costs involved, the incomparability and generally the need to clean up the mess of non-financial reporting was raised by the author as early as in 2016 (Hejduk, Karmańska, 2016) and again in 2019 (Hejduk, Karmańska, 2019).

⁶ The prospect of developing a unified ESG reporting standard becomes real and looks promising, not only because the *ISSB* can base its works on the results obtained in the course of the *IFRS Foundation's* past cooperation with institutions such as the *Global Reporting Initiative – GRI* and the *Task Force on Climate-related Financial Disclosures – TCFD*. The results of this collaboration were reflected in an invaluable joint effort to determine (in 2021) the way in which key methodologies used by the ESG leaders connect. For the sake of completeness, it is worth adding here that, in addition to representatives of the world of financial and non-financial reporting, the *International Organisation of Securities Commissions – IOSCO* has also been involved in the cooperation in this area, and can play an important role in the implementation of the standards developed (globally and in the EU). The basis for a coherent, comprehensive sustainability reporting system was developed in 2021 by leading sustainability reporting organisations (*Climate Disclosure Standards Board - CDSB*, *Carbon Disclosure Project - CDP*, *Global Reporting Initiative - GRI*, *International Integrated Reporting Council - IIRC*, and *Sustainability Accounting Standards Board - SASB*). See: (*Why ESG?*, n.d.). *GRI* is an independent international organisation that has been a pioneer in sustainability reporting since 1997. The *GRI* indicators are an international standard for reporting on sustainability and responsible business issues for companies. See: (*The global leader*, n.d.). The *Task Force on Climate-related Financial Disclosures (TCFD)* is a task force on climate-related financial disclosures established by the *Financial Stability Board* to improve and enhance reporting of climate-related financial information. See: (*Task Force*, n.d.).

under a particular leadership model is actually effective. This makes thinking through a prism of sustainability an integral part of every process implemented in the organisation. The accountability of each of them is important here and depends on corporate governance practices.

Based on the foregoing, it can be concluded that the concept of corporate governance serves to solve the problem defined by the agency theory as the formation of relationships between entities that have different interests: the owners of the company (principals) and the management hired to manage their assets (agents). Today, the imperative of sustainability means that owners aware of the need of combining financial goals with environmental and social issues expect the same from the persons holding managerial positions. Changes in the investing procedures towards socially responsible investing lead to the situation in which, in the cases of many entities, the existing corporate governance principles may need to be revised and improved. Measures adopted for that purpose can therefore be focused in two areas: *corporate governance practices relating to the board of directors and corporate governance practices relating to shareholders (more broadly: investors)* (Glen et al., 2023, p. 326).

In terms of *corporate governance practices relating to the board of directors*, three issues are of particular significance. The first one is related to ensuring that the effectiveness of the board of directors is supervised, which requires that a supervisory board or board of directors is composed of qualified, independent, well-informed, diverse, committed persons with an unambiguous attitude of not permitting that monitoring and supervisory functions be interfered with. The second issue refers to the organisation of the supervisory activities, which can be assisted by special committees, appointed by tasks to be overseen, in particular, by important areas of supervision. These committees become then an integral part of the entity's corporate governance. The third issue relates to remuneration of the entity's management, which can be linked to the interests of the entity's owners through the use of incentives such as 'performance fee'. On the other hand, in terms of *corporate governance practices relating to shareholders (investors)*, the focus is primarily on two practices: those relating to the exercise by shareholders of their voting rights and those ensuring that shareholders are able to communicate and cooperate with the board of directors or supervisory board.

The synthetic overview of corporate governance presents this concept through a prism of a potential risk that can arise from the improper formation of relations between the company's management and ownership. Corporate governance that ignores the 'E' and 'S' rationale can lead not only to a loss of reputation or other significant economic risks. It can even result in a business entity becoming bankrupt. Therefore, within the framework of sustainability reporting standards, corporate governance should be of particular importance. This is because sound corporate governance is an important information message, a prerequisite for the successful

implementation of policies, projects and for the application of measures in order to address environmental and social challenges.

This section does not focus on assessing past corporate governance practices in Poland⁷, nor does it apply to practices in other European countries. This is being done for the reason that unprecedented changes have just taken place in the EU

⁷ A good description of corporate governance practices in Poland has been obtained as a result of the survey conducted in September 2020 by the CFA Society Poland, See: (Corporate Governance, n.d.). Its purpose was, among other, to find out opinions of finance specialists and the state of knowledge on corporate governance practices in Poland.

Thus:

- 1) Corporate governance is one of the key factors that determine the reputation of companies in the long term, and consequently their investment attractiveness;
- 2) The prevailing view is that the degree of compliance with corporate governance principles among the companies listed on the Warsaw Stock Exchange is low;
- 3) The majority of respondents are of the opinion that the size of the company has no impact on compliance with corporate governance principles, and that the approach of the key shareholder is more important;
- 4) In Poland, the adherence to corporate governance principles is primarily associated with the way companies are managed and controlled based on statutes, regulations and procedures, but the concept of corporate governance is related with the way a board of directors treats shareholders, and in particular the minority shareholders;
- 5) Investors, consider the quality of the financial statements and of the report of the management board, as well as the company's approach to minority shareholders as the most important elements of corporate governance;
- 6) The composition of supervisory boards is important; it should not be the case that persons appointed to the board by a major shareholder represent primarily its views, rather than the interests of all shareholders; independent board members are needed in companies; the most important factor for their independence is the absence of a reasonably identifiable conflict of interest;
- 7) Investors in Poland have limited confidence in the companies' declarations that they adhere to the principles of corporate governance; they emphasise the need to put pressure on the issue of corporate governance in their investment decisions, as this would also become more important for the company boards;
- 8) The corporate governance statement can be a valuable source of information for capital market participants and those wishing to include the 'G factor' in their investment decisions, only if it communicates reliably the status quo; hence, the need to have the content of the statements verified externally; to decide on the person that should carry out this task:

a statutory auditor, the FSA, a trade organiser or perhaps another entity – each of which has its own advantages and disadvantages.

laws relating to sustainability reporting, the effects of which will take some time to materialise. (In December 2022, *the Corporate Sustainability Reporting Directive* (CSRD) was adopted, i.e., Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No. 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU with regard to corporate sustainability reporting (OJ L 322/15). In addition, on 31 July 2023, the European Commission issued a delegated regulation introducing the first set of twelve sustainability reporting standards (*The European Sustainability Reporting Standards – ESRS*)⁸.

⁸ On 31 July 2023, the European Commission adopted a delegated regulation adopting European Sustainability Reporting Standards. It is a set of 12 universal standards, consisting of: 2 cross-cutting standards, namely ESRS 1 *General Requirements and ESRS 2 General Disclosure*, and 10 topical standards, including: 5 standards on environmental issues (ESRS E1 *Climate Change*, ESRS E2 *Pollution*, ESRS E3 *Water and Marine Resources*, ESRS E4 *Biodiversity and Ecosystems*, ESRS E5 *Resource Use and Circular Economy*), 4 standards on social issues (ESRS S1 *Own Workforce*, ESRS S2 *Workers in the Value Chain*, ESRS S3 *Affected Communities*, ESRS S4 *Consumers and End-Users*), and 1 standard on management issues (ESRS G1 *Business Conduct*). These standards will be applied by the first group of entities (the largest public interest entities currently reporting non-financial information) as early as for 2024 sustainability reporting. (See: *Commission Delegated Regulation* (EU), (2023)).

At the occasion, Mairead McGuinness, Commissioner for Financial Services, Financial Stability and Capital Markets Union, said: *‘The standards we adopted today are ambitious and are an important tool underlying the EU’s sustainable financing program. They strike the right balance between reducing the burden on reporting companies, while allowing them to demonstrate their efforts to implement the green agenda, and thus access sustainable financing.’* Cf. (The Commission adopts, n.d.). It is worth mentioning that these standards cover the full range of environmental, social and corporate governance issues, and also have been discussed with the International Sustainability Standards Board (ISSB) and the Global Reporting Initiative (GRI) to ensure a very high degree of interoperability between the EU and global standards and to prevent unnecessary double reporting by companies (The Commission adopts, n.d.). At the EFRAG itself, the fact that the European Commission has adopted the above standards is considered a milestone for adequate and comparable sustainability reporting and the ‘mission accomplished’. It culminates the ongoing process of developing relevant projects, which started in September 2020 (April 2022, November 2022). Patrick de Cambourg, the chairman of the EFRAG SRB (European Financial Reporting Advisory Group Sustainability Reporting Board), commented: *‘Owing to the CSRD and now the Delegated Act on Sector-Independent European Sustainability Reporting Standards [ESRS – A.K. note], we are pleased to confirm such a critical step toward the goal of putting sustainability reporting on par with financial reporting has been accomplished. (...) We will now make every effort to facilitate implementation and make the ESRS a success.’* Cf. (EFRAG welcomes, n.d.).

At this point, it is worth pointing out to coincidence of these events with the publication of the aforementioned *G20/OECD Corporate Governance Principles (2023)*. Thus, on the one hand, there are guidelines on how to ensure corporate governance, and on the other, on how to present reporting information on it. Thus, the two sources of information (OECD Action Guidelines and EU reporting standards) can be recognised as somewhat complementary, and supplementary, and their confrontation can be cognitive in several aspects, especially since the wording of these documents is based on similar foundations, derived from the premises and principles of sustainable development.

5. Confronting organisational guidelines with reporting guidelines in the area of corporate governance

Given that the corporate governance reporting, which is mandatory for certain entities, follows the *ESRS G1 Business Conduct* standard, it is necessary to focus on issues that strongly relate to the management practices adopted by entities. A list of questions that gives an idea of what should be reported as part of a report on corporate governance of a business entity has been presented below. The importance of these issues in the structure of the referenced standard should be viewed simultaneously: from an *external stakeholder perspective* and from a *management perspective*. This is because the standard indicates particularly sensitive areas of decisions and activities of the entity's management, which as one of the criteria of socially responsible investing will be of great significance for the evaluation of the company's achievements, and for this reason strongly forms part of corporate governance, i.e., order and management governance in the entity (Table 2).

Tabela 2. Specification of corporate governance issues subject to reporting

<p style="text-align: center;">(G1)</p> <p style="text-align: center;">CORPORATE CULTURE</p> <p>The entity discloses information on its policies with regard to conducting business activities and on the way in which it promotes its corporate culture.</p>	<ul style="list-style-type: none"> • <i>How are the entity's administrative, management and supervisory bodies engaged in creating, monitoring, promoting and assessing its corporate culture?</i> • <i>Is the entity capable of mitigating negative impacts and enhancing positive impacts associated with its operations?</i> • <i>Does the entity monitor and manage the risks involved?</i> • <i>Does the entity have mechanisms in place to identify, report and investigate concerns about illegal behaviour or behaviour contrary to the code of conduct or similar documents?</i> • <i>Does the entity already have an anti-corruption or bribery policy, and if not, in what mode does it plan to implement it?</i> • <i>How is whistleblowing organised in the entity, and in particular, protection for whistleblowers and those employees who refuse to act unethically? How does the entity act to prevent retaliation against these individuals?</i> • <i>Does the entity, if justified, have an animal welfare policy?</i> • <i>What is the entity's strategy for internal training activities?</i> • <i>Does the entity identify functions and processes that are most vulnerable to corruption/bribery?</i>
<p style="text-align: center;">(G2)</p> <p style="text-align: center;">SUPPLIER RELATIONSHIP MANAGEMENT</p> <p>The entity provides information on supplier relationship management and on its impacts on the supply chain.</p>	<ul style="list-style-type: none"> • <i>What is the entity's strategy in relation to relationships with suppliers, and in particular in the context of supply chain risk and sustainability in general?</i> • <i>Does or how does the entity take into account social and environmental criteria when selecting business partners?</i> • <i>How does the entity support its key (important) business partners in strengthening their environmental and social performance?</i>

<p style="text-align: center;">(G3)</p> <p style="text-align: center;">PREVENTION AND DETECTION OF CORRUPTION AND BRIBERY</p> <p>The entity provides information on its system for preventing, detecting, investigating and responding to allegations or incidents of corruption or bribery, including training on these issues.</p>	<ul style="list-style-type: none"> • <i>Does the entity have procedures in place to prevent, detect and respond to allegations or incidents of corruption/bribery?</i> • <i>Is the investigator or investigating committee truly independent, uninvolved in the cases pending?</i> • <i>Is there a clear process for reporting events of corruption/crime to administrative, management and supervisory bodies?</i> • <i>How does the entity communicate relevant policies to those for whom they are relevant to ensure that the policies are accessible and their consequences are understood?</i> • <i>Does the entity hold training (of what nature and detail) on anti-corruption/bribery?</i> • <i>To whom are they addressed?</i>
<p style="text-align: center;">(G4)</p> <p style="text-align: center;">INCIDENTS INVOLVING CORRUPTION OR BRIBERY</p> <p>The entity provides information on incidents of corruption or bribery in the reporting period.</p>	<ul style="list-style-type: none"> • <i>Does the entity ensure transparency in disclosing information on the confirmed incidents of corruption or bribery, and how?</i> • <i>Does it communicate their quantity and nature?</i> • <i>Does it provide information on convictions and on fines for violations of anti-corruption and anti-bribery laws?</i> • <i>Does it disclose details of public corruption or bribery court cases brought against the entity and its employees and results of such cases, of confirmed incidents in which employees were fired or disciplined for corruption or bribery?</i> • <i>Does it report on confirmed incidents concerning contracts with contractors that were terminated or not renewed due to violations related to corruption or bribery?</i> • <i>How does the entity protect individuals who expose corruption or crime (whistleblowers)?</i>
<p style="text-align: center;">(G5)</p> <p style="text-align: center;">POLITICAL INFLUENCE AND LOBBYING ACTIVITIES</p> <p>The entity provides information on activities and commitments related to political influence, including lobbying activities related to its material impacts, risks and opportunities.</p>	<ul style="list-style-type: none"> • <i>What kind of activities does the entity undertake in this area?</i> • <i>What is their purpose and what are the costs associated with them?</i> • <i>Who in the administrative, management and supervisory bodies is responsible for overseeing these activities?</i> • <i>What is the financial and in-kind political (direct and indirect) involvement of the entity and who and where is the beneficiary of this activity?</i> • <i>What issues (topics) are lobbied on and what position does the individual take?</i> • <i>Does the entity appear in the EU or national transparency register?</i>

<p>(G6)</p> <p>PAYMENT PRACTICES</p> <p>The entity provides information on its payment practices, in particular, with regard to late payments to small and medium-sized enterprises (SMEs).</p>	<ul style="list-style-type: none"> • <i>What payment policy (contractual terms and actual realisations) does the entity adopt for SMEs?</i> • <i>What are the entity's standard payment terms (in days) by major supplier category?</i> • <i>How long is the average – actual – term (in days) of trade credit?</i> • <i>How much of the entity's payment is in practice consistent with standard terms and conditions?</i> • <i>Are there any legal proceedings pending regarding late payments?</i>
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Source: based on *Commission Delegated Regulation (EU) (2023), Annex 1, pp. 271–280*

In confronting the *G20/OECD Principles of Corporate Governance (2023)* with the aforementioned EU reporting guidelines, one may be tempted to formulate some observations and then recommendations for business organisations which should already face them in the not-too-distant future and, for this reason, evaluate, or review, the current way of doing business. They are formulated as follows.

- 1) Both sources of guidance are strongly anchored in the idea of sustainable development.
- 2) The OECD guidelines provide for an in-depth picture of the good corporate governance properties, which requires, first and foremost, macroeconomic activities and decisions, largely of a legal and institutional nature. For these determine the framework for ensuring good corporate governance at a microeconomic level. Deficiencies or shortcomings in the first aspect can only result in negative effects and translate into a façade of sustainability and the actions of economic organisations. In countries that wish to subordinate their economies to this idea, this is the area of responsibility of the bodies that make national economic laws and decide on the institutional order for the security of economic transactions. (This is indicated primarily by the imperatives in Block I to III).
- 3) In turn, responsibility for organising corporate governance adequate to carry out business activities in a sustainable manner, at a microeconomic level, is primarily indicated by the imperatives that form part of Blocks IV and V in the OECD guidelines. They unequivocally emphasise the importance in this order of the professionalism of the accounting information system and the responsibility of external auditors, which jointly provide information on the financial and operational performance of the business organisation and information related to sustainable development. In

addition, they define in more details the function, powers and responsibilities of supervisory boards in business organisations.

- 4) The OECD guidelines (in Block VI) draw attention to the stakeholders of business activities and define their right of information and proper treatment, which implies that it is necessary to take care of corporate governance taking into account the specific needs of various external stakeholder groups and relationships with the business organisation concerned.

Sustainability reporting standards understandably take into account primarily the OECD guidelines, presented primarily in Block IV–VI. It can be said that they make them operational, so that the business organisation is made sensitive to issues that are important for carrying out business activities in the spirit of pursuing sustainability. The EU's concept of standardising a range of detailed issues that are of importance for carrying out business activities in a sustainable manner has also an educational value. This is because an organisation that prepares such reporting can identify flaws in its corporate governance and take steps to improve it.

6. Recommendations for the organisation of corporate governance at a microeconomic level

Taking the foregoing into consideration, one may be tempted to formulate some recommendations, as a kind of indicator for improving the areas of corporate governance in business organisations, the verification of which at this historic moment of sustainability reporting in the EU is of primary importance and at the same time seems to be feasible in a relatively quick manner.

Recommendation No. 1

A key factor in the area of corporate governance, which determines whether a company will be able to manage environmental and social risks, is the composition of its management board, supervisory board or board of directors. The management board is responsible for managing the company's risks, including environmental and social risks. If board members do not have necessary experience and skills, they will not be able to manage such risks. If the entity's management board and supervisory board, or board of directors, do not share concerns about environmental and social risks, corporate governance will not be effective in overseeing those risks. If members of these bodies do not understand the company's operations sufficiently and its exposure to environmental and social risks, the management board will not be able to effectively manage these risks. If the management board is made up of members who have the same, non-diversified

backgrounds, the importance of environmental and social risks may even be overlooked or underestimated. And if the supervisory board members or directors (especially those other than the management board members) devote insufficient time to their supervisory duties, effective environmental and social risk management will be challenged.

Recommendation No. 2

An important role in the management of environmental and social risks can be played by specially established committees, to which tasks related to the supervision of certain aspects in selected risk areas can be delegated, regardless of the fact that the entire board of directors is responsible for overseeing the company's comprehensive risk exposure. Thus, in the context of ESG, a key decision in the area of corporate governance is whether to entrust social environmental risk issues to a specialised committee already in place and operating, or whether another committee should be established. This decision strongly relates to corporate governance and will ultimately affect the board's ability to manage environmental and social risks.

Recommendation No. 3

In order to effectively mitigate environmental and social risks, the issue of remuneration for management must also be addressed in order to provide for the right incentives to increase the shareholders' value and to simultaneously prioritise the environmental and social risk issues. It is therefore within corporate governance to promote such management practices that expose the board's responsibility for ensuring effective management of environmental and social risks. Managing these risks seems to be all the more effective the clearer the prospect of the board's dismissal if the shareholder expectations are not met.

Recommendation No. 4

The fact that more and more institutional investors recognise the importance of ESG reporting and supporting proposals from environmentally and socially sensitive shareholders is of great importance for the entity's efforts to operate in a sustainable manner. For the purpose of ensuring that management boards do not ignore such proposals that are supported by the majority of the entity's shareholders, it is necessary to incorporate into the corporate governance practices the management board policies determining a procedure for deciding on such matters and for notifying investors by the by the management board of the related activities.

Recommendation No. 5

The presentation of the entity's corporate governance organisation in the framework of the sustainability reporting (in accordance with EU standards) must not merely be a tool for legitimising the corporate governance practices that may be far from being perfect. The lack of ethics in this area means as a rule a reprehensible superficiality. Its disclosure can bring consequences that can be serious for both the company's image and finances. It is therefore in the interest of the entity's management board to take a keen interest in implementing good corporate governance practices, even if it would be required and disciplining for that board to evaluate projects undertaken in the aspect of their environmental and social impacts.

Recommendation No. 6

The introduction of mandatory sustainability reporting, which should follow certain standards, draws attention to the organisation of the internal information system in the entities subject to that obligation, the way it functions, the quality of the information provided and the costs involved. The latter are particularly important when they are caused by duplication of work, redundancy of information or inconsistency between information created in different modules of the same system. Consequently, in addition to the creation of non-value-adding costs, this can also lead to lower reliability of both external and internal reporting. The problem becomes more acute when information circulating within the entity can simultaneously be used for the purposes of externally standardised reporting (ESG) and for the purposes of internal reporting, carried out adequately to meet diverse needs of internal stakeholders. A good example of this situation concerns the issues regarding the obligation to disclose risk factors as part of external reporting and to recognise risks for the purposes of the internal risk management practices.

The ESG reporting involves the collection and processing and the maintenance, especially for this purpose, of operational and other data sets and the creation of narrative descriptions, the correctness of which should be reflected in the entity's practices. There is no doubt that reporting is a cost driver at the entity and an opinion maker in its environment, which is of significance for its financial performance. It is therefore important the information reported casts no doubt. The requirement of corporate governance for transparency of information sources relating to the 'E' and 'S' reporting and of the introduction of order in the entity's information system is therefore justified. This is because, the adoption of different sources of information for the 'E' and 'S' areas, i.e., different ones for internal management purposes and different ones for external ESG reporting may lead to information being inconsistent in a given area, and to discrepancies in risk assessments, and also to manipulation

of assessments of the entity's stakeholders, including its shareholders. And beyond all that, it can also be considered a sign of mismanagement of the entity's resources.

A clear message in corporate governance, especially now, i.e., during the implementation of the sustainability reporting obligation, as to the quality of information sources related to it is particularly important. It can anticipate many risk factors, the occurrence of which can be effectively prevented at the stage of preparation of reporting information.

Summary

The two issues outlined above, namely the corporate governance principles formulated by the OECD with the intention of global coverage, and the standardisation within the EU of reporting information on it, are of a complementary nature. It is not possible to discuss these issues in detail herein, but nevertheless, even their synthetic overview makes it possible to note how wide the spectrum is of areas, relations and activities which are covered by the definition of 'corporate governance', and which require in practice an institutionalised implementation at a macroeconomic scale and then a systemic implementation at a microeconomic scale.

The purpose hereof was not to discuss academic definitions or models of corporate governance, nor to prepare a cross-sectional and historical presentation of (various non-OECD) institutions that have been active in the area of developing framework guidelines for such governance. The focus on the OECD was not accidental. After all, the OECD countries and key partners represent approximately 80% of global trade and investment, and furthermore, the corporate governance guidelines are relevant to the economic order in our country as well, since Poland is one of the OECD members. These two facts, juxtaposed with the wording of corporate governance imperatives are to indicate the role and responsibility of institutions and various other organisations responsible for the security of economic transactions in various jurisdictions of the OECD countries. They also raise awareness of the importance of overcoming implementation difficulties in this area. The problem of reporting corporate governance information in accordance with the ESG reporting principles, on the other hand, served here to determine in a holistic manner the responsibility that lies with economic organisations.

In light of the above, and especially in view of the fact that both issues are extremely current (due to their importance and the fact of the sanctioning of important documents for them in 2023), it should be stated that a reliable assessment of the status quo of corporate governance in Poland is absolutely necessary, as a scientific diagnosis is urgently needed as to which elements of the national system defining the framework of such governance on a macroeconomic scale require improvement. This is a primary issue at this scale. It is hoped here that a review of national

solutions in the context of the latest OECD guidelines, which are referenced and outlined herein in their current wording, may be helpful in dealing with this diagnosis. On the microeconomic scale, on the other hand, the priority is to review the existing corporate governance practices in individual economic organisations. Here, too, diagnoses of the status quo of corporate governance are necessary. Their framework is determined, as a kind of benchmark, by a sustainability reporting standard dedicated to the conduct of business activities and, within it, corporate governance. And here, too, it is hoped that the approximation of this problem at a very historical moment from the perspective of the development of business entity reporting, and the recommendations presented herein will prove useful.

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The Place of Conducting the Audit of Financial Statements versus the Location of the Head Office of Audit Firms in Poland

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Abstract

Purpose: The aim of the study is to recognise the relationship between the location of conducting an audit of financial statements and the location of head offices of audit firms operating in Poland.

Methodology/research approach: The document examination method was used in the study. The analytical approach involved a targeted search of the content of the annual reports of audit firms submitted for 2022 to the Polish Agency for Audit Oversight – PANA (as part of the statutory auditors’ reporting obligations under Article 51 of the Act on Statutory Auditors, Audit Firms and Public Supervision of 11 May 2017 (Journal of Laws of 2023, item 1015)) to determine the relationship between the place of the audit of financial statements and the head office of their audit firms. The results of the search performed were then aggregated and plotted on a map showing the administrative division of Poland into provinces.

Results: Audit firms from all over Poland audit a relatively large number of entities based in Mazowieckie Province. In many provinces, due to the distribution of the location of major cities, audit firms, while conducting audits close to their head office, actually conduct them in another province. Most audits are performed by audit firms in their own province or in neighbouring provinces. However, audit firms established in Mazowieckie Province and Wielkopolskie Province audit entities all over Poland. The TOP12 firms, i.e., audit firms with more than 1% share in audits of public interest entities (PIEs), have a significant share here.



Research limitations/implications: The research limitations result from several reasons. The rigid information structure of the annual financial statements submitted to PANA is fundamental (<https://strefa.pana.gov.pl/wyszukLwarka/>). For this reason, for the purposes of the audit, the head office in accordance with the PANA register of audit firms was accepted as the head office of the auditing entity. Other limitations relate to the fact that the head office of the audited entity may be different from the place where operations are actually performed, while the geography of Poland and differences in the development of the infrastructure of individual regions may distort the idea of local performance of the financial statement audit service.

Originality/value: This is the first data analysis of this type in Poland, enabled due to the reporting information about their activity by audit firms to the supervising authority – through the STREFA System of Registration and Records of Audit Firms. Earlier analyses referred only to the activities of audit firms taking into account their geographical distribution across the country. It allows to identify the business model of audit firms operating in Poland and their preferences regarding contacts with clients, as well as to recognise the market of financial statement auditing services in terms of its saturation in individual regions of the country.

Keywords: financial audit, audit of financial statements, financial review, location of audit firm

Introduction

In Poland, consolidated reports of capital groups and annual financial statements of entities that continue its operations, as listed in Article 64 para. 1 pt. 1 to 3 of the Accounting Law (Accounting Law of 1994), are subject to the statutory auditor's examination. Financial statements of other entities (such as limited liability companies, limited partnerships, partnership limited by shares, limited liability partnership, registered partnerships, civil partnerships and natural person's businesses) that meet additional conditions set forth in Article 64 para. 1 pt. 4 are also subject to examination. The activities of statutory auditors and audit firms are regulated by the Act on Statutory Auditors, Audit Firms and Public Supervision of 11 May 2017 (Act on Statutory Auditors, Audit Firms and Public Supervision of 2017). Requirements for auditing financial statements of public-interest entities (PIEs) are also regulated by Regulation (EU) 537/2014 of the European Parliament and the Council. (Regulation of the European Parliament and the EU Council of 2014).

Audit firms that operate in Poland, especially the large ones, have their offices in different cities to facilitate contacts with clients, but their annual reports do not include information on which office (or offices) handled a particular audit. According to the literature analysed, there has been so far no research¹ carried out into a relation between the registered offices of audit firms and the entities audited, and thus a research niche has been identified.

The aim of the paper is to recognise the relationship between the location of conducting an audit of financial statements and the location of head offices of audit firms operating in Poland. The analytical approach adopted for this purpose involved firstly a targeted search of the content of the annual reports of audit firms submitted for 2022 to the Polish Agency for Audit Oversight as part of the statutory auditors' reporting obligations under Article 51 of the Act on Statutory Auditors, Audit Firms and Public Supervision of 11 May 2017 (Journal of Laws of 2023, item 1015). The search performed was then aggregated and plotted on a map showing the administrative division of Poland into provinces. The analysis was firstly carried out in total for all the audit companies, then by their size, and then in detail by province. The location of the audit firm was its headquarters as entered in the PANA Register of Audit Firms², and the location of the audited entities was their registered address as indicated in the annual financial statements submitted by audit firms to the Polish Agency for Audit Oversight.

The analysis discussed herein is the first data analysis of this type in Poland, enabled due to the reporting information about their activity by audit firms to the

¹ The research was carried out comprehensively on the entire population of audits performed by audit firms. The data analysed included: (1) data on the entities audited, as provided for in reports submitted to PANA, in which the audit firm reports data concerning the registered office of the entity audited, (2) data on the registered office of the audit firm in accordance with the PANA Register of Audit Firms (with the term of the 'registered office (location) of the entity' being defined by Polish legislation, e.g., in the Civil Code or the Commercial Companies Code).

It would be extremely difficult and expensive, if not impossible, to obtain the detailed data on the audit offices and teams from all the audit firms. This is business data, the disclosure of which could face opposition from the audit firms. In addition, research teams are often composed of employees that perform their work tasks in various offices or units, and in particular, of employees from shared services centres, i.e., from specialised units dealing with specific audit areas.

Besides, the chief statutory auditor in charge of the audit may come from a different office than the other auditors (selected to facilitate direct contact with the client). In view of the above, in order to standardise the approach, it was necessary to adopt a consistent assumption, which was a kind of simplification, but which allowed for a comprehensive analysis of data on the entire market in Poland to be carried out.

² <https://strefa.pana.gov.pl/wyszukiwarka/> [accessed: November 2023].

supervising authority – PANA through the STREFA System of Registration and Records of Audit Firms. Earlier analyses referred only to the activities of audit firms taking into account their geographical distribution across the country.

1. Determination of the validity of the analysis carried out

In order to justify the choice of the research topic made, an analysis of literature on the research into a relation between the location of the examination of financial statements and the location of the registered offices of audit firms was carried out. The review of the selected Polish studies, which is presented below, was complemented by research into the publications listed in the Google Scholar database.

Zeszyty Teoretyczne Rachunkowości (ZTR), a popular journal of accounting and auditing from 2020–2023, was analysed in detail in the scope concerned. According to the literature reviewed, the research carried out into the subject of auditing covered the following issues: internal audit, historical aspects of accounting, acceptances of financial statements audited by statutory auditors or aspects related to specific items of financial statements (outside the scope of this paper). Research works directly related to financial auditing cover three areas:

- 1) an impact of ethics on the audit practices (e.g., Czerny, 2020; Kotyla and Hyży, 2021; Malchev and Bozhinovska-Lazarevska, 2021; Zyznarska-Dworczak, 2022);
- 2) an impact of COVID-19 on the companies' operations and on their continuation as assessed by the statutory auditor (e.g., Chrostowska and Koleśnik, 2021; Chrostowska, 2023; Hyży, 2023);
- 3) a new format for financial reporting by issuers (ESEF) as a subject of examination by a statutory auditor (e.g., Kobiela-Pionnier, 2023; Frendzel and Firkowska-Jakobsze, 2022).

