SESSION 1.02: ACCOUNTING FIRM POLICY AN AUDIT QUALITY
DATE: FRIDAY, JANUARY 12, 2018
TIME: 10:15 AM - 11:45 AM

Accounting Firm's Internal Characteristics and Audit Quality

Joshua Khavis
Temple University

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Temple University

ABSTRACT: The PCAOB's audit quality framework dictates that superior inputs (e.g., audit engagement team personnel) are prerequisites for achieving high audit quality. Accounting firms' input quality rests on their ability to recruit and retain top talent as well as maintain certain levels of employee satisfaction. This study uses crowd-sourced employee-level reviews of accounting firms to examine: (1) what determines employee's ratings of Big 4 and non-Big 4 accounting firms, (2) what drives employee turnover, and (3) how internal accounting firm characteristics relate to audit quality. We find that "career opportunities", "senior management", and "culture and values" play a more important role in how accounting firm employees rate their employer overall than "compensation and benefits" or "work-life balance" does. We also document a Big 4 brand effect, as Big 4 employees rate their employer consistently higher and recommend their employer to others more often than non-Big 4 employees do. We find evidence that accounting firm employees' overall satisfaction is associated with audit quality, as measured by discretionary accruals and the propensity to issue a going concern opinion. Audit quality is negatively related with employee satisfaction for the non-Big 4, but appears to be positively related with employee satisfaction for the Big 4. Additionally, we provide some evidence suggesting that although a better work-life balance at the non-Big 4 translates into higher audit quality, improving work-life balance at the Big 4 may not necessarily improve audit quality. Finally, we find that the longer employees work at an accounting firm, the lower is their clients' audit quality, on average.

SESSION 1.02: ACCOUNTING FIRM POLICY AN AUDIT QUALITY
DATE: FRIDAY, JANUARY 12, 2018
TIME: 10:15 AM - 11:45 AM

Do Satisfied Auditors Perform Better? Investigating the Association between Audit Firm Employee Job Satisfaction and Audit Quality

Anna Gold
Vrije Universiteit Amsterdam

Yu Flora Kuang
The University of Melbourne

Gladys Lee
The University of Melbourne

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ABSTRACT: We examine the association between employee job satisfaction in audit firms and audit quality. Using a US-based dataset of auditor self-assessments on their job satisfaction during 2008 through 2017, we find that auditor job satisfaction is positively associated with audit quality measured at both an audit-firm level and a client level. At the audit firm-level, we show that audit firms with higher employee satisfaction have a lower tendency to be involved in a SEC or PCAOB enforcement action. At the client-firm level, audit firms with higher employee satisfaction perform higher quality audits in that their clients report lower discretionary accruals, experience a lower propensity of restatement, and a lower likelihood of fraudulent financial reporting. Further, we find that the positive effects of audit firm employee job satisfaction on audit quality are mainly applicable to non-Big 4 audit firms (vis-à-vis Big 4 firms), and staff-level auditors (vis-à-vis managers, partners and directors).

SESSION 1.02: ACCOUNTING FIRM POLICY AN AUDIT QUALITY
DATE: FRIDAY, JANUARY 12, 2018
TIME: 10:15 AM - 11:45 AM

Human Resource Management in Big Four Audit Firms and Audit Quality

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Ines Simac
KU Leuven

Marleen Willekens
KU Leuven

ABSTRACT: In this paper we examine whether human resource management (HRM) practices affect objective measures of audit quality in Big Four audit firms. Prior research on HRM practices in audit firms does not make direct links to objective measures of audit quality. Based on prior research on human capital effects in professional service firms (e.g. Hitt et al. 2001) as well as behavioral accounting research (e.g. Bol et al. 2015) we motivate two hypotheses. First, we argue that audit firms which have more extensive selection practices are likely to attract higher quality hires and the latter are likely to deliver higher quality audit services, ceteris paribus (Hypothesis 1). Second, we predict that extensive human capital development practices increase audit quality (Hypothesis 2). To test our predictions we rely on a combination of a recent unique and private survey dataset tapping into the HRM practices of Big Four audit firms in the Netherlands and corresponding archival data to objectively measure various objective audit quality proxies. We test four different audit quality models covering different dimensions of audit quality as classified by DeFond and Zhang (2014). Our hypotheses are confirmed as we find a significantly positive effect of perceived HRM practices across all four audit quality models. These results suggest that HRM practices are important organizational factors influencing audit quality.

SESSION 1.03: AUDIT PARTNER
DATE: FRIDAY, JANUARY 12, 2018
TIME: 10:15 AM - 11:45 AM

What's in a Name? Initial Evidence of U.S. Audit Partner Identification Using Difference-in-Differences Analyses

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The University of Tennessee

Chan Li
University of Pittsburgh

Sarah E. Stein
Virginia Polytechnic Institute and State University

Nicole Wright
James Madison University

ABSTRACT: Under the premise that audit partner identification would improve accountability and transparency, the PCAOB implemented Rule 3211 to capture partner names for audits of publicly-traded companies in Form AP. A natural question is whether this rule was effective in motivating partners to improve audit quality, and whether it resulted in additional costs to companies. As with many studies examining the effect of new regulation, it is difficult to separate changes due to Rule 3211 from changes due to general macroeconomic trends. To address this concern, we examine the impact of U.S. audit partner identification using difference-in-differences analyses with separate control groups, including a novel, hand-collected dataset of U.S. companies that voluntarily disclosed the audit partner name prior to Form AP. Collectively, we do not find consistent evidence of a change in audit quality or fees for the treatment group relative to each control group following mandatory partner identification in Form AP.

SESSION 1.03: AUDIT PARTNER
DATE: FRIDAY, JANUARY 12, 2018
TIME: 10:15 AM - 11:45 AM

On the Economics of Audit Partner Tenure and Rotation: Evidence from PCAOB Data

Brandon Gipper
Stanford University

Luzi Hail
University of Pennsylvania

Christian Leuz
The University of Chicago

ABSTRACT: This paper provides the first partner tenure and rotation analysis for a large cross-section of U.S. publicly listed firms over an extended period. We analyze the effects on audit quality as well as economic tradeoffs related to partner tenure and rotation with respect to audit hours and fees. On average, we find no evidence for audit quality declines over the tenure cycle and little support for fresh-look benefits after rotations. Nevertheless, partner rotations have significant economic consequences. We find increases in audit fees and decreases in audit hours over the tenure cycle, which differ by partner experience, client size, and competitiveness of the local audit market. More generally, our findings are consistent with efforts by the audit firms to minimize disruptions and audit failures around mandatory rotations. We also analyze special circumstances, such as audit firm switches and early partner rotations, and show that they are more disruptive than mandatory rotations, and also more likely to exhibit audit quality effects.

SESSION 1.03: AUDIT PARTNER
DATE: FRIDAY, JANUARY 12, 2018
TIME: 10:15 AM - 11:45 AM

Out of Sight, Out of Mind: Does Audit Partner Proximity to Clients Matter?

Nicholas Jennings Hallman
The University of Texas at Austin

Jere R. Francis
University of Missouri

Nargess Golshan Mottaghi
University of Missouri

ABSTRACT: Using newly mandated disclosures which reveal the identity of the lead engagement partner for publicly traded US firms, we examine whether audit partners' geographic proximity to their clients affects the quality of the audits they perform. We find that nearly 30 percent of clients have non-local partners, defined as partners with "home" locations at least 100 kilometers away from their clients' headquarters. We build on an extensive literature examining the effects of proximity between economic agents to predict that audit quality is lower when a lead engagement partner is located farther from her client. Our findings are consistent with this prediction. In our primary analysis, we find that clients' audited earnings are of lower quality (i.e. discretionary accruals are more likely to significantly increase net income) when the lead engagement partner is non-local. Our findings are consistent across several alternative measures of audit quality and are robust to a battery of sensitivity tests, including alternative model specifications designed to rule out alternative explanations. In cross-sectional analysis, we show that the effect of partner distance is mitigated (partially) among Big 4 audit firms and (completely) for audit partners with easy access to a direct flight to their clients' headquarters. Finally, we find that audit firm tenure increases the odds that a client will have a non-local partner. We suggest that this association is caused by mandatory audit partner rotations and, combined with our primary findings, points to a potential unintended (negative) consequence of such mandatory rotation policies.

SESSION 1.04: AUDITOR CHOICE AND AUDIT QUALITY
DATE: FRIDAY, JANUARY 12, 2018
TIME: 10:15 AM - 11:45 AM

A Two-Sided Matching Model of the Audit Market for IPO Firms

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London School of Economics

Maureen McNichols
Stanford University

Ken Li
Stanford University

ABSTRACT: We estimate a two-sided matching model of IPO firms to auditors. Doing so allows us to study the effects of sorting and influence in the audit market and the effect that each has on audit quality. We find that Big 4 auditors and more complex clients prefer to be matched with each other. We find evidence that sorting on inherent quality of the client exists at the time auditors are matched with clients but that even after controlling for the effects of sorting, Big 4 auditors exert positive influence; the probability of a restatement is significantly lower, all else equal, for clients of Big 4 auditors.

SESSION 1.04: AUDITOR CHOICE AND AUDIT QUALITY
DATE: FRIDAY, JANUARY 12, 2018
TIME: 10:15 AM - 11:45 AM

An Investigation of the Market's Perception and Pricing of Auditor Competence: Evidence from PwC's Oscars Blunder

William L. Buslepp
Louisiana State University

Lawrence J. Abbott
University of Wisconsin–Milwaukee

ABSTRACT: On Sunday, February 26, 2017, PwC erred on live television when Brian Cullinan, PwC's U.S. Board Chairman and Managing Partner of PwC's Southwest Region handed the wrong envelope for Best Picture to the announcers at the 2017 Academy of Motion Picture Arts and Sciences Awards Ceremony ("the Oscars"). The error was later attributed to a lack of due professional care by Cullinan. We hypothesize that the market recognizes and interprets this event as a signal of PwC's competence. Consistent with this theory, we find that abnormal returns in the days following the error are significantly lower for PwC clients audited by offices in the Southwest United States relative to other, non-Southwest PwC clients. We document similar results when comparing abnormal returns of Southwest Region, PwC clients vis-à-vis Southwest region clients not audited by PwC. We interpret these results as evidence that stock prices impound investors' perceptions of the reliability of the financial statements (i.e., the perception of the auditor's competence). Further, our findings support the Public Company Accounting Oversight Board's (PCAOB) recent decision to disclose the name of the audit engagement partner.

SESSION 1.04: AUDITOR CHOICE AND AUDIT QUALITY
DATE: FRIDAY, JANUARY 12, 2018
TIME: 10:15 AM - 11:45 AM

Auditor Selection and Investment Risk

Benjamin Hoffman
Kent State University

Trung Huy Pham
Kent State University

Mai Dao
The University of Toledo

ABSTRACT: Using a sample of U.S. publicly listed companies for the 2004-2014 period, we investigate the relation between the riskiness of a firm's investment policies and the firm's appointment of an external auditor. We hypothesize that firms with riskier investment policies are more likely to choose a higher quality auditor to reduce information asymmetry and increase the credibility of financial reports. With two measures of auditor quality (Big 4 and industry specialized auditors) and three measures of investment policy risk (research and development (R&D) expenditure, standard deviation of monthly stock returns and diversification), we generally find that firms with riskier investment policies choose higher quality auditors. Specifically, a firm with a higher ratio of R&D expenditure over sales is more likely to hire a Big 4 and/or industry specialist auditor. Firms with a higher standard deviation of monthly stock returns are more likely to select industry specialist auditors. We also find that more diversified firms are more likely to appoint a Big 4 auditor. Our paper expands prior research on auditor selection by potentially identifying a previously unidentified determinant: investment policy risk.

