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 naar de invloed van economische relaties tussen verschillende auditklanten, op de kwaliteit van de audit. De onderzoekers vinden bewijs voor de veronderstelling dat de afhankelijkheid van een audit partner van de audit fee van andere klanten in een netwerk - als gevolg van *zogeheten 'audit committee member-audit partner interlocks'* - de kwaliteit van de audit in het desbetreffende netwerk vermindert.

De volgende samenvatting betreft een onderzoek naar de aard van afwijkingen in financiële informatie, te weten fouten respectievelijk fraude. Aan de hand van een experiment concluderen de auteurs dat accountants die het *perspectief van het management van de klant* overwegen, een beter inzicht hebben in hoeverre dit management een persoonlijk voordeel kan hebben, en het gemak waarmee de aard van de afwijking kan worden verhuld. Dit inzicht helpt bij het evalueren van de bedoelingen van het management van de klant.

De derde samenvatting gaat over een onderzoek naar *"real earnings management (REM)"*. De auteurs concluderen op basis van diepte-interviews onder meer dat accountants bezorgd zijn over REM omdat dit impliceert dat het management kortetermijndoelstellingen nastreeft en dat mogelijk sprake is van een slechte 'tone-at-the-top'. Dit kan er vervolgens op wijzen dat het management ook andere – niet aanvaardbare – earnings management-methoden hanteert.

De laatste samenvatting beschrijft een onderzoek naar de invloed van prikkels. Deze kunnen bestaan uit beloningen respectievelijk straffen. Zowel de prikkels als de hechtheid van de werkrelaties beïnvloeden de *bereidheid om de klok te luiden*. Op basis van een experiment concluderen de auteurs dat de effectiviteit van een beloningsprikkel sterker wordt verminderd in geval van een hechte werkrelatie dan in het geval een prikkel bestaat uit het opleggen van straf. ∎

research summary

Title:	The Effect of Networked Clients' Economic Importance on Audit Quality.
Practical Implications	Relationships between an auditor and the client have the capacity to impair auditor independence, which may have a negative impact on financial reporting quality. As such, research that examines issues that have the potential to impair audit quality should be important to the auditing profession. Furthermore, audit committees play a critical role in ensuring auditor independence and audit quality; therefore, it is important to consider the potential impact of the auditor's economic dependence created by interlocking on audit quality.
Citation:	Hossain, S., G. S. Monroe, M. Wilson, and C. Jubb. 2016. The Effect of Networked Clients' Economic Importance on Audit Quality. *Auditing: A Journal of Practice and Theory* 35 (4): 79 – 103.
Keywords:	audit committee-audit partner interlocks, audit quality, client importance, fee dependence, going-concern opinions, and discretionary accruals.
Purpose of the Study:	The authors examine the association between audit quality and the economic importance of client networks that are created by audit committee member-audit partner interlocks, which occur when an audit committee member of a company is also an audit committee member of other companies that are audited by a common audit firm and engagement audit partner. When an audit partner audits several companies that have audit committee members in common, there is potential for a self-interest threat to auditor independence. The interlocked audit partner may perceive that disputes with the management of a particular client within the network may threaten future fee income from the other companies in the network; thus, these economic ties have the have the potential to erode auditor independence and, as a consequence, reduce audit quality.
Design/Method/ Approach:	The authors test the association between each audit-quality proxy and each client network fee dependence measure using regressions based on unrestricted samples and samples of clients matched on their inherent propensity to be associated with an audit committee-audit partner interlock.
Findings:	• The authors find that network fee dependence is significantly associated with lower audit quality as measured by each of their audit-quality proxies, suggesting that the economic dependence created by such links may reduce the likelihood of an auditor issuing a first-time going-concern opinion and may increase the extent to which reported earnings are biased away from the level at which a neutral application of GAAP would precipitate. • Collectively, the authors' findings provide support for the contention that audit partner dependence on fees from other companies in the network created by audit committee member-audit partner interlocks erodes audit quality in economically significant client firms.

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research summary

Title:	Evaluating the Intentionality of Identified Misstatements: How Perspective Can Help Auditors in Distinguishing Errors from Fraud
Practical Implications:	This study contributes by providing evidence regarding a type of reasoning process that appears to help auditors assess the risk that a misstatement identified during audit fieldwork was caused intentionally. In addition to considering fraud risks at the company level, auditors should also consider fraud risks that are specific to an operating location or individual manager. By considering a client manager's perspective, auditors presumably gain insight into whether the manager perceived misstating to be personally beneficial and reasonably easy to perpetrate and conceal, assisting in the evaluation of the manager's intentions.
Citation	Hamilton, E. L. 2016. Evaluating the Intentionality of Identified Misstatements: How Perspective Can Help Auditors in Distinguishing Errors from Fraud. *Auditing: A Journal of Practice and Theory 35 (4): 57 – 78.*
Keywords:	perspective taking, fraud risk, fraud detection, misstatement, and audit quality.
Purpose of the Study:	Although auditors are responsible for detecting misstatements arising from wither error or fraud, the auditing standards require very different audit responses when a misstatement is believed to be the result of an intentional act. Specifically, auditors are instructed to perform additional audit procedures, reassess overall fraud risk and the integrity of management, and communicate potential concerns to the audit committee if they suspect intentional misstatement; thus, if the auditors fail to recognize and respond to information indicating a misstatement was caused intentionally, then audit quality may be impaired. The author uses this study to investigate whether auditors who consider the perspective of the manager responsible for a misstatement's occurrence are more sensitive to circumstances indicating the misstatement was intentional.
Design/Method/ Approach:	The author creates an experiment utilizing auditor participants at the manager level and above with a case describing an identified misstatement that resulted from the actions of a client manager and ask them to assess the likelihood that it was caused intentionally.
Findings:	• The author finds that auditors who considered the client manager's perspective, compared to those who did not, assessed the misstatement as significantly more likely to be intentional, but only when such increased skepticism was warranted. • The author finds that, while auditors who considered manager's perspective assessed the misstatement's intentionality higher in the high-fraud-risk condition than in the low-fraud-risk condition, auditors who did not consider the manager's perspective assessed the misstatement's intentionality the same regardless of whether the circumstances surrounding the misstatement were indicative of high or low fraud risk. • The author finds that auditors who consider management's perspective respond to the identified misstatement more appropriately.