A search of the Google Scholar database (for the period 2020–2023) was carried out with the use of such keywords as 'audit firm', 'audit' and 'location'. This resulted in information having been collected out of 36 publications. The issues addressed therein included, among many, the certification of non-financial information, issues relating to the impact of COVID-19 on the operations of the entities audited, and the impact of financial security on corporate sustainability as well as specific issues relating to the examination of financial statements. Simultaneously, interestingly enough, a significant number of them did not concern the examination of financial statements by auditors at all. The foregoing leads to the conclusion that the issues addressed herein have not been the subject of previous scientific dissertations published in the database searched. However, this does not mean that publications in a similar field are not included in other

databases³. Nevertheless, even if this is the case, the analysis carried out can be considered comparative and original due to the source (information available to the supervision authority) and geographic scope (Poland) of information used for the purposes of its completion.

At this point, it is also worth pointing out that due to the outbreak of COVID-19 (during which the auditing services have undergone major changes due to restrictions aimed at preventing the spread of the virus, in particular, lockdowns), the auditing procedure which was traditionally performed in person by the team of auditors at the audited entity's premises had to be changed. Due to the limitation in face-to-face contacts, most of the audit tasks were carried out remotely (in particular, meetings with both the management and employees of the entity audited).

In conclusion, it can be stated that the existing (recently carried out) scientific research does not directly demonstrate that the relation between the location of the audit and the location of the registered offices of the audit firms was analysed. In addition, the particular pandemic period bringing unprecedented radical changes to the carrying out of business activities and to the functioning of entities and institutions important to their security, could (and did, as stated above) change the way in which the audit firms and the entities audited operate. This fact may have been of significance for the modification of audit procedures by audit firms, including in terms of the location of their performance. The foregoing constitutes a rationale for concluding that the analysis carried out seems to have attributes that originally form part of the characteristics of the audit sector.

2. Analysis of the relation between the registered office of the audit firm and the registered office of the entities audited

The relation between the registered office of the audit firm and the registered office of the entities audited was analysed on the basis of the annual reports submitted by 962 audit firms. Audit firms, especially large ones, have offices in different cities, which facilitates them keeping in contact with clients, but their annual reports do not include information on the office (or offices) that conducted a given audit; therefore, for the purposes of carrying out the analysis, it has been assumed that the location

³ The use of the Google Scholar database only is intentional. The analysis presented herein covered the audit market in Poland, so the focus hereof was primarily on ZTR, a Polish academically recognised journal with a strong interest in accounting and reporting issues. The purpose of the Google Scholar search in Polish was to identify publications edited in that language by other authors.

of the audit performed corresponded in each case to the location⁴ of the audit firm's registered office. The registered office of an audit firm (AF) is understood to mean its principal office according to the register of audit firms maintained by the Polish Agency for Audit Oversight, pursuant to Article 57 of the Act on Statutory Auditors, Audit Firms and Public Supervision of 11 May 2017 (Journal of Laws of 2023, item 1015). The analysis was carried out on the basis of data derived from nearly 36,000 statutory⁵ and voluntary audits (including 2,020 audits of entities of public-interest entities).

The audit firms analysed performed 35,917 audits, out of which 21,961 (61.1%) were performed for entities with their registered offices in the same province as the registered office of the audit firm. The highest number of audits conducted within the same province were conducted in the following provinces: Kujawsko-Pomorskie (83.6%), Zachodniopomorskie (82%) and Podkarpackie (81.7%). The share of audits lower than 50% for the audits conducted by audit firms within their own province was in the following provinces: Łódzkie (43%), Wielkopolskie (46.5%) and Lubuskie (48.8%). Detailed results have been presented in Table 1 and Figure 1.

As far as the public-interest entities are concerned, it is concluded that 51.6% of the entities audited are based in Mazowieckie Province and they are primarily audited by the audit firms also based in Mazowieckie Province (78.7% of all the audits conducted). A significant share in the number of audits are conducted by the audit firms based in Wielkopolskie Province, which carry out every eighth audit. Their combined market share in terms of the number of the public-interest entities audited is 91.2%.

⁴ The actual auditing services are provided at various locations. They can be rendered at the registered office of the entity audited, and if the accounts are kept by an accounting office, some of the audit tasks are performed at the registered office of the accounting office, meetings with the entity's management or persons authorised by the entity audited can also be held remotely or at the registered office of the AF. Some of the activities relating, for example, to stock taking, or ascertaining the existence of assets, can take place elsewhere. For example, in the case of stock taking, if the entity has warehouses in different parts of the country a statutory auditor should visit at least some of them. For large AFs, some of the tasks can be carried out by their shared services centres situated at different locations. The KBR data may also be analysed in the office. At this point, a uniform assumption should be made, according to which the analysis carried out covers the relation between the registered office of the AF and the registered office of the entity analysed. The results of the research carried out indicate that the services are provided in the province in which the audited office of the AF is located or in a neighbouring province; this demonstrates that a direct contact with clients remains of importance for statutory auditors, even though some of the auditing services can be rendered remotely.

⁵ Audits of both individual and consolidated financial statements of the capital group.

Table 1. Percentage distribution of audits conducted by audit firms from a given province, according to the registered office of the entity audited

Registered office of the AF	Registered office of the entity																	
	dolnośląskie [%]	kujawsko-pomorskie [%]	lubelskie [%]	lubuskie [%]	łódzkie [%]	małopolskie [%]	mazowieckie [%]	opolskie [%]	podkarpackie [%]	podlaskie [%]	pomorskie [%]	śląskie [%]	świętokrzyskie [%]	warmińsko-mazurskie [%]	wielkopolskie [%]	zachodniopomorskie [%]	Other countries [%]	Total [%]
dolnośląskie	77,1	0,6	1,0	1,6	0,7	2,1	6,0	3,9	0,1	0,1	0,6	2,2	0,1	0,2	3,1	0,6	0,0	100
kujawsko-pomorskie	0,3	83,6	0,3	0,3	2,1	0,3	7,1	0,0	0,0	0,1	1,4	0,4	0,0	1,3	1,6	1,3	0,0	100
lubelskie	2,2	0,2	74,6	0,0	0,6	0,2	17,3	0,2	2,4	0,5	0,0	0,5	0,6	0,5	0,2	0,0	0,0	100
lubuskie	6,6	1,8	0,6	48,8	2,8	1,4	6,9	0,5	1,1	0,2	2,8	3,7	0,6	1,8	11,5	9,0	0,0	100
łódzkie	3,7	4,3	1,9	0,6	43,0	2,5	19,2	1,1	1,6	1,2	3,4	6,2	1,8	2,0	5,2	2,2	0,0	100
małopolskie	2,7	1,0	1,4	0,4	1,7	63,6	8,6	0,7	5,1	0,4	0,6	9,2	2,1	0,6	1,3	0,4	0,1	100
mazowieckie	5,5	2,7	1,9	0,9	2,7	4,5	58,5	0,8	1,6	1,0	4,2	5,5	1,0	1,1	6,1	1,7	0,3	100
opolskie	6,7	0,3	0,0	1,0	1,0	1,6	4,5	78,2	0,0	0,0	0,0	5,4	0,0	0,6	0,6	0,0	0,0	100
podkarpackie	0,0	0,0	1,6	0,0	0,0	5,9	4,8	0,3	81,7	0,4	0,0	1,3	3,6	0,1	0,1	0,0	0,0	100
podlaskie	0,3	0,6	0,8	0,0	1,1	0,2	15,3	0,3	0,3	69,6	0,8	0,3	0,0	9,5	0,8	0,0	0,0	100
pomorskie	0,4	5,3	0,1	0,2	0,4	2,2	7,4	0,0	0,2	0,1	79,2	0,4	0,1	1,6	1,2	1,1	0,0	100
śląskie	3,2	0,6	0,6	0,6	1,3	7,7	9,6	2,2	1,1	0,3	1,1	69,6	0,5	0,3	1,0	0,3	0,0	100
świętokrzyskie	0,7	0,0	0,5	0,5	1,9	1,4	11,4	0,0	2,7	0,0	0,2	0,7	78,0	0,0	1,7	0,2	0,0	100
warmińsko-mazurskie	0,4	1,4	0,4	0,0	0,2	0,0	8,7	0,0	0,4	8,5	11,6	0,4	0,0	67,6	0,4	0,0	0,0	100
wielkopolskie	6,0	2,8	0,8	1,8	2,7	2,9	22,6	0,9	0,7	0,4	3,0	4,5	0,7	1,0	46,5	2,6	0,1	100
zachodniopomorskie	0,5	0,7	0,0	2,2	0,1	0,5	4,2	0,0	0,3	0,0	5,2	0,5	0,0	0,4	3,3	82,0	0,0	100

Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

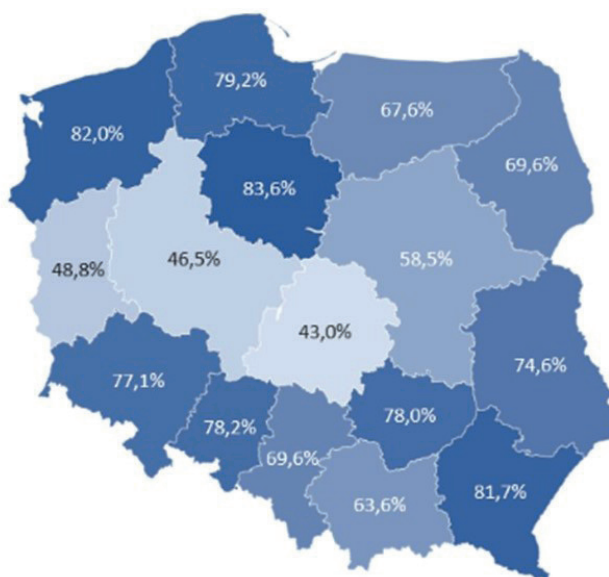


Figure 1. Percentage of audits conducted by audit firms of entities based in the same province

Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

In contrast, a total of 59.1% of all the audits of public-interest entities conducted by the AFs based in Mazowieckie Province involved entities from the same province.

For the purposes of carrying out a more detailed analysis, the population of audit firms was divided into three groups:

- A – audit firms with a market share of more than 1% in the total revenues from statutory audits of public-interest entities in 2022 (TOP12);
- B – other audit firms auditing public-interest entities and audit firms other than those auditing public-interest entities, which meet the criterion of 1 million of revenues from certified services rendered by statutory auditors or 1 million of other revenues;
- C – other audit firms that do not audit public-interest entities.

The group B and C audit firms were analysed in more detail⁶.

⁶ The group B and C audit firms, i.e., smaller AFs, were analysed in detail, and the results obtained was compared with the result obtained for the entire population. The multi-office problem affects mainly the largest AFs, that is, those from the TOP12. Smaller AFs i.e., from groups B and C have

In Group B, which consisted of 12,300 audits, just over 7,000 were conducted for entities based in the same province. This constitutes 56.8% of the total audits performed. The largest number of audits conducted within a single province were conducted in the following provinces: Świętokrzyskie (84.7%) and Podkarpackie (84.4%). Very similar values (just over % of audits) were conducted in the following six provinces: Opolskie (78.9%), Dolnośląskie (78.1%), Zachodniopomorskie (78%), Kujawsko-Pomorskie (77.3%), Warmińsko-Mazurskie (77.3%) and Pomorskie (76.4%). In only two of the provinces this result is less than half of the audits conducted, namely Łódzkie (29.4%) and Wielkopolskie (36.6%).

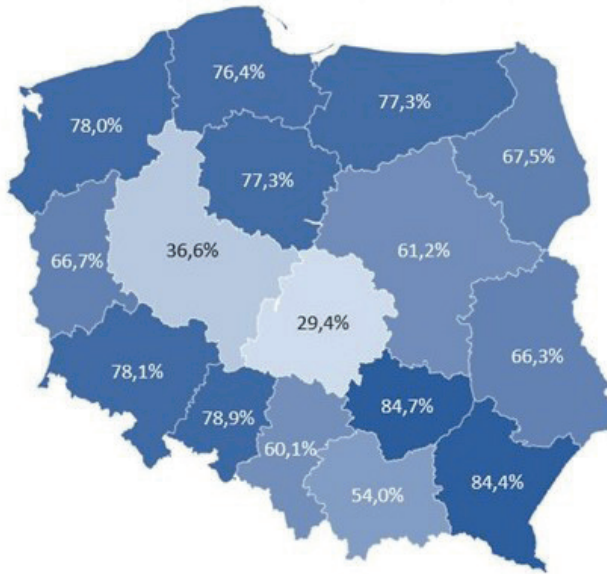


Figure 2. Percentage of the audits performed of entities based in the same province – Group B

Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

In Group C, of the more than 13,700 audits, more than 10,300 were conducted for entities based in the same province. This is more than the % of all the audits conducted (75.5%). The largest number of audits of entities based in the same province were conducted in Kujawsko-Pomorskie (85.7%) and Lubelskie (85.6%), and more than 80% were also conducted in Zachodniopomorskie (82.8%), Pomorskie (81.5%)

their registered offices in 10 out of 12 provinces. Smaller entities usually do not have more than one office.

Table 2. Percentage distribution of audits conducted by AFs from a given province, according to the registered office of the entity audited – Group B

Registered office of the AF	Registered office of the entity																	
	dolnośląskie [%]	kujawsko-pomorskie [%]	lubelskie [%]	lubuskie [%]	łódzkie [%]	małopolskie [%]	mazowieckie [%]	opolskie [%]	podkarpackie [%]	podlaskie [%]	pomorskie [%]	śląskie [%]	świętokrzyskie [%]	warmińsko - mazurskie [%]	wielkopolskie [%]	zachodniopomorskie [%]	Other countries [%]	Total [%]
dolnośląskie	78,1	0,4	0,0	1,2	0,5	1,4	7,7	4,5	0,1	0,0	0,4	1,7	0,0	0,0	3,7	0,3	0,0	100
kujawsko-pomorskie	0,6	77,3	0,0	0,0	0,0	0,6	11,4	0,0	0,0	0,0	2,8	1,7	0,0	1,7	1,7	2,3	0,0	100
lubelskie	3,1	0,3	66,3	0,0	0,8	0,3	23,8	0,0	3,1	0,3	0,0	1,6	1,1	0,3	0,0	0,0	0,0	100
lubuskie	1,8	0,0	0,0	66,7	0,0	0,0	1,8	0,0	0,0	0,0	0,0	0,0	0,0	12,3	17,5	0,0	0,0	100
łódzkie	4,3	6,0	1,9	0,8	24,9	3,5	20,3	1,3	2,1	1,8	4,4	8,9	2,6	2,8	6,4	3,4	0,0	100
małopolskie	5,2	1,6	2,3	0,7	2,7	54,0	11,9	0,8	4,3	0,6	0,9	8,0	2,5	1,2	1,2	2,3	0,8	100
mazowieckie	4,7	5,0	1,7	0,9	2,3	3,2	61,2	0,6	1,1	0,7	5,9	3,8	0,7	1,2	6,0	1,0	0,1	100
opolskie	8,3	0,8	0,0	0,8	2,3	0,0	1,5	78,9	0,0	0,0	0,0	7,5	0,0	0,0	0,0	0,0	0,0	100
podkarpackie	0,0	0,0	0,7	0,0	0,0	4,1	6,9	0,5	84,4	0,5	0,0	1,2	1,2	0,2	0,2	0,0	0,0	100
podlaskie	0,5	0,5	0,0	0,0	2,4	0,0	19,4	1,0	0,0	67,5	1,0	0,0	0,0	7,8	0,0	0,0	0,0	100
pomorskie	0,5	4,7	0,2	0,3	0,8	1,5	11,1	0,0	0,0	0,2	76,4	0,7	0,2	1,6	0,8	1,0	0,0	100
śląskie	4,7	1,3	0,8	1,2	1,7	8,0	14,9	1,6	1,7	0,3	1,4	60,1	0,3	0,3	1,4	0,4	0,0	100
świętokrzyskie	0,5	0,0	0,0	0,5	0,5	2,2	8,2	0,0	2,2	0,0	0,0	0,0	84,7	0,0	0,5	0,5	0,0	100
warmińsko-mazurskie	0,0	0,0	0,0	0,0	0,0	0,0	13,6	0,0	0,0	0,0	0,0	0,0	0,0	77,3	9,1	0,0	0,0	100
wielkopolskie	7,3	2,2	0,6	2,3	2,2	3,5	29,0	0,9	1,0	0,6	2,9	6,4	0,7	1,5	36,6	2,3	0,0	100
zachodniopomorskie	0,0	3,4	0,0	0,8	0,0	0,0	2,5	0,0	0,0	0,0	13,6	0,0	0,0	0,0	1,7	78,0	0,0	100

Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

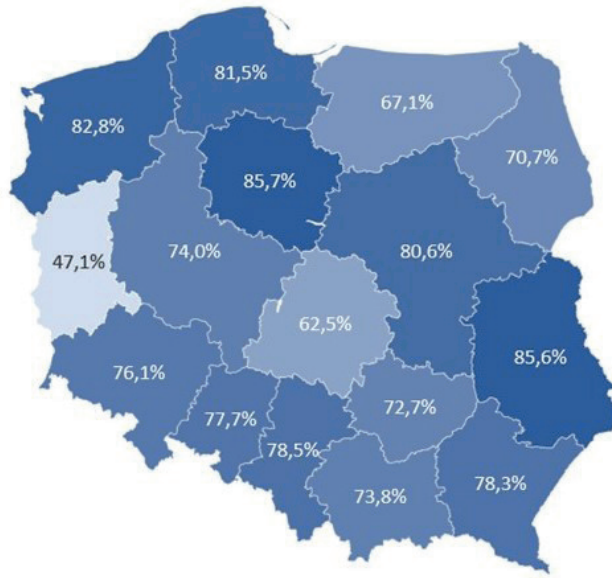


Figure 3. Percentage of the audits performed of entities based in the same province— Group C

Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

Table 3. Percentage distribution of audits conducted by AFs from a given province, according to the registered office of the entity audited – Group C

Registered office of the AF	Registered office of the entity																	
	dolnośląskie [%]	kujawsko - pomorskie [%]	lubelskie [%]	lubuskie [%]	łódzkie [%]	małopolskie [%]	mazowieckie [%]	opolskie [%]	podkarpackie [%]	podlaskie [%]	pomorskie [%]	śląskie [%]	świętokrzyskie [%]	warmińsko -mazurskie [%]	wielkopolskie [%]	zachodniopomorskie [%]	Other countries [%]	Total [%]
dolnośląskie	76,1	0,8	2,0	1,9	0,9	2,8	4,3	3,4	0,0	0,1	0,9	2,7	0,1	0,4	2,6	0,9	0,0	100
kujawsko -pomorskie	0,2	85,7	0,4	0,4	2,8	0,2	5,6	0,0	0,0	0,2	0,9	0,0	0,0	1,1	1,5	0,9	0,0	100

Registered office of the AF	Registered office of the entity																	
	dołnośląskie [%]	kujawsko - pomorskie [%]	lubelskie [%]	lubuskie [%]	łódzkie [%]	małopolskie [%]	mazowieckie [%]	opolskie [%]	podkarpackie [%]	podlaskie [%]	pomorskie [%]	śląskie [%]	świętokrzyskie [%]	warmińsko - mazurskie [%]	wielkopolskie [%]	zachodniopomorskie [%]	Other countries [%]	Total [%]
lubelskie	1,1	0,0	85,6	0,0	0,4	0,0	8,9	0,4	1,5	0,7	0,0	0,4	0,0	0,7	0,4	0,0	0,0	100
lubuskie	7,1	2,0	0,7	47,1	3,0	1,5	7,4	0,5	1,2	0,2	3,0	4,0	0,7	2,0	11,4	8,2	0,0	100
łódzkie	2,9	1,9	1,9	0,2	62,5	1,2	17,7	0,9	0,9	0,3	2,1	2,2	0,6	0,7	3,4	0,5	0,0	100
małopolskie	0,1	0,5	0,6	0,1	0,6	73,8	5,1	0,6	5,9	0,1	0,2	10,5	1,7	0,1	0,2	0,0	0,0	100
mazowieckie	1,7	1,1	2,7	0,3	2,2	1,4	80,6	0,1	1,1	1,7	0,9	1,8	0,9	1,5	1,4	0,9	0,0	100
opolskie	5,6	0,0	0,0	1,1	0,0	2,8	6,7	77,7	0,0	0,0	0,0	3,9	0,0	1,1	1,1	0,0	0,0	100
podkarpackie	0,0	0,0	2,8	0,0	0,0	8,3	2,1	0,0	78,3	0,3	0,0	1,5	6,7	0,0	0,0	0,0	0,0	100
podlaskie	0,2	0,7	1,2	0,0	0,5	0,2	13,2	0,0	0,5	70,7	0,7	0,5	0,0	10,4	1,2	0,0	0,0	100
pomorskie	0,4	5,7	0,0	0,1	0,1	2,7	4,4	0,0	0,4	0,1	81,5	0,3	0,1	1,6	1,4	1,2	0,0	100
śląskie	1,8	0,0	0,4	0,1	1,0	7,4	4,6	2,9	0,6	0,2	0,8	78,5	0,7	0,3	0,5	0,2	0,0	100
świętokrzyskie	0,9	0,0	0,9	0,4	3,0	0,9	13,9	0,0	3,0	0,0	0,4	1,3	72,7	0,0	2,6	0,0	0,0	100
warmińsko-mazurskie	0,4	1,5	0,4	0,0	0,2	0,0	8,4	0,0	0,4	8,9	12,1	0,4	0,0	67,1	0,0	0,0	0,0	100
wielkopolskie	3,2	3,2	0,2	1,6	2,4	1,1	6,4	1,0	0,2	0,0	1,9	1,2	0,4	0,3	74,0	2,8	0,0	100
zachodniopomorskie	0,6	0,2	0,0	2,5	0,2	0,6	4,5	0,0	0,3	0,0	3,6	0,6	0,0	0,5	3,6	82,8	0,0	100

Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

and Mazowieckie (80.6%). The lowest number, i.e., almost half of the audits were carried out in Lubuskie Province, and subsequently over 60% in Łódzkie (62.5%) and Warmińsko-Mazurskie (67.1%).

3. Concentration of audits conducted by audit firms in the province in which their registered offices are located

When analysing the share of the number of audits conducted of the entities based in the same province as the audit firm, it is also important to draw attention to a very crucial factor, namely the number of entities and audits to be conducted in the province concerned. As shown in Table 4, the number of audits conducted by audit firms based in a given province versus the number of audits of entities based in a given province varies widely. They are not in proportion to one another. For each province, a ratio was calculated showing the relation between the number of audits conducted by audit firms based in the province concerned and the number of the entities audited based in that province. If the value of the coefficient is 1, it can be concluded that the demand balances out the supply, i.e., if AFs based in a given province provided auditing services only in their province they would have provided such services to all the entities based in the province which had commissioned such audits. A value of less than 1 means that with the number of audits currently conducted, AFs from a given province would not be able to conduct all the audits commissioned by the entities based in the province (they had to be provided with audit services by the AFs based in other provinces, as the supply was lower than the demand); in turn, a value of more than 1 means that the AFs performed more audits than the number of audits commissioned in a given province, so in order to continue to conduct the same number of audits as currently, they must perform them in other provinces (demand for audits is lower than AFs' ability to conduct them).

In three provinces, namely Łódzkie, Wielkopolskie and Mazowieckie, the number of audits conducted by audit firms based in those provinces was more than 30% higher than the number of audits of entities that were conducted in a given province. The number of audits conducted by auditors based in the province was less than the number of audits commissioned by the obliged entities based in the province concerned. It is also worth noting that, as shown in Table 5, in the case of Wielkopolskie Province and Mazowieckie Province, audit firms based in these provinces have a very large share in all the audits conducted in Poland.

The concentration of audits conducted by audit firms in each province has been presented below, firstly in the form of brief description and then in the form of graphic presentations (Figures 4 to 19).

Table 4. Comparison of the number of audits conducted by audit firms with the number of audits commissioned by entities in the same province

Province	Number of the audits conducted by AFs	Number of audits commissioned by entities based in the province	Number of audits conducted by AFs/ Number of audits commissioned by entities based in the province
dolnośląskie	1.548	2.656	0.58
kujawsko-pomorskie	707	1.384	0.51
lubelskie	623	929	0.67
lubuskie	652	638	1.02
łódzkie	2.291	1.681	1.36
małopolskie	2.487	2.821	0.88
mazowieckie	15.273	11.588	1.32
opolskie	312	584	0.53
podkarpackie	745	1.124	0.66
podlaskie	629	700	0.90
pomorskie	1.382	2.145	0.64
śląskie	2.991	3.613	0.83
świętokrzyskie	414	660	0.63
warmińsko-mazurskie	484	720	0.67
wielkopolskie	4.623	3.456	1.34
zachodniopomorskie	756	1.166	0.65

Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

Table 5. Percentage share of audit firms based in each province in the number of audits conducted in all the provinces

Province	Share of AF based in the province in the number of audits in Poland
dolnośląskie	4.3%
kujawsko-pomorskie	2.0%
lubelskie	1.7%
lubuskie	1.8%
łódzkie	6.4%
małopolskie	6.9%

Province	Share of AF based in the province in the number of audits in Poland
mazowieckie	42.5%
opolskie	0.9%
podkarpackie	2.1%
podlaskie	1.8%
pomorskie	3.8%
śląskie	8.3%
świętokrzyskie	1.2%
warmińsko-mazurskie	1.3%
wielkopolskie	12.9%
zachodniopomorskie	2.1%

Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

The AFs based in Dolnośląskie Province conduct 4.3% of the total audits conducted nationwide (see Table 5). 77.1% of these AFs operate in their own province. The size of the AF has no significant effect on this percentage share. Taking into account the neighbouring provinces, namely Lubuskie, Wielkopolskie and Opolskie, this share rises to 84.1%–87.4%, depending on the size of the AF. In Dolnośląskie Province, the ratio of the number of audits conducted by AFs based in this province to the total number of audits of the entities based in the same province is one of the lowest in Poland and amounts to 0.58 (see Table 4).

The number of audits conducted by AFs based in Kujawsko-Pomorskie Province is 2% of the total audits conducted by AFs in Poland (see Table 5). Overall, 83.6% of these audits were conducted in Kujawsko-Pomorskie Province, and this percentage share rises for the Group C audit firms to 85.7%, and is slightly lower for the Group B audit firms (77.3%). The AFs based in Kujawsko-Pomorskie Province also conduct audits in neighbouring provinces. Such audits account for up to 2.8% of the audits conducted, depending on the province and the group to which the AF is classified. It is worth noting that the total number of audits conducted by the AFs based in Kujawsko-Pomorskie Province represents only slightly more than half (51%) of the total audits of the entities based in Kujawsko-Pomorskie Province. The ratio of the number of audits conducted by AFs based in Kujawsko-Pomorskie Province to the number of audits commissioned by local entities is 0.51 (see Table 4). This is the lowest rate among all the provinces. At the same time, taking into account that the companies conducted a dozen or so percent of their audits outside their province,

this means that most audits of the entities based in Kujawsko-Pomorskie Province were conducted by audit firms based in other provinces.

The AFs based in Lubelskie Province conducted 1.7% of the total audits conducted by the AFs in Poland (see Table 5). Nearly % of them were conducted for entities based in the same province.

In the case of small entities (Group C), the percentage was much higher, i.e., 85.6%, while for the entities in Group B it was much lower, i.e., just over 66%. It is worth pointing out that a significant share of the audits conducted were audits performed for entities based in Mazowieckie Province – almost 9% in the case of entities in Group C and as much as 23.8% in the case of Group B. In total, more than 90% (91.9%) of the audits were conducted in Lubelskie Province and Mazowieckie Province. The ratio of the audits performed by AFs based in Lubelskie Province to the number of audits commissioned by the entities based in Lubelskie Province is 0.67 (see Table 4).

The AFs based in Lubuskie Province conducted 1.8% of the total audits conducted by the AFs in Poland (see Table 5). About half of these audits were conducted for the entities based in Lubuskie Province. In contrast to other provinces, the Group C AFs conducted significantly fewer audits in their own province (47.1%), as compared to the Group B AFs (66.7%). Simultaneously, the Group C AFs conducted audits in all the provinces in Poland, and the Group B AFs, except for Lubuskie Province, only in the neighbouring provinces (Zachodniopomorskie, Wielkopolskie and Dolnośląskie) and Mazowieckie Province. In total, approximately % of audits were conducted in their own province or in a neighbouring province. A similar value applies to the Group C AFs. For the Group B AFs, this value is as high as 98.2%. The analysis of the annual report data also indicates that Lubuskie Province is also characterised by a large share of small AFs (Group C) in the total number of audits conducted by the AFs based in this province – only every eleventh one was conducted by the Group B AF. Lubuskie Province is the only province in which the number of audits conducted by the AFs (see Table 4) is almost the same as the number of audits commissioned by the entities based in that province (the ratio is 1.02).

The AFs based in Łódzkie Province conduct 6.4% of the total audits in Poland (see Table 5). Overall, they conduct only 43% of audits commissioned by the entities in the province, with the Group B AFs conducting just less than 30% of them, and the Group C AFs conduct almost double number of audits, i.e., 62.5%. A significant number of audits are conducted in Mazowieckie Province, which borders Łódzkie Province (approx. 20%). However, the capitals of the two provinces are located close to each other and perfectly communicated (attractive travelling time by highway, as well as by timely-running trains). In addition, the price of the audit in Mazowieckie Province is significantly higher (both in terms of the median and the mean) than in Łódzkie Province (Baklarz, Kreis, 2023). The Group B AFs also account for a large

share in the audits conducted in the neighbouring provinces of Kujawsko-Pomorskie, Wielkopolskie and Śląskie (from 6% to nearly 9%). It is also worth noting that the AFs based in Łódzkie Province conduct significantly more audits than commissioned by the entities based in the same province. This number is more than 1/3 higher, and the ratio of audits conducted by the AFs based in the province to the number of audits commissioned by the entities based in the province is the highest among all provinces, at 1.36 (see Table 4). It is also worth noting that both the median and mean price for a statutory audit of non-public-interest entities⁷ are among the lowest in Poland and are significantly lower than those applicable in the neighbouring provinces (Baklarz, Kreis, 2023).

The AFs based in Małopolskie Province conducted 6.9% of the total audits conducted by Polish AFs in 2022 (see Table 5). The AFs based in Małopolskie Province conducted a total of 63.6% of the audits conducted in their province. In the case of the larger AFs (Group B) – the share was just over half (54%), and in the case of the smaller AFs, the share increased to almost % (73.8%). The AFs conducted audits in all provinces in Poland, but the Group C AFs did not conduct audits of entities based in Zachodniopomorskie Province. The AFs conducted 80% of the audits in these provinces, including the neighbouring provinces (Śląskie, Świętokrzyskie and Podkarpackie) (with the Group B AFs conducting 68.8% and the Group C AFs conducting 91.9%). A significant share in the audits conducted were the audits of entities based in Mazowieckie Province. The ratio of the total audits conducted by the AFs to the audits conducted for the entities based in Małopolskie Province was 0.88 (see Table 4).

