Trustworthy AI and Trust in Audit:
between Prudence and Reputational Risks

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Abstract

In this article the authors explore the matching between the theory and practice of trust in audit and trustworthiness of Artificial Intelligence (AI). While AI does not have a theory of its own, it is an instrument that contributes to theory testing and has conceptual lenses of its own. The currently existing narrow AI has its limits in connecting to audit services. Document processing, data collection and structuring are among the possible functions, however, human supervision is needed as much as professional judgement. The effects of using AI in auditing practice are not clear yet and how reputational risk and independence are affected will be explored. Also, uncertainty dominates the cost benefits analysis in using AI powered technology and services in audits. There is a supply and demand of services in audit and advancements that go hand in hand with regulation of safety, consumer protection and sustainability. Both AI behaviour and audit practice are a matter of socially constructed functions where peer to peer review plays a great role in markets in terms of reputational risks and independence.

1. Introduction

Audit as a profession and domain of activity has been a changing environment over the last decades, the supply and demand of services being in a dynamic equilibrium. As a result, including the audit theories, its necessity and functions were successively addressed in the academic literature through the prism of various theories, but also of the empirical aspects of audit and practice. Capturing knowledge of such changes can be done through structure and agency, which puts forward multifaceted instruments of providing informed understanding on the relationship between structure and agency. Hay (2003) and Hay (2018) question whether agents (the executives, auditors, etc), have their own objectives different from the principles (shareholders) and whether this difference and clash of vision

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generated any additional costs for the company. The other part of the structure and agents' theory is that neither of the agents manage to be on top of the game, and that the structure (the business environment, the regulatory environment) controls the agents who just perform their professional task. Balancing off these two sides rather that playing them off against each other cast into light the current situations in audit, especially as AI, a new player, a disruptive technology plays its part. There are "unknown knowns and known unknown", as well as "unknowns unknowns" in between the relationship between audit and AI, making in effect grounded theory of great value as the rules seem to be set when the game is playing.

In this article, the authors consider AI implications for audit, in regards to quality, independence and reputation. Also, the authors explore the matching between audit theories like inspired confidence and credibility theory in relation to trustworthiness of AI to check for similitudes and to what extent AI fits into audit practice and how audit via its social role and function manage to keep AI within safety boundaries. Next, this article is structured as following: first a literature review is conducted to try to capture change in audit theory and practice to better frame the two audit theory used: theory of trust and theory of borrowed credibility, in comparison with Trustworthiness AI.

2. Literature review

Ittonen (2010) presents a series of theories that are used nowadays in audit domain. This author salutes also the audit theories that were used in the 1960-1980, like the inductive theory of audit and process theories which were fit for purpose for those decades, however, fail in gaming in modem aspects like social mechanisms, ESG and further links between accounting and audit outside the box of economic algebra only. Behrend & Eulerich (2019) understands audit in its evolution practices and its new role within organisations and society adding a new dimension of accountability to the control and command dimension of previous practice, which goes all the way down to ancient Greek times (Pop, 2012).

Gasper & Gullbekk (2016) as well as others analyzed audit evolution in time and how the influence of medieval church manifested along with the new accounting after Renaissance and Luca Piccioli, credited as the father of accounting. Worth mentioning is that the history of accounting and of audit cannot be possibly separated despite the difference perspectives and possibly skills, they remain parts of similar professions. Yet, recently, audit seems to have a trajectory of its own Matthews (2006).

The industrial revolution got a new vibe within the audit profession, especially as the state manage to grow and be more attentive with its public and private wealth management and taxes. In this respect professional audit associations were created, like in 1900 in Switzerland, Sweden and Japan (Öhman & Wallerstedt, 2012), yet, this was rather isolated activities. An important milestone was in 1970s when the business environment separated itself from commercial and financial aspects, requiring auditors to be more specialized in certain areas which came along

with improved efficacity and further professionalization impacting the role of auditors (Bae et al., 2019).

At this point in time, according to Gupta (2004), audit is 'an independent review of the financial information of any entity, whether profit-oriented or not, regardless of its size or legal form, when such a review is carried out in order to express an opinion on it'. Accordingly, specific activities seek to assess whether financial and accounting records are kept in compliance with the existing legal framework and also with the reported numbers and narratives. However, auditors are not passive performers with mandatory tasks to be made for listed companies; they are active in providing opinions and recommendations as well as maintaining themselves independently.

Next, two audit theory will be presented to understanding current practices before we dive into current technologies of audit.

The theory of trust is one of the first theories stating the expert role of the auditor and the reliance on audit report in a company. Rodgers et. al (2019) opinion identified six trust positions: a rational choice, rule-based trust, category-based trust, third parties as conducts of trust, role-based trust, and history-based trust/dispositional-based trust, and apply them to the auditors' going concern opinion.

