

Belief in a Just World: Negative Career Shocks and Subsequent Audit Quality of Innocent Auditors

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Abstract: We examine how auditors change their audit performance after a negative career shock when they are innocent. We define innocent auditors as those who have not been involved in audit failures themselves but been adversely affected by the audit failures of their peers due to the collapse of Ruihua Certified Public Accountants and GP Certified Public Accountants in 2019. We can track each individual auditor to compare his or her audit quality between the pre- and post-event periods because the identities of the signing auditors have long been publicly disclosed in China, which are not in the U.S. We find that innocent signing auditors adopt more aggressive auditing, with increased tolerance for accrual-based earnings management and accounting fraud, reduced conservatism and audit effort, and fewer modified audit opinions after experiencing negative career shocks. These findings are robust to a series of sensitivity analyses. We posit that innocent auditors decrease their audit quality because of their anger from feeling betrayed by their “belief in a just world” (BJW) and the busyness to adapt to their new employers. Various cross-sectional tests support these mechanisms. Our study enriches the related literature and has practical implications for audit firms and regulators. Although our research focuses on the Chinese audit market, it may have important implications for the sustainable development of other audit markets.

Keywords: innocent auditor; negative career shock; audit performance; belief in a just world