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Editorial

Auditing Research Summaries[1]

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De eerste research summary heeft betrekking op het mogelijke effect van het tekenen van de controleverklaring met de naam van de verantwoordelijk accountant op de controlekwaliteit (Carcello and Li 2013). Voorstanders van het tekenen met de persoonlijke naam wijzen op het expliciet zichtbaar maken van verantwoordelijkheid terwijl tegenstanders betogen dat het geen waarde toevoegt ten opzichte van het tekenen met de naam van de accountantsorganisatie. Ook zou de mogelijke dreiging van persoonlijke aansprakelijkheid worden vergroot. In het Verenigd Koninkrijk is het tekenen met de naam van de partner in 2009 ingevoerd. De onderzoekers constateren zowel een positief effect van het tekenen met de persoonlijke naam op verschillende indicatoren van controlekwaliteit als op de hoogte van de audit fee.

Lisic et al. (2016) hebben de invloed van CEO Power en Internal Control Quality op de effectiviteit van het auditcomité onderzocht. Hoewel er veel regels zijn opgesteld om de effectiviteit van het auditcomité te verbeteren, kan dat niet voorkomen dat een CEO te veel macht heeft. De onderzoekers concluderen dat de negatieve associatie tussen de financiële expertise van het auditcomité en de leemten in de interne controle afneemt wanneer de CEO krachtig is. Dit impliceert dat vereisten aan het auditcomité, zoals financiële expertise en volledige onafhankelijkheid, onvoldoende effect hebben om het toezicht te versterken.

Carcello et al. (2011) geven een overzicht van onderzoek naar de relatie tussen corporate governance en de kwaliteit van de financiële verslaggeving. Een van de bevindingen luidt dat zwak bestuur samenhangt met een verhoogde kans op onjuiste financiële verslaggeving (in het bijzonder fraude en restatements). Wel zijn onderzoeksresultaten over het algemeen eensluidend als het gaat om de relatie tussen verbeteringen van het ondernemingsbestuur (bijvoorbeeld onafhankelijkheid, expertise van het auditcomité) en hervormingen in de regelgeving zoals SOX. Aangezien de CEO en / of CFO bij de meeste boekhoudfraudes een rol hebben gespeeld, moeten externe auditors de kenmerken en processen van corporate governance bij het beoordelen van de interne beheersingsomgeving zorgvuldig onderzoeken. Ook blijkt uit onderzoek dat wijziging / ontslag van de auditor vaak kan worden gerechtvaardigd door slechte prestaties van de auditor of door buitensporig hoge kosten. Tenslotte lijkt een goed bestuur en goede auditor complementen te zijn in plaats van substituten.

Christensen et al. (2015) hebben aan de hand van een survey onderzoek gedaan naar steekproefbeleid van de big 6-accountantsorganisaties. De uitkomsten van het onderzoek leren dat de gehanteerde steekproefmethoden sterk verschillen waarbij soms de nadruk ligt op statistische en niet-statistische steekproefmethoden. Ook worden vaak verschillen inputvariabelen gebruikt die leiden tot verschillen in steekproefomvang. Dergelijke verschillen kunnen leiden tot verschillen in verkregen controle-informatie en verschillen in auditkwaliteit.

Elder et al. (2013) bevestigen dat steekproeven op verschillende wijze worden getrokken maar ook dat wetenschappelijk onderzoek naar de toepassing in de praktijk beperkt is. Zo constateren zij onder andere dat, vergeleken met andere audittechnieken, weinig onderzoek is gedaan naar de effectiviteit van steekproeven in termen van verkregen controle-informatie. De grote verschillen in toepassing en beperkte aandacht voor steekproeven is opmerkelijk gezien de recente ontwikkelingen rondom big data en data-analytics.

Costs and Benefits of Requiring an Engagement Partner Signature: Recent Experience in the United Kingdom, Carcello, J. V. and C. Li., 2013, *The Accounting Review* 88 (5): 1511–1546.

Practical Implications

Requiring engagement partners to sign their names to audit reports appears to result in increased audit quality, earnings informativeness, and audit fees, suggesting that the signature requirement emphasizes personal accountability for engagement partners. Requiring the identification of engagement partners in audit reports would likely have similar effects. Thus, there are both costs and benefits that the PCAOB should consider in making its decision regarding partner identification.