SESSION 1.05: AUDIT TEAM COMMUNICATION/KNOWLEDGE SHARING
DATE: FRIDAY, JANUARY 12, 2018
TIME: 10:15 AM - 11:45 AM

Auditor Integration of IT Specialist Input on Internal Control Issues: How a Weaker Team Identity Can Be Beneficial

Cassandra Estep
Emory University

ABSTRACT: I investigate how auditors integrate information technology (IT) specialist input into internal control over financial reporting (ICFR) issue classifications. Given the ill-structured nature of ICFR issue classification and the importance of appropriate classification due to the potential impact on audit quality, combining knowledge from different perspectives is likely beneficial. Drawing on social identity theory, I predict and find benefits result from a weaker one-team identity between auditors and IT specialists. Specifically, I find auditors with a weaker versus stronger team identity place more weight on IT specialist input for IT-related issues and are more likely to differentiate between more and less accurate input. My study provides a better understanding of how team identity influences auditor integration of input from specialists. The implications of my study are of interest to researchers, regulators, and practitioners, especially as recent firm initiatives push auditors and IT specialists to view themselves as one team.

SESSION 1.05: AUDIT TEAM COMMUNICATION/KNOWLEDGE SHARING
DATE: FRIDAY, JANUARY 12, 2018
TIME: 10:15 AM - 11:45 AM

Overcoming Communication Challenges: Can Taking the Specialist's Perspective Improve Auditors' Critical Evaluation and Integration of the Specialist's Work?

Jennifer R. Joe
University of Delaware

Yi-Jing Wu
Texas Tech University

Aleksandra B. Zimmerman
Northern Illinois University

ABSTRACT: This study investigates whether perspective taking (adopting the expert's perspective) improves auditor's processing of highly technical evidence when the communication complexity (i.e., the presentation of technical information) is high versus when it is low. We also anticipate that communication complexity contributes to the challenges auditors encounter in critically evaluating and integrating technical information when auditing complex estimates. We find that holding the information content in the expert's evidence constant, but varying the degree of communication complexity in the expert's (e.g., specialist's) evidence results in audit judgments that are consistent with lower critical evaluation and integration when communication complexity is high versus when it is low. However, when auditors adopt the specialist's perspective prior to reviewing high communication complexity specialist evidence, they exhibit higher critical evaluation and integration of the evidence than auditors who maintained an auditor's perspective. Specifically, the auditors who engage in specialist perspective taking and elect to follow-up on the specialist's evidence pursue more follow-up questions and allocate more audit effort to testing the specialist's evidence than the other auditors. Regulators and auditors identify these follow-up actions as important inputs to audit quality. Thus, this study provides the first evidence that adopting a specialist's perspective when auditors are at an expertise disadvantage has the potential to enhance auditor's judgments and decision-making, which has implications for collaboration across geographically-distributed and cross-functional teams.

SESSION 1.05: AUDIT TEAM COMMUNICATION/KNOWLEDGE SHARING
DATE: FRIDAY, JANUARY 12, 2018
TIME: 10:15 AM - 11:45 AM

The Multitasking Audit Environment: How Alternative Modes of Communication Affect Team Performance

Veena Looknanan Brown
University of Wisconsin–Milwaukee

Juergen Sidgman
University of Wisconsin–Oshkosh

Joseph F. Brazel
North Carolina State University

ABSTRACT: Despite the considerable evidence suggesting multitasking reduces performance, multitasking is unavoidable in the audit profession. Auditors are often required to work on multiple engagements and perform multiple tasks simultaneously to keep up with the demands of their profession. In the hopes of facilitating their multitasking, auditors have extended beyond face-to-face interactions to computer mediated communication (CMC) technologies. However, little is known about the relative impact of these modes of communication on the performance of audit teams working in multitasking environments. Accordingly, in a laboratory experiment, we examine the effects of alternative modes of communication (face to face, chatroom, and discussion board) on audit team performance in a multitasking setting. Our results demonstrate that traditional face-to-face communication outperforms both forms of CMC (chatroom and discussion board). Also, within CMC, teams using a discussion board significantly outperform teams using a chatroom.

SESSION 1.06: AUDITOR INTERVENTIONS TO IMPROVE AUDIT QUALITY
DATE: FRIDAY, JANUARY 12, 2018
TIME: 10:15 AM - 11:45 AM

How Does an Audit or a Forensic Mindset Influence Auditors' Fraud Risk Assessment and Subsequent Risk Response?

Lawrence Chui
University of St. Thomas

Mary B. Curtis
University of North Texas

Byron Pike
Minnesota State University Mankato

ABSTRACT: Fraud risk assessments have a direct effect on financial statement auditors' ability to detect fraud. However, prior literature demonstrates that auditors are generally not the optimal assessors of fraud risk, nor do they always respond to assessed risk adequately. The PCAOB Standing Advisory Group (SAG) suggests that auditors may improve fraud detection performance by adopting a forensic mindset. The purpose of this study is to determine whether it is possible to inculcate auditors with a forensic mindset and whether such a mindset will improve their risk assessments and corresponding risk response performance. Using an experimental setting, we manipulate both mindset and fraud risk environment to evaluate their individual and interactive effect on fraud risk assessments and risk responses. We examine three mindset conditions (auditors using their typical audit mindset, auditors primed to adopt a forensic mindset, and forensic specialists using their typical forensic mindset) and find that it is possible to use a simple prime to inculcate auditors with a forensic mindset. In both the high and low fraud risk environments, auditors primed with a forensic mindset report significantly higher fraud risk assessments related to the hypothetical client in the experiment. Moreover, these primed auditors demonstrate the most efficient and effective risk response. Specifically, in the high fraud risk environment, primed auditors propose the greatest risk response, proposing additional audit procedures from both the audit and forensic domains. In the low fraud risk environment, primed auditors exhibit a sensitivity towards risk whereby their risk response is consistent with auditors using their typical audit mindset. Finally, we demonstrate that mindset impacts risk response through its influence on risk assessment.

SESSION 1.06: AUDITOR INTERVENTIONS TO IMPROVE AUDIT QUALITY
DATE: FRIDAY, JANUARY 12, 2018
TIME: 10:15 AM - 11:45 AM

How Simple Changes to Language and Tick Marks Can Curtail the Ghost Ticking of Audit Procedures

Jessica Buchanan
Kent State University

David Piercey
University of Massachusetts Amherst

ABSTRACT: Ghost ticking, or documenting audit work not actually performed, is a persistent concern as auditors face significant budgetary pressure, and pose a danger to the basis of the audit plan. For example, risk-based audit plans that rely heavily on controls testing to reduce or eliminate substantive tests in some areas can be based on spurious risk assessments if subordinate auditors ghost tick controls testing procedures. We examine whether requiring self-references in audit workpapers (i.e., “I” performed the controls test) can effectively curtail ghost-ticking, compared to two other types of language use common in workpapers. While recent research has focused on the importance of disclosure language in influencing investors judgments and decisions, our study focuses on how language use influences the honesty and actions of the language user. We also design and test an alternative to tick marks (symbol-based notation commonly used to designate audit procedure results in workpapers), replacing them with automated “full explanations”, in which auditors select the full description of the result of each procedure performed from a drop-down list. Consistent with our hypotheses, we find that the use of self-references nearly eliminates ghost ticking, but only when auditors use automated full explanations. Additional analyses suggest that the joint use of self-references and automated full explanations (versus tick marks) increases the accessibility of their moral identity, which, in turn, reduces ghost ticking. Overall, we demonstrate how two simple changes to language and tick marks can significantly curtail ghost ticking. These changes are easily implementable in practice, and therefore could reduce the risk and implications of ghost ticking in auditing, especially when the clean results of audit tests are used to justify the elimination of

further testing under a risk-based audit approach.

SESSION 1.06: AUDITOR INTERVENTIONS TO IMPROVE AUDIT QUALITY
DATE: FRIDAY, JANUARY 12, 2018
TIME: 10:15 AM - 11:45 AM

On-the-Job Coaching: Does One “Bad Apple” Spoil Audit Subordinates’ Commitment to the Firm?

Lindsay Andiola
Virginia Commonwealth University

Jean C. Bedard
Bentley University

Joleen Kremin
Portland State University

ABSTRACT: On-the-job coaching is a key topic in audit firms due to its potential value in improving learning and performance of subordinates. However, it may also have a direct impact on subordinates’ job attitudes (e.g., organizational commitment) and longer-term actions (e.g., leaving the firm). This study investigates the audit subordinates’ perceptions of on-the-job coaching quality of supervisors on multiple engagements, and the link of these perceptions with coaching satisfaction and commitment to the firm. These possible effects are important to audit firm management because under negative conditions they can lead to dysfunctional behaviors and employee turnover, which are detrimental for audit quality and costly for the firms. Based on survey responses from 131 subordinate auditors providing perspectives on 374 supervisors, we find that supervisors’ capabilities are viewed by subordinates (both associates and senior associates) as the greatest inhibiting factor of supervisors’ coaching quality, but that there is variation in the other significant factors between auditor ranks. These results contribute to the audit literature by providing an initial understanding of factors inhibiting coaching quality of audit supervisors. We also find significant variability in the perceived coaching quality of supervisors, and a differential influence of those supervisors on subordinates’ coaching satisfaction and organizational commitment. This result is novel in the literature on coaching, providing an incremental contribution to the one-one-one coaching interactions previously studied.

SESSION 2.02: AUDIT PRICING
DATE: FRIDAY, JANUARY 12, 2018
TIME: 2:00 PM - 3:30 PM

Not Only Who but Where: A Structural Approach of Incorporating Location into our Understanding of the Audit Market

Seong Jin Ahn
Washington University

ABSTRACT: This paper investigates the effects of auditor office location on client and auditor surplus. Using a two-sided matching market model, I find that, while both clients and auditors bear the costs of geographic distance, auditors disproportionately bear costs. Although distance exerts costs on clients, clients incur distance costs to gain auditor expertise. Next, I examine how the stickiness of audit office locations affects equilibrium audit market matches. The immobility of audit office locations results in a market-wide surplus loss of 1.6%, and leaves 8% of clients worse off. In addition, by aggregating individual client-auditor surplus at the MSA and state level, I find that in underserved regions, clients are more likely to choose their second-best auditors, and auditors are more likely to extract rents from clients. Finally, relocating audit offices in overserved regions, such as Detroit and Cincinnati, to underserved regions, such as Austin and Houston, improves market-wide surplus, and therefore, leaves clients and auditors in both regions better off. Overall, this paper contributes to the literature by highlighting how an audit market friction (stickiness in audit office location) affects surplus and auditor matches.