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research summary

Title:	Real Earnings Management: A Threat to Auditor Comfort?
Practical Implications:	Given that REM often causes significant auditor discomfort, the authors' paper provides broader REM and auditor comfort-related questions pertaining to the effects of management's focus on short-term results, the extent to which REM is a problem that can or needs to be fixed, and the possibility that REM is a gateway to more serious forms of accounting manipulation.
Citation:	Commerford, B. P., D. R. Hermanson, R. W. Houston, and M. F. Peters. 2016. Real Earnings Management: A Threat to Auditor Comfort? *Auditing: A Journal of Practice and Theory 35 (4): 39 – 56.*
Keywords:	real earnings management, auditor, comfort, rationality, emotions, and body senses
Purpose of the Study:	The authors address two overarching questions that have not received very much attention to date. First, "To what extent does real earnings management (REM) affect auditor comfort?" Second, "What strategies do auditors rely on in trying to reach a state of comfort when the client engages in REM?" Auditing standards that relate to REM are vague and limited and, despite evidence showing that REM is becoming increasingly common, little research considers auditors' perceptions of REM and how they respond to it. The authors wish to fill this void by writing this paper.
Design/Method/ Approach:	The authors conduct in-depth interviews with experienced auditors to examine how auditors respond to an emerging issue in the post-SOX period, the increasing use of real earnings management to achieve financial reporting objectives.
Findings:	• The authors find that auditors are aware of REM and often identify it through formalized audit protocols, including analytical procedures, discussions with management, ad/or their knowledge of the business. • The authors find that formal audit procedures play a role in identifying sources of discomfort but also find references to body senses and the use of emotive language related to feelings of discomfort. • The authors find that most of the interviewees have concerns about REM, largely because they believe it indicates management's desire to meet short-term targets, implying poor management tone, which could signal other, less acceptable earnings management methods.

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research summary

Title:	Effects of Incentive Scheme and Working Relationship on Whistle-Blowing in an Audit Setting
Practical Implications:	The results of this study suggest that, while both types of incentive schemes are effective in promoting whistle-blowing behavior in the absence of close working relationships, the effectiveness of a rewarding incentive scheme is more likely to be undermined by the presence of close working relationships than a penalizing incentive scheme.
Citation:	Boo, E., T. B. Ng, and P. G. Shankar. 2016. Effects of Incentive Scheme and Working Relationship on Whistle-Blowing in an Audit Setting. *Auditing: A Journal of Practice and Theory* 35 (4): 23 – 38.
Keywords:	reward and penalty, incentive scheme, working relationship, and whistle-blowing.
Purpose of the Study:	Prior research shows that providing an incentive, either in the form of a reward or a penalty, can help promote whistle-blowing behavior. Other studies show that close relationships between employees can exert a negative impact on whistle-blowing behavior. An important yet unanswered question is whether and to what extent the effectiveness of different types of incentive schemes to promote whistle-blowing could be undermined by the presence of close working relationships likely to be forged among team members in audit firms and other organizations. Furthermore, the current incentive system in the auditing profession is dominated by penalties; however, many are calling for a shift toward incorporating more ways to reward auditors rather than penalize them, suggesting the importance of understanding the implications of alternative incentive systems. Also, there has not been much research done on the effectiveness of punitive schemes, despite their prevalence in the profession. Finally, whistle-blowing has been found to be a significant means by which frauds and other forms of misconduct are detected, which suggests the crucial importance of understanding factors that could enhance or undermine its effectiveness.
Design/Method/ Approach:	The authors conduct an experiment involving 90 auditors from a Big 4 firm in Singapore. The participants are presented with a hypothetical scenario in which an audit manager encountered a wrongdoing by the engagement partner who allowed the client to materially misstate sales revenue, and assess their propensity to report the act through the firm's whistle-blowing hotline after making no headway despite having voiced concerns to the partner.
Findings:	• The authors find that a rewarding incentive scheme, relative to the control group, increases auditors' whistle-blowing propensity in the absence, but not in the presence, of a close working relationship. • The authors find that a penalizing incentive scheme increases auditors' whistle-blowing propensity regardless of the presence of a close working relationship. • The authors find that auditors' whistle blowing propensity is reduced by the presence of a close working relationship in the rewarding incentive scheme, but not in the penalizing incentive scheme or the control group.

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