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Purpose of the Study

The Public Company Accounting Oversight Board (PCAOB) is considering requiring the identification of the engagement partner in audit reports. Proponents of the proposal argue that it will increase accountability and transparency, which will result in improved audit quality. Opponents argue that engagement partner identification is unnecessary, as audit firms' quality control systems and the threats of sanctions by regulators and private litigation are sufficient to hold partners accountable. Identifying engagement partners is similar to them signing audit reports in their own name, which the U.K. began requiring in 2009. Because of the similarities between the U.K. and the U.S., it is likely that the effects of requiring engagement partner identification in the U.S. will be similar to the effects of requiring the engagement partner to sign the audit report in the U.K. Therefore, the authors investigate the benefits and costs of requiring partner signatures in the U.K. in the form of changes in audit quality and audit fees. The results are likely informative of the benefits and costs of requiring partner identification in the U.S.

Design/Method/ Approach

Using publicly-disclosed data on companies listed on the London Stock Exchange (LSE) between 2008 and 2010 (the years surrounding the implementation of the signature requirement), the authors examine audit quality changes using the following measures:

- Abnormal accruals
- Likelihood of meeting earnings thresholds
- Earnings informativeness
- Likelihood of qualified opinions

The authors also examine the change in audit fees following the implementation of the signature requirement.

Findings

The authors find that following the implementation of the signature requirement, abnormal accruals and the likelihood of meeting earnings thresholds decrease in the U.K. These results suggest that audit clients' earnings management declines due to the signature requirement. Further, the association between return on assets and stock market returns increases following the signature requirement, implying that reported earnings becomes more informative of firm value to investors following the implementation of the signature requirement. The likelihood of audit clients receiving a qualified audit opinion following the signature requirement also increases, suggesting that audit reporting becomes more conservative with the signature requirement. Finally, audit fees increase with signature requirement. Thus, signature requirement appears to result in higher fees for audit clients. These changes do not occur for U.S. firms or other European firms during the same period and do not occur for the U.K. in the period prior to the introduction of the signature requirement, providing evidence that the changes in the U.K. are the result of the signature requirement.

CEO Power, Internal Control Quality, and Audit Committee Effectiveness in Substance versus in Form, Lisic, L. L., T. L. Neal, I. X. Zhang and Y. Zhang, 2016, *Contemporary Accounting Research* 33 (3): 1199–1237.

Practical Implications

The findings of this paper have significant policy implications and are important to shareholders. While regulators have set rules to improve audit committee effectiveness, the reforms may not change the substantive effectiveness in certain cases, one case being that the CEO has too much power. The authors provide empirical evidence showing that the negative association between audit committee financial expertise and internal control weaknesses becomes weak when the CEO is powerful. The result implies requiring audit committee to possess certain characteristics, such as financial expertise and fully independence, may not be sufficient to strengthen the underlying substance of monitoring effectiveness. The findings are consistent with evidences from survey and interview studies that argue top management ultimately determine the effectiveness of audit committee. The authors also show a powerful CEO can affect the substantive effectiveness even though he/she is prohibited from selecting audit committee members under the SOX Act. Finally, the findings raise concerns over the common practice of CEO duality in the U.S. A CEO, being the chairman of the board at the same time, can adversely affect audit committee effectiveness.

Purpose of the Study

Since the passage of SOX Act of 2002, regulators have implemented several changes to strengthen audit committees' oversight of public companies' financial reporting, such as requiring a completely independent audit committee and a disclosure on whether the firm has at least one financial expert on the committee. A stream of academic research shows that financial expertise improves audit committee effectiveness. However, there is an ongoing debate on whether these requirements can truly enhance audit committee's monitoring effectiveness. Some argue the reforms merely represent a change in form rather than substance. To add additional insights to the debate, the authors examine whether top management can exert detrimental influence on audit committee effectiveness. Specifically, the authors investigate the effect of CEO power on the substantive effectiveness of audit committee, as measured by the firm's internal control quality. The authors expect a powerful CEO reduces the positive effect of financial expertise on audit committee effectiveness. They also

expect this moderating effect of CEO power is stronger when the CEO behaves in a way to benefit him/herself at the expense of the shareholders (i.e., extract rents from the firm).

Design/Method/ Approach

The initial sample comes from public companies' firm-years without CEO changes between 2004 and 2010. The final sample consists of 7,217 firm-years at the intersection of three databases: COMPUSTAT for financial information and ExecuComp and Corporate Library Directors Databases for information on CEOs and directors. Most CEO characteristics and audit committee financial expertise data are hand-collected by the authors from proxy statements. Audit opinions on internal control effectiveness are obtained from Audit Analytics.