SESSION 2.02: AUDIT PRICING
DATE: FRIDAY, JANUARY 12, 2018
TIME: 2:00 PM - 3:30 PM

Customer-Base Concentration and Audit Pricing

John Daniel Eshleman
Michigan Tech University

Yun Ke
Brock University

Shuo Li
Western Washington University

ABSTRACT: This paper examines whether and how auditors' pricing decisions are affected by their clients' customer base. We first document that customer concentration is negatively related to audit fees. This negative relationship is stronger for clients whose customers have higher costs of switching suppliers and clients who have high relationship-specific investments with their major customers. The effect of concentration on fees also depends on which stage of the firm life cycle the firm is in. The discount is strongest for firms in the growth and maturity stages, and there is actually a fee premium for firms in the decline stage. In additional analyses, we find that customer concentration is associated with a lower likelihood of accounting restatements, indicating higher audit quality. We also test whether the effect of concentration on fees differs for governmental customers. We find that governmental customer concentration is associated with higher audit fees. Thus, the relationship between customer concentration and audit pricing is nuanced, and depends upon the type of customer(s) the firm has. Finally, we find that governmental customer concentration is associated with longer audits. We find no evidence that corporate customer concentration is associated with the length of the audit.

SESSION 2.02: AUDIT PRICING
DATE: FRIDAY, JANUARY 12, 2018
TIME: 2:00 PM - 3:30 PM

Misclassification of Audit-Related Fees as a Measure of Pre-Audit Financial Reporting Quality: Implications for Financial Reporting and Audit Quality

Joseph Legoria
Louisiana State University

William L. Buslepp
Louisiana State University

Regina Cavalier Rosa
University of New Orleans

Danny Shaw
Louisiana State University

ABSTRACT: Financial reporting quality (FRQ) is a product of both the accounting system that produced the financial statements and the effort exerted by the auditor to correct errors in the financial statements (audit quality). In this study, we attempt to disentangle these two components to assess whether a higher quality auditor improves financial reporting quality. We suggest that a misclassification of audit-related fees in the unaudited disclosures of the annual report is a proxy for low pre-audit financial reporting quality (PAFRQ). Consistent with our expectation, we find that firms that misclassify audit-related fees are more likely to report a material weakness when compared to firms that correctly classify audit-related fees. Further, firms that misclassify audit-related fees (i.e., low PAFRQ firms) tend to have greater abnormal accruals (lower FRQ) than firms that correctly classify audit-related fees. Finally, low PAFRQ firms audited by a higher quality auditor (Big 4 or Tier 2 auditor) have lower abnormal accruals (higher FRQ) than low PAFRQ firms audited by a lower quality auditor (triennially inspected auditor). In contrast to prior literature suggesting that there is minimal difference in audit quality across auditors (Lawrence et al. 2011), our findings suggest higher quality auditors do improve FRQ.

SESSION 2.03: AUDIT QUALITY
DATE: FRIDAY, JANUARY 12, 2018
TIME: 2:00 PM - 3:30 PM

Are Referred-to Auditors Associated with Lower Audit Quality?

Jayanthi Krishnan
Temple University

Mengtian Li
Temple University

ABSTRACT: The Public Company Accounting Oversight Board (PCAOB) has proposed a new auditing standard, Auditing Standard (AS) 1206, for audits in which the lead auditor divides responsibility with other auditors, and “refers” to the other auditors’ work in its audit report. In response to the Board’s call for data and analyses relating to referred-to auditors, we document trends in the use of referred-to auditors and examine their association with “actual” (discretionary accruals) and perceived (earnings response coefficients) audit quality. Using the Audit Analytics database, we document, consistent with the PCAOB’s observations, that referred-to auditors are used predominantly in two settings: when the lead auditor’s client has equity method investees or consolidated subsidiaries. Further, the use of referred-to auditors has declined over the period 2000-2015. Our audit quality analyses yield mixed results. We find some evidence indicating that referred-to auditors for consolidated subsidiaries are associated with higher perceived audit quality. In contrast, referred-to auditors for equity method investees are associated, in some subsets of our sample, with both lower actual audit quality (higher discretionary accruals) and lower perceived audit quality (lower earnings response coefficients). We conclude that, in addition to its focus on referred-to auditors’ involvement with consolidated subsidiaries, the Board should also consider potential audit quality effects of equity method investees.

SESSION 2.03: AUDIT QUALITY
DATE: FRIDAY, JANUARY 12, 2018
TIME: 2:00 PM - 3:30 PM

Audit Personnel Salaries and Audit Quality

Jeffrey Lamro Hoopes
The University of North Carolina at Chapel Hill

Kenneth Merkley
Cornell University

Joseph Pacelli
Indiana University Bloomington

Joseph H. Schroeder
Indiana University Bloomington

ABSTRACT: This study examines the relationship between audit personnel salaries and office-level audit quality. We measure audit personnel salaries at the Associate, Senior and Manager ranks for Big 4 audit offices from 2004 to 2013 using unique data obtained from the U.S. Department of Labor. We find that offices that pay lower salaries have a higher percentage of clients that experience restatements. In related analysis, we also find lower levels of audit quality when audit employees are paid less relative to other lines of service in accounting firms (tax, consulting, etc.). Finally, we examine the ability of audit offices to pass the costs of audit labor onto their clients. We document positive and significant associations between salary and fees, suggesting that audit offices pass the cost of labor onto their clients. Overall, our findings provide initial evidence on the role of audit salary and its impact on audit quality and fees.

SESSION 2.03: AUDIT QUALITY
DATE: FRIDAY, JANUARY 12, 2018
TIME: 2:00 PM - 3:30 PM

Is Office Human Resource Capacity Associated with Engagement Audit Quality?

Albert L. Nagy
John Carroll University

Matthew Sherwood
University of Massachusetts Amherst

Aleksandra B. Zimmerman
Northern Illinois University

ABSTRACT: This study examines whether audit offices with greater human resource capacity for the given level of office workload (audit and non-audit) for issuer audit clients deliver higher audit quality. Specifically, we hypothesize that the availability of more CPA-certified personnel in audit firm offices enhances audit quality primarily due to the audit teams being populated and supervised by competent and experienced CPAs. We measure office human resource capacity as the ratio of CPA professionals to total fees (audit and non-audit fees) paid by issuer clients to Big 4 accounting firms' offices in the U.S. Consistent with our expectations, the results indicate that offices with a greater human resource to workload allocation deliver higher quality audits as measured by the lower likelihood of restatements and less extreme accruals earnings management. Additional analyses reveal that the effect of human resource capacity on audit quality is more pronounced for busy season audits than non-busy season audits and that our results are not driven by office size. This study contributes to a developing stream of literature investigating the determinants of office-level audit quality.

SESSION 2.04: AUDITOR CHOICE
DATE: FRIDAY, JANUARY 12, 2018
TIME: 2:00 PM - 3:30 PM

Do Lenders Have Favorite Auditors?

Andrew Bird
Carnegie Mellon University

Thomas Ruchti
Carnegie Mellon University

Stephen Adam Karolyi
Carnegie Mellon University

ABSTRACT: Yes. We construct a novel revealed preference measure of financial statement verification based on matching among lenders, borrowers, and auditors. When borrowers use their lenders' preferred auditors, they borrow larger amounts and at lower rates and contracts depend more on accounting information. Lender preferences are determined by their historical experience with individual auditors; when borrowers in their loan portfolio default or restate their financials, lenders shift their loan portfolio away from the implicated auditor. These preferences impact borrowers' post-financing auditor choices as well as subsequent matching between borrowers and lenders. Finally, when borrowers follow their lenders' preferences, loan terms are more sensitive to financials and borrowers are less likely to default in the future. Our findings suggest that, through financial statement verification, auditors play a significant role in contracting efficiency and matching in the private loan market.

SESSION 2.04: AUDITOR CHOICE
DATE: FRIDAY, JANUARY 12, 2018
TIME: 2:00 PM - 3:30 PM

Financial Reporting Choices of Large Private Firms

Jennifer J. Gaver
The University of Georgia

Paul Mason
Baylor University

Steve Utke
University of Connecticut

ABSTRACT: We investigate large private firms' choices to obtain audits, prepare GAAP financial statements and, if audited, use a Big 4 auditor. We also explore determinants of firms' distribution of financial statements and the decision to obtain internal control audits. Using a sample of private funds (e.g., private equity and hedge funds), an increasingly important part of the economy, we find that nearly 80% of private firms not subject to mandatory audit requirements obtain audits voluntarily. Larger, older firms with more owners and more sophisticated owners are more likely to obtain audits, while firms with more inside ownership are less likely to obtain audits. Many of these same characteristics are associated with private firms' decisions to use GAAP, engage a Big 4 auditor, obtain an internal control audit, and distribute financial statements to investors. Our evidence suggests investors' information demands influence financial reporting decisions whereas debt usage appears to play a limited role in financial reporting choices. We also find that GAAP and Big 4 usage are positively associated with growth in both firm size and number of investors. Our analysis comprises the first examination of the financial reporting choices of private funds such as private equity, venture capital, and hedge funds.

SESSION 2.04: AUDITOR CHOICE
DATE: FRIDAY, JANUARY 12, 2018
TIME: 2:00 PM - 3:30 PM

To Share or Not to Share: The Importance of Peer Firm Similarity to Auditor Choice

Kenneth L. Bills
University of Arkansas

Matthew Cobabe
Virginia Polytechnic Institute and State University

Jeffrey Pittman
Memorial University of Newfoundland

Sarah E. Stein
Virginia Polytechnic Institute and State University

ABSTRACT: A firm's decision on whether to choose the same auditor as a close competitor reflects a trade-off between exercising caution to protect its proprietary information and pursuing the benefits of auditor expertise. Using a pairwise similarity measure based on descriptions from regulatory filings, we find that peer firms are more likely to engage the same auditor when their product offerings are more similar. Importantly, we find this relation is greater when the focal firm experiences more litigation risk, but is moderated when the focal firm operates in a highly competitive or innovative industry, is a market leader, or has a "cozy" relationship with its auditor. We extend prior research on auditor choice by analyzing whether firms perceive that the upside stemming from auditor expertise dominates the downside of greater vulnerability to proprietary information leakage to competitors, as well as the role that auditor and client characteristics play in this decision.

SESSION 2.05: CLIENT INFLUENCE
DATE: FRIDAY, JANUARY 12, 2018
TIME: 2:00 PM - 3:30 PM

Audit Partners' Acceptance of Client-Preferred Accounting Methods: The Influence of Client Importance and Role Identity Salience

Sean Hillison
Virginia Polytechnic Institute and State University

ABSTRACT: Audit partners protect capital markets by assuming a duty-focused stakeholder interest role of constraining aggressive, client-preferred financial reporting; yet to profitably operate as a business, audit partners must also undertake a sales-focused commercial role of acquiring or retaining profitable clients. In this study, I report the results of an experiment testing whether the salience of audit partners' role identity (stakeholder interest versus commercial) and client importance (lower versus higher) interact to jointly influence judgments about client-preferred accounting methods. Drawing on research in psychology, I predict and find that seasoned audit partners are subject to an identity-related information processing bias when incentives related to client importance are lower, but the bias is reduced as incentives related to client importance increase. Specifically, when client importance incentives are lower, audit partners are more likely to accept client-preferred accounting methods when a commercial role identity is salient and less likely to accept client-preferred accounting methods when a stakeholder interest role identity is salient. As client importance increases, audit partners make judgments about the acceptability of client-preferred accounting methods consistent with motivations related to the theory of reputation protection. Specifically, I find that as client importance increases, audit partners are less likely to accept client-preferred accounting methods, regardless of role identity salience. Supplemental analyses reveal that audit partners' motivations related to reputation protection dominate motivations related to economic dependence as client importance increases. Counter to regulator and investor concerns, this study demonstrates that auditors, specifically audit partners, do not allow more aggressive, client-preferred accounting methods as client importance increases, but rather make more conservative client accounting judgments as incentives related to client importance increase.