This is a very basic prescriptive function yet it is a direct consequence of stakeholder participation (including government) on how managers are accountable to the company and to shareholders. (Ittonen, 2010). The rightful owner of the audit report is the shareholders, however increasingly more and more stakeholders' expectations are taken into consideration (Olowookere, 2011). The agency theory can add in and make the auditor the person who closes the gaps in between information asymmetry in between all the actors involved, at least avoiding situations of moral hazard and assessing and measuring performance in an unbiased manner, generating indicators for further reference (Okolie, 2014).

There are obviously critiques to this theory and that show differentiated level of trust in between investors, creditors, stakeholders, even auditors and investigators aligned or not with the auditor's professional judgement. This may have an effect on decision making and promotion of efficient relationships and corporate governance creating a vicious circle. This internal information that transpires outside is due to the governance of companies and the separation of ownership and control and difference in needs and logics of what rational expectations of economic performance means. This is especially important as the backbone of reporting is not necessarily there any longer for accountants to use, managers to consider and shareholders to comment on. The principle of prudence accordingly to which loss has to be recognised before profit is no longer of great importance, at least under the new IFRS Conceptual Framework and auditors react as such.

As a follow up from the previous theory, the borrowed credibility theory provides connections between two elements: (1) the demand shown for sound and good quality economic and accounting reporting and (2) the ability of auditors to provide an offer that is consistent with the characteristics of the demand shown.

From these perspectives, audit reports and auditors' work have to increase trust. The most important consequence of this mechanism is that the main function that a quality audit could be considered to increase the trust that users have in the financial statements of an entity. According to this view, the main function of any audit should be to increase trust into the financial statements and ensure credibility as a status quo into shareholders, manages, stakeholders and the organisation.

As a critique, borrowed credibility theory is not generally accepted among academics, as country-by-country reporting principle lacks harmonisation and in countries with strong central governments auditors stand for the position of the government rather than being a peer to peer review from whiten the private sector for the government, as a special stakeholder Okolie & Izedonmi (2014); Lin, Chan (2000).

Mirroring on these two theories AI has trustworthiness as one of its main characteristics. Ryan (2020) argues "that AI cannot be something that has the capacity to be trusted according to the most prevalent definitions of trust because it does not possess emotive states or can be held responsible for their actions—requirements of the affective and normative accounts of trust."

Artificial Intelligence is different from natural intelligence in the sense that is based on machine learning, which in certain areas performs complex task much faster than humans, due to processing capacity, however does not have professional judgement. Furthermore, exerts make the difference in between narrow intelligence AI and general intelligence AI with the main difference that narrow intelligence despite its progress and capacities cannot be fully trusted yet, performing limited tasks. Matthias (2004) argues that trust comes with values such as responsibility and accountability and this may eventually puzzle traditional concepts of morality and social justice in regard to AI machines' actions.

The European Commission's High-level Expert Group on AI established at normative level a matter of trust in AI as an effort of government created trust into such technologies, rather than on individual applications. The EU Regulation on AI provides a balanced approach in between innovation and safeguards, which for the first legislation on this kind is something expected. Next countries to provide laws on AI like the UK, US and China are expected to put forward a bolder approach, especially as technology makes fast advancements.

The values envisioned by the National Institute of Standards and Technology in the US. This governmental institution put forward seven variables for AI to be responsible and trustworthy, as following:

- validity and reliability
- safety
- security and resiliency
- accountability and transparency
- explainability and interpretability
- privacy
- fairness with mitigation of harmful bias (The National Institute of Standards and Technology, n.d.).

European Union has a more direct approach and considers AI trustworthiness in the following way:

- lawful – respecting laws and regulations
- ethical – respecting certain agreed on values
- robust- both from a technical perspective while taking into account its social environment

Certain risks are also considered by the EU legislation which presents a scale going from minimal risks, which are under to restrictions, up to unacceptable risks which are Ai manipulative practices, prohibited by law. In between it stands high risk, mainly in the area of law enforcement, healthcare and education, and limited risk for now aimed at monitoring chatbots and transparency obligation of AI systems European Commission (2019).

For the time being, AI Trustworthy is working in progress. A KPMG (2023a) survey revealed that: "in fact, 72% of financial reporting leaders in the US believe that external auditors are ahead of financial reporting functions on using AI, and expect them to be using AI to enhance audit quality". This professional perspective legitimises some academic work present in the literature review, especially of the lack of development of general-purpose AI and prudent use by professional. EY (2020) concluding results make the opposite argument that: "banks are using AI for real-time identification and prevention of fraud in online banking. The AI checks the plausibility of clients' credit card transactions in real time, compares new transactions with previous amounts and locations, and blocks them if it identifies a risk.'