The AFs based in Mazowieckie Province conducted the highest number of audits in all the provinces, i.e. 42.5% (see Table 5). Ten out of 12 AFs in the TOP12 have their registered office in this province. The largest AFs based in Mazowieckie Province also have offices in other cities across Poland, which provide auditing services to local entities, and this explains the significant share of the audited entities based in other provinces, especially in the aggregated number (for all the AFs). A total of 58.5% of the audits conducted by the AFs based in this province were conducted in Mazowieckie Province. In the case of the Group B AFs, the share rises to 61.2%, and of the Group C to more than 80%. The AFs based in Mazowieckie Province conducted audits in all provinces (this applies to all groups), in addition to Mazowieckie Province, mostly in the provinces of Wielkopolskie, Dolnośląskie and Śląskie. Mazowieckie Province, along with Łódzkie Province and Wielkopolskie Province, is among the provinces from which the AFs originate, which conduct significantly more audits than commissioned by the entities based in the said province. The ratio of the total audits

⁷ Other non-public-interest entities.

conducted by the AFs to the audits conducted for the entities based in Mazowieckie Province was 1.32 (see Table 4).

The share of the AFs based in Opolskie Province in the total number of audits conducted in Poland is the smallest among all the provinces, i.e., 0.9% (see Table 5). Approximately 78% of the audits were conducted in Opolskie Province (irrespective of whether the AFs were classified to Group B or Group C). A significant number of them were also carried out in the neighbouring provinces (Dolnośląskie Province and Śląskie Province), and a slightly smaller number in Łódzkie Province (Group B). In total, the AFs based in Opolskie Province conducted 91.3% of the audits in these provinces (97% of the Group B AFs and 87.2% of the Group C AFs). Opolskie Province is the province with the second lowest ratio of the number of audits conducted by the AFs based in Opolskie Province to the number of audits of the entities based in the province. It is 0.53 (see Table 4), which means that even if all the AFs conducted audits locally almost half of the audits would still have to be outsourced to audit firms based in other provinces.

The AFs based in Podkarpackie Province conducted 2.1% of the total audits conducted by the AFs based in Poland (see Table 5). The vast majority of them were conducted locally (in the same province) – 81.7% of the audits conducted (including 84.4% conducted by the Group B AFs and 78.3% by the Group C AFs). A significant portion of the remaining audits were carried out in the neighbouring provinces, mostly in Małopolskie Province, as well as in Świętokrzyskie Province and Lubelskie Province. A total of 92.9% of audits (90.4% in Group B and 96% in Group C) were conducted in the province or in neighbouring provinces. A significant portion of audits were also conducted in Mazowieckie Province (in particular, by the Group B AFs – 6.9%). The AFs did not conduct any audit in other provinces. The ratio of the total audits conducted by the AFs based in Podkarpackie Province to the total audits commissioned by entities based in this province was 0.66 (see Table 4), so with the same number of audits conducted by local AFs, 1/3 of the audits conducted had to be commissioned to the AFs based in other provinces.

The AFs based in Podlaskie Province conducted 1.8% of the total audits conducted by the AFs in Poland (see Table 5). Approximately 70% of them were carried out locally (in the same province). Approximately 10% of them were conducted in Warmińsko-Mazurskie Province, and a significant number also in the neighbouring province, i.e., Mazowieckie Province. Both of these provinces are very vast, with significant distances between their capitals, so the auditing of entities situated near their borders seems very natural. In total, in these three provinces, the AFs based in Podlaskie Province conducted about 94.5% of their audits. The ratio of the total audits conducted by the AFs based in Podlaskie Province to the audits commissioned by entities based in this province was 0.9 (see Table 4), so it can be concluded that

the capacity of the AFs based in this province to conduct audits is similar to the demand for such audits.

The AFs based in Pomorskie Province conducted 3.8% of the total audits conducted by the AFs in Poland (see Table 5). They conduct about 80% of audits in their own province (including 76.4% conducted by the Group B AFs and 81.5% by the Group C AFs). They also conduct a significant number of audits (about 5%) in the neighbouring Kujawsko-Pomorskie Province. In addition, a significant percentage of the audits is commissioned by entities based in Mazowieckie Province (4.4% to Group C and 11.1% to Group B). The ratio of the total audits that the AFs based in Pomorskie Province conduct to the audits commissioned by entities based in this province was 0.64 (see Table 4). The audits of entities based in the province is thus roughly one-third greater than the total of audits conducted by the AFs based in the province.

The AFs based in Śląskie Province rank third in Poland in terms of the number of audits conducted and first among provinces without the AFs from the TOP12. Their share was 8.3% of the total audits in 2022 (see Table 5). Depending on the size of the AFs, they conduct from just over 60% (Group B) to almost 80% (Group C) of the audits in their own province (69.6% in total). The neighbouring Małopolskie Province (7.7%) and Opolskie Province (2.2%) also have a significant share of the number of audits conducted. A total of 81.3% of the audits conducted by the AFs based in Śląskie Province were conducted in the province or one of the neighbouring provinces. A significant share of audits (almost 10%) were also carried out in Mazowieckie Province. For larger AFs (Group B), the share reaches almost 15%, and for the smaller AFs (Group C) it is 4.6%. The ratio of the total audits conducted by the AFs based in Śląskie Province to the number of audits commissioned by entities based in that province was 0.83 (see Table 4). It is also worth noting that Śląskie Province is the second in Poland in terms of demand for the auditing services rendered by AFs (see Table 4) – entities based in Śląskie Province commissioned 3,613 audits (out of almost 36,000 in Poland).

The number of audits conducted by the AFs based in Świętokrzyskie Province is the second smallest among all the provinces and amount to 1.2% (see Table 5). A total of 78% of the 2022 audits conducted by the AFs based in Świętokrzyskie Province were conducted in the province. Interestingly, larger audit firms (Group B) conducted more audits, i.e., 84.7% of audits, and smaller AFs (Group C) only 72.7%. A significant number of audits were also conducted in Mazowieckie Province, i.e., 11.4% (with 8.2% in Group B and as much as 13.9% in Group C). It is worth noting that the distance between the entities based in Mazowieckie Province, which are located near the border of the province, and the AFs based in Świętokrzyskie Province, is much shorter than to Warsaw. Other provinces with a significant share in the number of audits conducted are also the neighbouring provinces: Łódzkie, Podkarpackie and Małopolskie. In total, the audits conducted in these provinces were between 5 and

7%, depending on the group of the AFs. The ratio of the total audits conducted by the AFs based in Śląskie Province to the number of audits commissioned by entities based in that province was 0.63 (see Table 4). As a result, more than one-third of the audits that were commissioned by entities based in Świętokrzyskie Province had to be conducted by the AFs based in other provinces.

The next province, in terms of the number of audits conducted by the AFs based in this province, is the Warmińsko-Mazurskie Province with 1.3% of the total audits conducted by Polish AFs (see Table 5). 67.6% of them were conducted in the same province. This figure was as high as 77.3% for larger AFs (Group B). Small AFs (Group C) definitely dominate in Warmińsko-Mazurskie Province. Among the audits conducted by the AFs based in Warmińsko-Mazurskie Province, only every 20th one was conducted by the Group B AFs. Given the size and geography of the province, it seems natural to audit entities based in neighbouring provinces. A significant number of audits were carried out in Pomorskie Province, Podlaskie Province and Mazowieckie Province (a total of between 8.5% and 11.6%), and a significantly smaller number in Kujawsko-Pomorskie Province (1.4%). Audits were not conducted in the remaining provinces or their number was insignificant. The ratio of the total audits conducted by the AFs based in Warmińsko-Mazurskie Province to the number of audits commissioned by entities based in this province was 0.67 (see Table 4). As a result, at least one-third of the audits that were commissioned by entities based in Warmińsko-Mazurskie Province had to be conducted by the AFs based in other provinces.

The AFs based in Wielkopolskie Province ranked second in terms of their share in the number of audits (see Table 5) which amounted to 12.9% (every eighth audit in Poland was conducted by the AF based in Wielkopolskie Province). It also houses the remaining two ⁸ of the AFs from the TOP12. Owing to the Group A AFs (TOP12) and Group B AFs, which conduct a significant number of their audits in other provinces (mostly in Mazowieckie Province), only 46.5% of the audits were conducted in the province in which they are based, and another 22.6% in Mazowieckie Province. For Group B, this share is even lower, i.e., 36.6% in Wielkopolskie Province and as high as 29% in Mazowieckie Province. A large number of audits were also carried out for entities based in Śląskie Province and Dolnośląskie Province. In general, larger AFs conduct audits of entities in all the provinces. The Group C AFs are quite different, as they conducted 74% of their audits in their own provinces, between 1% and 3.2% in their neighbouring provinces, and 6.4% in Mazowieckie Province. Wielkopolskie Province is one of the three provinces (along with Łódzkie Province and Mazowieckie Province) with the highest ratio of the number of audits conducted by the AFs based

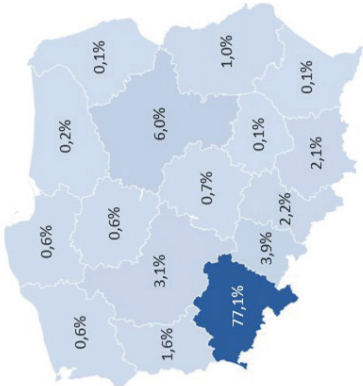
⁸ As indicated earlier in the analysis of Mazowieckie Province, the other 10 are based exactly in that province.

in Wielkopolskie Province to the number of audits commissioned by entities based in this province, i.e., 1.34 (see Table 4).

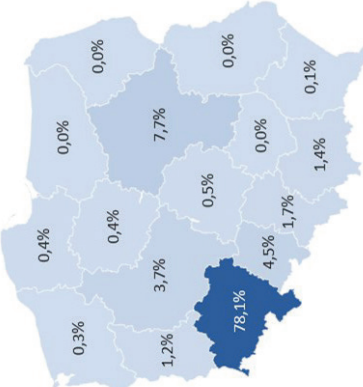
The AFs based in Zachodniopomorskie Province conducted 2.1% of the total audits conducted by Polish AFs (see Table 5). 82% of the total number of audits conducted by the AFs based in Zachodniopomorskie Province were conducted in the province (78% by the Group B AFs and 82.8% by the Group C AFs). In the neighbouring provinces, i.e., Pomorskie Province, Wielkopolskie Province and Lubuskie Province, the AFs completed more than 10% of their audits. It is worth mentioning that the Group B AFs conducted as much as 13.6% of the audits in Pomorskie Province. A significant number of audits were also conducted in Mazowieckie Province (4.2% in total, of which only 2.5% by the Group B AFs and 4.5% of the Group C AFs). In the other provinces, the AFs either did not conduct audits or the number of the audits carried out was insignificant. The ratio of the total audits conducted by the AFs based in Zachodniopomorskie Province to the number of audits commissioned by entities based in that province was 0.65 (see Table 4).

Dolnośląskie Province

AFs in Dolnośląskie Province



AFs in Dolnośląskie Province – Group B



AFs in Dolnośląskie Province – Group C

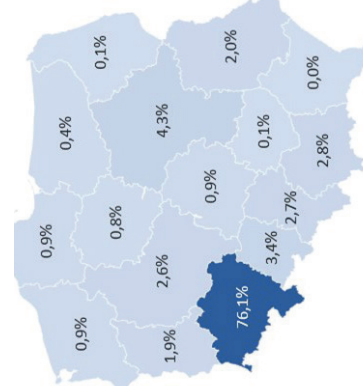
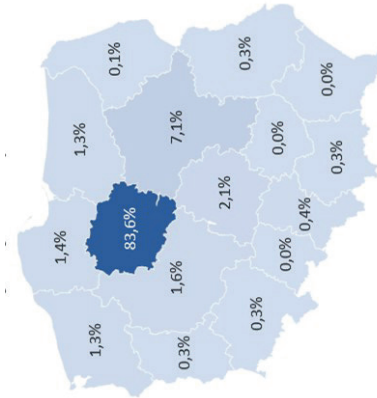


Figure 4. Concentration of audits conducted by audit firms in the province in which their registered offices are located – Dolnośląskie Province

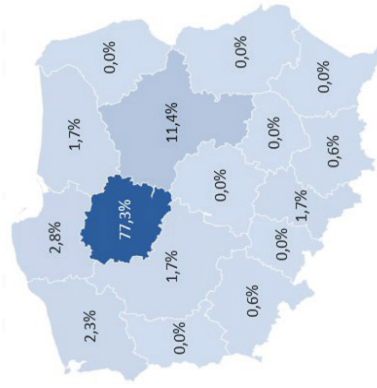
Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

Kujawsko-Pomorskie Province

AFs in Kujawsko-Pomorskie Province



AFs in Kujawsko-Pomorskie Province – Group B



AFs in Kujawsko-Pomorskie Province – Group C

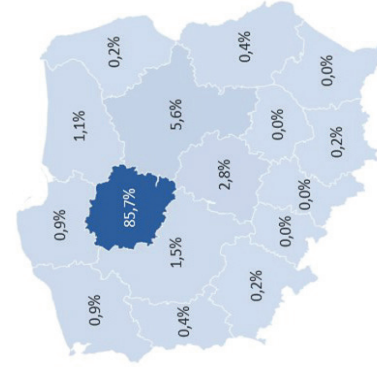


Figure 5. Concentration of audits conducted by audit firms in the province in which their registered offices are located – Kujawsko-Pomorskie Province

Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

Lubelskie Province

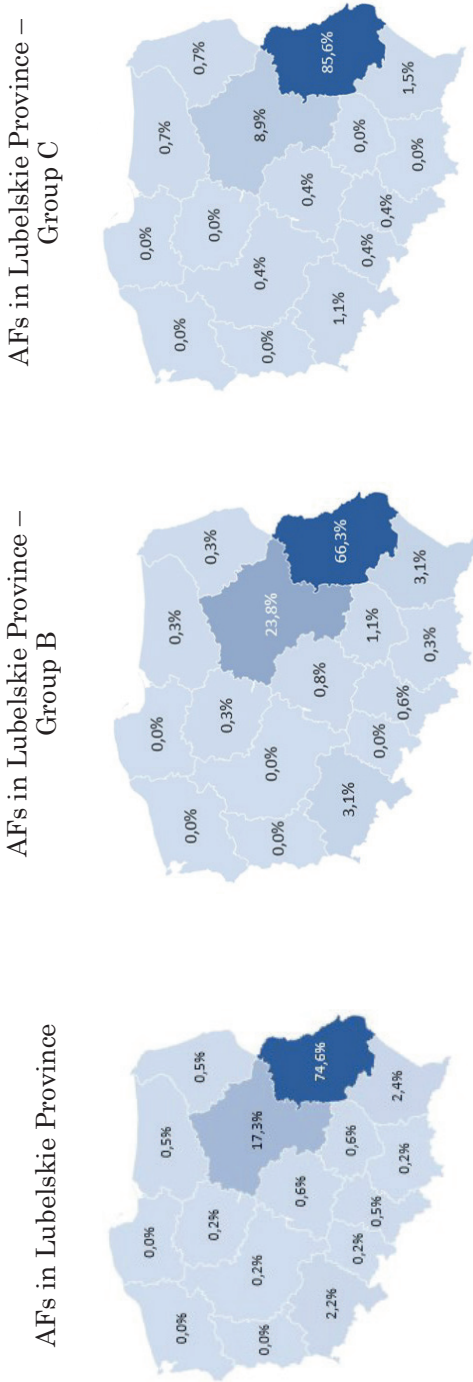


Figure 6. Concentration of audits conducted by audit firms in the province in which their registered offices are located – Lubelskie Province

Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

Lubuskie Province

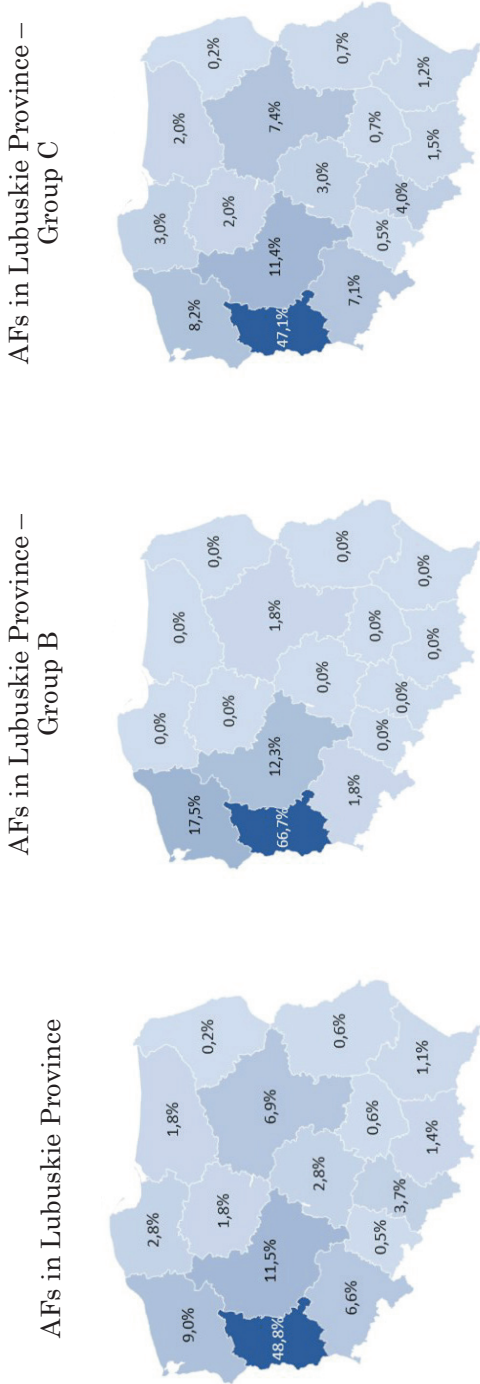
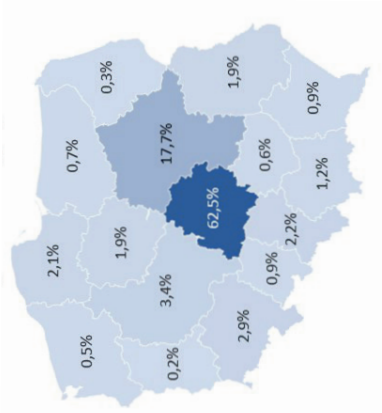


Figure 7. Concentration of audits conducted by audit firms in the province in which their registered offices are located – Lubuskie Province

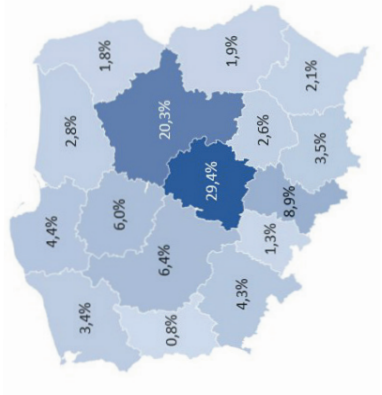
Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

Łódzkie Province

AFs in Łódzkie Province
– Group C



AFs in Łódzkie Province
– Group B



AFs in Łódzkie Province

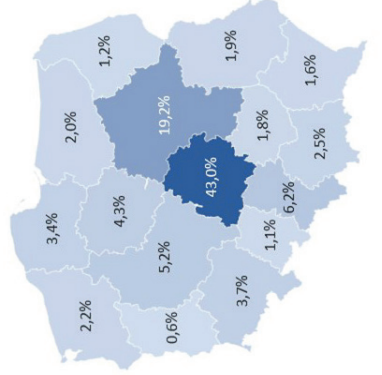
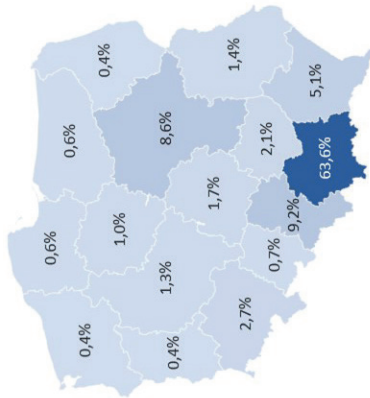


Figure 8. Concentration of audits conducted by audit firms in the province in which their registered offices are located – Łódzkie Province

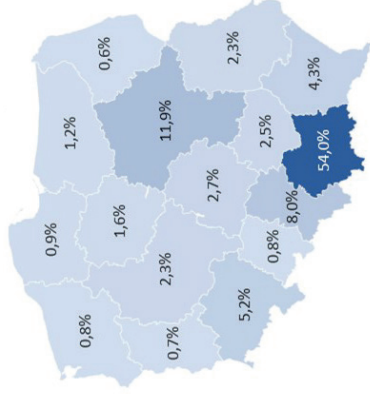
Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

Małopolskie Province

AFs in Małopolskie Province



AFs in Małopolskie Province – Group B



AFs in Małopolskie Province – Group C

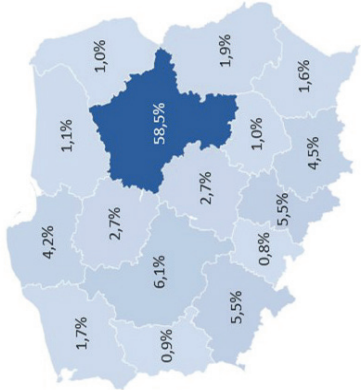


Figure 9. Concentration of audits conducted by audit firms in the province in which their registered offices are located – Małopolskie Province

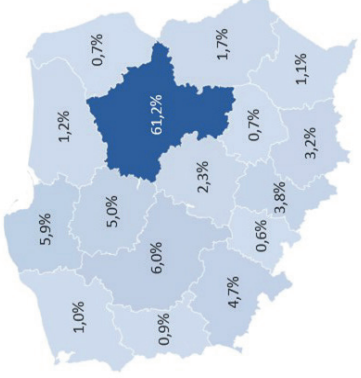
Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

Mazowieckie Province

AFs in Mazowieckie Province



AFs in Mazowieckie Province
– Group B



AFs in Mazowieckie Province
– Group C

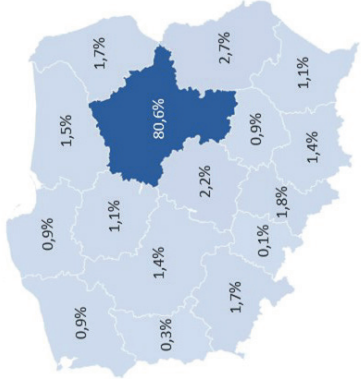


Figure 10. Concentration of audits conducted by audit firms in the province in which their registered offices are located – Mazowieckie Province

Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

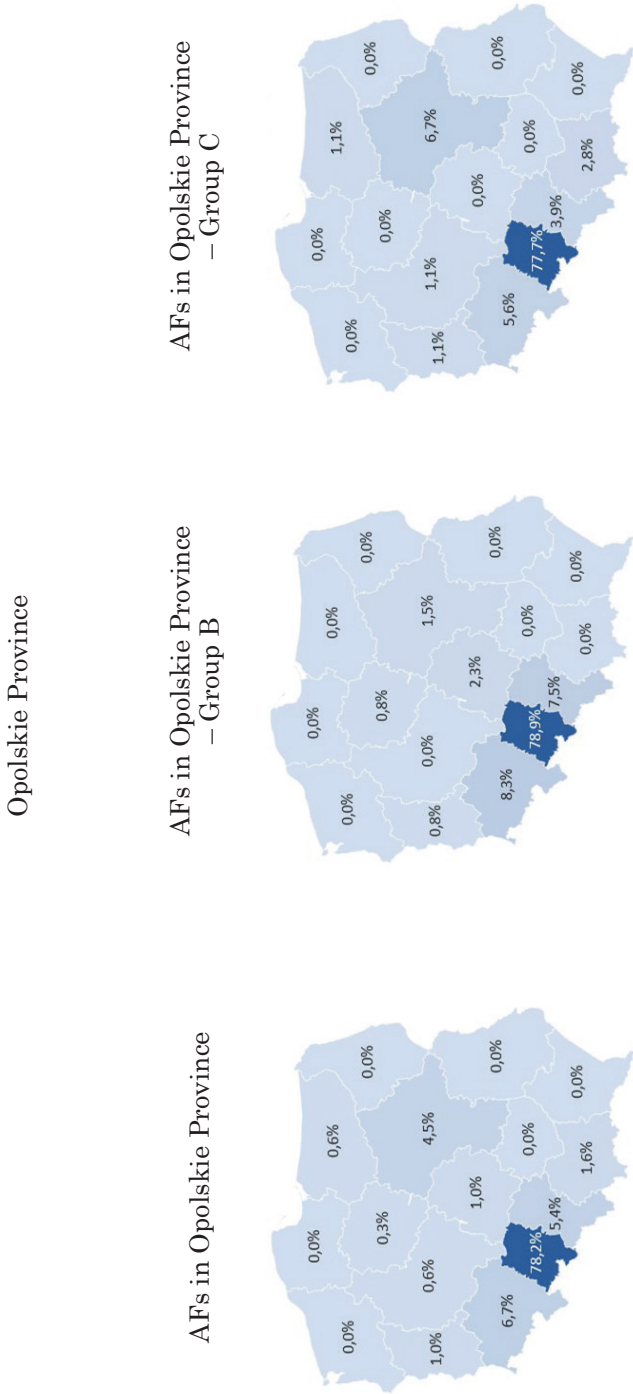
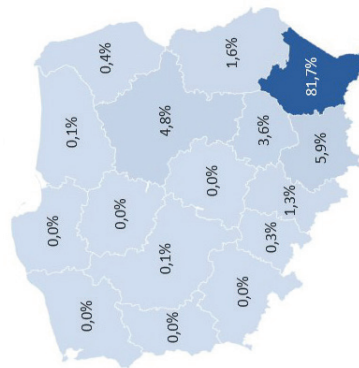


Figure 11. Concentration of audits conducted by audit firms in the province in which their registered offices are located – **Opolskie Province**

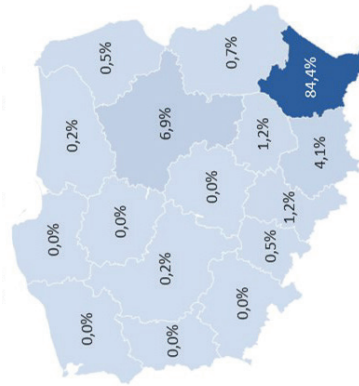
Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

Podkarpackie Province

AFs in Podkarpackie Province



AFs in Podkarpackie Province
– Group B



AFs in Podkarpackie Province
– Group C

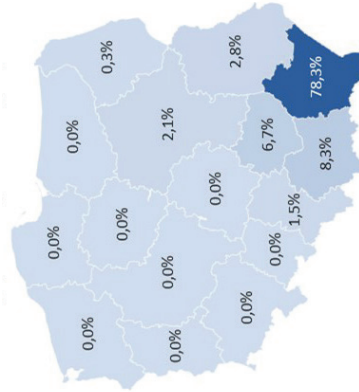
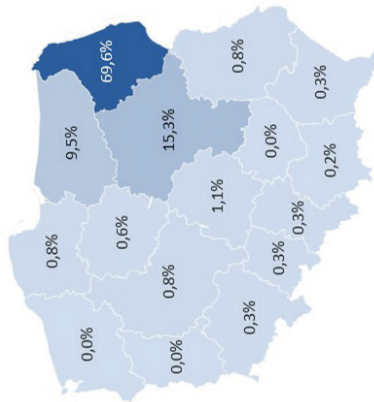


Figure 12. Concentration of audits conducted by audit firms in the province in which their registered offices are located – Podkarpackie Province

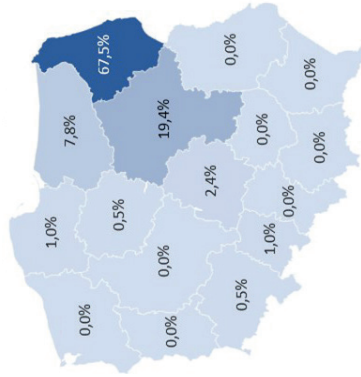
Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight.