SESSION 2.05: CLIENT INFLUENCE
DATE: FRIDAY, JANUARY 12, 2018
TIME: 2:00 PM - 3:30 PM

How Higher Performance on Client Service Affects Auditors' Willingness to Challenge Management's Preferred Accounting

Michael Ricci
The University of Georgia

ABSTRACT: Satisfying the client and performing a high quality audit are important goals for auditors. However, these goals often conflict (e.g., when management has aggressive reporting preferences). This conflict is an ongoing concern of regulators and academics because auditors motivated to satisfy the client may be more likely to inappropriately accept management's preferred accounting, impairing audit quality. However, accepting management's preferred accounting is not the only way for auditors to pursue their client satisfaction goals. Auditors can also satisfy the client by performing client service activities, such as communicating effectively and being accessible to clients (Hoang et al. 2017, Koch and Salterio 2017). I address auditors' competing client satisfaction and audit quality goals by experimentally examining how higher performance on client service affects auditors' willingness to challenge management's preferred accounting. I draw on theory from psychology (Fishbach et al. 2009) explaining that people can focus on monitoring their goal progress (i.e., moving forward on a goal) or their goal commitment (i.e., the importance of a goal). I expect and find that when auditors monitor their progress toward (commitment to) their client satisfaction goals, auditors who perform higher on client service make judgments that are more (less) challenging of management's preferred accounting than auditors who perform lower on client service. This challenges the conventional wisdom that the pursuit of client satisfaction goals necessarily undermines audit quality.

SESSION 2.05: CLIENT INFLUENCE
DATE: FRIDAY, JANUARY 12, 2018
TIME: 2:00 PM - 3:30 PM

The Influence of "Relationship" Partners on Client Managers' Negotiation Positions

Mary Kate Dodgson
Northeastern University

Christopher P. Agoglia
University of Massachusetts Amherst

Bradley Bennett
University of Massachusetts Amherst

ABSTRACT: Maintaining a positive auditor-client relationship is critical for audit firms. One voluntary action firms might take to maintain a positive relationship is to assign non-decision-making liaisons (often referred to as relationship partners or "RPs") to clients. RPs can play a major role in navigating the auditor-client relationship during sensitive issues, yet little is known about their influence on issue resolution. We conduct an experiment with financial executives to examine the influence that RPs have on the resolution of subjective issues between auditors and their clients. We also consider whether a RP's influence varies depending on the extent to which the engagement partner and client manager have tried, albeit unsuccessfully, to resolve the issue (i.e., negotiation "ripeness"). We find that, in a traditional setting in which a RP is not assigned, client managers concede less toward a position deemed appropriate by the engagement partner when the negotiation has reached a more ripe stage (i.e., a stalemate) than when the negotiation stage is less ripe. However, we find it is at a more ripe stage that RP intervention is more effective at building trust in the audit firm and moving client managers toward the audit partner's more acceptable position. These findings suggest that RP intervention can provide an end to a stalemate, limiting the risk of seeking alternative methods of resolution that may impair the auditor-client relationship (e.g., issuing a qualified audit opinion). Our study informs audit regulators about the influence that a RP (a non-decision making party) can have on the audit process and provides insight to audit practitioners about how to effectively utilize RP resources during auditor-client disagreements. Additionally, through a test of the ripeness theory of third party intervention, this study presents a contribution to the general negotiation literature by responding to a broader call for research to examine how the impact of third party intervention approaches can vary based on the stage of implementation.

SESSION 2.06: EFFECTS OF EXPANDED AUDIT REPORTING
DATE: FRIDAY, JANUARY 12, 2018
TIME: 2:00 PM - 3:30 PM

The Effect of Expanded Audit Report Disclosures on Users' Confidence in the Audit and the Financial Statements

Peter Kipp
University of North Texas

ABSTRACT: I investigate how nonprofessional investors' confidence in the financial statements and the audit report is influenced by the details of a critical audit matter (CAM) disclosure in conjunction with the description of the audit procedures engaged to address the CAM in the audit report. Using business school alumni as a proxy for nonprofessional investors in a 2 x 2 between-participants experiment manipulating CAM disclosure detail (Detailed/Generic) and the description of the audit procedures engaged to address the CAM account (Detailed/Generic) I find that more detailed descriptions of the audit procedures performed results in greater confidence in the accuracy and reliability of the disclosed account relative to a generic description of the audit procedures performed, consistent with the intuitive predictions of Support Theory. Further, I find that a more detailed description of the related audit procedures engaged to address the CAM increases nonprofessional investors' perceptions of audit quality relative to a generic description. Finally, evidence of main effects for both CAM disclosure detail and audit procedure disclosure detail shows that nonprofessionals' investment judgments significantly increase when both CAM disclosure detail is generic and audit procedure performed are disclosed in detail. These results have implications for researchers, practitioners, and regulators to carefully consider the language used to disclose CAMs and related audit procedures in the auditor's report.

SESSION 2.06: EFFECTS OF EXPANDED AUDIT REPORTING
DATE: FRIDAY, JANUARY 12, 2018
TIME: 2:00 PM - 3:30 PM

The Effect of Increased Audit Disclosure on Managerial Decision Making: Evidence from Disclosing Critical Audit Matters

Jeremiah Bentley
University of Massachusetts Amherst

Tamara A. Lambert
Lehigh University

Ying Wang
University of Massachusetts Amherst

ABSTRACT: The Public Company Accounting Oversight Board (PCAOB) proposed a standard that requires auditors to provide information on “critical audit matters” (CAMs) identified during the financial statement audit. We use this context to examine whether and why increased auditor reporting impacts managers’ decision making. Using a 2x3 between-participants experimental design, we manipulate the purpose of a financial transaction (hedge versus speculation) and the type of CAM disclosure anticipated (No CAM versus Standard CAM verses Disclaimer CAM). Compared to the No CAM condition, we find managers in the Standard CAM condition are less likely to hedge, but more likely to speculate. A disclaimer CAM disclosure (related to the scope of the auditor’s assurance role) attenuates the impact of CAM disclosure on speculation. We contribute to literature on audit, financial, and managerial decision making and the debate over the proposed regulation.

SESSION 2.06: EFFECTS OF EXPANDED AUDIT REPORTING
DATE: FRIDAY, JANUARY 12, 2018
TIME: 2:00 PM - 3:30 PM

How Do Nonprofessional Investors Respond to Disclosure of Audit Quality Indicators?

Jeffrey Brown
Baylor University

Velina Krastimirova Popova
Kennesaw State University

ABSTRACT: Both U.S. and international standard setters have sponsored initiatives to develop a reliable portfolio of audit quality indicators (AQIs). The primary goal of these initiatives is to provide new insights into how to evaluate audit quality and, critically, how high-quality audits are achieved. In an experiment, we examine how nonprofessional investors, a primary beneficiary of the financial reporting process, respond to receiving auditor-disclosed AQIs. We manipulate both the trend of the AQI data disclosed (positive or negative) and whether the quantitative AQIs are accompanied by a qualitative contextual narrative from the auditors (present or absent). We also include a control group conforming to the current audit reporting environment that omits any AQI disclosure. We find that investors experience more positive feelings and affective reaction towards the auditors when they receive a positive-trending AQI portfolio compared to when a negative trend of AQIs is disclosed. In turn, investors receiving a positive-trending AQI portfolio are more likely to ratify the selection of their company's auditor and voluntarily increase their equity investment in the company. Our results also indicate that a positive-trending AQI portfolio is more influential on investor decision-making when it is accompanied by a qualitative discussion providing additional context. Our findings should be of interest to regulators and standard setters as they consider how to advance the dialogue on AQIs and determine the proper communication medium to disseminate AQI data.

SESSION 3.02: AUDITOR AND CLIENT REPUTATION
DATE: FRIDAY, JANUARY 12, 2018
TIME: 4:00 PM - 5:30 PM

Auditor Response to Negative Media Coverage of Client Environmental, Social, and Governance Practices

Jenna Burke
University of Colorado Denver

Rani Hoitash
Bentley University

Udi Hoitash
Northeastern University

ABSTRACT: We use new data to examine auditor response to negative media coverage of client environmental, social, and governance (ESG) practices. Although media is not expected to be a primary information source for audit risk judgments, we predict that it generates a different risk for the auditor. Specifically, auditors may anticipate reputation loss spillovers when client reputation is damaged via negative media coverage. We hypothesize that auditors will respond to manage this element of business risk, which has not been examined by prior research. Supporting this prediction, we find that ESG-related negative media coverage of an audit client is associated with a higher likelihood of auditor change and increased audit fees. These results suggest that auditors respond to potential reputation spillovers by avoiding or sharing the burden with the risk-generating client. We also explore whether our results can be attributed to negative media reflecting traditional risk considerations (e.g., risk of material misstatement and financial risk) and do not find support for this explanation. Overall, our results document that auditors incorporate client negative media coverage into their pricing and retention decisions. Our findings suggest that audit firms have reputation and risk concerns beyond those connected to the audited financial statements, which enhances the literature's understanding of the audit market.

SESSION 3.02: AUDITOR AND CLIENT REPUTATION
DATE: FRIDAY, JANUARY 12, 2018
TIME: 4:00 PM - 5:30 PM

Internal Audit Stigma Awareness and Internal Audit Outcomes: Stuck Between a Rock and a Hard Place

Marc Eulerich
University Duisburg-Essen

Joleen Kremin
Portland State University

Kristen Kelli Saunders
University of Nebraska–Lincoln

David A Wood
Brigham Young University

ABSTRACT: Prior research finds that the internal audit function (IAF) plays a critical role in organizations but that stakeholders are still relatively dissatisfied with the IAF and that those out of internal auditing hold a negative stigma toward the profession. We therefore test if internal auditors are aware of these negative perceptions and whether this awareness is associated with negative internal audit outcomes. The results of two samples of experienced internal auditors, one from the United States and one from Europe, suggest that practicing U.S. (European) internal auditors have relatively neutral (positive) perceptions of their profession. However, when either group believes there is a negative stigma about internal auditing, they report negative work outcomes, including less ability to add value, less influence in the organization, more resistance to implementing their recommendations, and more pressure to change audit findings. We also find that increased perception of stigma is only moderately related to increased turnover intentions (but not actual turnover rates), and we find no connection between perception of stigma and job satisfaction. Taken together, the results suggest that negative perceptions of internal audit have significant impact on the profession, and, consequently, more efforts are needed to improve the perception of internal auditing.

SESSION 3.02: AUDITOR AND CLIENT REPUTATION
DATE: FRIDAY, JANUARY 12, 2018
TIME: 4:00 PM - 5:30 PM

The Role of ex-ante Beliefs in Auditor-Client Matches

Elisabeth Plietzsch
University of Graz

Sebastian Kronenberger
Leibniz University of Hanover

ABSTRACT: In this paper, we emphasize the importance of ex-ante reputation in context of auditor-client matches. Thereby, we understand reputation as the market's belief on whether the auditor is a good fit for the client firm. A good fit is characterized by higher audit efficiency, meaning that the audit effort of an auditor results in higher audit quality. We show that the expected audit quality does not always increase in the auditor's expected fit, as commonly suggested. If litigation does not play a dominant role, auditors with a lower expected fit can deliver higher expected audit quality since their incentives from reputation are stronger. As a consequence, the client does not automatically prefer the perfect audit match. An auditor who is less likely a good fit can render a higher firm value.