Further on, these two opposite opinions will be researched. The thread will be provided by two questions informed by this literature review covering a short intellectual history of audit and a brief of two theories and AI regulation:

To what extent AI fits into audit practice in its new socially constructed function?

Is AI affecting the independence of the auditor or the reputation of the firm?

3. Audit's economic implications

Scott (1984) came up with the primally social role of economics, including audit as a because it contributes to satisfying human needs in a mix economy capitalism Gough (1994). From this perspective which goes back at the fundamentals of economics, auditors contribute to a social role primally derived from economic needs leading to a revolving door system in broader theories, regulation and practices, eventually establish mechanisms that are socially constructed, legitimised by economic activities. Scott's arguments are utilitarian and point in the direction of higher efficiency, audit being a way to check upon costs and benefits.

Scott's merit is that he manages to better connect numbers and narratives, framed into the utility theory, providing a broad perspective outside out, however, carrying its conceptual lenses. This perspective has been built, as argued by Elliott & Jacobson (1998) which adds into capital providers especially investors and

creditors and the benefits of lower capital costs. Accordingly, social mechanisms and accessibility for society in general is regarded as somewhat audited contributed to which further effected into informed decision-making process and economic growth.

From the perspective of decision-making audit helps to eliminate uncertainty, especially as information gap between shareholders, stakeholders and managers is already a classical situation which gets addressed, yet, it does not have a business as usual solution. It this respect the auditor plays a role as a mediator, audit report being a filter of even a mechanism for decision making. Kieslich & Littlejohns (2015) design a decision-making structure in audit explaining that there are two pillars: process and content. Process is normally dominated by transparency, participation and accountability, while content is dominated by variables such as relevance, efficiency, fairness. Both of these pillars are subject to check and balances in terms of audited numbers and check upon narratives via surveys to employees and decision makers, where responses are required to choose on a scale different intensity on participation, solidarity, etc, for instance.

The profession is regulated and subject to investigations and fines as a coercive manner from fiscal authorities in case of wrong-doings, however, academic research found some aspects that may prove to be problematic. "Lowballing" is one curious aspect presented by Al-Qatamin & Salleh, (2020), Cho et al., (2021) where cutting on cost of audit affects the quality received in terms of services. In this respect the mandate received by the auditor is very important. Some scholars, like Hosseinniakani et al., (2014) see the relationship between audit and quality as a matter of sufficient time so technical gaps are spotted. Though this aspect makes a point and connects some dots, there is also a matter of costs in terms of money and additional resources for long time audits. Eventually, long time audits may affect the independence of auditors as a relationship might establish between them and the client, and the risk of a more favourable opinion. It is for this reason the rotation principle was introduces in audit, as the relationship between auditor and client had to be monitored (Lin & Yen, 2022).

Early pronouncements are risky as well as premature approvals are an obvious risk affecting the final audit report. Brandon-Vagner (2018) researched such cases and discovered that such practices are made on purpose, ignoring some data. In the circumstances created, academic research discloses that simplifying procedures in the audit process are used. Such practices prove to be tempting, but has implications outside the poorly audited company, affecting competitiveness on the market. The systemic effects outside the quality of audit has repercussions also on decision making process (Al-Qatamin & Salleh, 2020). Hence, this has implications for future as well, affecting confidence and trust. Such an audit optics of unqualified opinions made academics to look deeper into the relationship between quality and the audit process. From a methodological qualitative perspective, correlations explain precise measures taken. In terms of methodologically quantitative research, low quality can be explained via small samples, or selective observations of transactions analysed leading to certain numerical algorithms with expected outputs, limiting the investigative potential and quality.

Managers are required to disclose audit reports to shareholders as a legal requirement and also a business practice to disclose on performance. The real facet of a low-quality report poses risks on non-reported issues and distortions in economic true and faire view, carrying over a subjective approach in the opinions formulated by the auditors, not necessarily of misstated aspects Hosseinniakani et al., (2014).

"Loyal audit" should not be casted into a negative light only, as it comes with certain advantages. Diminished quality of audit is a one-sided argument and there is more to it. Audit companies do not only perform auditing, yet, also consultancy, though not both of them in the same time. Eventually this rotation of services may lead to lowering the risks for the company and built trust in between the firm and the auditor and even lower but stable tariffs.

Reputation is very important in the market, as correlations are done in terms of size and quality. In this respect larger firms tend to be more trusted and size seems to be a conditionality for the perceived quality of audit. The mechanisms of the market make companies with positive reputation to tax more and addressing the higher end. These companies are credited to use sound professional judgement which creates a revolving door system on the quality of audit performed. (Hosseinniakani et al., 2014).

