Audit Research Summaries

Ook deze maand presenteren wij weer enkele "Audit Research Summaries" uit de database van de American Accounting Association (www.auditingresearch-summaries.org).

Op 6 april jongstleden is de consultatieperiode van het voorstel voor de herziening van de Nederlandse Corporate Governance Code afgerond. De Monitoring Commissie Corporate Governance verwacht na de zomer de definitieve aangepaste code te presenteren. Transparantie en verantwoording vormen bouwstenen voor goede corporate governance. In het bijzonder vervult de accountant bij de verantwoordingsinformatie in de vorm van de jaarrekening een belangrijke controlerende rol; de accountant communiceert over zijn controlebevindingen primair met directie en commissarissen. De Nederlandse Corporate Governance Code besteedt van oudsher de nodige aandacht aan de taak en rol van de accountant. Het MAB zal na verschijnen van de herziene Code een themanummer over de aangepaste code uitbrengen.

In de Verenigde Staten heeft het nodige onderzoek naar corporate governance - in relatie met verslaggeving en controle - plaatsgevonden. In de Audit Research Summaries Database zijn de volgende categorieën te onderkennen:

- Board/Audit Committee Composition
- Board/Financial Experts
- Board/Audit Committee Tenure
- Board/Audit Committee Compensation
- Board/Audit Committee Oversight
- Board/Audit Committee Processes
- Internal auditor role and involvement in controls and reporting

Ter illustratie volgen onderstaand een aantal summaries. ■

research summary	
Title:	Corporate Governance Research in Accounting and Auditing: Insights, Practice Implications, and Future Research Directions
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 effectiveness 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.
Citation:	Carcello J. V., D. R. Hermanson, and Z. Ye. 2011. Corporate Governance Research in Accounting and Auditing: Insights, Practice Implications, and Future Research Directions. *Auditing: A Journal of Practice & Theory* 30 (3): 1-31.
Keywords:	Corporate governance; board; audit committee; literature review.
Purpose of the Study:	Over the past two decades, the corporate governance literature in accounting and auditing has grown rapidly. We review this literature, primarily focusing on corporate board and audit committee issues.
Design/Method/ Approach:	We discuss 12 recent literature review or meta-analysis papers and summarize selected results (i.e., clusters of papers with new and interesting results) from recent empirical research papers, after reviewing the findings of over 250 studies.
Findings:	We discuss the major insights from this literature and the practice implications of these findings. In addition, we identify a number of opportunities for future research. In particular, we make suggestions for: (1) improved research paradigms in corporate governance, (2) extensions of existing research, and (3) new or emerging lines of research

Overgenomen van www.auditingresearchsummaries.org, 6 mei 2016.