SESSION 3.03: CORPORATE GOVERNANCE
DATE: FRIDAY, JANUARY 12, 2018
TIME: 4:00 PM - 5:30 PM

Audit Committee Expertise: An Examination of the Post-SOX Era

Brandon Szerwo
University at Buffalo, SUNY

ABSTRACT: I examine whether accounting experts on the audit committee outperform other financial experts in monitoring financial reporting in the post-SOX era. Because SOX changed both audit committee composition and financial reporting quality, findings of the association between accounting expertise and financial reporting quality from the pre-SOX and SOX-implementation eras may not generalize to the period after SOX implementation. When assessing this possibility, I find that accounting experts, including former audit partners, fail to outperform other financial experts subsequent to SOX implementation. I further examine how the association between accounting expertise and financial reporting quality varies within expert type, based on when the expert was first appointed as an audit committee member. I find that pre-SOX appointment former audit partners are the only group consistently associated with higher financial reporting quality, suggesting that previously identified incremental associations have been diluted by more recently appointed experts. Taken broadly, the results suggest that regulation aimed at influencing audit committee composition and expertise has altered the previously documented relation. They also suggest that changing the definition of a financial expert to be more accounting-focused, as some investor advocates have recently requested, is unlikely to improve financial reporting quality.

SESSION 3.03: CORPORATE GOVERNANCE
DATE: FRIDAY, JANUARY 12, 2018
TIME: 4:00 PM - 5:30 PM

Corporate Philanthropy and Auditors' Engagement Risk

Feng Guo
The University of Kansas

Stephen John Lusch
The University of Kansas

Adi Masli
The University of Kansas

ABSTRACT: There is an ongoing debate about the pros and cons of corporate philanthropy. Proponents suggest that philanthropy beneficially affects corporate reputation, profitability, and employee retention. Critics argue that corporate donations drain shareholder wealth and are a misappropriation of resources. We study how corporate philanthropy affects the external auditor's assessment of engagement risk. Understanding how auditors perceive the riskiness of corporate giving is informative to the debate, particularly because auditors are an independent third party and have access to private company information. Using data from the Indiana University School of Philanthropy's Million Dollar List, we find that corporate philanthropy is positively associated with audit fees. However, the effect is less pronounced among companies having higher customer awareness. The results are robust to controlling for broad measures of corporate social responsibility (CSR), controlling for future firm performance, and propensity score matching. We contribute to the literature examining the value of corporate philanthropy, the literature on CSR in accounting, as well as the auditing literature.

SESSION 3.03: CORPORATE GOVERNANCE
DATE: FRIDAY, JANUARY 12, 2018
TIME: 4:00 PM - 5:30 PM

Does Audit Committee Accounting Expertise Curtail Auditor Rent Extraction? Evidence from Two Natural Experiments

James C Hansen
Weber State University

Ling Lisic
Virginia Polytechnic Institute and State University

Timothy Andrew Seidel
Brigham Young University

Michael S. Wilkins
The University of Kansas

ABSTRACT: We investigate whether audit committee accounting expertise limits external auditors' ability to extract rents from their clients. We posit that greater accounting expertise among audit committee members should reduce information asymmetries between the auditor and the client that arise from accounting and auditing complexities. Our tests use two natural experiments in which audit effort necessary to obtain reasonable assurance likely was reduced as a result of changes in professional standards. First, ASU 2011-08 significantly simplified how companies test goodwill for impairment purposes. We find that companies with goodwill that was not likely to be impaired paid significantly lower fees after ASU 2011-08 when they had accounting experts on their audit committees. Second, Auditing Standard No. 5 (AS5) eliminated the requirement that auditors issue an opinion on management's assessment of internal controls and permitted the scaling of audits for smaller clients. We find that smaller companies and clients of non-Big 4 auditors paid significantly lower fees in the transition to AS5 when they had accounting experts on their audit committees. Our results in both of these settings highlight an important and previously undocumented benefit of audit committee accounting expertise – a reduction in auditors' ability to extract rents.

SESSION 3.04: INTERNAL CONTROLS AND FIRM PERFORMANCE
DATE: FRIDAY, JANUARY 12, 2018
TIME: 4:00 PM - 5:30 PM

Do Auditors Correctly Identify and Assess Internal Control Deficiencies? Evidence from the PCAOB Data

Preeti Choudhary
The University of Arizona

ABSTRACT: Auditors routinely fail to disclose material weaknesses prior to a material error (i.e. restatements). One potential reason is that auditors misclassify the severity of identified internal control deficiencies due to complexity in judging the materiality and likelihood of potential related errors. Another reason is that auditors face disincentives to report a material weakness without a clear indication of an existing error. We evaluate these possibilities using a proprietary database on auditor-identified control deficiencies that are not deemed material weaknesses, hence not publicly disclosed. We compare the severity of the control deficiency with the severity of ex-post reporting errors. Even though we find some evidence consistent with auditor and management incentives to misclassify material weaknesses as less serious deficiencies, we generally find that 1) the severity of identified control deficiencies is properly assessed and 2) the auditor is able to gather additional audit evidence in the wake of identified internal control deficiencies such that the financial statements are not materially misstated. Our evidence indicates that the inability of auditors to properly identify relevant internal controls is a contributing reason why material weaknesses are not discovered and disclosed prior to material error restatements.

SESSION 3.04: INTERNAL CONTROLS AND FIRM PERFORMANCE
DATE: FRIDAY, JANUARY 12, 2018
TIME: 4:00 PM - 5:30 PM

Internal Control Quality and Bank Risk-Taking and Performance

Matthew Baugh

Arizona State University

Matthew Stephen Ege
Texas A&M University

Christopher G. Yust
Texas A&M University

ABSTRACT: Bank regulators have long asserted the importance of internal controls in enhancing the safety and soundness of the banking systems. However, it is unclear whether internal controls improve bank risk-taking and performance. Using two proxies for internal control quality, unremediated material weaknesses and quarterly abnormal loan loss provisions, we find that strong internal controls both reduce risk and increase performance. Additionally, we find that banks with material weaknesses are more (less) likely to experience extreme negative (positive) performance, suggesting that internal controls are effective at helping banks engage in more efficient risk-taking. We also find that internal controls affect performance directly as well as indirectly through risk-taking. The results are economically meaningful. For example, a bank that discloses first-time material weaknesses in 2007 has approximately 50 percent more non-performing loans and stock returns that are 1.8 times lower during the crisis period compared to banks without material weaknesses in 2007.

SESSION 3.04: INTERNAL CONTROLS AND FIRM PERFORMANCE
DATE: FRIDAY, JANUARY 12, 2018
TIME: 4:00 PM - 5:30 PM

Internal Controls and Operational Performance of Nonprofit Organizations

Nathan R. Berglund
Mississippi State University

Mikhail Sterin
Oklahoma State University

ABSTRACT: Prior literature documents a negative association between internal control deficiencies (ICDs) and subsequent contributions for nonprofit organizations (Petrovits, Shakespeare, and Shih 2011). However, there is a lack of understanding as to how ICDs impact donor behavior. In the for-profit environment, prior literature documents evidence of a spillover effect whereby ICDs negatively impact operational performance (Feng, Li, McVay, and Skaife 2014; Cheng, Goh, and Kim 2017). We examine this spillover effect in the nonprofit environment and model operational performance as a potential mediating variable between ICDs and subsequent contributions. Results demonstrate a robust negative association between ICDs and the charitable expense ratio (a key operational performance metric for nonprofits). We find that this association at least partly mediates the negative relationship between ICDs and subsequent contributions. Our results are relevant to donors and managers, demonstrating the pervasive impact of internal controls on a nonprofit's ability to effectively execute its charitable mission.

SESSION 3.05: FRAUD

DATE: FRIDAY, JANUARY 12, 2018
TIME: 4:00 PM - 5:30 PM

A Buffer/Conduit Theory Relating Organizational Culture to Fraud

Philip Beaulieu
University of Calgary

Alan Reinstein
Wayne State University

ABSTRACT: Buffer/conduit theory is a proposed taxonomy consisting of three layers: organizational fraud orientation, a buffer/conduit layer, and individual fraud orientation. The middle layer contains organizational culture–related internal controls that buffer the orientation layers from spreading fraud-encouraging values, and serve as conduits transmitting fraud-deterring values—or, when controls do not function as intended, transmitting fraud-encouraging values. A factor analysis of 11 indicators of this three-layer taxonomy suggests that older generations of accounting practitioners apply it, but millennials do not. Experience appears to cause this generational difference, rather than unique millennial traits. We also discuss implications of our findings for internal control frameworks.

SESSION 3.05: FRAUD
DATE: FRIDAY, JANUARY 12, 2018
TIME: 4:00 PM - 5:30 PM

Decomposition Approach in Enhancing Auditors' Fraud Risk Assessment

Waymond Rodgers
University of Hull/ The University of Texas at El Paso

Badriya Al Shammakhi
Higher College of Technology

ABSTRACT: The auditor task of assessing fraud risk is a critical step that affects auditing planning and procedures. Several prior studies suggest that a decision aid is an effective way to improve fraud risk assessment and professional skepticism. Following the recommendations in current auditing standards as well as fraud triangle factors, this research paper suggests an approach to fraud risk assessment that employs AU 316 and AS 2401 example fraud risk factors and decomposes them in a Throughput (TP) decision model. The TP model breaks up the decision-making into four main dominant concepts: Perception (P), Information (I), Judgment (J) and Decision Choice (D). This study employs a 2x2 experimental design with 42 auditors from different audit positions. When fraud risk factors are decomposed into the dominant concepts of the TP model, an effect is found between the four dominant concepts. These findings suggest that the TP model is an effective decision aid in consideration of fraud risk factors and can effectively increase the auditors' sensitivity to high risk factors when the situation suggests high fraud risk. We advance the literature by providing a framework that employs one of the ethical pathways of the TP model--the virtue ethics-based pathway, which is explained by the virtue perspective of ethics. This perspective highlights cultivation of virtuous traits of individuals' character, which is viewed as morality's primary function. In the context of auditing, virtues, such as professional skepticism, are ideal traits that are necessary for auditors to attain a state of consistency within oneself, and to attain such a state in relation to their environment. Virtues can also be viewed as a primary condition for an organization's so-called "tone at the top" and audit quality. The virtue ethics perspective combines the elements of auditors' professional skepticism and manner of evaluation in that it emphasizes rules and duties as well as the consequences of actions. This pathway was chosen for this study because we believe that auditors should begin their critique process with knowledge about an entity's fraud risk factors (perception) as well as all other dominant concepts in the TP model (i.e., information, judgment, and decision choice) to have a comprehensive view of risk and, thereby, avoid overlooking important fraud risk areas. Prior research in fraud risk assessment has not empirically investigated these elements of the fraud triangle when decomposed in a cognitive process model.

SESSION 3.05: FRAUD
DATE: FRIDAY, JANUARY 12, 2018
TIME: 4:00 PM - 5:30 PM

Error or Fraud? The Effect of Omissions on Management's Fraud Strategies and Auditors' Evaluations of Identified Misstatements

Erin L. Hamilton
University of Nevada, Las Vegas

Jason L. Smith
University of Nevada, Las Vegas

ABSTRACT: Auditing standards require auditors to consider whether identified misstatements may have been caused intentionally. Unfortunately, client managers may perpetrate fraud in ways that appear less intentional on the surface, making it difficult for auditors to identify instances of fraudulent financial reporting. To examine this possibility, we conduct two experiments: one with 58 corporate managers, the other with 108 experienced auditors. In Study 1, we find that managers prefer to perpetrate fraud using an "omission strategy" (i.e., omitting expenses from the financial statements or omitting critical information about the transaction from a supporting document) compared to a more active form of misrepresentation (i.e., recording revenue prematurely or providing misleading information). In Study 2, we find that auditors evaluate an identified misstatement as less likely to be intentional when it results from omission compared to a more active form of misrepresentation. Together, our two studies indicate the method of fraud preferred by managers (omission) is also the method auditors are less likely to believe is intentional. These findings suggest some frauds may go undiagnosed, not because managers have effectively concealed their fraudulent misstatements, but because they have effectively concealed their fraudulent intentions.

