

Audit Research Summaries

Ook deze maand presenteren wij weer enkele “Audit Research Summaries” uit de database van de American Accounting Association (www.auditingresearchsummaries.org).

De eerste samenvatting betreft een onderzoek van Brown en Knechel naar *de mate waarin de accountant en audit cliënt bij elkaar passen*. De mate van “fit” wordt door veel factoren beïnvloed zoals tariefstelling, expertise, locatie, interpersoonlijke relaties en de mate van “agency”-problemen bij de klant. De “fit” is gedefinieerd als de mogelijkheid van de accountant om te voldoen aan de behoeften van de klant gegeven de behoeften van de accountant en mogelijkheden en beperkingen. De uitkomsten impliceren onder andere dat de kwaliteit van de audit toeneemt bij een betere “fit” tussen auditor en cliënt in het geval discretionary accruals als kwaliteitsmaatstaf voor de audit wordt gehanteerd. Ook blijkt dat bij een slechte “fit” de kans op een accountantswissel groter is.

De volgende samenvatting betreft een veldonderzoek naar het gebruik van *fraude-brainstormsessies* in de audit. Uit het onderzoek blijkt onder meer dat partners en managers de grootste bijdrage leveren aan de brainstormsessies. Het is opmerkelijk dat als voor een specifieke opdracht een brainstormsessie belangrijk is, senior-staf relatief weinig aan de brainstormsessie bijdraagt. Fraude-brainstormsessies zijn in de meeste gevallen open discussies en worden gehouden in de planningsfase van de controle. Audit partners staan tijdens de sessies open voor suggesties.

De derde samenvatting gaat over een experiment naar

open interne rapportage en “managerial collusion”. Uit dit onderzoek blijkt dat interne openheid over onjuiste rapportage en samenspanning, juist kan leiden tot samenspanning om onjuist te rapporteren. De kans hierop is tweemaal zo groot als in een situatie waarin dergelijke openheid ontbreekt. De onderzoekers ontkennen de voordelen van open interne rapportage niet, maar wijzen op het ongewenste effect dat zich uit in meer samenspanning om onjuist te rapporteren. Met significante kapitaalvernietiging als gevolg.

Het vierde onderzoek betreft een experiment waarin wordt nagegaan wanneer een *financiële beloning voor een klokkenluider* een economisch voordeel oplevert voor de onderneming. Hieruit blijkt dat de bate voor de onderneming groter is naarmate er minder meldingen worden gedaan, er relatief lage lonen worden betaald of medewerkers beperkte ethische prikkels hebben om interne misstanden te melden. In het laatste geval hebben medewerkers financieel baat bij het in het vooruitzicht stellen van een beloning.

De laatste samenvatting betreft een surveyonderzoek naar het begrip *audit quality* onder audit professionals en beleggers. De resultaten impliceren onder andere dat auditors kwaliteit van de audit primair beschrijven in termen van naleving van standaarden en regels terwijl beleggers individuele kenmerken van het auditteam centraal stellen. De respondenten zijn het er vrijwel allemaal over eens dat persoonlijke kenmerken van de auditor de kwaliteit van de audit beïnvloeden. Betrokkenheid van “national office” en engagement review partners dragen volgens respondenten in belangrijke bij aan de kwaliteit. ■