research summary	
Title:	The effects of disclosure type and audit committee expertise on Chief Audit Executives' tolerance for financial misstatements.
Practical Implications:	The results suggest that internal auditors contribute to decreased reliability of disclosed amounts. It appears that the incentives of external auditors and internal auditors are closely aligned on this issue. In general, both of these parties seem to feel less responsibility for disclosed, relative to recognized amounts. The results indicate that financial reporting location has significant effects on internal auditors' decisions to correct misstatements. Specifically, internal auditors are more willing to waive disclosed misstatements relative to recognized misstatements. Contrary to expectations, the results do not indicate that increased audit committee expertise and associated increases in audit committee members' perceived powers cause internal auditors to be less willing to waive misstatements.
Citation:	Norman, C. S., J. M. Rose, and I. S. Suh. 2011. The effects of disclosure type and audit committee expertise on Chief Audit Executives' tolerance for financial misstatements. *Accounting, Organizations & Society* 36 (2): 102-108.
Purpose of the Study:	External audit partners are more willing to waive misstatement corrections for disclosed than for recognized amounts. This willingness to allow misstatements may increase management's incentives to manipulate disclosed amounts and increase the levels of error and bias in disclosed information. While external auditors are more willing to waive disclosed amounts, relative to recognized amounts, internal auditors may require management to adjust misstatements regardless of their reporting locations. If internal auditors do not tolerate misstatements that are disclosed, this will increase the reliability (i.e., decrease the random error and bias) of disclosed amounts and decrease the likelihood of management manipulation of disclosed amounts. As a result, the impact to practice of external auditors' willingness to waive misstated disclosures could be mitigated or even eliminated by internal audit oversight. The authors examine Chief Audit Executives' and deputy Chief Audit Executives' decisions to require adjustments of misstatements that are either recognized or disclosed. Chief Audit Executives (CAEs) may require equivalent adjustments for recognized and disclosed amounts, and act to counter the actions of management and external auditors. Understanding the decision processes of CAEs will help to inform regulators and standard setters of the underlying factors that drive financial statement reliability.
Design/Method/ Approach:	The participants are 73 Chief Audit Executives (CAEs) and deputy CAEs. CAEs and deputy CAEs are the ultimate decision makers in internal audit. None of these participants are from outsourced internal audit departments. The average number of years of internal audit experience is 13.71. The study was completed on paper and provided to participants in sealed envelopes by one of the study's authors. All participants completed the materials in their professional offices under controlled conditions in the presence of one of the authors. The evidence was gathered prior to 2011.
Findings:	The results of this study indicate that reporting location has a significant effect on internal auditors' decisions. Specifically, CAEs and their deputies require lesser amounts of misstatement correction of disclosed amounts relative to recognized amounts. While increased audit committee expertise increases audit committee members' perceived power over management, the authors do not find that CAEs require greater misstatement corrections when the audit committee has more financial expertise, relative to less expertise. It appears that internal auditors may not have enough concern about disclosed misstatements to warrant a decision to exercise the power they derive from audit committee expertise. The results suggest that internal auditors, like external auditors and managers, act to decrease the perceived and actual reliability of disclosed information. Further, increasing the power of the internal audit function does not mitigate this problem. The authors find reason for serious concerns about the accuracy of disclosed amounts, relative to recognized amounts.

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research summary	
Title:	Serving Two Masters: The Association between Audit Committee Internal Audit Oversight and Internal Audit Activities.
Practical Implications:	The results speak to the need for regulators to consider the incentives of the various stakeholders when determining policy. Should policy makers consider expanding or restricting specific oversight roles, they should consider the concomitant effects on the internal audit function, and the differential incentives faced by the audit committee and executive management. In addition, as audit committees and managers jointly work or oversee the work of internal auditors, the results suggest that these two oversight participants should consider how their respective incentives potentially bias the focus of the internal audit department away from a mix of activities that optimally address the greater business risks of the company. Likewise, as external auditors assess the organizational status of the internal audit department, they may also wish to consider the apparent focus of internal audit as a potential indication of oversight control.
Citation:	Abbott, L. J., S. Parker, and G. F. Peters. 2010. Serving Two Masters: The Association between Audit Committee Internal Audit Oversight and Internal Audit Activities. *Accounting Horizons* 24 (1): 1-24.
Keywords:	internal auditing, audit committees, best practices, internal auditors
Purpose of the Study:	This study examines the association between the activities performed by the internal audit function (hereafter, IAF) and the extent of audit committee oversight of the IAF. Two primary concerns motivate this study. First, relatively little regulatory or best practices guidance relates to the distribution of IAF activities, and virtually no current research has been done about these activities. The authors believe this topic to be important because current New York Stock Exchange listing rules require registrants to maintain an IAF, increasing the pervasiveness of internal audit. The second motivation concerns the relatively incomplete set of audit-committee related regulations. In particular, the Sarbanes-Oxley Act of 2002 (SOX) requires audit committee oversight of internal controls over financial reporting and also mandates reporting on a registrant's internal controls. However, SOX is silent on internal audit, a key participant in both the financial reporting process and the internal control structure. Moreover, SOX does not address internal audit's reporting relationship with the audit committee or the audit committee's duties concerning internal audit resources.
Design/Method/ Approach:	The survey questionnaire was mailed to *Fortune* 1000 companies, after excluding banks. Consistent with much prior internal audit research, the survey was directed to CIAs. The first survey was sent in July 2006 and resulted in a total of 72 usable responses. A follow-up mailing was conducted in September 2006 and produced an additional 62 usable responses. This lead to the final sample size of 134 observations.
Findings:	The authors find that the percentage of the IAF budget devoted to internal-controls-based activities is positively related to the measure of the audit committee's oversight. In particular, audit committees with greater IAF oversight are associated with larger percentages of IAF hours being allocated toward internal controls activities. Moreover, the results suggest that a significant number of *Fortune* 1000 companies have audit committees that appear to have little oversight of the IAF. This speaks to the relevance and timeliness of the recommendations of numerous parties concerning audit committee internal audit termination/hiring rights and budgetary controls. The authors also document significant differences in the allocation of IAF budgets across different activities, an area with very little prior research. They find that the majority of the IAF budget is devoted to internal controls activities, but the remainder, allocated to non-controls activities, is considerable. The evidence indicates that outsourcing arrangements are quite prevalent, but are also quite specific. In particular, the majority of outsourcing hours were spent on Section 404- related activities, with a lesser portion devoted to assisting the external auditor with the financial statement audit. The results suggest that an audit committee's demand for better internal controls may lead to greater IAF focus on internal controls.