SESSION 3.06: INTERESTING STUDIES/UNRELATED TOPICS
DATE: FRIDAY, JANUARY 12, 2018
TIME: 4:00 PM - 5:30 PM

Does the Reporting of Critical Audit Matters Affect Nonprofessional Investors' Perceptions of the Readability of the Audit Report and Audit Quality?

Brian Todd Carver
Clemson University

Leah Elena Muriel
Oklahoma State University

Brad Trinkle
Mississippi State University

ABSTRACT: The Public Company Accounting Oversight Board (PCAOB) recently adopted a new auditing standard that would require the auditor to report critical audit matters (CAMs) in the body of the audit report. This new standard will lengthen the audit report but may also provide investors with cues about the quality of the audit. This study examines whether the disclosure of a CAM reduces the readability of the audit report and whether it, either directly or indirectly, affects nonprofessional investors' perceptions of audit quality. We find that the disclosure of a CAM does not directly affect the quality of the audit. It does, however, lead to a less readable audit report that, unintentionally, causes investors to lower their perceptions of audit quality, and, as a result, increase their perceived risk of the investment when no real change in audit quality has taken place. Increasing the readability of the disclosures mandated by the PCAOB's new auditing standard may, however, be able to eliminate these unintended, negative consequences.

SESSION 3.06: INTERESTING STUDIES/UNRELATED TOPICS
DATE: FRIDAY, JANUARY 12, 2018
TIME: 4:00 PM - 5:30 PM

Knowledge Sharing to Internal Auditors: Examining Procedural Fairness of the Internal Audit Process and Internal Auditor Type

Megan Seymore
University of North Texas

Jesse C. Robertson
University of North Texas

ABSTRACT: Knowledge sharing by employees helps internal auditors learn about critical information. However, employees may be hesitant to share knowledge with internal auditors and they may not share the same information with in-house and outsourced internal auditors. We develop theory on how procedural fairness at the start of an internal audit and auditor type influence two types of knowledge sharing: tacit knowledge sharing during an audit and subsequent knowledge sharing about material issues. We conduct a 2 X 2 between-participants experiment with MBA students. We find that enhancing perceptions of procedural fairness is an intervention that can increase knowledge sharing yet it depends on the internal auditor type and differs for type of knowledge sharing. Specifically, procedural fairness increases tacit knowledge sharing for outsourced internal auditors but not for in-house internal auditors. Yet, procedural fairness increases subsequent knowledge sharing for in-house internal auditors but not outsourced internal auditors.

SESSION 3.06: INTERESTING STUDIES/UNRELATED TOPICS
DATE: FRIDAY, JANUARY 12, 2018
TIME: 4:00 PM - 5:30 PM

Rewards and Pressure to Improve Audit Quality: Facilitative for Auditors With Low Drive but Undermining for Auditors With High Drive

Herman van Brenk
Nyenrode Business University

Barbara Majoor
Nyenrode Business University

ABSTRACT: The Public Company Accounting Oversight Board has proposed that rewarding auditors for high audit quality might create incentives for improving audit quality. Prior research indicates that the effects of financial rewards on performance are influenced by the work environment (e.g., pressure) and/or the person (e.g., motivation). We therefore investigate the effectiveness of audit quality bonuses by focusing on their combined influence with engagement pressure and auditors' drive levels. In an experimental study with 420 auditors, we manipulated the audit quality bonus ("present" versus "absent") and level of engagement pressure ("low" versus "high"). Both the audit quality bonus and high engagement pressure are intended to control participants' motivation and undermine their feelings of autonomy and self-determination. Drive is a measured personality factor regarding autonomous or inherent motivation. We find, as expected, that the presence of an audit quality bonus and high engagement pressure increase the level of audit quality for auditors with low drive but decrease it for auditors with high drive. Overall, our findings suggest that audit firms need to reconsider their practice of providing financial rewards to auditors who contribute to improving audit quality because, in their current form, these rewards undermine audit quality for the majority of professionals (auditors with high drive).

TABLE FORUM: TABLE 1: AUDIT INDUSTRY EXPERTISE
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Auditor Industry Expertise, Fee Premium and Audit Quality: An Examination from Audit Team Perspective

Zilong Song
Wuhan University

Yumiao Yu
Wuhan University

Jun Zhan
California State University, Northridge

ABSTRACT: Using unique Chinese data, this study analyzes auditor industry expertise from individual auditor perspective, and examines whether and how audit team industry expertise affects audit pricing and audit quality. We find audit team with industry expertise commands higher audit fees and provides higher quality of audit service. We also document that the positive association between the auditor industry expertise and audit quality becomes more pronounced when fee premium becomes greater. These findings lead to the conclusion that audit team with industry expertise have incentives to provide quality service and thus charge a higher fee premium to devote more resources into audit, which ultimately improve audit quality. Our findings provide empirical evidence on how auditor industry expertise may yield greater fees and higher audit quality, especially from a micro-level analysis. Our findings are also important for PCAOB policies related to mandating the engagement partner’s signature on audit report.

TABLE FORUM: TABLE 1: AUDIT INDUSTRY EXPERTISE
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Do Banks Audited by Specialists Engage in Less Real Activities Management?

Neil L. Fargher
Australian National University

Wenxuan Hou
University of Edinburgh

John Ziyang Zhang
University of Liverpool

ABSTRACT: Prior research documents that non-financial firms resort to more real activities management when their ability to manage accruals is constrained by specialist auditors. Within the context of banks' real activities management through repurchase agreements (repos), we argue that repo management can increase litigation risk for auditors and, hence, specialist auditors will pay greater attention to repo management and will better constrain the extent of such real activities management than non-specialists. We find that banks audited by specialists have less downward repo deviation than banks audited by non-Big 4 non-specialists. We find that audits by both Big 4 and non-Big 4 specialists are associated with less downward repo deviation than banks audited by non-Big 4 non-specialists.

TABLE FORUM: TABLE 2: AUDIT PARTNERS
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Determinants and Economic Consequences of Signing Auditor Turnover

Juan Mao
The University of Texas at San Antonio

Baolei Qi
Xi'an Jiaotong University

ABSTRACT: This study investigates why auditors leave one accounting firm (and bring their clients) to another and the consequences of such auditor turnover. We find that auditors' professional competency is positively associated with a departure decision in additional to their demographics. Specifically, younger auditors, auditors who are industry specialists, and auditors who audit more clients and have better education background, are more likely to move, suggesting that "rising stars" in the accounting industry are more likely to move from one accounting firm to another. However, female auditors, older auditors, and auditors with established status in the current accounting firm are less likely to do so. Interestingly, Big 4 signing auditors in China are less likely to move relative to non-Big 4 auditors. We also find that auditors with lower audit quality are less likely to move from one accounting firm to another, suggesting that the job market is penalizing auditors for bad quality audits. In terms of consequences, we find that the audit firm is more likely to lose clients whose incumbent auditor moves to another accounting firm and it tends to lower audit fees for clients that stay with the audit firm, assign better auditors to them, and treat them more leniently. Our study provides insights that should be of interest to the audit profession, audit firms, and regulators.

TABLE FORUM: TABLE 2: AUDIT PARTNERS
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Gender Representation Among the Partnership at Large CPA Firms: An Examination of Public Filers and Governmental Entities

Elizabeth D. Almer
Portland State University

Kathleen Harris
Washington State University

Julia L. Higgs
Florida Atlantic University

Joseph R. Rakestraw
Florida Atlantic University

ABSTRACT: This study examines whether there are systematic differences in the nature of work performed by female assurance partners at the seven largest U.S. public accounting firms in order to better understand whether female partners experience the same measures of success as their male counterparts. Using the new PCAOB Form A.P. data and the Single Audit Clearing House data we examine potential gender differences in client base among assurance partners and firms. Results indicate that female partners are more prevalent in certain lower prestige types of engagements such as single audits, investment funds and benefit plans, but that there are considerable differences among firms. Similarly certain industries that tend to be more male dominated are also less frequently assigned female audit partners. Within the most prestigious public filers, we find that the most experienced female partners actually manage a higher book of business than their similarly experienced male counterparts, which reflects favorably on the firms' efforts to provide equal opportunities.

TABLE FORUM: TABLE 2: AUDIT PARTNERS
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Retiring Auditors' Client Portfolio Decisions and Audit Quality

Li-Chun Kuo
National Taipei University

Chan-Jane Lin
National Taiwan University

ABSTRACT: The horizon issues of pre-retirement top executives or senior professionals have attracted attention from academic research. However, the findings from retiring CEOs may not be applicable to accounting professionals since there are some differences between the two roles. This study takes advantage of the audit reports in Taiwan, which disclose both the accounting firms as well as two signing partners, and tries to examine the decision behaviors of retiring auditors. Specifically, this study uses the retired auditors' clients which are listed companies from 1987 to 2012 as observations and examines retiring auditors' client portfolio choice and audit quality. We predict that retiring auditors tend to accept less risky clients since they become conservative and risk adverse when they age. However, our empirical findings suggest that two risk factors, financial risk and audit risk, considered by retiring auditors are indifferent between new clients and continuous clients. In the additional test, we further divide retired auditors into three groups by the ages they retire, and we find auditors retire at ages over 60 tend to accept new clients with less audit risks, which supports our hypothesis. As for audit quality analyses, by using the discretionary accruals of the clients to proxy audit quality, we find audit quality of retired auditors is relatively low in their retiring periods. However, audit quality improves if the retiring auditors are industry-specialized. Collectively, our analyses provide some evidence to show the effect of retirement on audit partners.

TABLE FORUM: TABLE 3: AUDIT QUALITY 1
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Accounting Firm Office Level Cultural Dynamics: Exploring Differences in Audit Reporting and Quality Following the Implosion of Arthur Andersen

Timothy J Fogarty
Case Western Reserve University

R. Drew Sellers
Kent State University

Aleksandra B. Zimmerman
Northern Illinois University

ABSTRACT: This paper situates audit quality as an outcome of organizational culture. It argues that when a firm undergoes extreme events that constitute organizational change, audit outcomes will also be changed. We study the aftermath of the Arthur Andersen demise – a unique setting - to examine the effect of acquiring a competing Andersen practice, including clients and personnel, on local acquiring office's restatement rates, client earnings management, and audit timeliness. Results of difference-in-difference analyses indicate that offices of the remaining Big 4 and non-Big 4 firms that acquired and incorporated Andersen clients and personnel into their audit practices saw lower restatement risk, higher accruals quality, and more timely audits (lower ARL) as compared to offices that did not acquire any Andersen clients and therefore did not undergo the same cultural and organizational change. These findings have significant implications for our understanding of both audit quality as an outcome of organizational culture and office-level audit quality differences post-Andersen.