research summary

Title:	Auditor-Client Compatibility and Audit Firm Selection
Practical Implications:	The authors' results may be of interest to policy makers for two important reasons. First, regulatory discussions on mandatory audit firm rotation could have implications for the cost and quality of auditing if a client is forced to switch from a compatible auditor to one that is less compatible. Second, proposals to expand the auditor's reporting responsibilities might mitigate the loss of audit quality when similarity arises in unaudited disclosures.
Citation:	Brown, S. V. and W. R. Knechel. 2016. Auditor-Client Compatibility and Audit Firm Selection. <i>Journal of Accounting Research</i> 54 (3): 725-775.
Purpose of the Study:	A great number of factors affect the complicated process of a client selecting an auditor. The factors that might affect the degree of compatibility between an auditor and a client include pricing, expertise, location, interpersonal associations and the extent of agency problems in the client. Research in the past has looked into some of these attributes and how they are relevant in determining the overall quality of the resulting audit. A limited amount of research has examined alignment between clients and certain types of auditors based on factors such as the size of the audit firm or degree of industry specialization. However, there is less research on the compatibility of specific auditors and specific clients. The authors define auditor-client compatibility as the ability of the auditor to satisfy a client's preferences, given the auditor's own preferences, abilities and constraints. With this in mind, the authors examine the narrative disclosures included in the text-based parts of the financial statements that provide information about a company, its operations and its accounting choices. Next, they develop a unique measure of auditor-client compatibility for Big 4 firms based on the similarity of their financial disclosures rather than their financial results.
Design/Method/ Approach:	The authors focus on three narrative disclosures separately and together: the company's business description, the accounting footnotes, and management discussion and analysis. They also compare the similarity of an individual client to all of the current clients within an industry of a specific auditor to generate a proxy for how well that company fits into each auditor's client base.
Findings:	<ul style="list-style-type: none"> • The authors find that clients clustered within an industry at the audit firm level tend to have higher similarity scores when compared to clients of other auditors in the same industry and time period; this suggests that the authors' proxy is capturing information about the compatibility between an individual client and an individual audit firm. • The authors find that the poorer the fit with an existing auditor, the greater the probability the client will choose to switch to a new auditor. • The authors find that the successor auditor is generally the non-incumbent firm that has the best relative fit. • The authors find that discretionary accruals are lower when auditor-client compatibility is better, suggesting higher audit quality; however, they find a higher incidence of accounting restatements when the similarity of the unaudited MD&A and client business description is high but not when the similarity of the audited footnotes is high. • The authors find that financially distressed firms that are more similar are less likely to receive a going concern opinion, but similarity is also associated with increased accuracy in going concern opinion reporting.

