

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 Svanberg en Öhman naar *de invloed van charismatisch leiderschap op de objectiviteit van de accountant*. De veronderstelling is dat charismatische leiders deze negatief beïnvloeden. Aan de hand van een survey onder Zweedse accountants concluderen de onderzoekers een positieve relatie tussen de mate waarin de objectiviteit wordt beleefd en de mate waarin de bestuurder van de cliënt als charismatisch wordt ervaren. Deze constatering zou bij het aanvaarden van cliënten en inschatten van risico's moeten worden betrokken.

De volgende samenvatting betreft een Amerikaans onderzoek van Laurion et al., naar *het effect van partnerrotatie*. De uitkomsten duiden er op dat partnerrotatie leidt tot een frisse blik. In het jaar na rotatie blijken er meer ‘restatement announcements’ te worden gedaan wat duidt op een hogere audit kwaliteit. De onderzoekers merken op dat het feit dat partnerrotatie waarde toevoegt zou moeten worden betrokken bij de afweziging of audit firm-rotatie noodzakelijk is.

De derde samenvatting betreft een ‘event study’ van Reid en Carcello. Zij zijn nagegaan hoe *beleggers reageren op gebeurtenissen die de kans op firm-rotatie* in de Verenigde Staten hebben vergroot. De onderzoekers constateren een significant en negatieve marktreactie naar aanleiding van het vergroten van de kans dat dit (ook in de VS) wordt verplicht. Het effect is groter bij cliënten van big 4-organisaties en in het geval de onderneming wordt gecontroleerd door een accountant met industrie-expertise. Interessant is de constatering dat

ondernemingen waar een lagere audit kwaliteit is geleverd een negatieve marktreactie ondervonden op momenten waar de kans op rotatie afnam.

In het vierde onderzoek van Bhaskar et al. wordt nagegaan *wat de invloed is van het schenden van “debt covenants” op de acties van de accountant* omdat een dergelijke schending een aanwijzing is van een onzekerheid omtrent de continuïteit. In de praktijk is een dergelijke schending vaker het gevolg van te zware eisen dan van financiële problemen. In de meeste gevallen worden dergelijke covenants aangepast of wordt een waiver verstrekt zodat betalingen kunnen worden uitgesteld. Uit het onderzoek blijkt dat ongeacht de oorzaken van dergelijke schendingen, accountants negatief reageren. Uitingen hiervan zijn relatief hogere audit fees, een grotere kans op een “going concern opinion” en een grotere kans op het wisselen van accountant.

De laatste samenvatting betreft een onderzoek van Bartlett et al. naar *de factoren die de recruitment van non-accounting business professionals voor internal auditing beïnvloeden*. Uit het onderzoek onder undergraduate and graduate non-accounting business students blijkt onder meer dat business professionals een positief beeld hebben van internal auditing en dat internal auditors worden gerespecteerd en goed worden betaald. Zij zijn ook van mening dat andere business professionals een negatief beeld hebben van internal auditing. Opvallend is dat studenten die gemiddeld lagere cijfers behalen meer geïnteresseerd zouden zijn in internal auditing als zij beter zouden worden betaald. Studenten met hogere cijfers zouden meer geïnteresseerd zijn als zij minder saai werk zouden doen en als zij het beroep beter zouden kennen. ■

research summary

Title:	Does Charismatic Client Leadership Constrain Auditor Objectivity?
Practical Implications:	The potential threat of constrained auditor objectivity due to charismatic leadership is one that has not previously been addressed before. Therefore, auditors should be proactive in making sure they are aware of this threat while working on various audit engagements. Additionally, audit firms should pay attention because it is unlikely that there are any mitigating strategies in place to combat the threat within the firm.
Citation:	Svanberg, Jan, and P. Öhman. 2017. "Does Charismatic Client Leadership Constrain Auditor Objectivity?" <i>Behavioral Research in Accounting</i> . 29.1 (2017): 103.
Keywords:	auditing; auditor objectivity; charismatic client leadership; client identification
Purpose of the Study:	An auditor's objectivity can be negatively affected by various financial or social characteristics of the client. This study examines whether or not auditor objectivity is constrained by perceived charismatic leadership of management. The initial assumption is that perceived charismatic client leadership will in fact negatively affect auditor objectivity. This threat is particularly concerning because it can rapidly materialize and is unable to be addressed by auditor rotation. Previous studies have focused on the financial size of clients as an indicator of possible problematic relationships between the auditor and client. If the initial assumption in this study is correct then this will suggest that charismatic leadership plays a role in auditor objectivity along with the financial size of the firm.
Design/Method/ Approach:	The sample consists of 1,000 Swedish auditors randomly selected using a 'Revisorsnämnden register'. There was a 19.9% response rate to a questionnaire that was sent out on September 2013. The majority of respondents were male partners or managers. The questionnaire was a cross-sectional survey where auditors were asked to recall their largest client's leader, and then to assess the extent to which the leader is charismatic. A regression model was then used to test the hypothesis.
Findings:	Overall, the authors find that there is a positive relationship between constrained auditor objectivity and the extent to which the auditor perceives the client leaders as charismatic. This suggests that client identification is not necessarily the only social factor leading to constrained objectivity. Additionally, the authors find the following: <ul style="list-style-type: none"> • Stronger levels of professional identification are not associated with more objective judgment. • Auditors for Big 4 firms are more objective when compared to auditors in smaller audit firms.