Podlaskie Province

AFs in Podlaskie Province



AFs in Podlaskie Province – Group B



AFs in Podlaskie Province – Group C

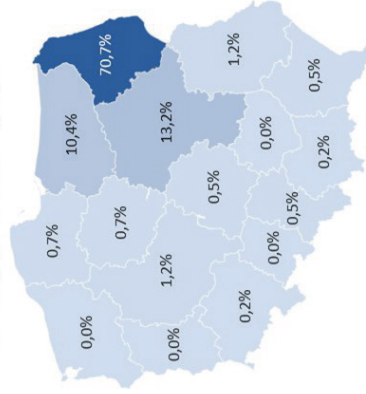


Figure 13. Concentration of audits conducted by audit firms in the province in which their registered offices are located – Podlaskie Province

Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

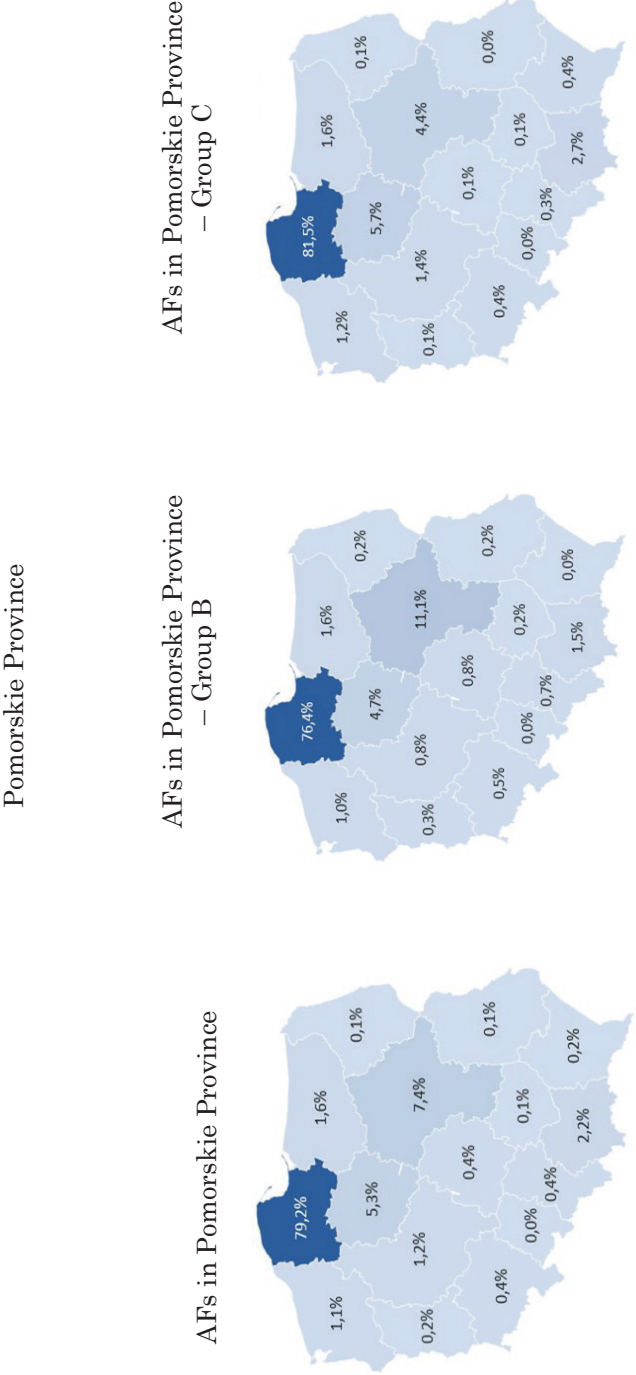


Figure 14. Concentration of audits conducted by audit firms in the province in which their registered offices are located – Pomorskie Province

Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

Śląskie Province

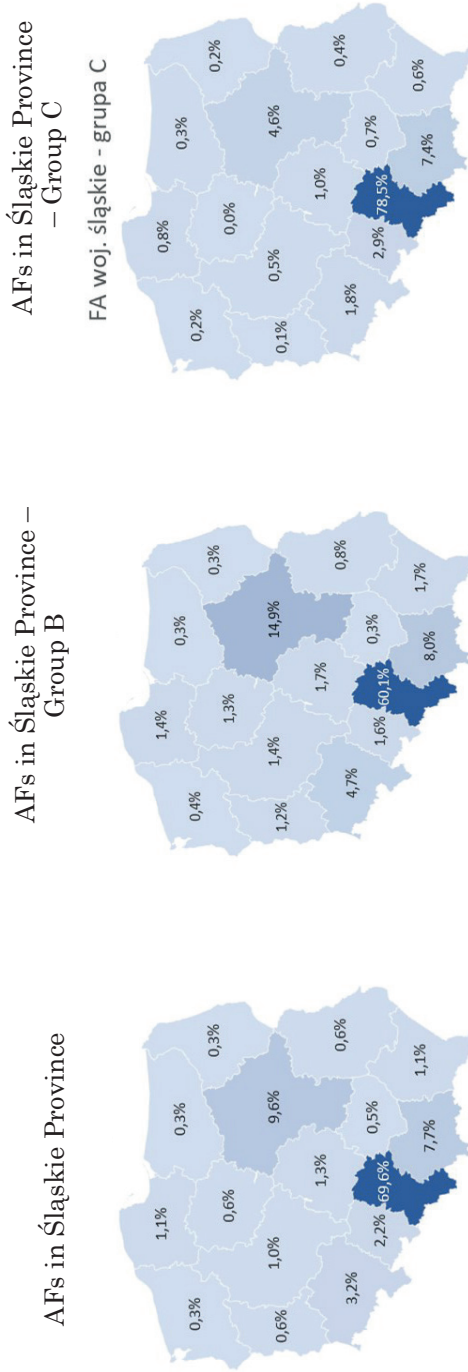
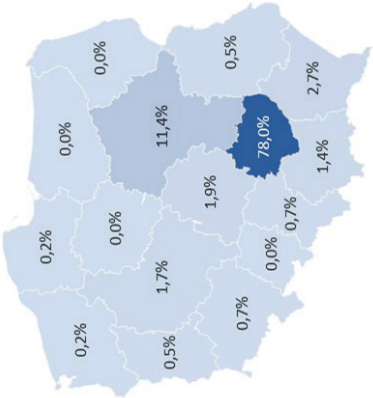


Figure 15. Concentration of audits conducted by audit firms in the province in which their registered offices are located – Śląskie Province

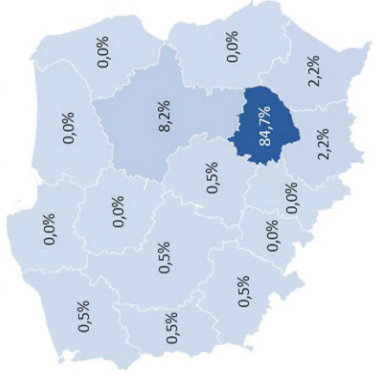
Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight.

Świętokrzyskie Province

AFs in Świętokrzyskie Province



AFs in Świętokrzyskie Province – Group B



AFs in Świętokrzyskie Province – Group C

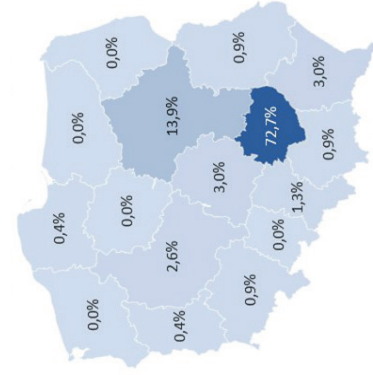
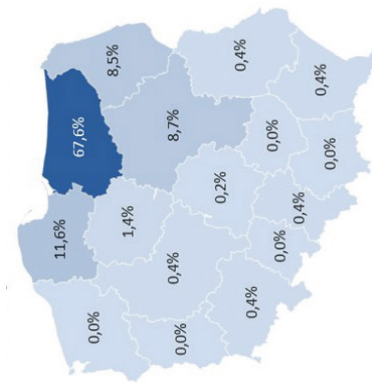


Figure 16. Concentration of audits conducted by audit firms in the province in which their registered offices are located – Świętokrzyskie Province

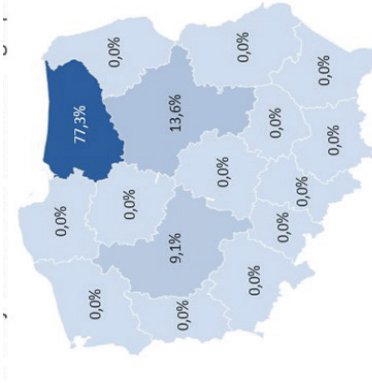
Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

Warmińsko-Mazurskie Province

AFs in Warmińsko-Mazurskie Province



AFs in Warmińsko-Mazurskie Province – Group B



AFs in Warmińsko-Mazurskie Province – Group C

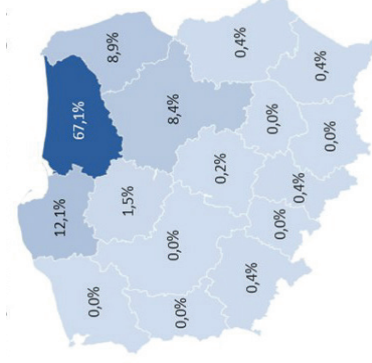
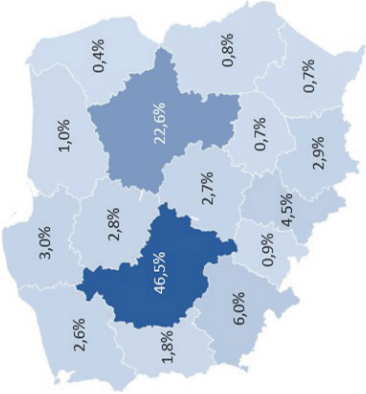


Figure 17. Concentration of audits conducted by audit firms in the province in which their registered offices are located – Warmińsko-Mazurskie Province

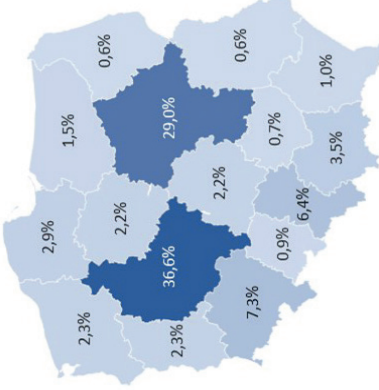
Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

Wielkopolskie Province

AFs in Wielkopolskie Province



AFs in Wielkopolskie Province – Group B



AFs in Wielkopolskie Province – Group C

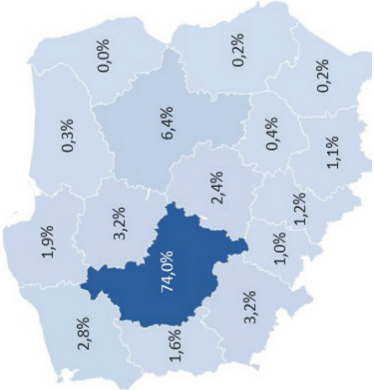


Figure 18. Concentration of audits conducted by audit firms in the province in which their registered offices are located – Wielkopolskie Province

Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

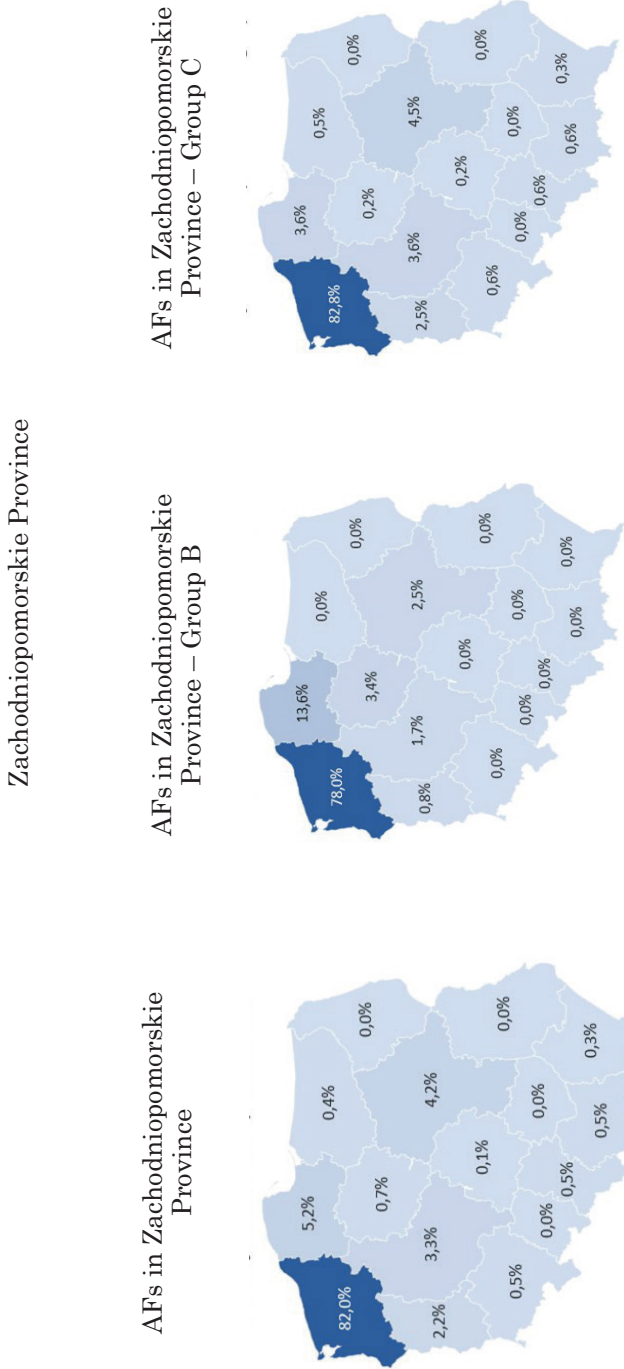


Figure 19. Concentration of audits conducted by audit firms in the province in which their registered offices are located – Zachodniopomorskie Province

Source: Own study based on the analysis of annual reports for 2022 submitted to the Polish Agency for Audit Oversight

Summary

The analysis carried out demonstrated that several regularities exist in the distribution of relations between the registered offices of audit firms and the registered office of the entities audited. The AFs based in Mazowieckie Province and Wielkopolskie Province (a significant share of the AFs from the TOP12) audit entities located throughout Poland. This is facilitated by the offices that the larger AFs have in many Polish cities. At the same time, Mazowieckie Province is the largest market in terms of the number of the entities based therein and of the audits commissioned by such entities to audit firms. The share in this market have the AFs from all over the country. At this point is worth noting that both the median price and the average price for auditing services in Mazowieckie Province are the highest in the country (Baklarz, Kreis 2023), which makes it an attractive market for the AFs from all over Poland. For the AFs based in smaller provinces, it is profitable to conduct audits in this province. At the same time, their price offers may be more attractive to the entities audited. It may also be that, in the case of statutory auditors that carry out business activities, they are more flexible and they can work in large cities without formally changing their registered offices.

The analysis also shows that the AFs, in particular, the smaller ones, conduct audits locally, that is in their own or neighbouring provinces. In the latter case, this may be due to the geographical proximity as well as the national transportation system. Large urban centres are sometimes located at the borders of provinces; therefore, entities based in neighbouring provinces are able to commission audits to be conducted by the AFs based in nearby provinces. The foregoing is also true in case of the provinces with small areas. In addition, it sometimes happens that the registered offices of the entities audited are based in locations different than the place in which their main activities are carried out (e.g., the registered office is situated in a large city and the production facilities and warehouses are located at a smaller town). In such a case, it is more advantageous for both parties to benefit from the auditing services rendered by a local entity (for the entity audited, it may be due to a lower price, and for the AF it may be due to the nearby location of the entity audited, even though its registered office is located elsewhere).

It is worth noting that the AFs based in three provinces, namely Łódzkie Province, Mazowieckie Province and Wielkopolskie Province, conduct a total of approximately 1/3 of audits more nationwide than is in total conducted in their own provinces. In order to maintain the number of audits conducted, the AFs must conduct them in other provinces. At the other extreme are Dolnośląskie Province, Opolskie Province and Kujawsko-Pomorskie Province, in which if the AFs based in these

provinces conducted only as many audits as they currently do, and conducted all of them locally, this would only satisfy between 50 and 60% of the demand for audits in these provinces (the number of audits commissioned by entities based in these provinces). Therefore, a significant number of audits were conducted by the AFs based in other provinces.

The majority of audits (for all the AFs – 61.1%, and for the Group C AFs as much as 75.5%) are conducted in the provinces in which the AFs are based. A large portion of audits is also conducted in neighbouring provinces, which may suggest that statutory auditors prefer face-to-face contact and audits conducted in person (not remotely). Some of the audit tasks can obviously be carried out remotely, which reduces costs and is less time-consuming (e.g., no time needed to commute).

In conclusion, the following can be summed up:

- audit firms with their registered offices at various locations in Poland provide auditing services to a relatively large number of entities based in Mazowieckie Province;
- ‘small auditors’ sometimes carry out their business activities at locations other than their registered offices;
- the place of business (e.g., main production facility) of some companies is situated at location other than the registered address of the entity audited;;
- audit firms have local offices that provide auditing services ‘locally’, despite the fact that their registered offices are located elsewhere;
- in many provinces, the distribution of the location of large cities means that audit firms although conducting audits close to their registered offices, conduct them actually in another provinces; this is facilitated, in the case of smaller provinces, also by the relatively smaller distances to cities in neighbouring provinces; the quality of the road or rail infrastructure facilitating quick and easy access to the client is also not without significance
- in some provinces (e.g., Mazowieckie Province) the price (average or median) for auditing services is much higher than in others; audit firms based in provinces with lower prices can therefore compete more effectively in more expensive provinces;
- in three provinces (Łódzkie Province, Mazowieckie Province and Wielkopolskie Province), the demand for audit services is much lower than the capacity of audit firms – they currently approximately 1/3 of audits more nationwide than is in total conducted in their own provinces. As a result, a significant portion of such audits have to be conducted in other provinces
- In other three provinces (Dolnośląskie Province, Opolskie Province and Kujawsko-Pomorskie Province), the number of audits conducted by audit firms based in these provinces is much lower than the demand and accounts for between 50 and 60% of the audits commissioned by entities based in

their provinces. In these provinces, it is therefore necessary that audit firms from other regions conduct audits;

- the majority of audits (61.1%) are conducted in their respective provinces; a large number of audits are also conducted in the neighbouring provinces, which may suggest that the auditors prefer face-to-face contacts and audits conducted in person (not remotely).

Some of the audit tasks can obviously be carried out remotely, which reduces costs and is less time-consuming.

To sum up, the conclusions of the analysis indicate that audit firms from all over Poland audit a relatively large number of entities based in Mazowieckie Province. In many provinces, due to the distribution of the location of major cities (and available transport infrastructure, such as roads or trains of good quality), audit firms, while conducting audits close to their registered offices, actually conduct them in another provinces. Most audits are performed by audit firms in their own provinces or in the neighbouring provinces. However, audit firms established in the Mazowieckie and Wielkopolskie Provinces (primarily the TOP12 companies) audit entities all over Poland. The analysis carried out has limitations, which are primarily due to the extent of information made available to the author hereof. It is likely that it may be of relevance to the conclusions made. Nevertheless, the relevance of such information is difficult to determine without making additional in-depth information inquiries.

The limitations can be generally characterised as follows. Firstly, audit firms, in particular the largest ones, have local offices in many locations all over the country. The annual reports submitted by audit firms to PANA lack information on the office or offices that conducted the audit, and employees from different offices and shared services centres may be delegated to participate in the audits conducted. For the purposes of the analysis carried out, the auditing services provided had to be assigned to the province in which the registered office of the AF was located. Secondly, the geography of Poland (e.g., the size of provinces, the location of major cities) and differences in the development of the infrastructure in different regions may distort the notion of the 'local' provision of audit services. Thirdly, an auditor who is a person that carries out business activities can easily change the actual place of work, e.g., by travelling to a large city in search of clients (without formally changing the registered office of the company). Fourthly, the registered office of the entity audited may be different from the location at which the actual operations are carried out, i.e., warehouses or factories are situated. Fifthly, the accuracy of data in annual reports submitted to PANA.

The analysis of the issue researched, as presented herein, allows for a particular image of the audit practices in Poland to be projected, and the way they are followed has no precedent. Owing to the laborious analysis of nearly 1,000 annual reports submitted to the Polish Agency for Audit Oversight by audit firms / statutory auditors,

it was possible to outline certain aspects of the business policies followed by audit firms based in different regions of Poland. This analysis by no means exhausts the multidimensional 'recognition' of these policies. However, it may provide a stimulus for further research to be undertaken into, for example, the conditions, circumstances and rationale for changes in their 'geographic' functioning.

Such research may foster greater recognition of the way in which audit firms, not just the largest ones, in Poland operate. Given the global and existing economic conditions in the region and taking into account the development of various communication technologies, it would be interesting to repeat the research over the next decade or so.

The findings presented herein could also be an aspiration for international comparative analyses, were they carried out in different EU countries in a similar convention and simultaneously on the basis of the criteria of comparison set for these countries as universal.

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Internal Audit versus Ethics Programmes

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Abstract

Purpose: The aim of the study is to present a proposal for the delimitation (determination of boundaries) of the internal audit spectrum in the area of ethics programmes of organisations, from the perspective of the draft new Global Internal Audit Standards.

Methodology/research approach: A comparative analysis, a critical analysis and a descriptive method of the proposed model were used in the study.

Results: The main findings of the analysis include the identification of new opportunities provided by the revision of the Global Internal Audit Standards in the area of auditing of ethics programmes, the illustration of challenges in the area of analysing the organisation's ethical maturity levels and the presentation of a list of audit tasks in the area of ethics: desirable; potentially acceptable; and not recommended.

Research limitations/implications: The proposed streamlining of audit tasks in the area of ethics from the perspective of the Standards is a proposal for discussion, resulting, among others, from the author's experience. Further development of the Global Internal Auditing Standards and potential official stances of the Institute of Internal Auditors, including the Institute's domestic branches, may serve its positive or negative verification.

Originality/value: This is the first publication comparing the qualitative as well as quantitative change between the existing International Standards for the Professional Practice of Internal Auditing, in force since 2017, the revision of which, called the Global Standards for Internal Auditing, was presented in 2023 and will be implemented in 2024–2025.

Keywords: internal audit, ethics programmes, ethical maturity levels, Global Internal Audit Standards



Introduction

The article's theme involving auditing ethics programmes and the questions the author seeks to answer is a consequence of the author's personal involvement in a number of organisational governance endeavours, including the formation of ethics and its individual components. It should be noted here that both the role of internal audit and the tools for shaping organisational governance with a particular focus on ethical issues have evolved. Changes in both areas studied have affected the perception as well as the functioning of internal audit and the effectiveness of ethics programmes in organisations.

The history of internal auditing dates back to the 1940s. Since then, the role and position of this function in business has undergone significant changes. The original assumption was that internal auditors – using analytical instrumentation similar to statutory auditors – are able to detect certain issues (e.g., irregularities) earlier, before the statutory auditor does so during the audit¹. Internal audit has evolved from a function that can be called 'internal financial review' to an assurance and advisory function that significantly goes beyond issues related to confirming the reliability of financial reporting. According to Teck-Heang and Ali, for the past 30 years the internal auditor has played an empowering role (Teck-Heang, Ali, 2008, p. 1). Today, internal auditors are expected not only to streamline the financial reporting process, but to provide value-added services in many areas of the organisation's operations (Teck-Heang, Ali, 2008, p. 1). At this point, it should be noted that internal auditors currently perform two types of tasks:

- *assurance* – that is, where the internal auditor provides the organisation's management (e.g., the company's board of directors) with an assessment of a particular process or area, e.g., in terms of its effectiveness, efficiency or level of maturity;
- *advisory (consulting)* – that is, where the internal auditor supports a particular process or area, according to the internal auditor's competence.

¹ This difference can be seen in the names of the professions in English, where an internal auditor is an internal auditor and a statutory auditor is an external auditor. This distinctiveness stems from the original idea that the two professions would perform similar tasks – the difference being that the internal auditor works throughout the year, inside the organisation, and not just during periods of financial statement audit. Nowadays, there are many more differences – both methodological and regarding the conception of the existence of the two professions.

It can be considered that the audit area, also known as the audit spectrum or audit space, is determined by the risk analysis and by the competence of the internal audit staff, that is, their knowledge, skills, experience and attitude.

Internal auditors are also increasingly performing tasks related to business ethics, both in the form of assurance tasks and in the form of advisory tasks. According to representatives of the Institute of Internal Auditors (hereinafter referred to as the IIA)²: *'Stakeholders see assurance activities as crucial, and there needs to be a balance in the work to reflect that. However, auditors are also mobilised to carry out assurance or advisory activities where the auditor has competence, resources and stakeholder support'* (Witzany, Harrington, 2016, p. 5).

Among the catalysts for change in the area of business ethics, the author primarily includes:

- 1) reputation (loss) risk management and perceived business interest in the relationship between accountability and trust, which usually follows image or financial crises,
- 2) changes in the law that force *compliance* activities to bring the organisation into compliance with external requirements, including raising ethical standards.

It is also worth bearing in mind, as Fukuyama points out, that *'More formal norms and rules (...) generally take the form of written laws, constitutions, regulations (...) or intra-organisational circulars.'* (Fukuyama, 2003, p. 176). Thus, it can be thought that the formation of ethical governance is influenced by regulations: both external and intra-organisational. Business practice additionally shows that internal regulations are a response to the expectations of regulators or stakeholders. This leads to the conclusion that ethical behaviour in an organisation can be a response to both the requirements of the law³ as well as the expectations of customers or shareholders.

The main purpose of this paper is to point out the necessity of taking steps to delineate the spectrum of internal auditing in the ethical area. In order to achieve the above goal, it is necessary to identify areas where audit tasks can be carried out, related to the implementation of ethics programmes in organisations.

² The Global Institute of Internal Auditors is based in the US and operates under the name of Institute of Internal Auditors – IIA. In Poland, the branch of the IIA is the Association of the Institute of Internal Auditors, to which the abbreviation IIA Poland is also used. Due to the institutional nature of the authorship of documents issued by the Institute, the documents cited here will be referred to as having been produced by the IIA.

³ For example, in 2016, the French parliament passed a law on anti-corruption and business transparency, more widely known as 'Sapin II', introducing obligations for certain groups of entities to, among other things, have a code of ethics describing desirable and prohibited behaviour, as well as mechanisms to protect whistleblowers.

Adequate – for such a goal – is the question: *To what extent can internal audit contribute to improving an organisation's ethics? And what follows: Can internal audit perform assurance and advisory tasks in the area related to ethics, adding significant value to improving the maturity level of the organisation⁴ in this area?* In attempting to formulate an answer to the above questions, the author poses three auxiliary questions:

- 1) How do the Global Internal Audit Standards adopted by the IIA on 13 December 2023 (IIA 2023a) affect the legitimacy of covering ethical issues in audit engagements?
- 2) To what extent can the practice guides made available – for internal auditors by the IIA – contribute to the effectiveness of ongoing ethics programme audits, and what changes, if any, do they require?
- 3) What tasks can internal audit perform in the area of ethics – to ensure impartiality and objectivity – and which are not advisable?

The author derives conclusions by way of:

- outlining the area of analysis,
- conducting a comparative analysis of the IIA regulations: of 2017 and 2023 to identify the tasks of internal auditors in the area of ethics, and then,
- presenting a critical analysis of the levels of ethical maturity that are specified in the Practice Guide published by the IIA in 2012.

1. Scope of the analysis

According to Gasparski, Lewicka-Strzalecka, Bąk and Rok, the foundation of ethical capitalism is the belief that, *'at the core of doing business, in addition to consistently adhering to legal regulations, is the public good. Each company is therefore an actor on the global stage and with a sense of social accountability adapts its management systems to the expectations coming from diverse stakeholder groups'* (Gasparski et al. 2009, p. 26). In this aspect, therefore, it is important to set ethical issues in the context of the organisation's responsibility to a wide range of stakeholders, operating within a specific institutional framework. Further analysis in this text, relating to auditing ethical issues, is carried out by the author in the neo-institutional perspective, considering it the most appropriate for recognising the issue taken up. This approach is reinforced by the fact that institutions can be formal as well as informal, and that they fall into three groups (as conceptualised by Richard Scott): regulatory institutions, normative institutions, and

⁴ An organisation according to the nomenclature used by the Institute of Internal Auditors can be both a business organisation and a public or non-governmental institution.

cultural-cognitive institutions (Marczewska, 2016, p. 188), which may be relevant to the study of business ethics issues relating to their activities.

Recognising the title problem is strongly related to business ethics, ethical infrastructure and ethics programme.

Lewicka-Strzałecka defines business ethics as the formulation and analysis of ethical rules in the economic world (Lewicka-Strzałecka 1997, p. 56). In order to more clearly illustrate the issues presented, the author proposes to clarify that *business ethics* includes a set of principles and values of responsible business, which results in legitimate⁵ stakeholder trust. *Ethical infrastructure*, on the other hand, is a component of organisational governance regarding ethics, which includes both rules and the assignment of responsibility for their implementation in the organisation. For example, in the public sector, the International Monetary Fund includes the ethical infrastructure below:

- website (dedicated to ethics),
- hotline (*Integrity Hotline*), through which there is the possibility of anonymous notification (signalling) of irregularities, 7 days a week, 24 hours a day,
- ethics education and extraordinary ethics training,
- ongoing cooperation in the area of ethics with other organisations, such as the UN (as part of the Ethics Network) (The Fund, 2010, pp. 12–13).

The term *ethics programme*, in turn, refers to the process of shaping the ethics infrastructure and evaluating its effectiveness. At the same time, ethics effectiveness is understood as defining the organisation's professionalism, declaring core values appropriate to all areas of speciality, and implementation:

- ethical guidelines,
- organisational infrastructure and procedures,
- ethics education and training,
- ethics consultation services within the organisation,
- continuous evaluation and improvement (Soskolne, Siesward, 1998, pp. 111–112).

In this argument, the analyses conducted with regard to the internal audit function will use the concept of thinking about the title issue that has been proposed by the IIA, because the standards developed by the IIA, in this regard, are considered directional both in Poland and internationally. The Institute of Internal Auditors has 235,000 members in 180 chapters around the world. As a result, the concepts developed at the IIA resonate in the organisations where the audit is conducted.

According to the IIA, internal audit is an independent and objective activity aimed at adding value and improving the organisation's operational activities. It

⁵ Justified, in the sense of the English term reasonable, that is, having grounds for inspiring confidence..

involves – systematically and in a structured manner – evaluating the processes: risk management, control and organisational governance, and contributes to improving their performance. It helps the organisation achieve its goals by providing assurances about the effectiveness of these processes, as well as through advice (IIA 2016, p. 3).

It follows that it is possible to identify components of the organisation's functioning that are verifiable – so, internal auditors can assess them. And in the event that any of the components of the ethical infrastructure are missing – it is possible to complete an audit consulting assignment, which may allow for the ethical infrastructure to be completed with the missing component.

2. Comparative analysis of internal audit standards

For recognising professionalism in the field of internal auditing, the content of the documents that present the standards for practising the internal auditing profession is crucial. The analysis of their content, especially in the period when the amendment is taking place, will help identify the direction of changes taking place in the internal auditing profession and diagnose how to focus attention on the issues of ethics programmes.

Here, the subject of comparative analysis will be the content of the *Global Internal Audit Standards* (GIA) approved in December 2023. *Global Internal Audit Standards*, hereafter referred to as GIAS 2023 (IIA, 2023a) and the existing *International Standards for the Professional Practice of Internal Auditing* (IIA), hereafter referred to as IPPF 2016 (IIA, 2016).

As Anthony Pugliese, president of the IIA, points out: '*Standard-setting follows a rigorous process and aims to meet the basic needs of the profession and serves the public interest*' (IIA, 2023b, p. 3). Publication of the new and translated Standards is scheduled for the first quarter of 2024 (IIA, 2023c). However, organisations that use IPPF 2016 will have one year to comply with the new requirements, which means that internal audit governance documentation must be revised and brought into compliance with GIAS 2023 in 2025. GIAS 2023 will therefore certainly replace IPPF 2016 in 2024–2025.

GIAS 2023 provides for a significant change in the structure and presentation of requirements. The standards and implementation guidelines are presented in five domains, each of which addresses key aspects of the profession. Domains⁶ under which expectations for internal audit are regulated include (IIA, 2023a):

⁶ The English version of the document uses the term 'Domain', as well as the Polish version has been translated as 'Domains'. Although there are more appropriate formulations in Polish (areas, fields), the author uses the original nomenclature used by the IIA in the documents in question.

- Domain I – *Purpose of Internal Auditing* unifies descriptions of the profession that were scattered in various components of previous regulations.
- Domain II – *Ethics and Professionalism* includes the Code of Ethics⁷ and standards relating to the conduct of practitioners of the internal audit profession, and is enriched by standards relating to professional due diligence.
- Domain III – *Internal Audit Function Management* clarifies the issue of bodies responsible for the proper functioning of internal audit. This amendment defines for the first time the important responsibilities of the board⁸ in supporting effective internal audit and addresses how the internal audit manager can support the board in fulfilling its responsibilities.
- Domain IV – *Internal Audit Function Management* clarifies the role of the internal audit manager and provides guidelines for carrying out the internal audit function.
- Domain V – *Provision of Internal Audit Services* covers additional requirements and practices for the effective provision of internal audit services.

In GIAS 2023, the word ‘ethics’ in various variations appears 37 times, while in IPPF 2016, in effect from 2017–2023, it appears slightly less – 33 times. As an adjective – referring to an attribute of the audit, or the organisation – the word ‘ethical’ in various variations in GIAS 2023 appears 19 times, while in IPPF 2016 there were only 4 references. However, when the content of GIAS 2023 is analysed more closely, the overwhelming majority of the use of the word ‘ethics’ refers to a reference to the Code of Ethics of the internal audit profession, and is therefore autotelic, so to speak, i.e., referring to the requirements for auditors themselves.

⁷ In order to distinguish between two different issues, i.e., organisational ethics and internal audit ethics, consistently using nomenclature derived from both the IPPF 2016 and in GIAS 2023 – the author uses the term ‘Code of Ethics’ to refer to the ethics of internal auditors and ‘code of ethics’ to refer to the regulation of organisational ethics.

