

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 Eshleman en Lawson naar *de mate waarin concentratiegraad van de accountantsmarkt leidt tot hogere audit fees*.

De uitkomsten suggereren dat de concentratie op lokale auditmarkten een sterkere invloed heeft op de initiële audit fee van non-big 4-kantoren, dan van big 4-kantoren. De invloed is dan ook groter voor kleine klanten. Andere bevindingen zijn dat concentratie positief geassocieerd is met auditkwaliteit (met abnormal accruals als proxy) en dat verhoging van concentratie leidt tot lagere initiële kortingen van de audit fee.

De volgende samenvatting betreft een archival studie naar de relatie tussen *auditor tenure en audit failures*. Uit het onderzoek van Read en Yezegel blijkt onder meer dat er geen relatie bestaat tussen het aantal jaren dat de accountant fungeert (tenure) en type II errors (geen going concern-paragraaf in de controleverklaring opgenomen bij de jaarrekening voorafgaand aan het faillissement). Wel wordt bewijs gevonden dat bij non-big four auditors een hoger risico op een type II error bestaat in de eerste jaren van een audit. Deze relatie wordt zwakker na het vierde auditjaar.

De derde samenvatting betreft een experiment naar de *invloed van toezicht op de inspanningen en audit fees* van auditors. Stefanian et al. concluderen dat accountants zowel op intern als extern toezicht anticiperen door het audit risk hoger in te schatten en meer uren te besteden. De hogere audit fees worden verklaard door hogere inspanning en niet door het risico van kosten als gevolg van toezicht.

In de vierde samenvatting van onderzoek van Greiner et al. wordt een conceptueel audit fee-model gehanteerd om na te gaan of agressief “*real earnings management*” (REM) *het audit risk en audit fees verhoogt*. Laatstgenoemde door het in rekening brengen van een risicopremie of door verhoogde inspanningen. De onderzoekers concluderen onder meer dat een positieve relatie bestaat tussen agressieve REM en audit fees.

De laatste samenvatting betreft een archival onderzoek naar het effect van *nationale cultuur op de betrokkenheid van “auditors in charge”*. Uit dit onderzoek van Bik en Hooghiemstra volgt dat een relatie bestaat tussen de verschillen in de mate van “auditor in charge”-betrokkenheid, en “power distance”, individualisme versus collectivisme en het vermijden van onzekerheid. ■

research summary

Title:	Audit Market Structure and Audit Pricing
Practical Implications:	The results of this paper contribute to the understanding of the determinants of audit firms' initial audit price discount decisions. The results suggest that concentration of audit firms within the local audit market has a stronger influence on non-Big 4 audit firms' initial pricing decisions compared to Big 4 firms' initial pricing decisions. In addition, the results are of interest to regulators and managers who are concerned about the effect of audit market concentration on audit pricing and audit quality.
Citation:	Eshleman, J. D. and B. P. Lawson. 2017. Audit Market Structure and Audit Pricing. <i>Accounting Horizons</i> 31 (1): 57 – 81.
Keywords:	audit pricing, auditor switches, audit market concentration, and lowballing.
Purpose of the Study:	Increasingly, regulators, standard setters, and audit clients have expressed concern over the level of concentration in the U.S. audit market. The primary concern is that audit market concentration could result in higher fees for audit clients, which is supported by economic theory that suggests a positive association between concentration within an industry and industry prices. Despite this theory and the concerns that exist, the association between increased concentration within the U.S. audit market and audit fees remain unclear. Previous studies have examined this issue with mixed results. As a result of the mixed evidence that exists, the authors choose to re-examine the association between audit market concentration and audit fees.
Design/Method/Approach:	The authors use two settings to examine whether and how audit market concentration affects audit fees. First, they examine how concentration is related to audit fees in a sample of stable auditor-client relationships. Next, they examine how audit market concentration affects audit fees in a sample of firms that switch auditors. They conduct these examinations using a large sample of U.S. audit engagements covering the years 2000 – 2013.
Findings:	<ul style="list-style-type: none"> • The authors find, in their test of non-changing audit clients, a significantly positive association between audit market concentration and audit fees. <ul style="list-style-type: none"> • The authors find that the positive association is driven by the inclusion of MSA-level indicator variables in the audit fee model that they chose. For example, when they control for MSA-level fixed effects in their models, they find the association between audit market concentration and audit fees changes from significantly negative to significantly positive. • The authors' test of initial audit fee discounts indicates that increases in concentration significantly reduce the discounts. • The authors provide some evidence that the effect of local audit market concentration on audit fees is more pronounced for smaller clients. • The authors find that concentration is positively associated with audit quality, as proxied by abnormal accruals.