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research summary

Title:	A Field Survey of Contemporary Brainstorming Practices
Practical Implications:	Understanding that auditors allocate greater resources to fraud brainstorming when engagement risk is significant fosters brainstorming of a superior caliber corresponds to stronger regulatory compliance. Auditors report that engagement teams are holding fraud brainstorming sessions earlier in the audit, document more detailed risk assessments, plan more specific procedures, and retain more documentation. These characteristics contribute to adequately addressing increased PCAOB regulatory scrutiny. Additionally, brainstorming sessions are highly regarded when they occur in a face-to-face fashion and are attended by multiple levels of firm personnel—whether that is “core” or “non-core” professionals. Fraud brainstorming sessions are executed less mechanically (as determined by PCAOB inspectors) by using fewer checklists and increase the amount of time auditors prepare for brainstorming sessions.
Citation:	Dennis, S. A., and K. M. Johnstone. 2016. A Field Survey of Contemporary Brainstorming Practices. <i>Accounting Horizons</i> 30 (4): 449–472.
Purpose of the Study:	<p>The purpose of this study is to further understand current fraud brainstorming practices minding regulatory climate and its impression of brainstorming practices. The authors seek to understand the auditing profession’s existing framework to effectively brainstorm by evaluating audit team characteristics; attendance and communication; structure, timing, effort; and brainstorming quality. Fraud brainstorming environment is considered with respect to client characteristics; particularly, inherent, fraud, and engagement risks, and if the client is publicly traded or privately held. The authors refer to the characteristics as “partitions”. The partitions allow the study to better examine how each characteristic effects the deployment of resources in response to risk levels and trading status.</p> <p>The study poses further exploration into the implementation of Statement of Auditing Standards No. 99 and its effect on fraud brainstorming practices. Particularly addressing the Public Company Accounting Oversight Board’s report suggesting auditing professionals were “mechanically” addressing fraud-related auditing standards. SAS 99 sought to blend experienced audit professionals—those with greater client experience—with less-seasoned auditors to brainstorm how a fraud could occur specific to the client. As part of the brainstorming framework, the study seeks to understand if senior-level auditors (partners and managers) and seniors and staff members, along with “non-core” professionals, cultivate meaningful brainstorming sessions.</p>
Design/Method/Approach:	The authors collected field data from audits conducted between March 2013 and January 2014, per a survey of 77 audit engagements. Information pertaining to the client, audit team, and brainstorming sessions were called upon in the survey. The majority (93 percent) of observations were obtained by two Big 4 firms—7 percent from one non-Big 4 global firm. Each engagement’s partner received instructions for the distribution of the survey to lead managers and lead seniors on the respective engagement while the partner withheld that the survey was for research purposes. A total of 75 managers and 73 seniors participated.
Findings:	<ul style="list-style-type: none"> • Surveyed auditors rarely interacted with engagements where fraud in financial reporting was identified. • When fraud risk and inherent risk are both <i>elevated</i> for a particular engagement, perceived professional skepticism is also <i>elevated</i>. • Risk-based resource deployment is consistent when considering high- versus low-risk clients—particularly, when inherent risk is elevated, audit team size is also greater. • Public clients cultivate larger audit teams where managers and seniors have more client experience. • With respect to contributions made at brainstorming sessions, the audit partner and manager make the greatest contributions along with forensic specialists and audit seniors. Interestingly, when fraud brainstorming is more important with respect to the engagement, seniors make lower relative contributions. • Media richness theory is robustly at work with respect to attendance patterns at brainstorming sessions. Specifically, when engagement risk is elevated, staff and seniors are more likely to attend face-to-face. • Fraud brainstorming sessions are most commonly open-discussion (86 percent) where the session is held during the planning stage of the engagement (87 percent). • Results propose that audit partners are open-minded to suggestions made during fraud brainstorming. • Fraud risk assessments appear to be independent from brainstorming tactics; however, when inherent risk is elevated <i>and</i> if the client is public versus private, audit teams exert <i>more</i> effort.

research summary

Title:	Honor Among Thieves: Open Internal Reporting and Managerial Collusion
Practical Implications:	This study provides evidence that reporting openness can have the unintended effect of increasing collusion. Recognizing that reporting openness can have a downside can help executives make more informed decisions when considering how much organizational openness they want. Furthermore, this study demonstrates that, despite increasing trust and reciprocity among managers, open internal reporting can potentially result in more managerial collusion because openness fosters greater “honor among thieves.”
Citation:	Evans III, J. H., D. V. Moser, A. H. Newman, and B. R. Stikeleather. 2016. Honor Among Thieves: Open Internal Reporting and Managerial Collusion. <i>Contemporary Accounting Research</i> 33 (4): 1375-1402.
Purpose of the Study:	The authors examine whether open internal reporting, in which a manager observes another manager’s communications with senior executives, increases collusion between the managers. Open internal reporting environments certainly have benefits, but they can also expose firms to collusion, which is a significant control problem for firms. For this reason, documenting how open internal reporting affects managers’ collusion is important because the related insight can help top executives decide how much internal reporting openness they want in their firm.
Design/Method/Approach:	The authors use an experiment to examine the effect of reporting openness of misreporting and collusion because an experiment allows them to control the managers’ economic incentives and also to isolate the effect of social norms on managers’ behavior.
Findings:	<ul style="list-style-type: none"> • The authors find that agreements to collude lead to more misreporting in the open than in the closed reporting condition. • The authors find that individual managers were more than twice as likely to honor their agreements to misreport in the open condition, and pairs of managers colluded successfully nearly five times as often in the open condition. • The authors find that open internal reporting facilitated managers’ collusion, which significantly lowered firm welfare in the open reporting condition.