⁸ In the standards perspective, a board is the top-level body responsible for organisational governance, such as a board of directors, a committee or other body to which the board of directors has delegated certain functions (for example, an audit committee), a non-executive/supervisory board in an organisation that has more than one supervisory body, a board of managers or trustees, a group of elected officials or political appointees. If the council does not exist, the word ‘council’ refers to a group or individual entrusted with organisational governance responsibilities (...). According to the author, interpretation problems may arise against this background, since in Polish capital companies the word ‘council’ most often refers to the supervisory board, which would be limiting. Given the previous understanding of the word ‘council’ – still the interpretation in Polish will depend on the context and nature of the organisation. Sometimes it will actually be the board of directors, but in certain situations it may be the top management of a particular organisation in which the audit is active, such as a minister, president, director or rector.

Despite the above – a purely statistical observation – it is impossible to ignore the fivefold increase in the volume of regulations specifying why – and how – internal auditors should direct their tasks towards ethical issues. This regulatory change, axiological and at the same time significant in professional pragmatics in the analysed scope, in comparative terms, is presented in Table 1.

Table 1. References to ethical issues in internal audit standards

IPPF 2016	GIAS 2023
1) <i>Standard 2110 – Organisational Governance</i> , excerpt from one sentence relating to ethics.	1) <i>Standard 1.2 – Ethical expectations of the organisation, including</i> <ul style="list-style-type: none"> • requirements (four sentences relating to ethics)
2) <i>Standard 2110.A1</i> excerpt from one sentence relating to ethics	2) <i>Implementation tips and confirmation of compliance</i> <ul style="list-style-type: none"> • implementation (eight sentences relating to ethics) • confirmation of compliance (four sentences relating to ethics)
3) <i>Definition of the control environment</i> excerpt from one sentence relating to ethics	3) <i>Standard 9.1 – Understanding organisational governance, risk management and control processes</i> (one sentence relating to ethics)

Source: Own study based on IIA, 2016, p. 30; IIA, 2023a, pp. 15–16

The IPPF 2016 standards consist of two groups of standards: *Attribute Standards* and *Performance Standards*. The first group of standards defines the characteristics of internal auditing, such as independence. The second group of standards answers questions about how internal audit works, i.e., how it carries out its tasks. Within the group of *Performance Standards* in Standard 2110 – *Organisational Governance* there was the following requirement: *Internal audit must assess the processes that shape organisational governance and make appropriate recommendations for improving these processes in terms of: (...) to promote appropriate ethics and values in the organisation* (IIA 2016, p. 30). In addition to the above, Standard 2110.A1 (IIA 2016, p. 30), clarifying the previous standard with regard to assurance tasks, outlines that internal audit *must evaluate the objectives, as well as the design and implementation and effectiveness of the organisation's ethics programmes and activities*⁹. In addition, the audit's interest in ethical

⁹ The A designation in the standard number from the English term assurance limits a given standard to assurance tasks only, as opposed to the C designation – concerning consulting tasks.

issues should follow from the definition of internal audit, according to which audit work 'consists of a systematic and orderly evaluation of the processes of risk management, control and organisational governance, and contributes to improving their performance' (IIA, 2016, p. 3). In turn, the definition of the control environment in these Standards implies that the control environment consists of (among other things) integrity and ethical values (IIA, 2016, p. 49).

In the GIAS 2023 standards, the issue of ethics as a subject of internal auditing is specified in Standard 1.2 – Ethics Expectations of Organisations.

The requirements of this standard state that internal auditors must (IIA, 2023a, p. 15):

- respect and support the organisation's legitimate ethical expectations,
- understand and meet the organisation's ethical expectations and be prepared to recognise behaviour that is inconsistent with those expectations,
- support and promote an organisational culture based on ethics,
- evaluate and make recommendations directed at improving the organisation's goals, policies and processes that promote appropriate ethics and values. If internal auditors identify behaviour in the organisation that is inconsistent with the organisation's ethical expectations, they must report their concerns in accordance with the policies established by the internal audit manager.

According to the GIAS 2023 regulatory systematics, each standard includes a section referred to as *Guidance on Implementation and Confirmation of Compliance*. The guidelines for implementing Standard 1.2 state that the internal audit plan should include an assessment of the organisation's ethical risks to evaluate whether existing policies, processes and other controls adequately and effectively address them (IIA, 2023a, p. 15). In light of the IIA regulation under discussion¹⁰, the organisation's policies may specify: criteria and processes for communicating and handling ethical issues, the parties who should receive such communication, and the mode of escalation of unresolved issues. The internal audit manager should also establish a methodology for approaching ethical issues and discuss it with senior management and the board to ensure a common approach.

In light of GIAS 2023, internal auditors should consider ethics-related risks and controls during individual assignments. If internal auditors identify behaviours in the organisation that are inconsistent with the organisation's ethical expectations, they should follow the methodology and communicate such findings internally in accordance with the methodology established by the internal audit manager,

¹⁰ *Policies* – a document of direction and regulation – not politics – in reference to a political debate or agenda.

which in turn takes into account organisational policies and processes (IIA, 2023a, p. 15).

The standard in question also introduces a way to deal with situations in which it is senior management that violates ethical expectations. If there is an issue affecting, for example, the board, the internal audit manager should report his concerns to the board. If the ethical concerns involve the chairman of the board, the internal audit manager should raise his concerns with the entire board (IIA 2023a, p. 15). A new element of the IIA regulatory structure that was introduced in GIAS 2023 is ‘Confirmation of Compliance’. The idea behind this new – compared to IPPF 2016 – regulatory component is to clarify how auditors can demonstrate compliance for the implementation of a standard. Confirmation of compliance for the Standard 1.2 in question, is to be demonstrated (IIA, 2023a, p. 16):

- evidence of participation of internal auditors in workshops, trainings, meetings where ethical expectations and problems were discussed;
- forms signed by individual internal auditors confirming their understanding and commitment to the organisation’s ethical policies and processes;
- documented assessment of the organisation’s ethics policies and processes;
- documentation demonstrating that ethical issues have been effectively communicated to senior management, the board and the regulator in accordance with the organisation’s policies and relevant laws and regulations..

In addition to the above, Standard 9.1 – *Understanding Organisational Governance, Risk Management and Control Processes* indicates in the requirements ‘(...) *To understand organisational governance processes, the internal audit manager must consider how the organisation: (...) promotes an ethical culture*’ (IIA, 2023a, p. 68).

The above analysis shows that GIAS 2023 regulates not only the ethos of the internal auditor in a more precise and specific manner, but also makes it much more clear whether, why, and how to audit issues in the area of ethical functioning of the organisation. In the author’s opinion, this is not only a quantitative but also, above all, a qualitative change in the functioning of internal auditing in the world, relating to the challenges of the modern economy, in which issues of accountability are increasingly important.

3. Critical analysis of the organisation’s ethical maturity levels

In 2012, the Institute of Internal Auditors published a *Practical Guide* titled *Evaluating Ethics Programs and Activities* (IIA, 2012). The purpose of the guide was to provide internal auditors with tools to evaluate ethics-related programmes

and activities. Given both the fact that more than a decade has passed since the publication of this guide, and because today we already have knowledge of the contents of GIAS 2023, it is expedient to critically analyse this document.

It is worth mentioning at this point that internal auditors often use the term ‘maturity’ in their work, as well as matrices that characterise the levels of this maturity in relation to the audited area. Through them, they analyse the goals of this activity and determine its benefits. In its guide titled *Selecting, Using, and Creating Maturity Models: a Tool for Assurance and Advisory Services*, the Institute of Internal Auditors points to a number of benefits, the occurrence of which helps identify the use of maturity models. ‘Appropriately designed maturity models ensure’ (IIA, 2013, p. 29):

- a framework for predicting the future, the desired state and the development of improvement plans;
- benchmarks for an organisation to compare its processes internally or externally;
- a mechanism to provide insight into the improvement path from immature to mature process;
- a disciplined method that is relatively easy to understand and implement.

Thus, the maturity levels allow for the identification of organisational and regulatory gaps, the direction of expected changes and a structured approach to an issue. Recognising the differences between maturity levels and commenting on them is therefore cognitive and can lead to interesting observations, particularly if they are related – which the author does in further argument – to Edgar H. Shein’s theory of organisational culture.

In the period between the first publication of the *Practical Guide* and the implementation of the new standards, a number of events took place that affected the conditions of organisations in Poland and Europe. Such events include:

- measures to regulate customer and employee privacy in light of the implementation of European data protection standards;
- changes in the functioning of the labour market resulting from, for example, the *work life-balance* directive;
- regulation of the issue of whistleblowers at the European level; however, it needs to be mentioned that until the end of the last term the Polish model for the protection of whistleblowers has not yet been implemented;
- the outbreak of the global COVID-19 pandemic, the outbreak of wars, affecting global interests, including both human rights violations and changes in the ethics assessment of supply chains.

The practical guide, *Evaluation of Ethics Programs and Activities*, identified areas of organisational performance in six subject areas and five levels of maturity. This systematics (IIA, 2012, pp. 14–19) is illustrated in Table 2.

Table 2. Abbreviated scheme for analysing the levels of ethical maturity of an organisation

	Code of Ethics	Culture and consistency	Awareness	Structure and responsibility	Automation and process integration	Objectives and measurement system
Entry	The component in question is missing					
Practised	Component exists – but may be incomplete or outdated					
Defined	The component is complete and periodically reviewed (evaluated)					
Mature	Component is being improved, element is also being verified by employees					
World-Class	The component is evaluated by external parties using a variety of techniques					

Source: based on IIA, 2012, p. 14–19

At this point, it should be noted that the maturity level defined as ‘world class’ is not the standard level used to analyse the maturity level of processes and areas in internal auditing. More common is a 4-stage division, without the latter category.

To illustrate how ethical levels are presented, the maturity levels for the ‘code of ethics’ area are shown below.

Entry level is characterised, in the view of the guide’s authors, by the absence of a formal code of ethics and a lack of communication about management’s expectations for a code of ethics. *Practised level* indicates that the code exists, but may be incomplete or outdated. At this level, experienced employees in the organisation have a general understanding of management’s expectations for the code of ethics, but newcomers may struggle to recognise these expectations. At the *Defined level*, there is a complete code of ethics that has been approved by the board and is reviewed every two to three years to determine if it is still valid. In addition, all employees must sign a document acknowledging compliance with the code of ethics. New employees must sign the document confirming that they have read and understood the code. *Mature level*, on the other hand, requires that external reviews of the code be implemented to determine whether the organisation’s existing code of ethics is still valid and appropriate. The Code of Ethics is – at this level of maturity – reviewed annually and updated as necessary. All employees must complete an annual questionnaire with additional questions regarding their conduct in accordance with the code of ethics. The final level, *World-Class*, requires that detailed compliance policies be implemented to support and provide additional clarification on key elements of the code of ethics. In addition, in order to assess the understanding of the code of ethics and evaluate the compliance of the activities implemented in the organisation with the values specified in

the code, focus groups and/or surveys are periodically conducted throughout the organisation on a representative group of employees.

According to the author, communicating values does not have to be based on a new code of ethics. It can be about the overall values of a profession or industry. Hence, orientation to a specific organisation's code of ethics may be inappropriate for those organisations where ethical standards are defined in other, clearly identifiable sources of ethical operating principles.

Focus group interviews (FGIs) and surveys do not have to be attributed to a world-class ethics programme. Focus surveys can be carried out by an external consultant as well as an auditor, when analysing ethical issues. In particular, identifying the reasons for the lack of implementation or inadequate records according to employees will be possible precisely during the focus study, that is, the focus group interview. Successfully, such audits, performed by auditors, or by ethics coordinators established in an organisation, can be supported by tools used for online audits, and available in various Office applications (e.g., Google Forms as part of Google suite of applications, and Microsoft Forms as part of Office 365).

For the other areas, analogous levels were also used in the *Guide*, and their detailed analysis would exceed the volume of this article. However, other areas of ethics analysis point to analogous criteria, that is, the existence of a given document or requirement, assessment of the degree of implementation, assessment of deviations or identification of gaps, and the degree of involvement of management and selected employee groups in a given process or area.

The recommended maturity levels presented above can be identified by answering the questions presented in Table 3.

Table 3. Areas of analysis of the organisation's ethical maturity and key questions

1.	Code of Ethics	How effectively does the Code clarify management expectations for ethical behaviour?
2.	Culture and consistency	How does the organisation view management's commitment to compliance?
3.	Awareness	How aware are employees and external stakeholders of the compliance programme and its regulations?
4.	Structure and responsibility	How effective is the structure in terms of programme management and accountability enforcement?
5.	Automation and process integration	How effectively are compliance controls and processes standardised, integrated and automated?

6.	Objectives and measurement system	How is the success of a compliance programme measured?
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Source: based on the IIA 2012, p. 14–19

The above systematisation significantly corresponds to the characteristics of organisational culture in the theory of Edgar H. Schein, who introduced into management science the now classic concept of levels of organisational culture (Schein, 2004, p. 26). Relating Schein's concept of levels of organisational culture to the internal audit arena leads to some insights into the feasibility of including an organisation in an internal audit assessment. These are signalled in Table 4.

Table 4. Levels of organisational culture, along with an assessment of internal audit capabilities

The level of organisational culture and its characteristics according to H. Schein		Assessing the auditability (ability to be covered by an internal audit assessment) of an organisation
Level	Characteristics of	
Artefacts	Visible organisational structures and processes	<i>Artefacts</i> are the level of organisational culture assessed by standard evaluation techniques (verification: whether it exists or not, content evaluation).
Proclaimed beliefs and values	Strategies, goals, philosophies	<i>Beliefs and values</i> are assessed using standard assessment techniques, as well as in-depth techniques such as individual interviews and focus studies.
Podstawowe założenia	Nieświadome, przyjęte za pewnik przekonania, percepcje, myśli i uczucia...	<i>The underlying assumptions</i> are a difficult level of organisational culture for internal audit. Nevertheless, with a high level of employee confidence in the internal auditor, it is assessable. For example, an internal auditor can gain knowledge from employees about social consensus (e.g., 'everyone does this') or rationalisation (e.g., 'if I didn't do this I wouldn't get a bonus'). The internal auditor's acquisition of knowledge in this area can be supported by anonymous surveys and effective cooperation with the organisational unit or employee responsible for the communication channel for whistleblowing.

Source: Own study based on Schein, 2004, p. 26.

The maturity levels presented can be attributed to specific elements of a given level of organisational culture. For example, the existence of a code of ethics or compliance policy will be within the *proclaimed beliefs* and *values*. However, a careful analysis of the *Practice Guide's* guidance identifies some shortcomings in the mapping of organisational culture elements to appropriate maturity levels. What is most apparent here is the lack of attribution relating to the workspace and operating conditions of the organisation, which should be indicated when describing the level of *artefacts*. Meanwhile, this element is important in assessing the level of maturity and its omission gives an incomplete picture of – classified by maturity – organisational culture. For example, differences in: the equipment of the premises where different employee tasks are performed, the quality of equipment made available to different employee groups, the amount of wages, especially when there is a wage gap¹¹, may be elements that are not directly related to the ethical model of a particular organisation, but may indicate the existence or limitation of such phenomena as discrimination, or unequal treatment.

The most difficult for the internal auditor, and yet – for the organisation's management – presumably the most important for evaluating the usefulness of the audit results, will be to identify the *underlying assumptions*, including the actual reasons why expected ethical values are being violated. To identify the presence of characteristics of this most complex level of organisational culture, i.e., the level that reflects the real translation of code ethical values into the practice of organisational operations, the internal auditor has at his disposal a number of auditing techniques. The first (and primary) is the technique of the interview conducted as a one-on-one conversation. The second technique is to talk to the wider community. They can be in free form, but can also be more structured, as focus group interviews. A third form of obtaining information important in evaluation is surveys, which contain both closed questions (formulated using, for example, a Likert scale) and open-ended questions that allow free speech. The last is an increasingly popular source of knowledge about the values actually shared by employees, namely anonymous communication channels dedicated to informing the organisation about irregularities, i.e., whistleblowing channels¹².

¹¹ Gender pay gap – difference in pay between men and women, without a substantive reason, usually to the detriment of women.

¹² As of the date of publication of this article, Poland has not adopted a law implementing Directive 2019/1937 of the European Parliament and of the Council (EU) of October 23, 2019 on the protection of persons reporting violations of Union law. Nevertheless, many entities – anticipating a change in the law in this area – are getting ahead of the Polish legislator's move, implementing signalling solutions, regardless of national requirements, but in compliance with the Directive.

The effectiveness of the use of the above tools is determined by an important condition, i.e., the space of trust that the organisation's employees will place in the internal auditor (or not) and the way in which the internal auditor communicates both the audit task being carried out in the area of ethics and the tasks previously carried out by the auditor. A space of trust, after all, is an area of communication in which employees and managers will feel comfortable enough to be confident that their knowledge will be used to improve the organisation, rather than to draw negative consequences against those who in good faith communicate their knowledge of the organisation's weaknesses.

It should also be noted that the other – presented in the analysed *Guide* – descriptions of the organisation's maturity levels in the ethical area do not address such contemporary challenges as:

- privacy issues,
- applications of artificial intelligence (including biased courts identified in artificial intelligence activities),
- the ethics of the entire supply chain, including an assessment of how sanctions are implemented.

Summarising the above analysis of maturity levels, it should be noted that the Practice Guide entitled *Evaluation of Ethics Programs and Activities* (IIA, 2012) inspiringly identifies six subject areas and five maturity levels. In the author's opinion, interpretive dilemmas may largely relate to the differences between *Mature* and *World-Class* levels. Therefore – in the context of the implementation of GIAS 2023 – the focus of further work on updating the Guide should be both assessing the cognitive utility of the latest (*World-Class*) level and identifying the ethical challenges provided to organisations over the past 12 years.

Updating the structure of IIA documents, resulting from the implementation of GIAS 2023 from 2024, should also result in a revision of the wording of the guidance for internal auditors on internal audit's coverage of the area of ethics in organisational operations. This update should take into account, among other things, labour issues, including privacy and ethical dilemmas arising from the use of artificial intelligence as well as the effectiveness of ethics assessments along the supply chain (including the service chain).

4. Proposal for description of internal audit tasks in the area of ethics of the organisation

Earlier sections of the article outlined the new – relating to ethics – responsibilities of internal audit and the challenges in shaping assessments in this area (identifying an organisation's level of maturity from an ethical standpoint). At this point, it is reasonable to point out – once again – that in addition to assurance

tasks, in which internal auditors evaluate a particular area (here: ethics), it is possible to carry out advisory tasks (here: in the area of ethics). In doing so, it should also be borne in mind that auditors are expected to assist the organisation in identifying risks to which the organisation is exposed, and which the auditor perceives by virtue of experience and professional judgment. Thus, dilemmas can arise: what tasks the internal auditor can perform, and what tasks should be delegated to other employees or those in charge of areas important to organisational governance (such as the legal, compliance or risk function). To this end, the author proposes to apply – to the area of ethics and the risk of unethical of the organisation – a perspective, on the tasks of the auditor and the way they are carried out, analogous to that which applies to issues related to the management of risks identified in areas other than ethics.

The role of audit in risk management is evolving, and there is a wide debate in the auditing literature on this issue, but nevertheless a certain model has taken shape, which, although sometimes contested, has cognitive value and helps to ensure the independence of internal audit when evaluating assurance, advisory and possibly other audit tasks that are entrusted to the audit.

Based on the 2012 *Practical Guide* (IIA, 2010, p. 7) and the recommended section titled *Internal Audit Roles in the Risk Management System*, the author – presenting his point of view – uses the structure proposed therein for the description of the internal auditor's tasks, which distinguishes three types of tasks and their potential implementation, or limitations of internal audit activities.

The model proposed in this *Guide* for viewing the internal auditor's tasks assumes the existence of (IIA, 2010, p. 7):

- key roles of internal audit, i.e., those in which the role of internal audit is expected or desirable and the performance of tasks is in accordance with standards and thus does not violate impartiality;
- legitimate internal audit roles in which caution is necessary, and which are due to low maturity and the inability of another person or unit in the organisation to perform the tasks;
- roles that internal audit should not undertake, i.e., such tasks that should be entrusted to another person or organisational unit; in small organisations, where the existence of an audit is a formal, legal or best-practice requirement, these tasks are sometimes entrusted and, therefore, their possible evaluation (e.g., an audit task in this area) should be entrusted to an external entity.

The author, following the above course of organising the tasks of the internal auditor, in Table 5 presents his own proposal for determining the tasks that, in connection with ethical issues, the internal audit:

- should perform,
- can perform,

— should not perform.

The above systematisation of tasks in the area of organisational ethics and the role of internal audit is of a propositional nature and results from:

- the author’s experience in carrying out audit tasks in the field of ethics,
- discussions held with internal auditors during the author’s training courses on auditing ethical issues,
- GIAS 2023 content analysis.

Given that internal audit (IIA, 2018, p. 2) provides insightful analysis, this proposal can act as a catalyst for management and the board to better understand organisational governance processes and structures. The auditor’s tasks shown in the third column of Table 5 would – in the author’s opinion – severely limit the impartiality and objectivity of the implementation of audit tasks in other areas of the organisation’s functioning. Hence, although internal auditors are sometimes entrusted with tasks outside the internal audit function, any management responsibility for the area of ethics should be considered to limit the operation of internal audit.

Table 5. Proposal for systematisation of tasks in the area of organisational ethics and the role of internal audit

Key roles of internal audit	The legitimate roles of internal audit	Roles that internal audit should not undertake
<ul style="list-style-type: none"> • Provide reassurance about processes affecting ethics. • Evaluation of the ethics area. • Evaluating the reporting of major ethical incidents. • Review of ethics area management. 	<ul style="list-style-type: none"> • Facilitate the identification and evaluation of ethical issues. • Advise management on how to respond to the risk of unethical operation of the organisation. • Coordinate activities in the ethics area (e.g., collecting information on incidents and incident response, but not managing the organisation’s response to them). • Consolidated reporting. • Support the implementation of an ethical management system. • Develop an ethics strategy, excluding responsibility for its implementation. 	<ul style="list-style-type: none"> • Determine the organisation’s risk appetite for unethical in selected areas. • Impose ethical management processes on the organisation. • Deciding how to respond to the risk of unethical. • Implement responses to risk of unethical on behalf of management. • Responsibility for the ethical functioning of the organisation.

Source: own study based on the classification of internal auditor roles presented in: (IIA, 2010, p. 7)

Summary

The functioning of internal audit, as one of the tools supporting the effective implementation of organisational governance, falls within the perspective of neo-institutional management science.

The Global Internal Audit Standards, announced in December 2023, significantly and comprehensively regulate internal audit's responsibilities in assessing ethics in an organisation. The changes include not only an expansion of the semantic field of the analysed regulation, but also clarify and more clearly present the requirements for auditors in the presented area.

The Institute of Internal Auditors' 2012 *Practice Guide: Evaluating Ethics-related Programmes* and 2018 *Practice Guide: on Assessing the Risk Management Process* have a varying and extensively every so often less valid potential to add value. Accordingly, following the establishment of the new GIAS 2023 – guidance in this area, at a certain level of generality has been included in these standards, and at the detailed level of the implementation of audit tasks requires significant updating.

In order to ensure the impartiality and objectivity of internal audit, it is necessary to determine the scope of internal audit tasks desirable, possible and not desirable in the area of ethics of the organisation. The author proposed a systematisation in this regard as a suggestion for further discussion.

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Cost of Equity under the Circumstances of Uncertainties – the Example of the US Market

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Abstract

Purpose: The aim of this paper is to answer the question: Can the classical methodology for estimating the cost of equity capital (Capital Asset Pricing Model, CAPM) be applied under the conditions of particular economic uncertainty, without having to revise the legitimacy of its assumptions? The context for the search of an answer to this question is an analysis of the conditions for the estimation of the cost of equity capital in the USA under conditions of particular uncertainty, as observed in the period 2008–2023.

Methodology/research approach: The research approach entailed focusing analytical attention on identifying the characteristics of three periods of particular uncertainty (generated primarily by recent crises: the 2008–2012 subprime, COVID-19 and the high level of inflation caused by Russia's aggression against Ukraine) and examining their impact on parameters important for determining the level of the cost of equity. An additional study of related time series was also conducted, with the Kroll Inc. database used as the primary data source. Results: The cost of equity over approximately the last 15 years has become less and less



dependent on government bond interest rates. When estimating the level of the cost of equity, market participants start to use alternative methods that modify the classic CAPM model.

Research limitations/implications: Due to the availability of data, the analysis carried out focused on the US market, which is a limitation in view of the need to draw conclusions for the European market as well.

Originality/value: The article critically analyses mainstream research on the valuation of the cost of equity under the circumstances of uncertainty.

Keywords: cost of equity, CAPM, uncertainty, estimation methods

Introduction

The cost of equity is undeniably a central element in the analysis of economic viability of investment projects. It allows for streams of projected cash flows to be transformed into the expected present value. Owing to this, it is possible to make value estimation decisions in buy/sell transactions, as well as to compare the attractiveness of different physical investments.

In keeping with the most common definition, the cost of equity is the expected rate of return at which market participants make their funds available for specific investment purposes (Grabowski and Pratt, 2008, pp. 3 to 9). The aforementioned definition suggests that the cost of equity be used in purchases and sales, and in asset measurements as well as for the purposing of evaluating alternative investment opportunities. In the developed market economies, the concept of the cost of equity is being applied increasingly in almost every area of economic life, from the stock exchange to the valuation of health care services and the setting of tariffs for utilities. A particularly important area in which the concept of estimating the level of the cost of equity is used is in the area of auditing and controlling the work of statutory auditors who evaluate value estimates in the audit process. Therefore, having the tools to reliably assess the cost of equity capital under conditions of uncertainty, such as a financial crisis or a state of war, becomes a key problem in the economy.

This paper reviews the literature on the issue of determining the cost of equity capital under conditions of uncertainty, especially in light of three recent crises: the subprime crisis of 2008–2012; COVID-19; and Russia's aggression against Ukraine 2022. Despite the frequent references to the results observed in the

capital markets, this study does not include an analysis of investor behaviour, because in a stock market crisis, investors react based on models developed by behavioural finance, which are not the best tools for determining the long-term cost of equity.

1. Methodology of the analysis carried out

The aim of this paper is to answer the question: How does one estimate the level of the cost of equity capital under uncertainty? The tool to achieve the goal was a critical analysis of the state of the art in the area of the possibility of estimating the cost of equity capital in the U.S. under conditions of uncertainty, generated primarily by three crises: the subprime crisis of 2008–2012; COVID-19; and the Russian invasion of Ukraine 2022. The research was carried out from May to September 2023. The sources of the data used in the study are databases: EBSCO, Google Scholar and published industry materials (online sources) from consulting and audit firms.

The analysis was based mainly on the U.S. market, which was done due to the reliability of the data and the ease of obtaining it. In addition, in order to avoid less significant methodological problems, the Capital Asset Pricing Model was chosen as the reference model. The Capital Assets Pricing Model – CAPM – is used to determine the so-called base cost of equity:

$$\text{Cost of equity} =$$

$$\text{Normalised Risk-Free Rate} + \text{Equity Risk Premium}$$

where:

Normalised Risk-Free Rate means that in months when the risk-free rate is considered abnormally low, a proxy for the long-term stable risk-free rate is used. This is important because there are still issues of Treasury debt securities whose yields at auctions are close to zero or even negative; while the

Equity Risk Premium is calculated in this version of the equation relative to the normalised risk-free rate, so a change in, for example, the normalised risk-free rate to spot performance will result in a change in the equity risk premium, which should rebalance the model at the level before the change. Such a model will not be without drawbacks, but it is still the most common in practical use.

2. Volatility of the level of the cost of equity capital

Given the volatility of the level of the cost of equity, a key question must be asked: How should factors such as the financial crisis, the COVID-19 pandemic, or high inflation affect a company's cost of equity? Repeatedly in the literature on this issue one can find statements saying that higher interest rates smoothly translate into a higher cost of equity (Miller and Modigliani, 1958; Antoniou et al., 1998; Gregory and Michou, 2009; Duliniec, 2012; Marcinkowska et al., 2014; Białek-Jaworska et al., 2014). The effects of this process could be seen in declines in the level of stock returns in 2022. It would seem that a cause-and-effect relationship in this would be relatively observable. This is because, according to theoretical assumptions, in order to estimate the level of the cost of equity, an equity risk premium is added to the safe rate of return (expressed in terms of interest rates, such as 10-year government bonds).

The volatility of the level of the cost of equity capital has thus been the subject of many studies, among them:

- a study on the impact of financial market volatility on the cost of equity capital (Fama and French, 2015), resulting in the authors proposing a model that includes market volatility as one of the key factors shaping the cost of equity capital;
- a study on the relationship between bond interest rates and the cost of equity (Damodaran, 2012);
- a study on the variability of the cost of equity capital in different industries (Fernandez, 2004). This study focuses on analysing the volatility of the cost of equity in different industries and discusses the factors affecting this volatility, including the value of the tax shield;
- a study on the impact of macroeconomic volatility on the cost of equity capital (Dichev and Piotrowski, 2001) analysing how volatility in macroeconomic factors, including changes in bond ratings, affects the cost of equity capital and long-term returns in equity markets.

In turn, bearing in mind the issue of uncertainty – so important in this study – it is worth stating that, in the literature, it is possible to distinguish various methods of estimation, whose purpose is to quantify categories that allow, to some extent, to recognise the characteristics of uncertainty. Thus, science has developed the following tools useful here:

- 1) risk assessment models: e.g., Black-Scholes-Merton Model, CAPM Model, Price Arbitrage Model, Option-based Risk Assessment Model (Hull, 2006);
- 2) Monte Carlo simulation (Rubinstein and Kroese, 2016);
- 3) sensitivity analysis (Damodaran, 2012);
- 4) Delphi method – expert opinions (Jorion, 2007);
- 5) market research (Alexander, 2008);

6) the concept of security reserve (Damodaran, 2016).

Over the past few years, a divergence between theory and practice has become apparent in the way the level of cost of equity is estimated. The past two decades have witnessed several periods of 'transition' between periods of uncertainty, in which uncertainty can even be referred to as special uncertainty. Periods of particular, intensified uncertainty resulted from either a financial crisis, a pandemic crisis, or rising inflation caused by the armed conflict in Ukraine, among other factors. The fact of the existence of such periods of uncertainty, in the present study, provided the primary impetus for the formulation of its purpose: How to estimate the level of the cost of equity capital under uncertainty? Thus, the remainder of the argument presents a synthetic characterisation of the features of the three periods of exceptional uncertainty and points out their impact on the level of the cost of equity.