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research summary

Title:	Auditor Tenure and Going Concern Opinions for Bankrupt Clients: Additional Evidence
Practical Implications:	This study should be of particular interest because the findings represent evidence concerning the relationship between auditor tenure and audit failures. The tenure effect, which is pronounced in the early years, is particularly important to the non-Big 4 sample because approximately 75 percent of non-Big 4 clients in the author's sample have auditor tenures of four years or less. This short tenure, coupled with association between tenure and Type II errors suggest the adverse impact of short tenure is concentrated in the non-Big 4 sample. With this in mind, the findings of this paper may help to inform the continuing debate regarding the possible adverse effects of long auditor tenure.
Citation:	Read, W.J., and A. Yezegel. 2016. Auditor Tenure and Going Concern Opinions for Bankrupt Clients: Additional Evidence. <i>Auditing: A Journal of Practice and Theory</i> 35 (1): 163-179.
Keywords:	going concern opinions, Type II errors, and auditor tenure
Purpose of the Study:	<p>Regulators and lawmakers in the U.S. periodically express concerns about a possible association between auditor tenure length and audit failure. The authors define audit failure as a bankrupt company not receiving a going concern modified audit opinion prior to bankruptcy, a Type II reporting error. Geiger and Raghunandan began investigating this relationship in the early 2000's; however, the authors of this study hope to extend this investigation in the three following ways:</p> <ul style="list-style-type: none"> • Studies have shown that audit reporting companies in financial distress changed following the enactment of the Sarbanes-Oxley Act of 2002 and related legislature and media scrutiny of the auditing profession; ergo, a closer examination of more recent data would be a worthwhile measure. • The previous study did not examine differences between Big 4 and non-Big 4 audit firms, and studies show that there are significant differences between Big 4 and non-Big 4 auditors, including going concern decisions. • The previous study assumed and tested for a linear relationship between auditor tenure and audit reporting failures; however, more recent data leads the authors to allow the association between auditor tenure and audit quality to be nonlinear.
Design/Method/Approach:	The authors examine prior audit reports for a sample of 401 U.S. publicly held companies that filed for bankruptcy during the period 2002-2008. A quadratic model was used to control for potential nonlinearity in the relationship between audit tenure and audit reporting.
Findings:	<ul style="list-style-type: none"> • The authors did not find evidence of a significant relation between auditor tenure and going concern opinions issued by Big 4 firms to their subsequently bankrupt clients. • The authors did find evidence indicating a higher likelihood of Type II errors for non-Big 4 auditors in the early years of an audit; however, this relation weakens and after approximately year four of the engagement, the authors begin to observe no statistical association between tenure length and Type II errors for non-Big 4 auditors, either. • The authors' results from the endogeneity analysis are consistent with their primary conclusions that non-Big 4 audit firms are more likely to make Type II reporting errors compared to Big 4 firms during the initial years of an audit engagement. • The authors find that long auditor tenure, of itself, is not associated with Type II reporting errors.

research summary

Title:	Investigating Inspection Risk: An Analysis of PCAOB Inspections and Internal Quality Reviews
Practical Implications:	This paper complements and extends the limited extant research on inspection risk by clearly defining the construct and providing empirical evidence consistent with its existence and impact on auditors' planning decisions. The authors contend that while auditors may perceive that PARs do not influence effort or fees, both PARs likely cause auditors, perhaps unconsciously, to increase effort and fees.
Citation:	C. M. Stefaniak, R. W. Houston, and D. B. Brandon. 2017. Investigating Inspection Risk: An Analysis of PCAOB Inspections and Internal Quality Reviews. <i>Auditing: A Journal of Practice and Theory</i> 36 (1): 151 – 168.
Keywords:	inspection risk, audit quality, PCAOB inspections, and internal quality reviews
Purpose of the Study:	The authors report the results of an experiment that examines how auditor anticipation of the two primary external and internal post-audit reviews (PAR), specifically, U.S. Public Company Accounting Oversight Board (PCAOB) inspections or public accounting firms' internal quality reviews (IQRs), affects auditors' perceptions of overall engagement risk, as well as effort and pricing decisions. The authors define inspection risk as "the risk that an auditor or audit firm will suffer harm as a result of a PAR." Although the current PAR regime has been in place for over ten years, there is little empirical evidence concerning whether, and to what extent, anticipating a PAR impacts auditor behavior, and whether the effects of anticipating a PCAOB inspection or IQR differ. IQRs also remain largely uninvestigated, despite researchers beginning to investigate external PCAOB reviews.
Design/Method/Approach:	To investigate how PAR salience affects auditors' judgments and decisions, the authors conduct a 1 x 3 between-subjects experiment using a number of high-level auditors as participants. They manipulate PAR salience as PCAOB inspection salient, IQR salient, or no explicit expectation of a PAR.
Findings:	<ul style="list-style-type: none"> The authors find that PAR salience yields greater perceived overall engagement risk, even after controlling for traditional engagement risk-related factors, implying that auditors perceive inspection risk as incremental to these factors. <ul style="list-style-type: none"> In addition, increased PAR salience results in greater audit effort and fees, consistent with an inspection risk component. The authors find that both PARS yield higher fees, with the higher fees attributable only to greater effort, rather than an "inspection risk premium." PCAOB inspection results are more visible than IQRs, and partners perceive that PCAOB inspections can yield greater negative consequences for themselves and their firms; therefore, the authors find that PCAOB inspection salience involves larger increases in perceived overall engagement risk and audit effort than does IQR salience. <ul style="list-style-type: none"> However, the authors do not find differences in audit fees between PCAOB and IQR salience.