Findings

- The authors find CEO power has a moderating effect on audit committee effectiveness. When CEO power is low, audit committee financial expertise, a measure of audit committee effectiveness, is negatively related to the incidence of internal control weaknesses. However, this relationship is monotonically weakened by increasing CEO power. When CEO power reaches to a high state, audit committee financial expertise is no longer negatively associated with the incidence of internal control weaknesses. This result is not driven by potential indirect involvement by CEO in selecting audit committee members.
- Consistent with the authors' expectation, the moderating effect of CEO power is stronger when the CEO extracts more rents from the firm through profitable insider trading.
- Supporting the main findings, the results also show when CEO power is high, audit committee hold fewer meetings and financial misstatements are more frequent. Both relationships are stronger when internal controls are weaker.
- The authors also demonstrate the structure and expert dimensions of CEO power are most closely associated with the moderating effect. Specifically, the sources of power of a powerful CEO come from being the chairman of the board at the same time, receiving compensation much higher than other executives, and taking more management positions in the firm before becoming the CEO.

Corporate Governance Research in Accounting and Auditing: Insights, Practice Implications, and Future Research Directions, Carcello J. V., D. R. Hermanson and Z. Ye, 2011, *Auditing: A Journal of Practice & Theory* 30 (3): 1–31.

Practical Implications

First, the weight of evidence suggests that weak governance is associated with an increased likelihood of adverse financial reporting outcomes (in particular, fraud and restatements). Thus, perhaps the most fundamental practice implication is that the governance research findings to date are, on an overall basis, consistent with the focus on improved corporate governance (e.g., board independence, audit committee expertise) found in SOX and related regulatory reforms.

Second, since the board and the audit committee are primary mechanisms for the internal monitoring of top management's financial reporting behavior, and given that the CEO and/or CFO is involved in 89 percent of all public company accounting frauds (Beasley et al. 2010), external auditors need to very carefully examine corporate governance characteristics and processes in assessing the control environment.

Third, research finds that auditor changes/dismissals are less problematic in the presence of good governance. That is, in the presence of good governance, the auditor change/dismissal may be justified by poor auditor performance or excessive fees. Since regulators do not have the resources to examine all auditor changes, even if limited to dismissals, regulators might want to consider the client firm's governance characteristics when deciding whether to investigate an auditor dismissal.

Fourth, research indicates that external auditors assess risk higher and plan more audit hours for firms with weak governance. However, whether auditors adequately adjust for weak governance has not been examined. In other words, adjustments of risk assessments and audit hours occur, but is there enough adjustment in light of the higher risk?

Fifth, strong governance and strong auditing appear to be complements rather than substitutes—stronger boards and audit committees are associated with stronger auditing. Therefore, monitoring (both internal monitoring by the board and audit committee, and external monitoring by the auditor) is likely to be especially weak in firms with weak governance, for the quality of auditing is likely to be lower in the presence of weak governance.

Sixth, a number of studies have demonstrated the importance of audit committee accounting expertise, as well as auditing expertise and industry expertise. Firms should strive to appoint audit committee members with specific accounting and auditing expertise given their apparently greater effectiveness and the positive stock market reaction to the appointment of accounting experts.

Seventh, a growing line of research indicates that audit committee compensation methods can influence audit committee members' judgments, and audit committee compensation methods are associated with the risk of restatement and with the handling of auditor adjustments. We encourage auditors, analysts, and shareholders to be cognizant of the potential risks involved if audit committee members are compensated primarily with short-term, incentive-based pay.

Eighth, some audit committees appear to take their monitoring roles seriously, while others appear to be primarily ceremonial in nature. Auditors are in a unique position to evaluate the effectiveness of the audit committee process. Auditors should explicitly evaluate the effective-

ness of the audit committee's processes, and adjust their risk assessments, budgeted hours, and the nature, extent, and timing of audit testing, especially if effective audit committee processes seem to be attenuated by the intervention of a dominant CEO.

Finally, given the severe reputational damage experienced by directors, especially audit committee members, in cases of financial reporting failures, and given the difficulty of monitoring a large entity on a part-time basis, audit committees might want to consider retaining permanent staff or consultants to the audit committee.

Behind the Numbers: Insights into Large Audit Firm Sampling Policies, Christensen, B. E., Elder, R. J., & Glover, S. M., 2015, *Accounting Horizons* 29 (1): 61–81.

Practical Implications

Given the limited evidence on firms' sampling policies after Sarbanes-Oxley, these findings contribute to the current literature on audit sampling and provide insights into sampling policies and procedures that are important for researchers, educators, regulators, and practitioners to better understand the application of audit sampling in the current audit environment. This study provides evidence on current sampling practices and identifies important differences in sampling policy among the largest audit firms. Responses represent firm policy, and although the sampling experts indicate that they believe that firm guidance is followed in the field, actual sampling practices may vary.