3. The 2008–2012 subprime financial crisis and the level of the cost of equity capital

During the 2008–2012 financial crisis, press reports of spikes in the cost of both corporate debt and Treasury securities appeared with great frequency. Dobbs, Jiang and Koller pointed out that yields, to maturity, increased significantly (in absolute terms) when considering only the last months of 2008. Despite this, 'A' status bonds only became 1 percentage point more expensive during the period in question, reaching the YTM (Yield to Maturity) of about 7% for non-financial companies (Dobbs et al., 2008). However, considering the period of the last 20 years, this 'spike in the cost of debt' has no longer been observed, as only in the last 6 years before the crisis, these bonds have kept the YTM below 7%, and the median for the 20-year period is hovering around 8%. The authors emphasise that the high spread between the YTM of government bonds and high-rated corporate bonds has persisted and even increased over the period studied not because of the increase in the risk of corporate bonds, but because the yields on government bonds were being lowered by government decision (Dobbs et al., 2008b; Dobbs and Koller, 2009).

As a rule, it is assumed that risk very often manifests itself in higher levels of volatility in stock market returns. The historical data needed to determine the risk premium in the U.S. is mostly from the *Ibbotson SBBI (Stocks, Bonds, Bills and Inflation)* Yearbook or the *Duff & Phelps* (now Kroll Inc.) risk premium reports. Analysing the returns of the major U.S. stock market indices in the short term, it can be concluded that in 2008–2009 the cost of equity became increasingly volatile and at the same time higher. The published historical data significantly deviate from the rapid changes observed in the market during the period in question. It is worth mentioning here that stock market returns in 2008 in the U.S. were among the

lowest on record, except for 1931 and 1937, when there were declines of about 50% in 12 months. The 2008–2009 crisis years reversed capital market trends. However, during the period under review, there were voices – backed by research – that in view of the described market anomalies, investors should not base their conclusions solely on short-term stock market historical trends. Analysis of fundamental long-term trends, such as the 40-year trend, showed that the share of corporate profits in GDP hovered around a median of 5%. Thus, inflated by cheap credit, corporate profits should fall from 2007 levels by at least 20% to return to the 40-year trend, or by 40% to reach the minima of previous cycles (Dobbs et al., 2008b; Dobbs and Koller, 2009). It therefore seemed reasonable to consider the state of the economy and, consequently, the level of the cost of capital, both equity and debt, not only in the short term, but also in the long term.

The *long-term Equity Risk Premium (ERP)* approach, on the other hand, leads to the conclusion that basing an estimate of the ERP value on average historical data causes the ERP value to fall every time a decline in the interest rate on Treasury securities is observed (Damodaran, 2008). However, in times of crisis, the ERP estimate, with the simultaneous lowering of interest rates on Treasury securities caused by government actions, can lead to an underestimation of the cost of capital (Grabowski and Pratt, 2008). According to Pratt and Grabowski's research, the value of ERP in the long term is in the range of 3.5 to 6% (Grabowski and Pratt, 2008; Kroll, 2023). This raises the question of whether this is the right range for the development of the risk premium in each phase of the business cycle. If so, what should be the value of ERP during periods of crisis in order to reasonably reflect market risk and increased investor uncertainty? Calculations made available by Kroll indicate that the underlying cost of equity during the subprime financial crisis was between 9.0% and 10.5%. However, in assessing the severity and impact of the crisis on the cost of equity, it is important to consider the duration and magnitude of the decline in the value of the public market (as measured by the S&P 500) between October 2007 and March 2009, the S&P 500 index declined by almost 57% and the recovery period to pre-crisis levels was almost 5.5 years, although the market expected no recovery in less than 6 years (Nunes and Harrington, 2022).

During the crisis, one could observe a growing interest in the individual effect, i.e., the market's reaction to the specific characteristics of individual financial instruments or sectors. The real estate crisis highlighted the importance of distinguishing between systematic risk and specific risk. It was then that the so-called stress-tests (stress tests) for banks were introduced into wider use. A stress test is a forward-looking quantitative assessment of a bank's capital that shows how a hypothetical macroeconomic recession scenario would affect a bank's capital ratios. The Federal Reserve's (FED – Federal Reserve Bank of the United States) stress test assesses whether banks are sufficiently capitalised to absorb losses under stressful

conditions while meeting obligations to creditors and counterparties and being able to continue lending to households and businesses (Geithner, 2015). It is noteworthy that the ECB (European Central Bank) tests vital institutions under its direct supervision for a specific type of shock. While it would be difficult to move directly from the results of stress-tests to their appropriate inclusion in the process of estimating the cost of equity, it is worth mentioning the nature of the tests as a good start for analysts to distinguish between the effects of systematic and specific risk. This allows the introduction of alternatives for including specific risks in the valuation process, instead of an additional premium added to the cost of equity (Pęksyk et al., 2009).

4. COVID-19 pandemic and the level of cost of equity capital

In the case of the COVID-19 pandemic, the market expected a much worse outcome and consequently a much deeper crisis than in the case of the 2008–2012 subprime crisis (Patterson, 2023, p. 9). In the early months in the U.S., a coronavirus pandemic created millions of unemployed and caused the largest quarterly drop in GDP since the Great Depression. Naturally, this has led to deep uncertainty about the ultimate length and depth of the recession and the possibility of recovery.

The consequence of economic uncertainty is mostly volatility in stock market quotations. It is interesting to note that during economic uncertainty, the pattern for the recession mechanism of recording sharp declines in stock markets as negative news spreads in a cycle based on the impact of panic selling by some investors is replicated. The usual overall effect of this is an overreaction, which shrewd investors take advantage of by buying stocks, which in turn leads to a full or partial recovery long before the economy fully recovers. During the pandemic period, both the decline and rebound of the stock market occurred very quickly. At the end of March 2020, the S&P 500 index fell more than 30%. By mid-June, on the other hand, it had bounced back to about 5% of its value from the beginning of the year. One of the more interesting arguments to explain the market's unintuitive behaviour is the significant change in the industry composition of the S&P 500 index (Bradley and Stumper, 2021). Currently, the industries weighing heavily in the index are mainly technology, media, telecommunications, pharmaceuticals and medical equipment. These fast-growing industries have doubled their share of the index over the past 25 years to about 40%, while slow-growth industries (such as manufacturing and consumer goods) have fallen from about 35% to 20%. This is probably due to the fact that growing industries are more affected by the introduction of new products and services than by the condition of the overall economy (and in some cases have even benefitted from the current economic situation). The listings of old-economy companies, i.e., companies in industries that have not changed significantly despite technological advances, such as oil and gas and those related to tourism, fell by

20% or more in 2020. Because of the change in weights in the S&P 500 index, these declines have not had the impact on the market index that they would have had 25 years ago (Bradley and Stumper, 2021). The explanation for the – at first glance – irrational behaviour of the market can be sought outside the stock market. Some large sectors with high employment, such as department stores and supermarkets, had already suffered before the pandemic broke out. Their market capitalisations were low at the start of the crisis, so further declines had little impact on the index. In addition, many high-employment sectors – including restaurants, dry cleaners and local services – are dominated by private companies whose economic situation does not directly affect the formation of the S&P 500.

As part of the analysis conducted in this argument, in addition to reviewing and diagnosing the state of the art in the field of estimating the level of the cost of equity capital under conditions of uncertainty, our own estimates were made using, respectively, calculations made available by Kroll, Inc. (Nunes and Harrington, 2022; Kroll, 2023). The authors' findings make it possible to show that the baseline cost of equity during the pandemic crisis was in the range of 8.5% – 9.0%, i.e., slightly different from the baseline cost of equity during the 2008–2012 crisis and significantly different from the one considered by analysts to be 'canonical' i.e., in the range of 3.5 to 6% (Grabowski and Pratt, 2008, p. 113). The recovery period to pre-crisis levels was six months (Nunes and Harrington, 2022). Despite the fact that the underlying cost of equity has remained more or less comparable, both professional valuation organisations and supportive consulting firms have developed guidance that seeks to provide directions for dealing with the uncertainty and high volatility of the markets, both equity and non-equity. While institutions such as the International Valuation Standards Council were very cautious in encouraging the use of tools other than a risk premium added to the cost of equity for valuation, consulting firms, in the first phase of the pandemic crisis, were willing to make an adjustment to the cost of capital (PwC, 2020). More balanced positions reinforced the importance of scenario methods (Franceschi et al., 2020), while noting that scenarios cannot account for all risks associated with a pandemic (BVR, 2020).

It is worth referring here to the situation when, at the end of the COVID-19 pandemic, the US stock market plunged 18% in 2022 just after the yield on 20-year Treasuries rose from 1.947% to 4.454%. In theory, the Fed's lower interest rates should generate a higher return for shareholders (the Total Shareholder Return – TSR) and vice versa – higher interest rates (as in 2022) should generate a decrease in TSR. However, doing an analysis over a broader horizon than just the pandemic, facts such as the S&P 500 index rising by 47% at the same time as a rise in the level of 20-year Treasury bond yields was observed from 1.947% to 4.454%. It can be concluded that factors other than the level of interest rates must have driven the market in 2019–2021 (Gupta et al., 2023).

5. High inflation triggered by Russia's aggression against Ukraine versus the level of cost of equity capital

It is very difficult to predict the actual duration and level of inflation in the economy. There are many different forces at work on this phenomenon, including:

- supply and demand disruptions caused by the COVID-19 pandemic (Schmitz and Nguyen, 2022; Hobbs, 2021; Elleby et al., 2020; Notteboom et al., 2021);;
- war in Ukraine (Artuc et al., 2022; Yeoman, 2022; Seiler, 2022; Sohag et al., 2022);
- the reluctance of many to return to the labour market (Vesterlund, 1997; Babcock et al., 2012; Smet de, 2022);
- a prolonged period of aggressive fiscal spending, especially in response to the pandemic, which has contributed to unprecedented peacetime budget deficits (Bordo and Levy, 2021; Makin and Layton, 2021; Hughes, 2020);
- extremely expansionary monetary policy since the 2008–2012 financial crisis, which has led to historically low interest rates (Schnabl and Hoffmann, 2008; Bordo and Landon-Lane, 2013; Cukierman, 2013).

However, not even a few years have passed since the last period of uncertainty related to the COVID-19 pandemic, and inflation levels have begun to rise faster than the macroeconomic forecasts made just two or three years ago. Led this to the materialisation of another crisis in the US, resulting in the Fed's decisions to raise interest rates.

Economists list several reasons for the high inflation rate in the United States. Two of them, however, are here of key significance. First, the COVID-19 pandemic in 2020 has created an unprecedented set of inflationary creative factors in the US economy. The temporary closure of businesses led to a temporary period of recession, in which consumer spending fell and the personal savings rate reached its highest level in 40 years. However, according to most, this increase in savings would eventually lead to an increase in consumer spending as businesses reopen and economic conditions improve. Second, the federal government passed several stimulus packages related to COVID-19 in 2020 and 2021. These stimulus packages also helped mitigate the impact of COVID-19 on the U.S. economy and ensured continued growth in consumer spending. In May 2020 and June 2020, personal consumer spending increased by 8.6% and 6.4%, respectively, the two largest monthly increases in personal consumer spending in the past 40 years. In fact, the five largest monthly increases in personal consumer spending in the past 40 years occurred between May 2020 and March 2021.

Regardless of the opinions of financial market experts as to whether it was solely the pandemic that caused the disruption of supply chains around the world, among others (Miller, 2022), its impact on supply chain logistics cannot be ignored in this analysis. Global markets are slowly adjusting to the high level of consumer demand

for products and services, which is higher than before the COVID-19 pandemic. This led to supply shortages as companies struggled to keep up with consumer demand, resulting in higher prices. Supply chain problems were exacerbated by factory closures that occurred during the pandemic. Food and energy prices have also seen significant increases. This growth can be attributed to several factors, including strong global demand and the Russian-Ukrainian war, among others (Kroll, 2022). In addition, the United States has enjoyed low unemployment rates for several years, which has led to labour shortages in some industries and higher labour costs as employers have had to attract and retain workers. Thus, it can be concluded that wage inflation has also contributed to the increase in the level of total inflation.

At present, it is difficult to forecast how the monetary policy of the various central banks will evolve in connection with the fight against high levels of inflation. This has a direct bearing on the observable uncertainty in the US financial market. Current market expectations for the level of inflation in the U.S. fluctuate between 2.5% and 3.5%, while the real interest rate on 10-year U.S. bonds is expected to be 1%. This is interesting because, by comparison, expectations for the level of long-term inflation reached and exceeded as much as 10% in the 1970s and early 1980s (Piger and Rasche, 2006; Gupta et al., 2023).

So how might the processes described above affect the cost of equity? According to a large part of the market, there were claims that the rapidly rising interest rates in 2022 had significantly increased its level. Given the historical equity risk premium of around 5% and using a beta risk factor of 1, this ultimately boils down to the effect of higher government bond yields. If these yields were truly an approximation of the risk-free rate, then, according to comments from the Federal Reserve and other central banks, the cost of equity would have changed significantly, which could not be observed in the market (Goedhart et al., 2020; Goedhart et al., 2002).

6. Discrepancies between theory and practice of cost of equity estimates under uncertainty

The theoretical assumption that the level of the cost of equity is the normalised risk-free rate plus the market level of the risk premium has been in conflict with observations made in the market for some time (Gupta et al., 2023). Research by McKinsey & Company has shown that over the past 15 years or so, the cost of equity capital has become somewhat conceptually 'decoupled' from the level of interest rates on US government bonds. In addition, it was possible to conclude from this research that governments, through monetary policy, have manipulated long-term interest rates to such an extent that government bond yields did not, and perhaps no longer do, reflect what the market uses in the area of estimating the level of the cost of equity.

Moreover, McKinsey & Company's analysis shows that even when central banks raised interest rates significantly in 2022, the cost of equity rose only slightly, reflecting only slightly higher expectations for long-term inflation. A likely reason for this may be that the level of the cost of equity capital has not actually decreased over the past 15 years, but has actually reflected the low cost of public debt (Gupta et al., 2023).

In the same study, McKinsey & Company analysed the market's ability to take government bond interest rates into account when estimating the level of the safe yield. The research was based on the P/E ratio (*Price to Earnings ratio*) and the dependence of its value on the level of the cost of equity. In theory, the cost of equity should significantly affect the value of the ratio. This is because this indicator tells how much investors pay on average per unit of net (i.e., distributable) profit earned by a company.

The rising value of the index indicates that investors are paying more and more for each dollar of profit. Hence, it can be assumed that significant changes in the level of the cost of equity should result in significant changes in P/E ratios. The McKinsey & Company study observed, however, that over a period of about 15 years, when government bond yields fell to unprecedented lows and then rose to significantly high levels, median P/E ratios remained constant. The consistent median P/E ratio values observed during this time may lead one to believe that markets no longer use government bond yields as an indicator of the risk-free rate.

Moreover, given the low interest rates of the past 15 years, a typical large company should have been valued in a range well above the 20x P/E ratio since the last financial crisis, which has not been the case. Medium-sized large companies have consistently traded at multiples in the 15 to 17 times P/E range since the financial crisis despite low interest rates during this period. In addition, in the study, applying the assumptions of reverse engineering of P/E multipliers in relation to ROIC (Return On Invested Capital) highlighted a 'flattening' of the level of the cost of equity capital remaining in the range of 6.5–7.0% (Gupta et al., 2023) (Figure 1).

In addition, the results of the analysis presented in Figure 1 are consistent with the long-term analysis of the median level of P/E ratios of large companies, which shows an average of 15.9 and stability of P/E values in the range of 15 to 17 times from 1990 to 2022 (Figure 2).

According to McKinsey & Company, company valuation models based on low interest rates for the past 15 years may not have led to reasonable results. For example, if the level of the cost of equity had declined as interest rates fell over the past decade and a half, one would have seen a significant increase in P/E ratios. The observed 3% decline in the level of the cost of equity should increase the value of the P/E ratio, from an average trading range of a multiplier of 15–16, to a multiplier of more than 25 times. Such an increase, however, has not been observed (Gupta et al., 2023).

Figure 1. Changes in expected returns over time using the S&P as an example 500

Source: Gupta, V., Kohn, D., Koller, T., Rehm, W. (2023), Markets versus textbooks: Calculating today's cost of equity, Strategy & Corporate Finance Practice, McKinsey & Company

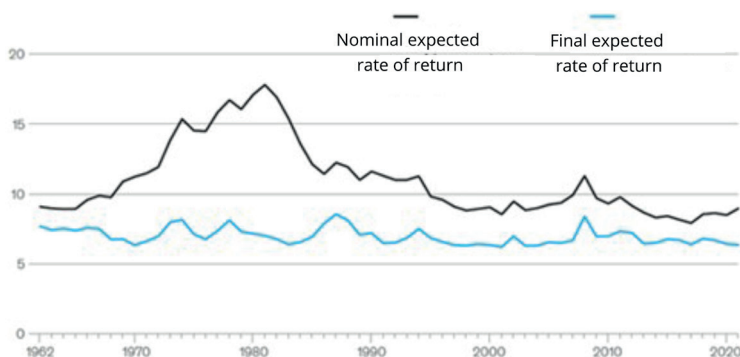
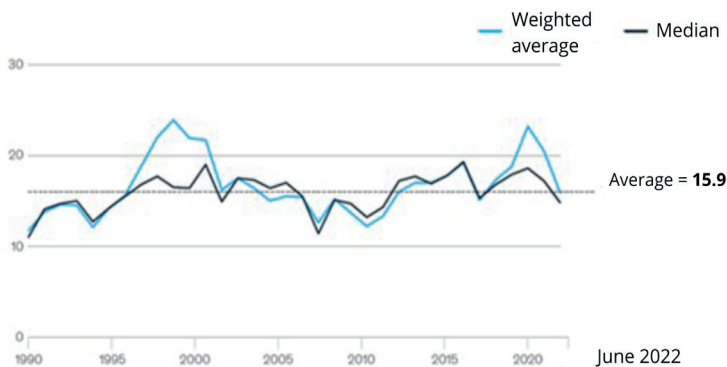


Figure 2. Stock price multiples (in the form of P/E ratio) of the S&P 500 index for the period January 1990–June 2022

Source: Gupta, V., Kohn, D., Koller, T., Rehm, W. (2023), Markets versus textbooks: Calculating today's cost of equity, Strategy & Corporate Finance Practice, McKinsey & Company



Let's assume that a synthetic estimate of the risk-free rate has been made instead of considering government bond yields, adding the expected inflation rate (about 2.5%) to the long-term average real interest rate (2%). The result will be a synthetic risk-free rate of about 4.5%, which, plus a 5% risk premium, translates into a cost-of-equity level of 9.5%. Thus, once again, it can be observed that the base cost of equity during the current crisis is in the range of 9.0–9.5%, which is slightly different from the base cost of equity observed during the previous two crises. This is significant because this value deviates significantly from the considered by analysts to be the 'correct' range, i.e., between 3.5% and 6% (Grabowski and Pratt, 2008). Thus, one can venture to argue that the new normal in terms of the underlying cost of equity capital in the US is a range of 8.0–9.5% rather than 3.5–6.0%, and the remaining risks, especially those of a non-systematic nature, should be included in the cash flow (Gupta et al., 2023; Franceschi et al., 2020).

Summary

The aim of this paper is to answer the following question: Can the classical methodology for estimating the cost of equity capital (CAPM) be applied under the conditions of particular economic uncertainty, without having to revise the legitimacy of its assumptions? How to estimate the cost of equity under the circumstances of uncertainty? The context for the search of an answer to this question is an analysis of the conditions for the estimation of the cost of equity capital in the USA under conditions of particular uncertainty, as observed in the period 2008–2023.

The main conclusions from the analysis carried out have been presented below. Firstly, the cost of equity over approximately the last 15 years has become less and less dependent on government bond interest rates and when estimating the cost of equity, market participants apply alternative methods in order to modify the classic CAPM model. Secondly, the underlying cost of equity capital during the current crisis in the US is in the range of 9.0–9.5%, which is slightly different from the underlying cost of equity capital observed during the previous two crises and significantly different (from the range considered 'correct' by analysts) of 3.5–6%. Thirdly, from observing the behaviour of participants in the market, it can be concluded that, considering the long time horizon (years from 1962 to 2020), a 'flattening' of the level of the cost of equity capital, maintained in the range of 6.5–7.0%, has become apparent. This may indicate that in the long term, market participants are somehow discounting emerging uncertainties, leading to lower long-term expected levels of the cost of equity capital.

In summation, estimating the cost of equity capital under uncertainty is a more complex task than the CAPM model assumes. For now – with the subprime crisis, the COVID-19 induced crisis and the Ukraine war crisis following in

relatively short intervals – estimating the cost of capital is becoming a challenge of fundamental importance for analysts, investment advisers, valuation report writers and statutory auditors alike. In addition, this is supported, among other things, by the fact that, as outlined in this paper, markets no longer interpret government bond yields as the basis for setting the risk-free rate. It follows that the inference on estimating the cost of equity these days is a clash of two approaches: behavioural and fundamental. Considering that financial crises of various backgrounds have occurred and are likely to occur with greater frequency than before, and that the market is beginning to deal with this phenomenon in a way that forces a change in the approach to already established patterns, including in the area of valuation, and that the issue of estimating the cost of equity – used in various management decisions and investment analyses, including in the area of financial reporting – becomes particularly sensitive.

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The Auditor's Professional Skepticism in Times of Economic Uncertainty

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Abstract

Purpose: The purpose of this article is to assess how contemporary conditions of economic uncertainty (the pandemic and post-pandemic periods, Russia's invasion of Ukraine, high inflation, cybercrime, manifestations of the environmental crisis) affect the importance of an auditor's professional scepticism.

Methodology/research approach: The main research method is an assessment of national auditing standards and professional studies and an in-depth review of the scientific literature. Data from the Web of Science database was used to carry out the bibliometric studies, while Biblioshiny for Bibliometrix software was used to present the results of the study. Methods of analysis and synthesis were used in the article.

Results: The article presents a positive and prescriptive approach to the auditor's professional scepticism in an audit of the financial statements of an entity operating in an environment of uncertainty, and the uncertainty exists across a range of business-relevant economic dimensions. In positive terms, the article demonstrates the importance of professional scepticism arising from changes in financial reporting in times of uncertainty. In normative terms, it identifies the applicable standards in the area under analysis, as well as the directions in which the importance of professional scepticism is changing.

Research limitations/implications: The research limitation is to infer from the findings presented in the scientific literature and professional studies. Supplementing these with the author's empirical research would allow for a deeper analysis, which may constitute a future research path. This is because the article serves to show the impact of uncertainty on the significance of professional scepticism in an ex-post perspective, showing changes to date, as well as ex-ante, i.e., in the perspective of



the evolution of the concept analysed. The research implications of the article are therefore both practical and theoretical.

Originality/value: The lack of comprehensive scientific research in the area identified above indicates a research gap, which the article partially fills. Contributes to understanding the impact of economic uncertainty on financial reporting and auditing, including the importance of professional scepticism. The findings presented may be useful for both the theory and practice of financial auditing.

Keywords: auditor, statutory auditor, financial audit, financial review, professional scepticism, inflation, uncertainty, pandemic, war

Introduction

Current conditions of economic uncertainty are largely due to the shock to civilisation caused by the COVID-19 pandemic. In the aftermath of the pandemic, many developed economies experienced inflation of an intensity not seen in several decades. At the same time, Russia's invasion of Ukraine has contributed to limited predictability in the functioning of financial markets, disrupted supply chains, purchasing bubbles, and unstable energy supply conditions and prices. Economic uncertainty implies business uncertainty, limiting the financial security of business entities and, consequently, their ability to anticipate continuing operations. Recently, increasing uncertainty has affected the accountability of entities and their approach to accountability (*accountability*) for performance, and changes in financial reporting, as well as sustainability reporting, are to be expected (Zyznarska-Dworczak et al., 2023). At the same time, the crisis associated with uncertain business conditions contributes to a greater risk of manipulation of disclosed financial and non-financial results (Austin, 2022; Chen et al, 2022; Hsu, Yang, 2022; IESBA, CPA, 2020; Ozili, 2021; Zhu et al, 2021; Zyznarska-Dworczak, Rudzioniene, 2022).

The unpredictable and unstable future means that the assumptions underlying the content of financial statements can become more risky than originally anticipated (Zyznarska-Dworczak, 2023). Indeed, conditions of uncertainty can compound the risk of material misstatement that is new or exacerbated under the circumstances (IAASB, 2020). This implies a stronger role for the statutory auditor's professional scepticism, essentially serving to identify circumstances or conditions of management bias and to determine the type, timing and extent of appropriate audit procedures (para. A55 KSB 540).

Determining the direction of development of the concept of professional scepticism under the influence of changes in financial reporting requires an in-depth analysis the rationale for change in light of positive theories, as well as an analysis of normative solutions that contribute to providing external stakeholders with reliable financial statements and audit reports. The lack of comprehensive research in this research area indicates a research gap. The article partially bridges it, contributing to the understanding of the impact of economic uncertainty on financial reporting and auditing, including the importance of professional scepticism.

The purpose of this article is to assess how contemporary conditions of economic uncertainty (the pandemic and post-pandemic periods, Russia's invasion of Ukraine, inflation, cybercrime, manifestations of the environmental crisis) affect the importance of an auditor's professional scepticism. To achieve the goal, an analysis of the study's standards and an in-depth review of scientific literature and practical professional studies were used. A bibliometric study based on the Web of Science database was used in the holistic interpretation and categorisation of the literature. *Biblioshiny for Bibliometrix* software was used to present its results.

The findings presented herein may be useful in both theory and practice. In positive terms, the article demonstrates the importance of professional scepticism arising from changes in reporting of business entities in times of uncertainty. The article indicates the desired directions of change in the analysed area based on normative positions presented in the literature as well as in professional studies.

1. Impact of economic uncertainty on financial reporting and auditing

Uncertainty is an inherent feature of accounting as well as of auditing. The Conceptual Framework for Financial Reporting issued by the International Accounting Standards Board (2018) refers to 'uncertainty' 83 times, mainly in the context of uncertainty of existence, uncertainty of result and uncertainty of measurement (Zyznarska-Dworczak, 2022, p. 164). In contrast, NSB 540 *Examination of Accounting Estimates and Related Disclosures* refers to uncertainty 131 times, mainly in the sense of estimation uncertainty.

The importance of uncertainty is highlighted by the European Securities and Markets Authority (ESMA), emphasising the obligation to ensure consistency between (ESMA, 2022):

- 1) the judgments and estimates adopted in the financial statements and the associated uncertainties, including information related to the carrying value of assets or liabilities at risk of material adjustment due to climate change, in accordance with paragraph 125(b) of IAS 1;

- 2) the information disclosed on climate risk and uncertainty in the management report and the statement on non-financial information.

Reflecting uncertainty in financial reporting primarily requires management's professional judgment regarding the basis for the entity's going concern as well as the assumptions underlying the estimation of balance sheet and performance values, including those related to (cf. para. A1 KSB 540):

- reserve calculations;
- employee benefit liabilities;
- write-downs of inventories;
- the method of depreciation of fixed assets and equipment
- valuation of financial instruments at fair value;
- financial assets at present value based on discounted future cash flows;
- assets based on probability-weighted expected future performance;
- assessing the results of pending litigation;
- settlement of revenues and expenses on long-term contracts.

Uncertainty in the estimation of these values is due to '*inherent knowledge or data limitations*', which can lead to '*inherent subjectivity and variability in measurement results*' (para. 2 KSB 540). This is because there is a risk of significant levels of management bias and opportunism in manipulating results around discretionary inputs for estimates (Lau, 2021).

The inherent uncertainty in reporting is now compounded by the economic and business uncertainty of operating business entities. According to ESMA (ESMA 2022), the simultaneous effects of a pandemic, inflation, rising interest rates, a worsening business climate, geopolitical risks and, more broadly, an uncertain future, require particular care in accounting for the impact, in financial reporting, of the macroeconomic environment, climate-related issues, and Russia's invasion of Ukraine. The current conditions of '*uncertainty*' are also highlighted by the Accounting Standards Committee (ASC) in its *Recommendations – Financial Statements and Management Report 2022 Under Uncertain Economic Environment* issued in January 2023 (ASC, 2023). It defines it as a condition caused by changes in the economic environment due to, among other things, increases in inflation and interest rates, significant changes in foreign currency exchange rates, rising costs of raw materials and labour, or the situation in the energy and heat markets, which may have a negative impact on the entity's operations, including the entity's ability to continue as a going concern. CRS notes that the uncertainty currently accompanying the activities of entities should be the premise of a particularly prudent assessment (cf. ESMA, 2022; CRS, 2023; Zyznarska-Dworczak, 2023) of the following:

- the company's remaining a going concern;
- the rationale for the risk of information distortion due to the use of simplified inventory methods and simplified valuation of goods and services;

- the circumstances determining the establishment of long-term provisions and factors affecting their valuation, including the discount rate and other actuarial assumptions;
- the impact of inflation and the macroeconomic situation on balance sheet valuation, including cash flow projections for the purpose of impairment testing of non-financial assets;
- an understanding of the functioning of information systems, including those operating in the IT environment;
- disclosures in the financial statements and management's report on operations, including those that enable assessment of the entity's exposure to interest rate risk, the risk of changes in commodity prices and the related risk of asset liquidity and ability to pay.

The current practice of Polish companies in the area of financial reporting may indicate the existence of a number of factors that limit the quality assurance of financial statements. Among them are such as (Kutera, Baklarz, 2022):

- lack of significant interest on the part of supervisory boards in the quality of financial reporting, including lack of communication with the auditor;
- entrusting bookkeeping to accounting firms while lacking internal controls;
- emphasis on fiscal bookkeeping as the primary task of an entity's accounting;
- low attention to mid-year reporting;
- being guided in the selection of an audit firm solely by the price for the audit service.

Uncertainty arising from contemporary conditions can increase the risk of materially distorting the presented results through intentional or unintentional management action (Zyznarska-Dworczak, 2023). Management may feel pressure to change or distort an entity's financial performance and financial picture in order for it to achieve its intentions, avoid bankruptcy or foreclosure, maintain its customer base, obtain financing in the form of debt or equity, or meet the criteria for obtaining government assistance (IESBA, CPA, 2020). In addition, shifting the attention of management and supervisors to the more pressing needs of the entity, such as financial and operational matters related to survival in a crisis, can result in a weakened control environment, which in turn creates more opportunities for fraudulent financial reporting or asset appropriation (IESBA, CPA, 2020).

Financial fraud in the pandemic and post-pandemic era is becoming more sophisticated and insidious (Zhu et al., 2021), as confirmed by empirical studies conducted internationally (Hsu, Yang, 2022; Susak, 2020; Zhu et al., 2021). Intentional manipulation applies to both financial and non-financial information (Zyznarska-Dworczak, 2022) and is intended to increase the value of reporting entities (Brooks et al., 2022; Fijałkowska, Zyznarska-Dworczak, 2017; Lee et al., 2023), expected by their stakeholders.

In the face of growing economic uncertainty, the International Auditing and Assurance Standards Board (IAASB) stresses the critical importance of maintaining professional scepticism when conducting audit procedures and urges auditors to be more aware of the potential for fraud or error in financial reporting (IAASB, 2020). Indeed, lack of sufficient professional scepticism is often cited as a reason why auditors fail to detect material misstatements (e.g., Beasley et al., 2001; Benston, Hartgraves, 2002; Quadackers et al., 2014).