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research summary	
Title:	Audit committee stock options and financial reporting quality after the Sarbanes-Oxley Act of 2002.
Practical Implications:	This study contributes to existing literature by re-examining the relationship between audit committee compensation and financial reporting quality. The findings indicate the continuance of a negative relationship between audit committee members' stock-option compensation and financial reporting quality in the post-SOX era. These results are relevant to regulators, compensation committees, and auditors because they imply that shifting audit committee director compensation away from stock options has the potential to improve financial reporting quality.
Citation:	Campbell, J. L., J. Hansen, C. A. Simon, and J. L. Smith. 2015. Audit Committee Stock Options and Financial Reporting Quality after the Sarbanes-Oxley Act of 2002. *AUDITING: A Journal of Practice & Theory* 34 (2):91-120.
Keywords:	audit committee quality, financial reporting oversight, financial reporting quality, independence
Purpose of the Study:	The Sarbanes-Oxley Act (SOX) was passed by Congress in 2002 in order to "improve the accuracy and reliability of corporate disclosures." The introduction of SOX resulted in a substantial increase in audit committee members' required level of independence and responsibility. In defining independence, however, regulators did not restrict companies from providing equity incentives for audit committee members. Pre-SOX research has shown stock option incentives to be associated with lower financial reporting quality. This study aims to re-examine the association between audit committee equity-based incentives and financial reporting quality (as proxied by a company's propensity to meet or beat its consensus analyst forecast) in the post-SOX environment.
Design/Method/ Approach:	After removing problematic data, the sample collected for the study consisted of audit committee members' equity holdings and compensation data for a sample of 2,172 company-year observations from 2006 to 2008. This information was then used in conjunction with a series of probit models in order to examine whether audit committee member' equity incentives are associated with the likelihood of meeting or beating the analyst forecast. In order to mitigate the effect of outliers, the top and bottom 1% of the selection was winsorized.
Findings:	Findings were consistent with stock-option incentives being associated with lower financial reporting quality. Specifically, it was found that: • 58.8 percent of the average audit committee members' pay is in the form of stock options and grants. • The likelihood of meeting or beating analyst expectations is positively associated with audit committee members' stock-option compensation and holdings. • There is no association for non-equity compensation and holdings, and meeting or beating analyst expectations. • A company whose audit committee holds the mean value of exercisable options (i.e., about $200,000 in exercisable options) is associated with a 10.0 percent increase in the likelihood of meeting or beating its consensus analyst forecast. • A high-growth opportunity company whose audit committee holds the mean value of exercisable options is associated with a 17.8 percent increase in the likelihood of meeting or beating its consensus analyst forecast.

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