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research summary

Title:	U.S. Audit Partner Rotations
Practical Implications:	This study helps to inform about the effects of audit partner rotations. The evidence suggests that partner rotation does add a fresh look at U.S. audit engagements. The results can also be applied to the U.S. debate over audit firm rotation. It demonstrates that firm rotation is not the only way to add a fresh look to audit engagements and that the current system of audit partner rotation already has a measurable effect.
Citation:	Laurion, Henry, A. Lawrence, and J. Ryans. 2017. "U.S. Audit Partner Rotations". <i>The Accounting Review</i> . 92.3 (2017): 209.
Keywords:	U.S. audit partner rotations; fresh look; restatements; valuation allowances and reserves; write-downs; special items
Purpose of the Study:	Currently, the SEC requires that lead partners rotate off an audit engagement after five years and then sit out another five years before returning to the audit engagement. The audit partner rotation requirement was put into place to add renewed professional skepticism and a fresh insight into the audit. Previous studies in the United States generally indicate that partner rotation decreases audit quality due to a loss of client-specific knowledge and expertise. This paper adds to the discussion by examining the incidence of restatements, write-downs, and special items, as well as changes in valuation allowances and reserves surrounding partner rotation.
Design/Method/ Approach:	The authors identified audit partner rotations by using SEC comment letter correspondences for issuers who have received comment letter reviews in two consecutive years that copy different audit partners for each of those years. The information was gathered using the Audit Analytics Comment Letter database and comprised of 205 U.S. partner rotations at 189 SEC public companies from 2006 to 2014. A difference-in-differences model was used to compare the before and after results against a non-rotating firm control group.
Findings:	<p>The authors find the following:</p> <ul style="list-style-type: none"> • There is no change in the frequency of misstatements after a partner rotation. • However, restatement discoveries and restatement announcements display relative increases of 5.9% and 5.1% respectively after there is a new lead partner. This suggests that the audit partner rotation requirement does in fact increase audit quality. • Additionally, there is some evidence of decreases in positive special items.

research summary

Title:	Investor Reaction to the Prospect of Mandatory Audit Firm Rotation
Practical Implications:	The implementation of a mandatory audit firm rotation in the United States would have large implications within the accounting industry. This study provides the PCAOB and other regulators with relevant information regarding the potential policy. The evidence indicates that the majority of investors would have a negative reaction to a mandatory audit firm rotation. It is possible the investors believe the potential benefits of rotation are outweighed by the costs, direct and indirect.
Citation:	Reid, Lauren C., and J. V. Carcello. 2017. "Investor Reaction to the Prospect of Mandatory Audit Firm Rotation". <i>The Accounting Review</i> . 92.1 (2017): 183.
Keywords:	mandatory audit firm rotation; event study; PCAOB; investor perception
Purpose of the Study:	In recent years the PCAOB has considered implementing a mandatory audit firm rotation in order to better align auditors' interests with investors' interests. This study examines investor reactions to a mandatory audit firm rotation in the United States. It is important to understand investor reactions because the implementation of such a policy would be enacted for their benefit. Due to the fact that it is still a potential policy, it is difficult to determine how investors will react if the PCAOB moves forward. Broadly, the authors test the overall stock market reaction. However, the primary focus is on whether certain markets react differently based on a company's auditor characteristics. The characteristics considered were industry specialization, audit firm tenure, Big 4/non-Big 4, and audit quality.
Design/Method/ Approach:	The sample contains 3,688 companies and represents over 75% of the entire market capitalization of U.S. companies. The authors obtained U.S. company returns through CRSP and the prices for the MSCI World Index excluding the U.S. through DataStream. The auditor tenure and fee data were collected through Compustat and Audit Analytics. The authors determined 10 main dates to observe investors' reactions and how that affected the markets for the following 3 days.
Findings:	Overall, the authors find a significant negative market reaction to events that increased the likelihood of rotation. Specifically, the authors find the following: <ul style="list-style-type: none"> • Companies that were audited by Big 4 firms were significantly more likely to have a negative reaction on dates that increased the likelihood of rotation. • Similarly, companies that were audited by an industry-expert were significantly more likely to have a negative reaction on dates that increased the likelihood of rotation. • Companies with a lower-audit quality experienced a negative market reaction on dates that decreased the likelihood of rotation.