TABLE FORUM: TABLE 3: AUDIT QUALITY 1
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Big 4 Auditor Choice and the 10-K Length

Nattavut (Simon) Suwanyangyuan
Simon Fraser University

ABSTRACT: This paper extends earlier research on the audit quality by documenting that the perceived higher quality of auditors, as captured by Big 4 membership, enhances their clients' financial reporting quality through more expanded disclosure in the 10-K reports. More importantly, I find that the choice of Big 4 auditors encourages firms to provide more narrative disclosure with the intention to increase the credibility of the financial reporting, explain poor financial performance and/or reduce information asymmetries. Lastly, I extend the audit fee literature by showing that the length of financial reporting is positively and significantly associated with higher audit fees. Collectively, this study contributes to a broader question of auditor's responsibility and its influential role during the disclosure process, which leads to a significant variation of disclosure volume in the 10-K reports.

TABLE FORUM: TABLE 3: AUDIT QUALITY 1
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Modeling Type I Going Concern Reporting Errors

Nathan R. Berglund
Mississippi State University

ABSTRACT: This study highlights an important feature of modeling Type I going concern reporting errors. Prior studies model determinants of these errors in one of two ways. They either 1) model determinants of the going concern opinion conditional upon subsequent firm viability, or 2) model determinants of subsequent firm viability conditional upon the going concern opinion. I demonstrate that an explanatory variable may exhibit either a positive or negative relationship with Type I errors depending entirely upon this research design choice. I examine 14 explanatory variables from prior literature and document that several are at risk for demonstrating such divergent relationships based on unconditional and conditional correlations. I find that two explanatory variables demonstrate statistically significant divergent results in multivariate analyses based entirely upon the research design decision. Future studies should carefully consider the appropriateness of each method and report sensitivity to their research design choice.

TABLE FORUM: TABLE 4: AUDIT QUALITY 2
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Do Extended Auditors' Reports Reveal Audit Quality? - A Textual Analysis

Penny Fanyuan Zhang
The Australian National University

Greg Shailer
The Australian National University

ABSTRACT: In order to improve audit report transparency regarding audit quality, regulators, including the FRC, have recently promulgated standards for extended audit reports (EARs) that require auditors to disclose the key audit matters (KAM) in that year's financial statement audit. The use of non-standardised language is the key to achieving the objectives. We compute textual similarity measures for both the KAM sub-sections and full EARs and examine whether they reveal differences in audit quality. We find that the KAM sub-sections and full EAR similarity measures are positively related to discretionary accruals. This relation is stronger for the KAM sub-sections than for the full EAR. The results suggest EARs can reveal differences in underlying audit quality across engagements.

TABLE FORUM: TABLE 4: AUDIT QUALITY 2
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

The Impact of PCAOB International Registration on Audit Quality and Audit Fees: Evidence from China

Wuchun Chi
National Chengchi University

Hamilton Elkins
University of Saskatchewan

Gerald Lobo
University of Houston

Partha Sarathi Mohapatra
California State University, Sacramento

ABSTRACT: Although the PCAOB allows registration of audit firms from non-US countries, China and a few other countries do not allow the PCAOB to conduct inspections of audit firms. We take advantage of this natural setting to investigate whether PCAOB registered audit firms increase audit quality in the absence of inspections. We also examine whether PCAOB registered firms charge an audit fee premium. If both audit quality and audit fees increase, then we can infer that PCAOB registration leads to improved audit quality and an associated increase in audit fees. Our results support these conjectures. Overall, our findings suggest that PCAOB registration has a positive impact on the quality of audits in China, for which clients are willing to pay higher audit fees.

TABLE FORUM: TABLE 4: AUDIT QUALITY 2
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

The Valuation, Revenue Management, and Subsequent Financial Restatement of IPO Firms

Norman Massel
Louisiana State University

Jungeun Park
Louisiana State University

Kenneth J. Reichelt
Louisiana State University

ABSTRACT: We demonstrate that investors in initial public offering (IPO) firms value revenues and that IPO managers report revenues opportunistically in the fiscal year just prior to the offer. We also find that these pre-IPO firm financial statements are more likely to be subsequently restated. Our results are consistent with the incentives of managers to report revenues opportunistically outweighing the higher monitoring and regulatory scrutiny pre-IPO. Our findings are in contrast to those presented in Venkataraman, Weber, and Willenborg (2008) and Ball and Shivakumar (2008) whom find evidence of more conservative reporting by IPO firms. We note that these two studies use abnormal accruals to reach their inferences, a financial metric that Armstrong, Foster, and Taylor (2016) demonstrate is not value-relevant to IPO investors. Extending Armstrong et al. (2016), we provide evidence that discretionary revenue is value-relevant to IPO investors.

TABLE FORUM: TABLE 5: CLIENT INDUSTRY AND AUDIT
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Determinants and Consequences of Assurance Purchases in Small U.S. Banks

Ashley W. Douglass
Trinity University

ABSTRACT: This paper explores the determinants and consequences of the level of assurance that a bank purchases. Using a sample of small, privately held U.S. banks, I find that two differing types of banks are likely to purchase more assurance. First, larger, growing banks purchase relatively more assurance than other banks. Second, poorly performing, complex banks are more likely to purchase an audit than a lower level of assurance. I find that financial reporting quality is higher when banks purchase higher levels of assurance. Specifically, banks that purchase an audit of their financial statements have lower levels of discretionary loan loss provisions, are less likely to just meet or beat prior year earnings, and are less likely to just avoid a loss using discretion. In addition, I find some evidence that banks that purchase lower levels of assurance also have better financial reporting quality than banks that purchase no external assurance.

TABLE FORUM: TABLE 5: CLIENT INDUSTRY AND AUDIT
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Non-Financial Disclosure, Assurance, and Financial Reporting Quality: Evidence from the European Banking Sector

Janine Maniora
Technical University of Dortmund

Nadine Georgiou
Technical University of Dortmund

ABSTRACT: This paper examines the impact of banks' non-financial disclosure and its quality of assurance on financial reporting quality. We use corporate social responsibility (CSR) disclosure to proxy for non-financial information and earnings quality measured by discretionary loan loss provisions (DLLPs) to proxy for financial reporting quality. Using a hand-collected dataset of European banks' CSR disclosure and assurance practices, our empirical analyses show that banks' CSR disclosure is negatively related with DLLPs, indicating that CSR disclosure mitigates bank managers' incentive to manage earnings. Moreover, we find that the level and scope of assurance on CSR disclosure significantly influences financial reporting quality. Our results show that high-quality assurance, i.e. reasonable assurance and assurance on the total CSR report, is significantly negative associated with DLLPs. In contrast, low-quality assurance, i.e. limited assurance and assurance on content parts of the CSR report or on selected CSR performance indicators, is significantly positive associated with DLLPs. We posit these findings to the bank managers' moral imperative participated by the information collection, processing and presentation of CSR disclosure. As such, low-quality assurance can indicate less socially responsible bank managers that engage only in CSR disclosure assurance for enhancing the bank's reputation. In this case, CSR disclosure assurance is not likely to constrain earnings management using DLLPs. Further sensitivity tests reveal that the effect is determined also by Big-4 assurance provider and the use of international assurance standards. Overall, our results suggest that the quantity and quality of CSR disclosure impacts the financial reporting quality of banks.

TABLE FORUM: TABLE 6: CORPORATE GOVERNANCE & MANAGEMENT FORECASTS
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

An Empirical Analysis of "Superior" Management Earnings Forecast

Tina Wang
University of Houston

ABSTRACT: This paper examines whether capital markets reward the controversial practice of issuing short-term management earnings forecasts. Using a sample of quarterly earnings forecasts issued over 2001-2009, we find that firms may temporarily reduce stock price volatility by providing quarterly earnings forecasts. Further, our analysis shows that not all guidance issuers are equally rewarded by capital markets. The benefits of reduced stock price volatility and favorable market valuation primarily accrue to firms with a track record of supplying accurate and timely short-term earnings forecasts. Our findings suggest that superior short-term earnings guidance, which fosters transparent financial information environments and reduces investor information uncertainty, is indeed rewarded by capital markets.

TABLE FORUM: TABLE 6: CORPORATE GOVERNANCE & MANAGEMENT FORECASTS
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Costs and Benefits of Audit Committee Interlocking

Ahmad Hammami
Concordia University

Alexey Lyubimov
Concordia University

ABSTRACT: The focus of this paper is the relationship between audit committee interlocking and audit fees, likelihood of a late filing of the form 10-k, and internal control effectiveness. We contribute to the corporate governance literature by showing that interlocked audit committee members are capable of positively influencing the corporate governance environment across the firms they serve, however that comes with a cost. Specifically, we show that interlocking of audit committee members has a significantly negative association with internal control weaknesses as well as late filing of 10-k reports. We also show that these favorable outcomes, come with an added cost of higher audit fees. We believe these results show that interlocked audit committee members transfer their company enhancing knowledge and expertise across the firms they serve, thus the improved internal controls and efficiency in meeting their filing deadlines, while demanding better quality audits from their external auditors, which explains the higher audit fees. Prior research shows that audit committee interlocking as associated with poor financial reporting, as indicated in Sharma and Iselin (2012), and Tanyi and Smith (2015). Our results, contrary to prior research, show that interlocked board members are associated with the transfer of favorable outcomes across the companies they serve.

TABLE FORUM: TABLE 6: CORPORATE GOVERNANCE & MANAGEMENT FORECASTS
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Reputation Capital of Directorships and Audit Quality Evidence from the Analysis of Board Centrality and Audit Fees

Antti Fredriksson
Turku School of Economics

Anila Kiran
Aalto University

Lasse Niemi
Aalto University

ABSTRACT: The aim of this paper is to investigate the relationship between reputation capital of directors and the demand for audit quality. It takes time to build reputation capital, but it is easily destroyed as many corporate scandals have shown us. One way that the directors can protect their reputation capital against these scandals is to invest in external monitoring such as high quality financial statement audits. Building on social networks literature, we argue that directors' reputation capital increases with the number of directorships they hold. We hypothesize and find evidence that the companies that are more connected to other companies through board of directors, demand for higher audit quality. More specifically, using data for Finnish listed companies over the period 2007-2016, we document that the quantity of board connections are positively related to our measure of audit quality, fees paid to the audit firm. We do not find similar results for the quality of those connections.

TABLE FORUM: TABLE 7: AUDITING ENVIRONMENT
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Analyzing Pedagogical Approaches Used in Second Auditing Courses

Alan Reinstein
Wayne State University

Natalie T. Churyk
Northern Illinois University

ABSTRACT: To help professors develop, design and improve second auditing classes, we surveyed members of the American Accounting Association's Auditing Section to identify programs that offer second auditing courses, the textbooks used for such courses, and the learning activities used. Total and second auditing course only respondents (n=252 and n=80, respectively) identified university, program, and auditing course demographics, while second auditing course respondents identified the classroom activities that extend the second auditing course beyond the basics found in textbooks. Results reveal the textbooks used for first and second auditing courses, learning objectives, website resources, manual and computerized cases, group projects, software programs, video presentations, supplementary materials, and an analysis of national syllabi. These results, drawn from a diverse group of institutions, can serve as a resource to help professors develop and improve the content for a second auditing course.