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research summary

Title:	The Relationship between Aggressive Real Earnings Management and Current and Future Audit Fees
Practical Implications:	Prior research concerning audit fees and earnings management has focused primarily on accruals management. This article shows how the audit fee and audit risk models support auditors' pricing behavior in a REM setting. Specifically, the results are consistent with auditors, after observing aggressive REM, increasing current audit fees to cover the cost of additional effort required to gain reasonable assurance that the financial statement are free of material misstatements and increase both current and future audit fees to cover increases in perceived business risk.
Citation:	Greiner, A., M. J. Kohlbeck, and T. J. Smith. 2017. The Relationship between Aggressive Real Earnings Management and Current and Future Audit Fees. <i>Auditing: A Journal of Practice and Theory</i> 36 (1): 85 – 107.
Keywords:	audit fees, business risk, audit risk, and aggressive real earnings management.
Purpose of the Study:	The authors examine whether aggressive real earnings management (REM) activities are associated with audit fees. Prior research focuses on accruals-based earnings management and suggests that auditors extract additional audit fees to cover costs associated with increased engagement risk, which includes audit risks related to the issuance of an incorrect opinion and nonaudit risk related to impaired reputation, fewer business opportunities, and the inability to collect desires and future audit fees. The distinction between accrual and real earnings management is important for auditors because the potential effects on company performance and engagement risks are different. REM alters normal firm operations, impacts current and future cash flows, imposes additional costs, and sacrifices firm value. Whether auditors charge higher fees for earnings management behavior that does not violate generally accepted accounting principles is important to study as clients continue to pursue REM to meet reporting objectives.
Design/Method/Approach:	The authors utilize a conceptual audit fee model to identify specific examples within this framework where REM is likely to increase engagement risk and thereby increase audit fees through either increased effort, a risk premium, or both. They perform further analysis to better understand the sources between aggressive REM and fees.
Findings:	<ul style="list-style-type: none"> • The authors find, overall, a positive association between aggressive REM and both current and future audit fees. • The authors find that changes in aggressive REM are associated with changes in fees. • The authors find that only current aggressive REM is positively associated with audit report delays. • The authors find evidence that the associations between aggressive Rem and future fees are driven by firms with higher REM incentives. <ul style="list-style-type: none"> • Further, they find that the future effect of aggressive REM is stronger among firms constrained by balance sheet bloat.

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research summary

Title:	The Effect of National Culture on Auditor-in-Charge Involvement
Practical Implications:	The results of this study may help researchers, practitioners, and others to develop a more nuanced approach toward the information value of auditor-in-charge involvement as potentially indicating audit quality. This would be a very timely contribution for audit firms given their desire to globalize their approach to and procedures followed during audits. Specifically, the results indicate that, while the extent of auditor-in-charge involvement may serve as a relevant audit quality indicator, culture needs to be taken into account; consequently, different thresholds may need to be considered for different regions in the world, as opposed to one global standardization.
Citation:	Bik, O. and R. Hooghiemstra. 2017. The Effect of National Culture on Auditor-in-Charge Involvement. <i>Auditing: A Journal of Practice and Theory</i> 36 (1): 1 – 19.
Keywords:	auditor behavior, auditor-in-charge involvement, cross-national cultural differences, international auditing, and national culture
Purpose of the Study:	Although audits are conducted in teams, the auditor-in-charge performs a pivotal role in the audit process. In fact, in an attempt to strengthen audit quality, global audit firms have contemplated setting some standardized thresholds for the number of hours an auditor-in-charge should spend on an audit. However, auditor-in-charge involvement is affected by numerous contextual factors at both the engagement level and the country level. In this study, the authors aim to advance the understanding of what affects differences in auditor-in-charge involvement by focusing on the effects of national culture.
Design/Method/Approach:	The analyses are based on unique, archival data from a Big 4 audit firm comprising time-record data regarding individual audit engagements reflecting audit practices in 50 countries across the globe.
Findings:	<ul style="list-style-type: none"> • The authors find that differences in the extent of auditor-in-charge involvement was associated with power distance, individualism versus collectivism and uncertainty avoidance.

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