User perception is very important in terms of determination of audit quality. Shareholders tend to trust audit reports as they reflect upon materiality and governance, spotting problems, if any. Third parties and some stakeholders may not place not much interest in the audit report, due to lack of skills in reading them. One important aspect about the audit that is not necessarily expressed straight but has direct implication is reputational risk for both the audited firm and the auditor, imposing a reciprocal reputational cost. Peer to peer review in the market and trustworthiness is a matter of capital. Next, we shall look into how AI trustworthiness interacts with this reputational mechanism.

4. The future of audit and AI: between prudence and risk taking

It is generally thought that AI as a new economic instrument will created economic growth. By 2030 AI market and its ramifications is supposed to produce 13 trillion USD (Mckinsey, 2018). However, various surveys produced by BIG 4 companies and professional associations disclose some concerns and worries especially of ethical and technical nature. Accountants fall into the same category. Some older studies show that only 19% of accountants use AI in their job ACCA (2021); KPMG (2023b).

In audit, AI can be used to perform certain task like checks on journals entry, test data for anomalies and risk identification, respecting auditing rules and principles. In practice, client ERP data gets filtered via AI powered technology. The advantage is that AI has the capacity to work simulations with large sets of data and structure its timely manners so it is useful to the auditor Dennis (2024). Beforehand, AI needs to be accurately trained with data, as AI capabilities should be directed for

bespoken needs and follow organisation goals. Some scholars like Christiano referenced in Manheim, Martin, Samin (2024) makes a difference between "simple training game" and more sophisticated type of AI training, including "deceptive alignment" where the AI fails to follow ethical behaviour and has hidden characteristics. For now, AI has to adapt and interact with data bases like MySQL, MongoDB and other (Prasada, et. al. 2024).

Manheim, Martin, Samin (2024) also argue that AI standards in auditing are needed, in the matter of "better safe than sorry", though their perspective is arguing for auditing standards body, not standard audits. Industries should be treated on individual basis as they have specificities that AI needs to learn and deliver on, for now under human supervision. Actions specific to audit are that the auditor for the time being needs to right a report proposing recommendations and measures fit for his findings. The auditor has also his own practice in data checking and financial health checks being accountable for the results. AI is more into a phase of monitoring which is a review of data and operations, cognitive process (IEEE, 2002) capturing change whenever outliers exist Ruppert (2004).

IAASB (2024) looked at some AI audit use cases in regards to document processing of audit planning, identifying risks and non-compliance situation. AI in audit can support the auditing process by optimisation of resources and, mapping them and provision for understanding. Language processes and machine learning is very important at this stage of collecting relevant data, structuring data and analysing the going concern of companies. Operational efficiency is desired as technology used in right way can save time and money, though due to increasing technological costs it is uncertain at this point in time if costs will be reduced.

However, AI can also have an impact on reputation as it interferes in between client and auditor as a third party, which involves costs and also reputational risks among peers, despite benefits. Organisational cultures are not yet prepared to integrate AI, which is still a novelty on the market and under investigation. New technologies are perceived as opportunities with beneficial effects. Major changes are expected to be present in the future as AI will get more and more triangulated for shared use in between client and auditor, both benefactors of AI services. Obviously, legal issues of transparency of algorithms will arise, as well as raised concerns over the independence of the auditor. Independence is a *sine qua non* condition for faire and competitive and effective markets. AI raises qustion on how auditor's independence gets interfered and also of professional reputation, for the best or for the worst, depending on benefits and conceptual lenses applied.

5. Conclusion

This article explored the matching in between AI trustworthiness and trust in audit. Previous research show that accountants and managers use AI with caution due to ethical considerations, fearing of bad advice and lack of accountability, possibly high fees, which may result in an unbalanced profit-cost relation. This disruptive technology is only at the beginning and hence early adopters may make a

statement by using AI, while laggards may cast AI into a bad reputational light for those use master it already.

Trained AI and advancements towards general purpose AI, as oppose to the currently existing narrow AI, may come with new paradigms. Fintech should come with economic value as much as social value due to its power to deliver timely information to a great number of people covering asymmetrical informational gap. In this sense, both AI and audit are socially constructed by laws, standards and principles generally agreed upon and understood to deliver efficiency.

Currently, only the EU has a regulation of AI, mainly addressing risks, while Council of Europe and UNESCO has conceptual frameworks. More customer protection is needed and also allocation of responsibility. From an EU legal perspective, AI has to be lawful, ethical and robust, while from an audit point of view is more sophisticated: rational choice, rule-based trust, category-based trust, third parties as conducts of trust, role-based trust, and history-based trust/dispositional-based trust, and apply them to the auditors' going concern opinion.

For now, trustworthy AI mirrors to some extent the theory of trust in audit, as AI is more widely social used, while audit reports have a narrower professional audience, despite the large amount of stakeholders existing. As we argued in the article, size matters and with it bigger charging fees and reputational assurance, working smart being one of the options, beyond prudence or risks, conventional economics being challenged for now.

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