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research summary

Title:	Debt Covenant Violations, Firm Financial Distress, and Auditor Actions
Practical Implications:	The findings from this study impact firms with debt covenant requirements. Violations from debt covenants occur frequently and are often due to tight restrictions rather than signs of financial distress. These types of violations often lead to renegotiations or waivers instead of immediate repayment. However, this study shows that auditors will still have negative reactions regardless of whether or not the violation is due to financial difficulty. It is important for firms to not only consider the financial and lending consequences of a violation, but the auditing consequences as well.
Citation:	Bhaskar, Lori Shefchik, G. V. Krishnan, and W. Yu.2017. "Debt Covenant Violations, Firm Financial Distress, and Auditor Actions". <i>Contemporary Accounting Research</i> 34.1 (2017): 186.
Purpose of the Study:	This study investigates auditor actions resulting from debt covenant violations for firms. The violations increase business risk and subsequently cause the auditor to respond negatively. The audit actions examined in this paper are: <ul style="list-style-type: none"> • Adjustments in the audit plan causing higher audit fees. • The issuance of a going concern opinion. • The resignation of the auditor. The authors also consider the financial health of the firms before the violation was given. It is hypothesized that auditors are more likely to have a negative reaction to firms that are already financially distressed.
Design/Method/Approach:	The sample includes 4,267 violations occurring from 2000 to 2008. All of the firms were U.S. nonfinancial public companies. The authors gathered the information from databases such as Compustat and Audit Analytics. The analysis was performed by estimating models of the auditor actions based on different client characteristics.
Findings:	The authors find the following: <ul style="list-style-type: none"> • Firms with debt covenant violations have significantly higher audit fees. • Firms have an increased likelihood of receiving a going-concern opinion after a violation. This is increased even more for firms that are not financially distressed. The authors attribute this to the fact that auditors tend to act more strongly because the information was inconsistent with prior beliefs. • Debt covenant violations lead to an increased likelihood of auditor resignation. • There is a positive association between the Big 4 auditors and all three auditor actions listed above.

research summary

Title:	Factors Influencing Recruitment of Non-Accounting Business Professionals into Internal Auditing
Practical Implications:	Internal audit plays a critical role in maintaining corporate governance. This study examines factors that lead into non-accounting business professionals' willingness to work in the internal audit function. This is an effort to provide guidance to the internal audit profession on how to better recruit students and non-accounting business professionals into internal audit roles.
Citation:	Bartlett, Geoffrey D., J. Kremin, K. K. Saunders, D. A. Wood.2017. "Factors Influencing Recruitment of Non-Accounting Business Professionals into Internal Auditing". <i>Behavioral Research in Accounting</i> 29.1 (2017): 119.
Keywords:	internal audit; hiring decisions; business professionals; outsourcing; management training ground.
Purpose of the Study:	An effective component of corporate governance for many entities is a strong internal audit function. According to recent studies stakeholders are generally dissatisfied with their current internal audit division. Additionally, prior research also indicates that companies face difficulties in recruiting for internal audit roles. This study examines the perception of the profession and factors affecting non-accounting business professionals' willingness to work within internal audit.
Design/Method/ Approach:	The research project contains two different studies. The first study had a final sample size of 502 and the participants were undergraduate and graduate non-accounting business students from four different universities. The participants were read job descriptions and their responses were used as data. The second test included 46 students from across the country. They were provided a survey and asked what would make a career in internal audit more appealing to them.
Findings:	<p>The authors find the following from the first study:</p> <ul style="list-style-type: none"> • Business professionals have positive perceptions of internal auditing. These perceptions include internal auditors being respected and highly compensated, while performing meaningful work and having abundant career opportunities. • Business professionals believe other business professionals hold negative stereotypes of internal auditing. • Business professionals are less willing to apply for positions in internal auditing than similar positions outside of internal audit. • Business professionals are not more inclined to work in internal audit even if the structure of their job is varied. <p>The authors find the following from the second study:</p> <ul style="list-style-type: none"> • Students with lower academic performance would be more interested in internal auditing if they were paid more. • Students with higher academic performance would be more interested in internal auditing if they performed less boring/tedious work, worked in a preferred company, and if they had a better understanding of the profession.

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