Purpose of the Study

This study addresses a number of research questions regarding the current state of audit sampling. Audit sampling is a fundamental audit testing procedure. Over the last two decades there have been significant changes in audit approaches, including strategic systems auditing in the 1990s and federally mandated audits of internal control over financial reporting for large public companies as a result of the Sarbanes-Oxley Act of 2002 (SOX). Revisions to audit approaches have the potential to change the nature and extent of audit sampling techniques used by accounting firms. For instance, the requirement to audit internal control over financial reporting has necessarily increased the extent and importance of tests of controls, many of which are performed using sampling. Additionally, the Public Company Accounting Oversight Board (PCAOB) has identified sampling as an area needing more emphasis, and inspection reports have identified multiple issues regarding audit sampling, including small and non-representative samples and incorrect or lack of error projection, among others.

The study focuses on the policies in place at the firms and not necessarily how these policies are implemented in the field. However, due in part to internal firm and federal oversight, discussions with firm experts indicate that audit teams are expected to comply with firm sampling guidance.

Design/Method/ Approach

The survey asked respondents a number of open-ended questions regarding sampling policies and practices currently in place at the Big 4 and two other international accounting firms. The authors worked in coordination with the participating firms. A version was sent by email in Spring 2013 to one of the Big 4 firms for completion and feedback, after which some additional clarifications were made before distributing electronically to the other firms.

Findings

- The sampling methods differ significantly among the largest auditing firms; while some emphasize statistical methods, others use nonstatistical methods.
- Firms frequently use different inputs to these sampling models, thus resulting in relatively different sample sizes.
- The authors find variation in the planned level of expected error, and they also find differences in error projection methods used and how firms respond to identified errors and misstatements.
- Sampling approaches and parameters within most firms are identical for large public and smaller private companies despite the likely differences in business and engagement risk.
- Some firms have significantly changed their approach to revenue testing due to PCAOB inspections, relying more heavily on substantive testing using sampling than other substantive testing such as analytical procedures.
- Some firms have significantly changed their approach to revenue testing due to PCAOB inspections, relying more heavily on substantive testing using sampling than other substantive testing such as analytical procedures.

Audit sampling research: A synthesis and implications for future research, Elder, R. J., Akresh, A.D., and S. M., Glover, J. L. Higgs, and J. Liljegren, 2013, *Auditing: A Journal of Practice & Theory* 32 (Supplement 1): 99–129.

Practical Implications

Although little research evidence exists on the effectiveness of audit sampling, auditors should consider the effectiveness of audit sampling compared to other sources of evidence, and the use of statistical compared to nonstatistical sampling for both tests of controls and tests of details to develop the most effective and efficient sampling plans. Auditors that use nonstatistical sampling techniques should evaluate procedures to determine whether sample sizes and evaluation of results are comparable to sample sizes and conclusions reached using statistical methods. Auditors also often fail to project sample misstatements and explicitly consider sampling risk; auditor performance in the evaluation of samples is enhanced with the use of standardized sampling templates.

Purpose of the Study

While research has influenced auditing standards for audit sampling, academic research provides limited insights into the current use of audit sampling. We synthesize relevant research based on a sampling decision framework and suggest areas for additional research. Important judgments include determining:

- Does sampling apply
- What type of sampling to apply (e.g., attribute or monetary sampling)
- Whether to use statistical or nonstatistical techniques, including appropriate inputs to determine sample size and evaluate results
- Consideration of environmental factors such as regulation, litigation, competition, culture, and technology

Design/Method/ Approach

We first design a framework of the audit sampling process based on existing auditing standards and guidance. We then review relevant literature for each step in the audit process. A fairly extensive literature exists on some sampling issues, such as determination of sample size and projection of misstatements found in the sample. An extensive, but generally dated literature also exists on various statistical sampling techniques. However, limited evidence exists for many issues related to audit sampling.

Findings

Auditing standards and guidance on audit sampling have not changed significantly since SAS No. 39 (1981) and the first *Audit Sampling* Accounting and Auditing Guide (AICPA 1983). However, a review of the literature suggests there have been major changes in sampling practices over the last three decades. Key findings from previous research include:

- Limited research evidence exists on the extent of the use of statistical and nonstatistical sampling for tests of controls and tests of details, and how use of these methods has changed over time or across client characteristics or other environmental factors.
- Little research evidence also exists as to the effectiveness of audit sampling relative to other audit procedures or the effectiveness of nonstatistical audit sampling relative to statistical audit sampling in providing sufficient audit evidence.
- When auditors select samples statistically (e.g., randomly) and evaluate the results nonstatistically, research suggests they may be prone to decision biases.
- Auditors often underestimate risks in order to minimize the extent of testing in tests of details, which could potentially compromise audit effectiveness.
- Several studies find that auditors may not consistently project sample misstatements as required by auditing standards, which could lead to incorrect acceptance of accounting populations. However, more recent research suggests that when decision aids such as templates are used, auditors do usually project misstatements observed in the sample to the population

Noten

1. De ARS’s zijn met toestemming van de American Accounting Association overgenomen op 6 september 2018.