2. Importance of professional scepticism according to national auditing standards

Professional scepticism is one of the fundamental issues of auditing. A statutory auditor, when conducting an audit, providing attestation services other than audit or related services, acts in the public interest and observes the principles of professional ethics, in particular professional scepticism (Article 69 (1) of the Law of May 11, 2017, hereinafter referred to as the Law). This concept means such behaviour that involves the statutory auditor or audit firm being critical, alert to conditions that may indicate possible misstatement due to error or fraud, and critically evaluating the audit evidence gathered (Article 68(2) of the Law). Professional scepticism is supposed to characterise both the statutory auditor and the audit firm (Article 69, paragraph 2. Law) and imply a critical approach during the entire audit process, including the planning stage of the audit. In doing so, it should be borne in mind that there may have been circumstances, including error or fraud, which caused material misstatements in the audited financial statements. The statutory auditor's or audit firm's attitude, respecting professional scepticism, should not be influenced by previous experience regarding the honesty and integrity of the audited entity's management and those responsible for management, including its corporate governance (Article 69, paragraph 2. of the Act).

The professional scepticism of both the audit firm and the audit team member is also highlighted by the ethical requirements addressed to statutory auditors and contained in the *Code of Ethics for Professional Accountants* developed by The International Ethics Standards Board for Accountants – IESBA. In doing so, the code points out the conceptual interconnectedness of professional scepticism with the basic principles of auditing, such as integrity, objectivity, professional competence, due diligence, confidentiality and professional conduct (para. 120.13 A1, IESBA Code). In addition, in accordance with para. 120.12 A1 of the Code, maintaining professional scepticism is a prerequisite for both independence of mind and a statutory auditor's image.

In none of the above-mentioned regulations is there an explicit definition of 'professional scepticism of the audit firm', as critically discussed in the *Commentary*

to the *Law on Statutory Auditors* (Slebzak, 2018, Article 68). Also, the National Auditing Standards (NSB) does not indicate the term 'professional scepticism of the audit firm' and only uses the term 'professional scepticism of the statutory auditor'¹. Article 7 KSB 200, indicates that the standards require the statutory auditor to exercise professional scepticism in planning and conducting the audit. The statutory auditor is expected to be guided by inquisitiveness, sensitivity to conditions that may indicate possible distortion due to error or fraud, and criticality in evaluating the examination evidence [para. 13(l) KSB 200]. In accordance with Article 15 KSB 200, the statutory auditor should be aware that there may be circumstances that cause a material misstatement of the financial statements (more in para. A20–A24) and should be sensitive to (para. A20), for example:

- contradictions in the audit evidence obtained;
- information that undermines the reliability of documents and answers to questions used as evidence in the study;
- various conditions that may indicate the possibility of fraud
- circumstances indicating the need for additional audit procedures in addition to those required by the standards (MSB/KSB).

Professional scepticism is essential in critically evaluating audit evidence and may involve legitimately questioning the evidence gathered for the audit, as well as responses to inquiries and other information obtained from the entity's head and supervisors (para. A22 KSB 200).

Today's conditions of uncertainty heighten the importance of professional scepticism. This is particularly noticeable during the audit itself, when the statutory auditor seeks to reduce risks (para. A21 KSB 200):

- overlooking unusual circumstances;
- overgeneralising when drawing conclusions based on observations collected during the audit;
- using inappropriate assumptions in determining the type, timing and scope of testing procedures and evaluating their results.

In addition, now that management's estimates relevant to assessing the audited entity's ability to continue as a going concern are subject to particularly high risks, the statutory auditor / audit firm should maintain professional scepticism toward estimates of (Article 69(3) of the Law) fair value and impairment of assets, reserves and future cash flows. Such a need arises primarily from the fact that the valuation

¹ [Footnote of the Editorial Board]: The lack of definition of 'professional scepticism of the audit firm' may be due to the fact that scepticism as an attitude can only be an attribute of a person, just like all the ethical values. However, the audit firm is an environment in which 'professional scepticism' as an attitude of action of the people in it should be nurtured, due to the need to uphold the professionalism of its operation.

of the aforementioned categories can be particularly sensitive to the impact of uncertainty attributes in business operations and environment. In view of this, the mentioned areas require sharpening the attentiveness of the study, which translates directly into increased professional scepticism. This issue is particularly important for audit periods beyond 2020.

3. The importance of professional scepticism in scientific research from 1993 to 2023

3.1. Basic assumptions of the bibliometric study

For the purposes of this publication, bibliometric analysis was used to assess changes in the importance of professional scepticism. For this purpose, a local database of articles available in the Web of Science database published between 1901 and 2022 was generated. Studies that meet the following criteria were accepted into the database: in one of the main subject areas, 'professional scepticism', research belongs to the scientific area of economics or to management. On this basis, 172 publications from 1993–2022 were obtained. The trend in publication and citation intensity is shown in Figure 1.

Three phases can be distinguished in the period presented, coinciding with the decades of the period analysed. The first decade saw single articles on professional scepticism being published, while the second decade saw several articles a year. The last decade of the period analysed was characterised by a significant increase in the interest in the issue analysed – both in terms of the number of the articles published (more than 80% of the articles published in the period analysed) and of the citations thereof. However, it is from 2017 onward that research on professional scepticism became most popular. In the period between 2017 and 2022, 60% of the articles on such research were published, as entered in the database of local articles published in 1993–2022.

The analysed articles were published in 74 journals, which means significant dispersion. The largest number of publications in the study area (43%) was published by six reputable journals specialising in accounting and financial auditing (see Table 1).

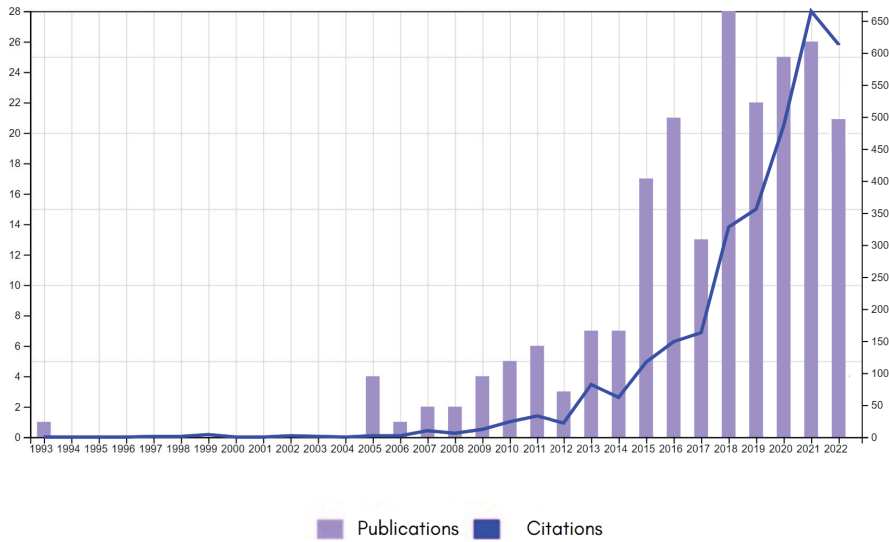


Figure 1. Analysis of publication trends and research citations in the statutory auditor's skepticism from 1993 to 2022

Source: Local database from *Web of Science*, data as of 28 March 2023

Table 1. Journals publishing the most research on professional auditor skepticism between 1993 and 2022

Magazine	Share of publications
<i>Auditing: A Journal of Practice Theory</i>	10.112%
<i>Contemporary Accounting Research</i>	9.551%
<i>Accounting Organizations and Society</i>	6.742%
<i>Behavioral Research in Accounting</i>	5.618%
<i>Managerial Auditing Journal</i>	5.618%
<i>Accounting Review</i>	5.056%

Source: Local database from *Web of Science*, data as of 28 March 2023

The largest number of publications on auditor professional scepticism comes from the United States (62%), Australia (13%), Canada (6%), France (4%), the United Kingdom (3%), Finland (3%), Indonesia (3%) and the Netherlands (3%). The local database does not include articles from Poland. This picture, with its juxtaposition of the characteristics of the economies of the countries mentioned and the risks involved, can be rich in various interpretations. However, they would require further complementary research, which will not be presented here. The geographic origin of articles on professional scepticism and their cross-citation is presented in Figure 2.

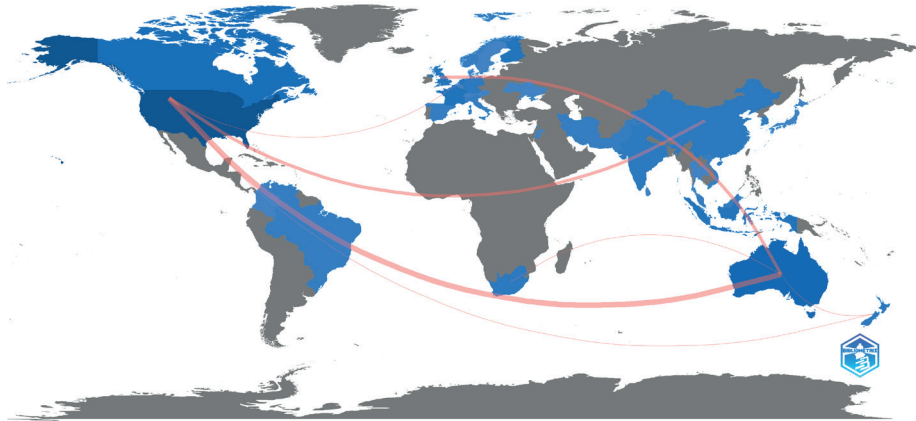


Figure 2. Geographical origin of articles on professional auditor scepticism and their cross-citation between 1993 and 2022

Source: Biblioshiny for Bibliometrics based on local database from Web of Science, data as of 28 March 2023

Citation statistics indicate a high interest in the topic of professional scepticism. The number of citations was 2516, and the average publication citation rate was 15 (see Table 2).

Table 2. Citation statistics for publications on professional scepticism from 1993 to 2022

Data	Number
Publications	172
Citations	2516
Average citation rate per publication	15
H-Index	29

Source: Local database from Web of Science, data as of 28 March 2023

Generalising the results of scientific research in the area of the statutory auditor's scepticism, it can be noted that they indicate the need for an in-depth analysis of this attitude in the audit study. The authors of the study not only seek, through a positive approach, to explore the mechanisms governing the use of this trait of statutory auditor behaviour in practice, but also, in large part, point to a normative belief in the need for adaptive changes in the understanding of this trait to the new operating conditions of the business entities studied.

3.2. A positive approach to professional scepticism in light of a bibliometric study

The positive approach used in accounting science explains reality, that is to say, it serves to explain the facts and processes that occur in accounting practice. It answers the questions 'How is it?' and 'Why is it so?' It does so essentially by inductive reasoning. Obtaining answers to these questions is supposed to make it possible to predict economic volumes and the behaviour of accountants, investors or managers (Zyznarska-Dworczak, 2019, p. 113). In formulating conclusions – in the light of positive theory – empirical research is applied, consisting of making hypotheses and testing them on the basis of data obtained through surveys, interviews, controlled experiments and case analysis (Szychta, 1996, pp. 78–84). The bibliometric test of the publication carried out is within the instrumentarium of the positive approach in accounting science, and focused on the topic of professional scepticism, it allows us to identify key observations and conclusions that characterise the status quo of a problem important to the professionalism of statutory auditors.

The bibliometric analysis carried out indicates the following keywords ranked by frequency of occurrence in the analysed articles:

- *professional scepticism (scepticism)*,
- *model (English)*,
- *impact*,
- *estimates/evaluations (judgments)*,
- *achievement/achievement (performance)*
- *risk (risk)*,
- *information (information)*,
- *quality (quality)*,
- *experience (experience)*,
- *management (management)*.

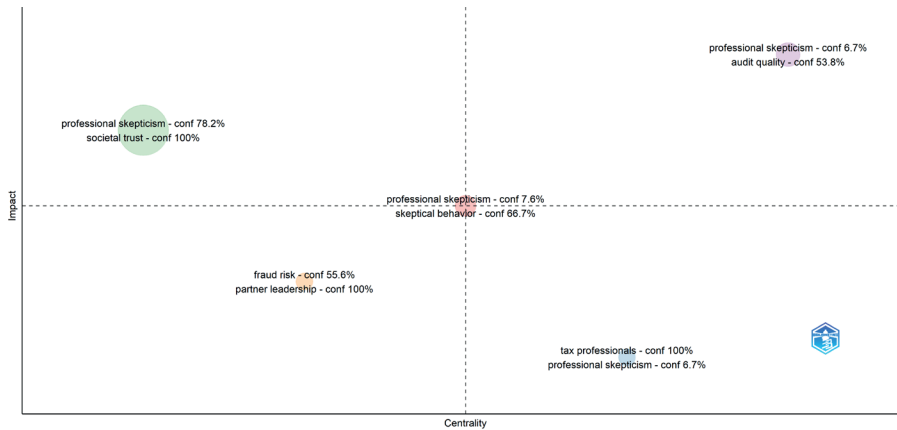


Figure 4. Meaning groups of the term ‘professional scepticism’ from 1993 to 2022

Source: Biblioshiny for Bibliometrics based on local database from Web of Science, data as of 28 March 2023

In the next decade, changes in financial markets and changes in reporting and auditing standards as well as the growing importance of estimation categories have contributed to the growing power of terms such as model, estimation, performance and information. In the past four years, the research on the very meaning of (strictly) professional scepticism as well as model and risk, has apparently increased in importance.

The continuing high importance of risk in professional scepticism research is indicated by the results of the analysis of variation in the formation of meaning groups over time, shown in Figure 6.

Within the three decades of published research on professional scepticism (1993–2022), the period of the last four years stands out significantly, due mainly to the scientific focus of researchers on the key problems of doing business under uncertainty. Research from this period focuses on risk, strictly professional scepticism, scale of operations, corporate governance, fraud, value estimation, as well as on perceptions of the reliability of financial reporting and customer risk assessment, financial statement quality and auditor independence. In the 25 years that preceded it, the research emphasis was on management, strictly professional scepticism, the field, and standards. Although there is now a strong regulatory influence on the way financial statements are audited and standard-setting bodies, regulators and researchers themselves advocate the continued reinforcement of an attitude of scepticism (Hurt, 2010), academic research in recent years has not focused on analysing standard norms relating to professional scepticism.

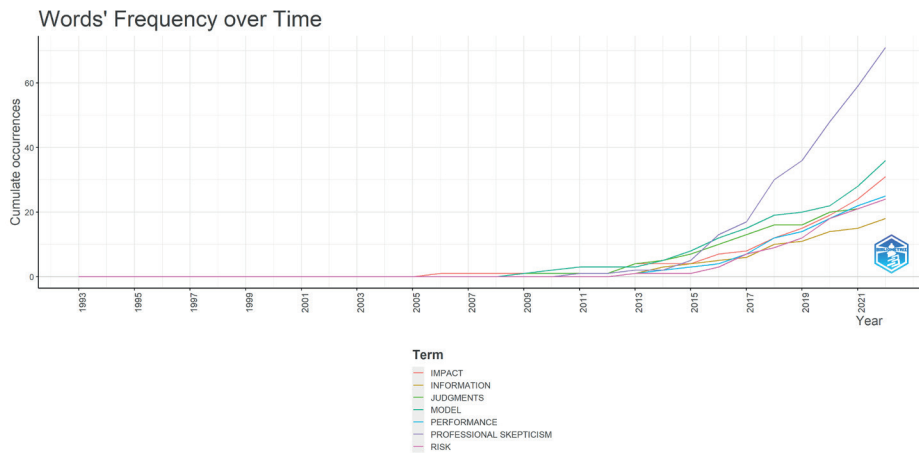


Figure 5. Variability of keyword frequencies in professional scepticism research from 1993 to 2022

Source: Biblioshiny for Bibliometrics based on Web of Science local database, data as of 28 March 2023

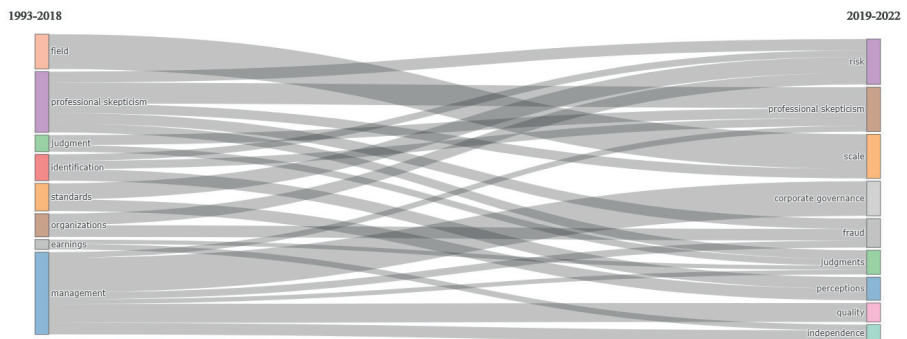


Figure 6. Variability of keyword meaning bundles in professional scepticism research from 1993 to 2022

Source: Biblioshiny for Bibliometrics based on the Web of Science local database, data as of 28 March 2023

In contrast, an analysis of the publications with the highest citation from 2019–2022 (cf. Table 3) indicates a strong semantic link between professional scepticism and the assurance of audit quality features, as well as the appropriate attitude of the auditor, i.e., his necessary substantive and psychological preparation. Also important is the development of Internet communication techniques, which, by technically supporting the auditor's work, can inhibit scepticism in the modern audit environment, affecting the quality of financial statements.

Table 3. Key findings of scientific research in the field of professional scepticism with the highest citation from 1993 to 2022

Publication	Capability of referencing	Research objective	Conclusions
Westermann, Cohen, Trompeter (2019)	70	Assessing the impact of PCAOB Public Company Accounting Oversight Board audits in the context of auditor professionalism, including professional scepticism.	<ul style="list-style-type: none"> • A prerequisite for audit quality is a highly qualified staff, as well as a strong motivation to adhere to the standards of the profession.
Nolder, Kadous (2018)	66	Conceptualising professional scepticism	<ul style="list-style-type: none"> • A critique of the previous meaning of scepticism as 'being alert' to the possibility of deception, bias and contradictory evidence, and critical evaluation of evidence. • Professional scepticism as the lens through which evidence is interpreted.
Bennett, Hatfield (2018)	34	Evaluate whether computer-mediated communication (CMC – <i>Computer-Mediated Communication</i>) reduces auditor questioning during customer interactions compared to face-to-face communication (FTF – <i>Face-to-Face Communication</i>)	<ul style="list-style-type: none"> • FTF interactions include more content and follow-up questions than CMC. • Auditors are more sceptical if the auditor showed non-verbal signals related to fraud than if these specific signals were not present or could not be observed during CMC. • Communication media with reduced channels (e.g., no audio or visual channels)

Publication	Capability of refer-encing	Research objective	Conclusions
			are less suitable for solving complex problems
Kadous, Zhou (2019)	25	Assessing how statutory auditors' intrinsic motivation for their work can improve their judgments about complex accounting estimates.	<ul style="list-style-type: none"> Statutory auditors with the right intrinsic motivation deal with a broader set of information, process information more deeply and demand more relevant additional evidence.

Source: Local database from Web of Science, data as of 28 March 2023

As Westermann et al. pointed out (2019), in an era of heavy regulation, it has become more important than ever to attract and retain a sufficient number of highly qualified and motivated statutory auditors who embody the ‘soul’ of the profession, maintaining professional scepticism, objectivity and due diligence, thus establishing the fundamental conditions for maintaining high-quality auditing.

3.3. A normative approach to professional scepticism in light of a bibliometric study

The broad interpretive possibility presented for the meaning of professional scepticism is confirmed by the cluster linkage analysis conducted with bibliographic coupling using Biblioshiny software (Figure 7).

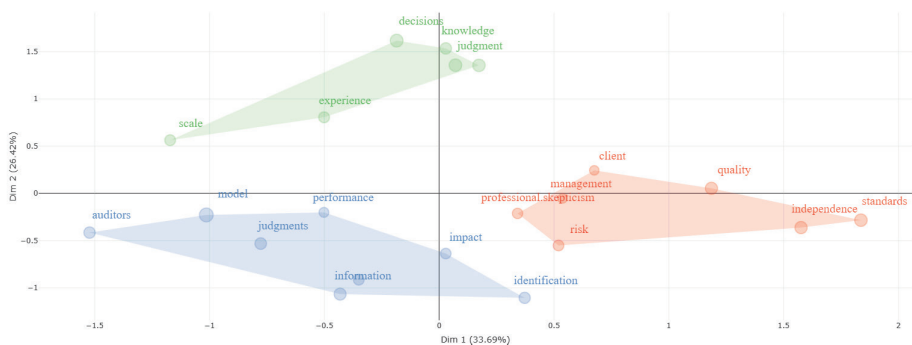


Figure 7. Cluster linkages of professional scepticism publications from 1993 to 2022

Source: Biblioshiny for Bibliometrics based on local database from Web of Science, data as of 28 March 2023

The bibliographic coupling method¹ allowed quantitative selection and extraction of a sample of the most bibliographically coupled articles clustered in three research clusters:

- 1) Experience and knowledge as the basis for decisions and estimates in professional scepticism;;
- 2) Determinants of process modelling in professional scepticism activities, estimating and identifying the impact of information resulting from professional scepticism;
- 3) Client relationship management versus risk of not ensuring audit quality and independence required by standards in light of professional scepticism.

The cluster approach can determine the main areas of normative research on the meaning of professional scepticism under uncertainty. Basically, the normative approach in science answers the question 'How and what should be?' and 'What should be applied?', determines the recommended course of action and the desired method or procedure of proceeding, and as well indicates adherence to certain values or standards (Zyznarska-Dworczak, 2019, p. 151).

Cluster One indicates that the primary determinant for applying professional scepticism should be experience and knowledge. According to Henrizi et al. (2021), professional judgment is a skill that a statutory auditor acquires over time. It is only by combining experience and knowledge that judgments can be made, guaranteeing independence from other opinions or biases in the circumstances. In addition, research by Pinsker et al. (2009) emphasises the importance of keeping knowledge up to date and recommends keeping it up to date. Results obtained by Ta et al. (2022), on the other hand, show that factors such as knowledge, experience and incentives positively influence the use of professional scepticism, while workload and time pressure exert a negative influence. This approach is supported by the authors of the study by Donnelly et al. (2021) proving that work-exhausted auditors will adopt a less cognitively demanding strategy and make more sceptical judgments as a more acceptable and safer assessment.

Within the first cluster, studies have also identified a key condition for effective and efficient identification of relevant fraud risks and selection of appropriate audit procedures in the form of professional scepticism on the part of the audit partnership partner (Carpenter and Reimers, 2013). Moreover, the effectiveness of professional scepticism depends on its proper balance between a mild and conservative approach. As the results of McMillan and White's (1993) study indicate,

² Bibliometric coupling assumes that the greater the number of common literature references (references) in two papers in a sample, the greater the similarity between them (Vogel and Guttel, 2013; Zupic and Cater, 2015). It provides a measure of similarity, based on an assessment of the frequency with which two publications have at least one common reference.

an overly conservative approach and a strong focus on error-related evidence can lead to unnecessary audit procedures and thus induce unnecessary costs, reducing the efficiency of the audit conducted. In contrast, according to Rowe's (2019) research, when estimation uncertainty is extreme, auditors feel more comfortable with more audit evidence. Conversely, in the face of moderate estimation uncertainty, auditors feel more comfortable with less audit evidence.

Another perspective on the analysis of the statutory auditor's work is shown by the results of Austin's (2022) study of the impact on this work of the audit processes implemented by various regulatory bodies. Audits lead auditors to focus too much on inspection risk, that is, they are less likely to detect fraud in high-risk areas of the report that are considered low inspection risk.

The findings of the research indicate that not only experience and knowledge, but also adequate dedication of time to the audit should be the basis for maintaining the auditor's professional scepticism. Its proper meaning is not built by a conservative approach, but by adaptation to the given circumstances of the study.

Cluster Two is concerned with modelling the processes of professional scepticism activities and estimating and identifying the impact of information resulting from professional scepticism. The authors of the study (Glover and Prawitt, 2014) call for recognition of the influence on the extent of professional scepticism of a group of factors, referred to by the study's authors as the structural levels of the statutory auditor's environment. These include: the individual qualities of the statutory auditor, the cooperation of the engagement team, the audit firm's quality assurance system, and in a broad sense, public confidence in the audit profession. Each level can simultaneously carry risks and factors that strengthen the quality of auditing. The need to take into account individual characteristics of the statutory auditor in assessing the effectiveness of professional scepticism is also demonstrated by the research of Ying et al. (2022). The authors proved that the impact on auditors' sceptical judgments is stronger for auditors who feel more pressure of social influence on the results of their work than those who do not feel such pressure as strongly or feel it on a much smaller scale. Vulnerability of auditors to environmental pressures is also taken up by research by Gates et al. (2009). The authors showed that auditors, like other professional groups, are not immune to information presented in the media, which is inconsistent with auditors acting in accordance with professional conduct and professional scepticism. They point out the need to educate and make auditors aware of this issue.

Also Eutsler et al. (2018), in line with social psychology research, indicate that an auditor's sceptical attitude depends on his personal characteristics. Auditors who score low on scepticism as an internal sense (sensitisation) are the least likely to identify control exceptions and recommend more detailed additional research be undertaken. Church (2020), in turn, emphasises, auditors' narcissistic

traits fuel competitiveness and emboldens them to be unwavering in negotiations, potentially lengthening the negotiation process but leading to more conservative negotiation outcomes. Narcissistic auditors are more likely to engage in negotiations that reach an impasse or take longer to resolve. Cluster Three relates to the risk of not assuring the quality and independence of the audit vis-à-vis the need for customer relationship management. Rennie et al. (2010) indicate that auditors consider their clients' trust in their work to be important. However, the statutory auditor's awareness of the existence of such trust in the relationship with his particular client should not impinge on limiting the application of professional scepticism in the audit of that client's reports. One way to ensure professional scepticism in such situations is through a rigorous audit process and adopting an independent stance. In their normative approach, Nolder and Kadous (2018) propose a dual conceptualisation of professional scepticism. The authors, in order to improve the predictive power of scepticism for evidence gathering, propose requiring the auditor to consider 'attitude' in addition to the sceptical mindset required by the standards to date. According to the authors, mindset drives the cognitive processing that gives way to critical thinking, which is an important part of professional scepticism and is required by the standards. The inclusion of a mindset component reflects the idea that scepticism involves not just doubt but the critical analysis of evidence. Attitudes, on the other hand, include affective and cognitive components to predict intentions and behaviour. Attitudes allow us to recognise the influence of social factors on evaluative judgments. Including this element expands the notion of evaluation to include auditors' feelings as well as their beliefs about risk and improves the predictive power of scepticism in auditors' evidence gathering (Nolder and Kadous, 2018).

In addition, according to a study by Asbahr and Ruhnke (2019), reporting value estimation as a key audit matter influences the statutory auditor's judgment on the estimate and the corresponding action. Actions of scepticism in the form of proposed adjustment amounts are much smaller when the estimate is cited as the key issue of the study. This approach limits the expected handling of the required procedures.

In summary, the normative approach in the presented scientific research in the field of professional scepticism of the statutory auditor indicates the need to view the importance of professional scepticism through the prism of the conditions that must be ensured for due diligence in the implementation of auditing. These include the experience and knowledge of the statutory auditor, the absence of time pressure during the audit, the professional scepticism of the audit firm partner, and the rejection of an extremely sceptical attitude. In turn, the assessment of the statutory auditor's retention of professional scepticism and its effectiveness should take into account a number of factors, including but not limited to the

impact on the audit process of online communication techniques and the need to model audit processes. Also important here is the observation that a statutory auditor's overly strong and long-lasting relationship with clients significantly increases the risk of not ensuring professional scepticism in the statutory auditor's work, and thus may be a premise for a lower quality audit.

Summary

Professional scepticism is an important feature of auditing in practice and is an interesting area for research. The article outlines the importance of maintaining the statutory auditor's professional scepticism in auditing an entity's financial statements. It reinforces them by pointing to the functioning of both business entities and auditors themselves under the conditions of special economic and business uncertainty today. On the ground of practice, the problem of professional scepticism is presented in the light of legal regulations and professional studies. On the ground of science – two-pronged, i.e., in the light of empirical research conducted in the canons of positivist and normative approaches. In Poland, the basic legal act on the application of professional scepticism is the Act on Statutory Auditors, Audit Firms and Public Supervision of 11 May 2017, as well as national auditing standards. In particular, the analysis of the standards pointed to the importance of the auditor's professional scepticism in the face of growing uncertainty, implying an increased risk of fraud. The conclusions of professional studies presented indicate that uncertainty can increase the risk of material misstatement of financial statements through, among other things, a lack of interest on the part of boards in the quality of financial reporting, including a lack of communication with the auditor, a lack of adequate internal controls, bookkeeping geared firmly toward tax accounting, and the selection of an auditor according to the price criterion of his services. Awareness of these factors is important for professional – i.e., fulfilling the attribute of sceptical judgment of audited matters, documents and areas – behaviour of the statutory auditor, regardless of the trust relationship between him and the client.

In particular, the bibliometric method of bibliographic coupling was used to analyse the importance of professional scepticism in scientific research, thus highlighting the latest literature and revealing mainstream research. The analysis performed made it possible to identify publications whose quantitative selection (using *Biblioshiny for Bibliometrix* software) indicated trends in scientific research on the title issue (quantitative trend, geographic location of research, specification and intensity of use as knowledge carriers of specific journals and citations). The bibliometric test, in turn, also identified the main keywords related to professional scepticism, their

variability over time, as well as the possibility of combining into meaning groups. Publications over the past four years, however, indicate a strong semantic link between professional scepticism and the assertion of qualitative characteristics of activities in financial auditing. They reinforce the links between professional scepticism and the appropriate attitude of the auditor, his necessary substantive preparation and psychological characteristics.

With the help of the aforementioned bibliographic coupling survey tool, findings on professional scepticism were also rearranged in light of three research clusters. This analysis identified the conditions for effective professional scepticism: the auditor's experience and knowledge, the absence of time pressure during the audit, the professional scepticism of the audit firm's partner, and the rejection of an extremely conservative sceptical attitude. At the same time, key determinants of the statutory auditor's sceptical attitude were identified, and among them, such as the auditor's personality traits, disclosure of key audit matters, the relationship with the client, its duration.... The cluster perspective made it possible to outline a framework, pointing the way for future research directions of the concept under study.

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Acts, regulations and other guidelines

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**REVIEWS –
RECOMMENDATIONS –
–RESUME – RELATIONS**





A Few Words about the Book:

Application of Machine Learning Techniques and Artificial Intelligence to Detect Financial Irregularities in Commercial Companies

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The author of this paper, Joanna Wyrobek, takes up a highly topical issue (from the moment accounting came into existence) of detecting financial irregularities (manipulations) in companies. This issue is important from a scientific (theoretical) and practical point of view. Noteworthy is the fact that this is the first such comprehensive study I know of that deals not only with various methods of detecting accounting manipulation, but also with the use of machine learning and artificial intelligence methods. In this regard, the book stands out strongly from other publications devoted to the problem of detecting irregularities in financial statements.