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research summary

Title:	When do employers benefit from offering workers a financial reward for reporting internal misconduct?
Practical Implications:	This study helps to clarify the conditions under which employers are most likely to benefit economically from offering their workers an explicit financial reward for reporting internal misconduct. His cost-benefit analysis reveals that offering a financial reward is likely to be most cost-effective when the existing rate of whistleblowing within the firm is low and least-cost effective when it is high. Furthermore, employers who pay relatively low wages and/or whose workers have weak ethical incentives to report internal misconduct are likely to gain the most economic benefit from offering a reward.
Citation:	Stikeleather, B. R. 2016. When do employers benefit from offering workers a financial reward for reporting internal misconduct? <i>Accounting, Organizations and Society</i> 52: 1 – 14.
Purpose of the Study:	Many employers incur significant economic losses from internal misconduct, such as stealing inventory, falsifying time records, or operating equipment under the influence of drugs or alcohol. As a result, employers are attempting to find a solution to combat this misconduct. One solution that has arisen is offering workers an explicit financial reward for reporting internal misconduct; however, no consensus exists on whether or when this approach should be used. This study seeks to clarify the matter by identifying organizational factors that help determine whether an employer will benefit from offering workers a financial reward for reporting internal misconduct. Specifically, the author investigates whether the level of workers' fixed compensation and their moral convictions influence their whistleblowing decisions and whether variation in these two key organizational factors moderates the cost-effectiveness for offering financial rewards for internal whistleblowing.
Design/Method/ Approach:	To test his hypothesis, the author runs an experiment consisting of three between-subjects conditions.
Findings:	<ul style="list-style-type: none"> • The author finds that workers who observed theft blew the whistle more frequently as their fixed wage increased and as their conviction increased that employees in the workplace have a moral obligation to report internal misconduct to their employer. • The author finds that offering a reward had an overall positive economic effect on employer payoffs; however, he also finds that the positive difference in employer payoffs decreases as the level of wages paid to workers increases to the point that employers who offered relatively high wages obtained statistically similar payoffs in both conditions. • The author finds that the positive difference in employer payoffs decreases as workers report having stronger convictions that employees have a moral obligation to report internal misconduct; thus, the economic benefit of offering a reward accrues primarily to employers who offer relatively low pay and whose workers have weak moral convictions about reporting internal misconduct.

research summary

Title:	Understanding Audit Quality: Insights from Audit Professionals and Investors
Practical Implications:	This study provides evidence that should help inform the public discussion of audit quality in the post-Sarbanes-Oxley era and adds empirical substance to theoretical frameworks of audit quality.
Citation:	Christensen, B. E., S. M. Glover, T. C. Omer, and M. K. Shelley. 2016. Understanding Audit Quality: Insights from Audit Professionals and Investors. <i>Contemporary Accounting Research</i> 33 (4): 1648 – 1684.
Purpose of the Study:	Much debate exists surrounding the definition, composition, and measurement of audit quality. This debate continues despite the importance of audit quality and the large body of research investigating the topic. This paper contributes to this debate by obtaining perceptions and measures of audit quality from audit professionals and investors, two groups heavily interested in the audit and financial reporting process. Furthermore, this study provides evidence that contributes to understanding and defining audit quality, providing empirical evidence regarding many of the audit quality indicators proposed by the PCAOB, adding empirical substance to existing theoretical frameworks of audit quality and highlighting differences and consistencies between auditor and investor expectations about the audit process.
Design/Method/Approach:	The authors conducted a survey of audit professionals and investors to obtain their insights on audit quality.
Findings:	<ul style="list-style-type: none"> • The authors find that audit professionals define audit quality primarily in terms of compliance with professional auditing standards, while investors rely more on the individual characteristics of the engagement team performing the audit. • The authors find almost unanimous agreement that individual auditor characteristics influence audit quality. • The authors find evidence that input from parties outside the core engagement team such as the national office and engagement review partners is an important attribute of audit quality. • The authors find evidence that client-specific factors such as restatements, SEC enforcement actions, and the frequency of audit committee meetings are significant indicators of audit quality; however, they also find that investors' perceptions of audit quality do not fully incorporate the importance of the audit committee in the audit process to the same extent as auditors.

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