The starting point is a review of previous research on detecting financial manipulation and studies using *black box* algorithms. The author identifies 18 models for detecting financial fraud and synthesises them to then present and systematise previous research using *black box* algorithms. Then the biggest financial scandals of the last century are presented, with an indication of the mechanisms of accounting manipulation (mainly in US companies), while it is worth adding that this is presented in a synthetic way, which allows the reader to grasp the essence of the various cases of manipulation identified. In the next chapter, the author attempts to build a financial fraud detection model for Polish listed companies. This chapter is the most extensive part of the work, which is justified by the type and scale of the empirical research conducted. The author introduces machine learning methods and then describes selected supervised learning methods in detail, providing a theoretical introduction to her own research. Using selected algorithms, the author positively verifies the hypothesis that entities suspected of fraud/financial manipulation can be identified using machine learning and artificial intelligence algorithms, and rejects the hypothesis that models developed in the US market achieve high efficiency for



detecting fraud in the Polish market. The author also points out potential reasons for the low effectiveness of the U.S. models in relation to Polish companies.

The work is innovative (especially in the methodological layer) and is sure to become a source of inspiration for other researchers interested in the problem of detecting manipulation in financial statements. The monograph is scholarly in nature, but it can be an extremely interesting publication not only for researchers, but also for students in the fields of economics (especially such as finance and accounting or management) and practitioners (accountants, statutory auditors, CFOs, business consultants, company board members, financial controllers and others).



Briefly on the Publication:

Thermodynamic Approach to the Discount Rate and Discounted Cash Flow Method

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A concept by Robert Wright according to which economics is a game with nature in competition for the unhealthy, positive total of winnings, raises the question of the source of capital inflow into the system. Capital cannot appear out of nothing, because that would be inconsistent with the first law of thermodynamics. At the same time, capital is depreciating in keeping with the second law of thermodynamics. The analogy with the laws governing physics, especially thermodynamics and energy transformation, is a key clue to understanding the argument of the authors of the article in question. The method known from the works of the physiocrats who saw economic growth as a result of impact of natural forces and especially photosynthesis was extended by Dobija and Renkas by a link between capital and time¹. The latter factor is defined as the process of transformation of the primary stock of vital energy of a modern human being into the ability to do work, i.e., into human capital (p. 5).

Conceiving of time as a process rather than a lapse measured in units of time is characteristic of the authors' argument, and they reject the traditional discount formula in favour of a new one that integrates the lapse of time t (the textbook approach) with a constant a , quantifying the action of natural forces in nature, proposing $[1 + p(a)]^{-t}$.

The question remains: 'What value do the authors assign to the constant a ?' Citing a range of historical data, from the interest allowed on borrowed capital in ancient Rome to observations of long-term returns on financial assets as well as human capital valuation and global biomass growth, the authors propose $a = 0.08$ [1/year]. After all, the measure thus adopted is only a starting point corresponding to the fair value of human labour or lent capital. The budgeting

¹ Dobija, Mieczysław, and Jurij Renkas. 2023. Thermodynamic Approach to the Discount Rate and Dis-counted Cash Flow Method. Risks 11(118). <https://doi.org/10.3390/risks11070118>.

process should, according to the experience of its participants, take into account risk factors leading to an adequate rate increase discount over a. At the same time, since the constant a is linked to the evolutionary process, it is expected that a deeper understanding of the latter may lead to a periodic revaluation of its value. In addition, linking it to the human labor factor can bring new insights into the issue of fair compensation.

In addition to its theoretical merits' extreme importance to the discussion of our understanding of discount rates, the article gives another reason to look at it. In modern attempts to quantify non-financial aspects and disclose them in corporate reports, finding measures that link the environment in which economic activity takes place, the laws of physics that govern it, and taking into account the primordial resource of the process, such as human capital, should go beyond the textbook understanding of the role of time as a discounting factor. The article under discussion can serve as an inspiring guide in the search for new formulas to quantify environmental, social or managerial characteristics.



Report Resume:

Back to Earth. Landing Real-World Impact in Research Evaluation

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It is a truism to say that we live in a civilisation marked by science. The scientific and technological achievements of recent centuries are responsible for the current well-being of humanity, including life expectancy and the management of diseases that once were an automatic death sentence. Technological developments resulting from past scientific inquiries continue to transform life on the planet, and scientists are far from issue the final word. ‘The endless frontier’, the unreachable horizon of scientific research, marks the fields of further research, exploration, discovery and inevitable questions about the implications of new knowledge.

There is, however, one ‘but’ in this. It is at the root of the study, which was conducted by scientific publisher Elsevier. The results were published in the report *Back to Earth. Landing Real-World Impact on Research Evaluation*¹. The ‘but’ is the question of what, how and why to measure the real impact of research on the surrounding reality. The Elsevier report is the result of a September 2023 online survey of 400 respondents in Australia, New Zealand, the Netherlands, the UK, the US and the Scandinavian countries, i.e., the most scientifically advanced countries in the Western world. Respondents included 180 representatives of academic institutions (including those in charge of them), 120 research scientists, and 100 managers of research funds at various companies and institutions.

The authors of the report remind us that the discussion on how to measure the usefulness of scientific inquiry has been going on for more than three centuries. Francis Bacon, the English Renaissance philosopher and statesman, had argued that science is a public good and as such should be supported by states. However,

¹ Back to Earth. Landing Real-World Impact on Research Evaluation, Elsevier, October 2023, [Back-to-Earth WEB.pdf \(ctfassets.net\)](#) [accessed: 15 December 2023].

as the report's authors point out, it must have taken 350 years after the great philosopher's words before governments harnessed science to change reality, as exemplified by the Manhattan Project, launched in 1942 to obtain nuclear energy and use it to produce a new type of weapon, the atomic bomb.

However, public belief in the need and usefulness of scientific research is not evident. Interesting phenomena in this regard can be observed on the example of the United States only in the last decade. According to the U.S. Pew Research Center², as recently as 2016, trust in science in the American public reached about 21% (in parallel with a higher rate of trust among Democratic party voters and a lower rate among voters declared Republican), to reach 39% in 2020. However, when the survey was repeated a year later (and thus at the apogee of the pandemic state), the rate had declined by a full 10 points to just 29% (with a concomitant drop in confidence among both groups of voters).

The report's authors thus recognise the political dimension of the research issue, but do not absolutize it. At the centre of this analysis, of course, is the issue of public funding for scientific research. It turns out that in this context, the relative decline in public confidence in science can be an incentive to create a system for evaluating the impact of scientific research. 63% of those surveyed in 2022 say there is an increasing overall desire for oversight of research spending.

A survey conducted by Elsevier shows that more than half of those surveyed see a need to change the current system. Indeed, as it stands, undue emphasis is placed on the academic effects of this research, or, in short, quantitative indicators of publications, citations, and the like. The shift, according to those surveyed, should be toward measuring the impact of research on society. Only 1% of respondents consider the existing state of affairs to be optimal, and see neither the need nor the necessity at all for scientific research to serve anything other than the pursuit of researchers' scientific interests. However, 99% reject such a concept of 'science for science's sake' in favour of seeking tangible results of scientific inquiry. As many as 58% feel frustrated by the inability to show the impact of the research on the wider world. The need for a paradigm shift in research evaluation in favour of a more holistic approach is a conviction held by most stakeholders. Strongly agreeing or agreeing with this statement were:

- 68% of academic leaders (20% and 48%, respectively),
- 58% of researchers (16% and 42%, respectively),

² The Pew Research Center is a non-partisan news centre that informs the public about the issues, attitudes and trends shaping the world. It conducts opinion polls, demographic surveys, content analysis and other data-driven social science research. It does not take political positions. For more see: Pew Research Center | Non-partisan, non-advocacy, public opinion polling and data-driven social science research | Pew Research Centre [accessed: 15 December 2023].

- 72% of funders (29% and 43%, respectively).

According to the Elsevier report, the consensus in all countries surveyed was that research evaluation should at least move toward measuring its real-world impact. The clear leader of such attitudes is the United Kingdom with 93% of such indications, followed by the following: New Zealand (88%), the US (88%), Japan (83%), Scandinavian countries (80%), Australia (69%) and the Netherlands (64%). According to the report's authors, it is possible to speak of a global trend toward a more holistic approach to research evaluation, while at the same time there is a growing emphasis on intensifying the process of transformation.

But what will it take for a change in the approach to research evaluation to take place? Among the barriers to change that survey respondents point to is the lack of a common methodological platform for developing evaluations (56% of indications). Other problems include the lack of consensus on what constitutes the impact of research on reality (48%), the lack of appropriate tools (45%), and the issue of synergy resulting from the interaction of different actors in the process (40%).

The differences in views on the current system and the prospects for changing it among representatives of research institutions (academics and scientists) and funders (private and public) are interesting. While both sides of the equation – because they are not in dispute – agree that it is necessary to move from bibliometric indicators of research effectiveness to a more holistic approach, while pointing out that the current arrangements promote vested interests (nearly two-thirds of respondents in both groups, with a slight advantage for the 'side' of the funders), they have a slightly different perception of the extent of change that should happen for the various participants in the process.

The academic and scientific side undoubtedly has greater demands on the level of industry involvement in the transition to new ways of evaluating research. Only 17% of researchers and academics consider industry involvement sufficient, whereas on the funders' side acceptance of the status quo reaches 33%. The two groups have slightly different emphases when it comes to perceived obstacles to change, although the differences are not significant. Both groups at the same time desire changes to the current system almost equally.

While the tone of the entire report is undoubtedly utilitarian and indicative of the need to increase the social utility of science, it is not a cry for greater mercantile or outright commercial benefits from scientific research. What benefits do respondents see in the potential systemic change? Fifty-four percent of respondents point to the impact on education first and foremost as a desired effect, 48% on the environment, 47% on academia, 45% on society, and 43% on the impact on the economy as a whole. Twenty percent point to specific commercial outcomes of the research. Thirty-one percent see potential in influencing health issues, 28% see opportunities to influence technological change.

Thus, the preference for the social benefit of science, first and foremost, by enriching it with knowledge that makes it possible to influence the surrounding world in the general interest of society, not strictly partisan or ad hoc economic interests, prevails.

The survey and report indicate a lively discussion and need for change in the scientific and academic world in the West. Although it is silent on the situation of research evaluation in the CEE region and in Poland (as well as in the European Union as a whole) it can certainly provide an analytically important reference point and encourage the scientific community with its own conclusions and initiatives.



Conference Coverage:

Security of Economic Trade, Responsibility of Institutions, Responsibility of Business

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In reality, the element of which are risks to the stability of the economy, such as war and inflation, it is particularly important to secure economic turnover, and thus strengthen its foundations such as ethics, responsibility and concern for the common good. Recognising the need in the financial community for a conversation, as part of a debate aimed at raising public awareness of perceived factors important for safe business, on June 21, 2023, the Polish Agency for Audit Oversight hosted the conference ‘*Security of economic turnover – responsibility of institutions, responsibility of business*’. Its primary goal was to develop recommendations that could serve institutions and business entities in shaping the conditions important for safe economic trading. The conference also aimed to discuss issues that often escape traditional debates, which are crucial for economic security of both citizens and investors, including retail investors.

The debates took place in three panels relating to: ***institutions, gatekeepers and their role in ensuring the security of economic transactions, business ethics and social relations, education, public awareness and financial crime prevention***. Their participants included invited guests: managers, university lecturers, financial reporting experts and opinion leaders. The diagnoses made in the various panels lead to the following statements.

Discussion during the first panel, titled ***Institutions, gatekeepers and their role in ensuring the security of economic transactions***, the panel:

- 1) made it clear that there is much to be done in terms of public awareness, and that its formation should be done systemically and should be discussed among the various institutions of the financial sector; this observation is confirmed by the fact that between 30 and 40% of joint-stock companies do not comply with the obligation to audit reports, which are helpful in curbing fraud;

- 2) stressed that an economically important issue is consumer protection, which cannot be put ‘outside the bracket of the economy’ because the consumer is an immanent part of it;
- 3) pointed out that the key to combating various fraud types is proper procedures to respond properly to signals of economic irregularities; however, the human factor causes decision-makers to prefer to remain silent and not take action appropriate to the circumstances; meanwhile, well-designed procedures make it possible to catch important signals from various sources (e.g., product complaints) and thus – by eliminating the ‘human factor’ – overcome the above limitation;
- 4) made the audience aware of the fact that institutions form a certain safety net system, of which the important attributes are communication, information and cooperation, and for the efficiency of which auditors are important, for they belong to the second and third lines of defence against economic fraud. An example of good systemic action is the presence of representatives of the Minister of Finance, the Financial Supervisory Commission and the National Bank of Poland on the supervisory board of the Bank Guarantee Fund; another positive systemic practice is the use of a well-constructed tool (product intervention by the Financial Supervisory Commission) that limits bad product design even before it reaches the customer;
- 5) emphasised the systemic role of corporate governance in countering fraud, which is important in ensuring the safety of economic trading; however, this area still requires education; a good example of activities in this field is the first guide for companies listed on the WSE, ‘*Guidelines for ESG Reporting*’, issued in 2021. Preventive measures are important here, but also restrictive or punitive in nature;
- 6) in the spirit of seeking answers to the question posed in the title for the conference, asked: What should institutions do to ensure the security of economic transactions?;
- 7) identified as an obvious key to success in this regard the proper performance of their tasks by all institutions, since statutory and systemic mechanisms already seem to be comprehensive; however, not everything can be written in law, so issues such as social awareness and ethics are also important. Institutions, retailers, investors and consumers should see a community of goals and thus build a civil society, which is essential for the smooth functioning of the economy. The panel made it clear that in such a society an important place is occupied by whistleblowers and gatekeepers: whistleblowers not only act to enhance the organisation’s security in the present, but also secure its potential for the future;

- 8) stressed that in this situation, it is extremely important – not only for current market participants, but also for those who enter this market, and in the context of various statutory and institutional changes – to educate representatives of the judiciary;
- 9) pointed to the need not only for sectoral cooperation, but also for rebuilding customer trust in institutions.

The second panel was held under the theme '*Does business have to be ethical? Business Ethics and Community Relations*'. In the course of the discussion, attention was drawn to:

- 1) the relationship of liability to awareness of the potential consequences of an action, especially when it takes place under conditions of heightened risk;
- 2) a strong 'forward' orientation in business, which always involves risk; for risk is always inherent in any business activity, and looking to the future – which is never certain – is a necessity;
- 3) the need for risk reporting and the ability to diagnose and analyse it, because risk itself is not a bad thing, but can often serve business well; this is the belief of Elon Musk, for example, who in his ventures looks for areas where he can create something new, and this always involves risk;
- 4) the continued and ongoing need to publicise issues related to business ethics (the growing trend of need in this regard is reflected in various empirical studies, which are being undertaken more and more each year in various business contexts); it is also important here to publicise issues that have the character of ethical dilemmas in business and related areas; discussing them makes it possible to recognise problems that are difficult for those who are caught up in such a dilemma, but also such controversial situations that, perhaps, can find a good institutional solution;
- 5) the human being who is the subject of ethics; being ethical means – in essence – simply doing one's duty to the best of one's ability; the level of ethics and the resulting place of the human being in the organisation determines the organisation's performance; a feedback loop must be seen here: treating employees well translates into their greater efficiency and, as a result, into better company performance;
- 6) implementation of ethics, which often involves trial and error; the key to building the right organisational culture is to involve employees in grass-roots initiatives that help to always look at the institution from a different perspective;
- 7) a culture of openness, which, along with the values of ethics, should be the DNA of any organisation, and that the key to an organisation achieving its goals is for employees to identify with the values and have

confidence in management; the formation of ethics and accountability in an organisation should be grassroots work and be done through the promotion of appropriate behaviour patterns;

- 8) the concept of sustainability (and ESG reporting), in the achievement of which, fundamental to E (*Environmental*) and S (*Social*) is G (*Governance*); on it can be built responsible sustainability reporting; meanwhile: everyone is talking about E, S receives less recognition, and G is almost absent from the debate and not understood by the public; he also emphasised that sustainability reporting grew out of financial reporting, and a concept more fundamental than ESG is the 5P principle promulgated by the United Nations: *People, Planet, Prosperity, Peace, Partnership*; he pointed out the low value of ESG rankings, which often do not contain specific and measurable information; perhaps in time, rating agencies will learn to properly interpret ESG data and thus distinguish between what is truly 'green' and *greenwashing*;
- 9) the place of the customer in the creation of ethical principles important to companies and the importance of ethical codes also 'around the customer'; companies should be customer-centric and act for the benefit of customers, because caring about the customer is likewise a duty to society that must be fulfilled.

The third (and final) panel, '**Public Awareness. How to counter financial crime?**' made the following observations::

- 1) a distinction must be made between the social awareness of every citizen and the awareness required of a professional trader;
- 2) the motivation to comply with economic law should be both positive (people should not cheat if they do not want to be treated the same way) and negative (effective prevention depends on the inevitability of punishment, this inevitability can dissuade someone from participating in an illicit or illegal practice);
- 3) regulations by themselves will not ensure the security of economic transactions, but they are necessary, because without them law enforcement agencies will not be able to take action to ensure security;
- 4) people often assume that institutions will provide them with security, so they don't need to do anything about it themselves (e.g., if they have a bank account, they assume that the security of their funds depends on that bank, not on themselves);
- 5) moderation should be believed in magically solving problems through education alone, for much depends on social and individual factors that shape a person's attitude; economic education should begin as early as possible and focus on instilling four principles: don't lose, as the very

protection of what you have is a value, earn, save and invest; education itself also has two ends, as there is always a risk that someone can take advantage of the knowledge and use it to break the law;

- 6) the spheres of supervision and business should not intermingle, because the situation regarding the respective roles then becomes unclear; supervision should understand whose side it is supposed to stand on, and the mere streamlining of it will already contribute to the security of business transactions;
- 7) financial crime is also changing under the influence of the latest technologies; for technological progress allows the creation of new tools to evade and break the law; it can be predicted that the greater the development of technology, the more tools criminals will have; the role of the state is to win this race and protect citizens from criminals; the reduction of the VAT gap can be pointed out as an effective example of state action in this area; the roots of current economic crimes are still in the system transformation, and Poland is still unable to deal with economic crime at the stock exchange and prosecutor level;
- 8) the state's fight against the VAT loophole has also had a major impact on changing public awareness; progress has been made in recent years, including through the media; in order to promote proper role models in society, it is necessary to praise honest entrepreneurs, talk about fraud in plain language, and take care to educate law enforcement and investigators;
- 9) auditors play an important role in detecting fraud, and in this regard, there is some change in public awareness; in their work, auditors use professional scepticism, and various analyses – in the spirit of (for example) such a theory as Cressey's triangle – make it possible to detect fraud, which in the case of complex economic organisms is not easy, due to extensive intra-group transactions; a major opportunity (for many fronts of action for safe economic trading) can be seen in the development of narrative economics, which can help to properly shape public awareness.

Recordings of the debates held at this conference are available at the following link:
www.youtube.com/@panagov



ENGLISH SUMMARIES OF ARTICLES





Model for Changes in Fees for Audits of Financial Statements during the Pandemic Period

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Purpose: The aim for undertaking of the title issue is the intention to examine - for audit firms outside the largest audit firms (TOP 11 or TOP12 for 2022) - the developments in fees for the audit of the financial statements of entities other than public interest entities during the pandemic period. An additional objective was to approach answering to the question: whether the pandemic forcing a shift to remote auditing of these statements has changed audit firms' behaviour in the practice of selecting clients from further distances.

Methodology/research approach: It was possible to fulfil the objective assumed by presenting a proposal for the author's model (function) of salary changes, which takes into account the specific nature of the pandemic period. When constructing and using this model, data resulting from the *Database of Annual Reports of Audit Firms for 2020-2022*, created at the Polish Agency for Audit Oversight – PANA since its inception in 2020, were used. The analysis of the data available in this database, at the same time those that coincided with the period of the Covid-19 pandemic and were appropriately extended for the needs of the analysis, consisted in diagnosing the peculiarities of the studied sample and establishing the characteristics of the explaining variables, as a result of which a proposal was formulated for modelling the issue undertaken.

Results: The article confirms the existence of a dependence of the remuneration for statutory audit services on the type of the financial statement audited, the “high” or “low” season of performing the audit and the distance between the audit firm and the entity audited. In addition, it focuses on a deeper understanding of the sign of the coefficient appearing in the model with the variable indicating the season. The study has also indicated a trend of undertaking financial statement audit assignments from entities relatively more distant from the audit firm.



Research limitations/implications: The main limitation is the identification of the actual location of the service within the audit firms. For this reason, the largest audit firms with multiple branches have been eliminated from the database. Another limitation (however, affecting the results only insignificantly) is the method used for measuring the distance. The distance was calculated as the distance in a straight line between the audited entity's registered office and the audit firm's registered office. Manual recalculation of a few examples indicates that the distance measurement error may be at a level of no more than several kilometres.

Originality/value: The author notes the lack of published research in the area assumed and identifies a research gap. The article partly complements it by contributing to the understanding of the functioning of the process of measuring revenue in audit firms earned from the provision of audit services performed in relation to entities other than public interest entities. The conclusions presented can provide an incentive for further research and development of the model for post-pandemic periods, taking into account the distinctive features specific to that period.

Key words: auditor, statutory auditor, audit, audit fees, pandemic



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Managing the Risk of Entering into a Toxic business Relationship from the Perspective of Anti-Money Laundering Legislation

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Purpose: The aim of this article is to provide an introduction to the issue of risk management and the standard of due diligence within the establishment of a business relationship with a client by members of the public trust profession, in particular auditors, in the context of anti-money laundering legislation.

Methodology/research approach: Literature research and review of national and European legislation relating to issues of counteracting money laundering and the statutory auditor profession.

Results: Based on the review of literature and the content of legal regulations relating to counteracting money laundering and the exercise of the statutory auditor profession, key risk areas and legal requirements for managing the risk of exposure to money laundering involvement were identified. The analysis performed made it possible to propose a number of recommendations in the scope of limiting the exposure to the conscious or unconscious involvement of a statutory auditor in unlawful activities in the context of legal obligations regarding anti-money laundering.

Research limitations/implications: The literature research and the review of legal regulations only covered documents selected by the author which he considered crucial from the perspective of the purpose of the analysis. The text is therefore not an exhaustive overview of all content relevant to anti-money laundering issues available in the public domain.

Originality/value: Gathering in one place the knowledge of the risks that surround the practice of the statutory auditor profession in the context of regulatory



requirements in the area of counteracting money laundering and exposure to the risk of the statutory auditor's involvement in money laundering.

Key words: money laundering, counteracting money laundering, AML, economic crime, financial crime, fraud risk management, due diligence, *compliance*.



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The Imperatives of Corporate Governance

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Purpose: The purpose of the text presented below is essentially to emphasise: (1) the dynamics and direction of the evolution of corporate governance principles as a guideline for the introduction of the global order in this area, (2) the importance of corporate governance for the sustainable development of business entities, and (3) the related reporting standard which, as a conceptual framework for the presentation of corporate governance reporting information of business organisations across the European Union, constitutes an important element of their policies.

Methodology/research approach: The presentation is based on the analysis of the official announcements and guidelines posted on the OECD website (and other cited institutions), which are collectively used here to provide a picture of the corporate governance framework/principles in global terms, followed by a confrontation with the legal regulation outlining the standard of corporate governance reporting in the European Union space.

Results: This text indicates the need to verify the functioning of corporate governance in practice, simultaneously at two levels: macroeconomic and microeconomic. It identifies the sustainable development imperative as a key premise. It presents six directional recommendations for improving organisational practice and corporate governance reporting from a microeconomic perspective.

Research limitations/implications: Due to the pace of change in global corporate governance guidelines, on the one hand, and EU law relating to sustainability reporting, on the other, this text focuses on the need to recognise the current shape of principles and rules occurring on both levels. This is because it will only be possible to study their impact on various areas of business organisations and carry out different comparative (and other) analyses in the future (from 2025 onwards), as they are implemented in practice.

Originality/value: The value of this study can be identified in the structuring of knowledge in the title area, in the presentation - through a historical outline - of



the global (OECD) approach and the institutional environment relevant to the formulation of the corporate governance framework. Its usefulness is supported by the provision of recommendations that can be considered as a guideline in reviewing - at the level of the business organisation - current practices in this area.

Key words: Corporate governance, OECD, reporting, sustainable development, epidemic, Covid-19, ESG.



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The Place of Conducting the Audit of Financial Statements versus the Location of the Head Office of Audit Firms in Poland

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Purpose: The aim of the study is to recognise the relationship between the location of conducting an audit of financial statements and the location of head offices of audit firms operating in Poland.

Methodology/research approach: The document examination method was used in the study. The analytical approach involved a targeted search of the content of the annual reports of audit firms submitted for 2022 to Polish Agency for Audit Oversight – PANA (as part of the statutory auditors’ reporting obligations under Article 51 of the Act of 11 May 2017 on Statutory Auditors, Audit Firms and Public Supervision (Journal of Laws of 2023, item 1015)) to determine the relationship between the place of the audit of financial statements and the head office of their audit firms. The results of the search performed were then aggregated and plotted on a map showing the administrative division of Poland into voivodeships.

Results: Audit firms from all over Poland audit a relatively large number of entities from the Mazowieckie voivodeship. In many voivodeships, due to the distribution of the location of major cities, audit firms, while performing audits close to their head office, actually perform them in another voivodeship. Most audits are performed by audit firms in their own voivodeship or in neighbouring voivodeships. However, audit firms established in the Mazowieckie and Wielkopolskie voivodeships audit entities all over Poland. The TOP12 firms, i.e. audit firms with more than 1% share in audits of public interest entities (PIEs), have a significant share here.

Research limitations/implications: The research limitations result from several reasons. The rigid information structure of the annual financial statements submitted to PANA is fundamental (<https://strefa.pana.gov.pl/wyszukiwarka/>). For this reason, for the purposes of the audit, the head office in accordance with the PANA register of

audit firms was accepted as the head office of the auditing entity. Other limitations relate to the fact that the head office of the audited entity may be different from the place where operations are actually performed, while the geography of Poland and differences in the development of the infrastructure of individual regions may distort the idea of local performance of the financial statement audit service.

Originality/value: This is the first data analysis of this type in Poland, enabled due to the reporting information about their activity by audit firms to the supervising authority - through the STREFA System of Registration and Records of Audit Firms. Earlier analyses referred only to the activities of audit firms taking into account their geographical distribution across the country. It allows to identify the business model of audit firms operating in Poland and their preferences regarding contacts with clients, as well as to recognise the market of financial statement auditing services in terms of its saturation in individual regions of the country.

Key words: financial audit, audit of financial statements, financial review, location of audit firm



Internal Audit versus Ethics Programmes

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Purpose: The aim of the study is to present a proposal for the delimitation (determination of boundaries) of the audit spectrum in the area of ethics programmes of organisations, from the perspective of the draft new Global Internal Audit Standards.

Methodology/research approach: A comparative analysis, a critical analysis and a descriptive method of the proposed model were used in the study.

Results: The main findings of the analysis include the identification of new opportunities provided by the revision of the Global Internal Audit Standards in the area of auditing of ethics programmes, the illustration of challenges in the area of analysing the organisation's ethical maturity levels and the presentation of a list of audit engagements in the area of ethics: desirable, potentially acceptable and not recommended.

Research limitations/implications: The proposed streamlining of audit engagements in the area of ethics from the perspective of the Standards is a proposal for discussion, resulting, among others, from the author's experience. Further development of the Global Internal Auditing Standards and potential official stances of the Institute of Internal Auditors, including the Institute's chapters, may serve its positive or negative verification.

Originality/value: This is the first publication comparing the qualitative as well as quantitative change between the existing International Standards for the Professional Practice of Internal Auditing, in force since 2017, the revision of which, called the Global Standards for Internal Auditing, was presented in 2023 and will be implemented in 2024-2025.

Key words: internal audit, ethics programmes, ethical maturity levels, Global Internal Audit Standards





Cost of Equity under the Circumstances of Uncertainty - the Example of the US Market

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Purpose: The aim of this paper is to answer the question: Can the classical methodology for estimating the cost of equity (capital asset pricing model, CAPM) be applied under the conditions of particular economic uncertainty, without having to revise the legitimacy of its assumptions? The context for the search of an answer to this question is an analysis of the conditions for the estimation of the cost of equity in the USA under conditions of particular uncertainty, as observed in the period 2008-2023.

Methodology/research approach: The research approach was associated with focusing analytical attention on identifying the characteristics of three periods of particular uncertainty (generated primarily by the recent crises: the 2008-2012 subprime, COVID-19 and the high level of inflation caused by Russia's aggression against Ukraine) and examining their impact on parameters important for determining the level of the cost of equity. An additional study of related time series was also conducted, with the Kroll Inc. database used as the primary data source.

Results: The cost of equity over approximately the last 15 years has become less and less dependent on government bond interest rates. When estimating the level of

the cost of equity, market participants start to use alternative methods that modify the classic CAPM model.

Research limitations/implications: Due to the availability of data, the analysis performed focused on the US market, which is a limitation in view of the need to draw conclusions for the European market as well.

Originality/value: The article critically analyses mainstream research on the valuation of the cost of equity under the circumstances of uncertainty.

Key words: cost of equity, CAPM, uncertainty, estimation methods



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The Auditor's Professional Skepticism in Times of Economic Uncertainty

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Purpose: The purpose of this article is to assess how contemporary conditions of economic uncertainty (the pandemic and post-pandemic periods, Russia's invasion of Ukraine, high inflation, cybercrime, signs of the environmental crisis) affect the importance of an auditor's professional skepticism.

Methodology/research approach: The main research method is an assessment of national auditing standards and professional studies, as well as an in-depth review of the scientific literature. Data from the Web of Science database was used to carry out the bibliometric studies, while Biblioshiny for Bibliometrix software was used to present the results of the study. Methods of analysis and synthesis were used in the article.

Results: The article presents a positive and normative approach to the auditor's professional skepticism in an audit of the financial statements of an entity operating in times of uncertainty across a range of business-relevant economic dimensions. In positive terms, the article demonstrates the importance of professional skepticism arising from changes in financial reporting in times of uncertainty. In normative terms, it identifies the applicable standards in the area under analysis, as well as the directions in which the importance of professional skepticism is changing.

Research limitations/implications: The research limitation is to infer from the findings presented in the scientific literature and professional studies. Supplementing these with the author's empirical research would allow for a deeper analysis, which may constitute a future research path. This is because the article serves to show the impact of uncertainty on the significance of professional skepticism in an ex-post perspective, showing changes to date, as well as ex-ante, i.e. in the perspective of the evolution of the concept analysed. The research implications of the article are therefore both practical and theoretical.



Originality/value: The lack of comprehensive academic studies in the research area identified above indicates a research gap, which the article partially completes by contributing to the understanding of the impact of economic uncertainty on financial reporting and auditing, including the importance of professional skepticism. The findings presented may be useful for both the theory and practice of financial auditing.

Key words: auditor, statutory auditor, financial audit, financial audit, professional skepticism, inflation, uncertainty, pandemic, war.



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