TABLE FORUM: TABLE 7: AUDITING ENVIRONMENT
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

An Analysis of CPA Perceptions of the Peer Review Process

Alan Reinstein
Wayne State University

Barbara Apostolou
West Virginia University

Timothy J. Fogarty
Case Western Reserve University

ABSTRACT: The AICPA Peer Review Program requires member firms and individuals to undergo a triennial peer review as part of required practice monitoring. The ultimate goal is to promote quality in the accounting and auditing services to best serve the public interest. This self-regulatory process is currently a topic of interest to the profession, as the AICPA is developing and implementing changes to improve the value and relevance of the process to all parties. We surveyed 152 experienced CPAs regarding their perceptions of peer reviewers' competence, plus the quality benefits and impact of the peer review process. We found many CPAs viewing the peer review process as a means to have the AICPA and others drive out many practitioners from performing audits and other attest services, but supporting an improved peer review process. We also see a need for the AICPA, state boards of accountancy, and state CPA societies to inform their members and constituents of the benefits of peer reviews. Finally, many respondents' viewed per reviews of a self-serving lens—those performing or using peer reviews wanting to expand its applicability than those who did not.

TABLE FORUM: TABLE 7: AUDITING ENVIRONMENT
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

The Scientific Landscape of Internal Audit Research – A Bibliometric Analysis

Joel Behrend
University of Duisburg-Essen

Marc Eulerich
University of Duisburg-Essen

ABSTRACT: Addressing the heavily increased attention on the topic of internal auditing in the post-SOX era, the research conducted aims to ascertain the impact of internal auditing on research and the different scientific sub-areas that define it. The work seeks to extent the existing scant body of literature reviews that has focused on the topic by pursuing an empirical approach. In this context, co-citation analysis is used in combination with social network analysis in order to empirically investigate different existing research fields of internal auditing and to discover the core work that has been done in this area. The scientific landscape of internal auditing can be characterized as profoundly fragmented and deeply rooted into different areas of adjacent accounting research fields. Identified subcategories from which research on internal audit is derived can be summarized as Corporate Governance, Auditor Independence, Auditing Professionalization, Audit Committee Effectiveness, Reliance on Internal Auditing, Internal Control over Financial Reporting, and finally the Regulatory Framework. Additionally, results show that there is an existing pivotal nucleus of research which comprises various topics that focus solely on the internal audit function. The study is limited to the analysis of major accounting journals namely The Accounting Review, Contemporary Accounting Research, Journal of Accounting Research, Journal of Accounting Economics and Accounting, Organizations and Society and is restricted onto the years between 1926 and 2016.

TABLE FORUM: TABLE 8: FINANCIAL RESTATEMENT, FRAUD AND AUDIT RISK
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Auditors' Response to Classification Shifting: Evidence from U.S. Firms

Hongkang Xu
University of Massachusetts Dartmouth

Mai Dao
The University of Toledo

ABSTRACT: The purpose of this study is to examine how external auditors react to clients' earnings management through classification shifting. It draws on the theory that auditors perceive earnings management as a reflection of managers' opportunism and potential litigation risk. Using audit fees, audit report lags and modified audit opinion as proxies for auditors' responses, we find that classification shifting is positively associated with audit fees, audit report lags and the likelihood of auditors issuing a modified audit opinion. Our findings remain the same when we use a propensity score matched sample. An additional analysis shows that abnormal audit fees are also higher in firms with classification shifting. Overall, our results suggest that auditors tend to be more conservative when auditing firms with misclassification. As such, auditors charge a fee premium, make more audit effort, and report more conservatively when the clients engage in

TABLE FORUM: TABLE 8: FINANCIAL RESTATEMENT, FRAUD AND AUDIT RISK
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Which Personal Beliefs and Values Make Fraud Justifications Easier? Evidence from the World Value Survey

Natalia Maksimovna Mintchik
University of Cincinnati

ABSTRACT: In this paper I use Word Value Survey data to explore financial pressures, personal beliefs, and values as determinants of people's predisposition toward fraud. Applying the emerging method of analysis – the partial least squares path modeling – I report that, consistent with suggestions of fraud triangle theory, financial pressures significantly increase predisposition toward fraud. In addition, financial pressures are positively associated with life dissatisfaction and negatively associated with feeling of being in control as well as with beliefs in hard work as the crucial success factor. Life dissatisfaction, commonly labeled as Relative Deprivation in scholar literature, does not seem to affect fraud predisposition. Feeling of being in control also does not affect fraud predisposition directly but such feeling is positively associated with the beliefs in importance of hard work. Further on, survey respondents who believe in importance of hard work as the crucial success factor exhibit lower predisposition toward fraud. Thus, people's beliefs in importance of hard work fully (partially) mediate the relationship between feeling of being in control (financial pressures) and fraud predisposition. Finally, I report that other personality traits and beliefs such as self-enhancing vs. self-transcending values and gender bias influence people's predisposition toward fraud. This evidence provides useful insights on why some people commit crime in certain circumstances while others are able to resist pressures and temptations. As a result, organizations might consider enhancing certain beliefs of their employees and promoting certain value-oriented aspects of their culture in order to prevent and deter fraud while auditors might incorporate these features of the corporate culture in their fraud risk assessments.

TABLE FORUM: TABLE 9: AUDIT REGULATIONS
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Adding Value to the Audit Engagement: The Compromising Effect of Regulatory Focus

Curtis Mullis
Georgia State University

ABSTRACT: In this study, I examine how auditors' regulatory focus and choice to add value affect judgment quality, and show how a slight modification to audit practice mitigates the potentially harmful effects of choosing to add value. Audit partners and managers commonly emphasize to audit staff the importance of adding-value to audit engagements. Adding-value is essential to attract and retain clients as it allows firms to differentiate their audit product from what other firms may offer. While adding-value is clearly important to audit firms, research has yet to broach the topic. Consistent with Regulatory Focus Theory, I find that when adding-value is framed as beneficial to the audit firm, rather than the client, auditors perform better on a subsequent audit task because they adopt more of a prevention (rather than promotion) regulatory focus. Additionally, auditors' regulatory focus moderates the effects of choosing to add value on judgment quality. Specifically, choosing to add value has a negative effect on judgment quality when auditors adopt a promotion focus, but a positive effect when auditors adopt a prevention focus. I contribute to the literature by demonstrating how auditors' regulatory focus, and choice to add value, can influence judgment quality, and how a slight alteration of audit methodology can mitigate this behavior.

TABLE FORUM: TABLE 10: AUDIT DEFICIENCIES
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Informing Root Cause Analysis of Audit Deficiencies from a Theoretical Perspective

Christine J. Nolder
Suffolk University

Kathryn Kadous
Emory University

ABSTRACT: Regulators around the globe have suggested that auditors' insufficient attitudes of professional skepticism are one root cause of audit deficiencies (IFIAR 2015, 2016). We investigate the legitimacy of this claim by examining current models of professional skepticism in audit research to gain insights regarding the causal relationship between auditors' attitudes and their corresponding behaviors. We draw from these models to develop the Auditors' Attitude Root Cause Framework to inform root cause analysis from a theoretical perspective. Inspired by the Theory of Planned Behavior, our framework includes proxies for auditors' attitudes of professional skepticism, their attitudes towards others (e.g., firm management, clients, and regulators), and their attitudes associated with their perceived control over the audit. We demonstrate how measuring multiple attitudes marks the first step in understanding actual root causes of audit deficiencies and thus, provides a way forward for responding to regulators' allegations of a lack of professional skepticism driving auditors' behaviors. Moreover, an important observation gleaned from our research is that professional skepticism is unlikely a root cause of audit deficiencies, but merely a symptom of a bigger problem.

TABLE FORUM: TABLE 10: AUDIT DEFICIENCIES

DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Incentives for Dishonesty: An Experimental Study with Internal Auditors

Loukas Balafoutas
University of Innsbruck

Simon Czermak
Management Center Innsbruck

Marc Eulerich
University Duisburg-Essen

Helena Fornwagner
University of Innsbruck

ABSTRACT: We conduct an experiment with professional internal auditors and evaluate their performance and objectivity, measured as the extent to which they truthfully report the performance of other participants in a real-effort task. It has been suggested in the literature that incentive-pay compensation for auditors has the potential to lead to dishonest behavior, for instance when their payoff depends on the performance of the unit they are auditing. In line with our hypotheses, we find that incentive-based compensation increases dishonest behavior among internal auditors: competitive incentives lead to under-reporting of other participants' performance, while collective incentives lead to over-reporting of performance. In addition, we find that moving from an environment with objective performance evaluation towards a peer evaluation scheme reduces performance. This highlights the importance of improving the precision of evaluation procedures in organizations.

TABLE FORUM: TABLE 11: FACTORS AFFECTING AUDITOR JUDGMENT
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Does Considering Key Audit Matters Affect Auditor Judgment Performance?

Nicole V.S. Ratzinger-Sakel
University of Hamburg

Jochen Theis
University of Duisburg-Essen

ABSTRACT: This paper investigates the potential impact of considering key audit matters (KAM) in line with the new IAASB International Standard on Auditing ISA 701 on auditor judgment performance related to goodwill impairment testing. Our study uses a 2x2 between-subjects experiment based on a goodwill impairment testing case. In this experiment with 157 auditors from two Big4 audit firms in Germany, we manipulated the two independent variables client pressure (high vs. low) and KAM consideration (present vs. absent). Client pressure was manipulated through two different components, client importance and client opposition to making audit adjustments. In the condition in which KAM consideration is present, participants were required to assess the likelihood that they will communicate matters regarding the estimation of the recoverable amount in a separate KAM section of the independent auditor's report. We opposed this condition with a condition in which participants were only required to assess the likelihood that they will communicate matters regarding the estimation of the recoverable amount with those charged with governance (KAM consideration absent). As dependent variables, we captured skeptical judgment and action as two different facets of auditor judgment performance. Our results suggest that auditors' reaction to our client pressure manipulation is rather weak (and in fact turns out to be insignificant). If at all, auditors seem to become slightly more skeptical in their judgments and actions when client pressure is high, which might suggest that a reasonableness constraint has been triggered. Furthermore, we find that auditors exhibit significantly less skeptical judgment (and at least possibly also action) when KAM consideration is present than when KAM consideration is absent. This finding suggests that, when considering KAM and due to moral licensing, auditors are more willing to acquiesce to their clients' desired accounting treatments.

TABLE FORUM: TABLE 11: FACTORS AFFECTING AUDITOR JUDGMENT
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Testing the Reliability of the Hurtt Professional Skepticism Scale

Jefim Boritz
University of Waterloo

Katharine Patterson
University of Waterloo

Carla L Wilkin
Monash University Caulfield

Kristian Rotaru
Monash University Caulfield

ABSTRACT: This study tests the reliability (stability) of the Hurtt Professional Skepticism Scale under varying conditions and compares it to the Rotter Interpersonal Trust Scale. We created three case scenarios involving three different auditing tasks adapted from current literature. For each scenario, we administered both scales, varying orders of scale administration. Our findings indicate that HPSS and RIT measures of skepticism and trust, respectively, do not vary based on the case presented. Also, Skepticism per the HPSS is not affected by the order of scale administration; however, Trust as measured by the RIT scale, is affected by order of administration. Specifically, measured Trust decreases when the scale is administered after the case is completed compared to the level when it is measured before the case is completed. This study contributes to our understanding of the reliability of the HPSS and RIT as well as identifying conditions under which they might not be substitutes for one another.

TABLE FORUM: TABLE 12: ASSURANCE AND EQUITY CROWDFUNDING
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Equity Crowdfunding: Investigating Assurance Products and Individual Factors in an Emerging Funding Context

Regan Stevenson
Indiana University

Jesse C. Robertson
University of North Texas

Bradley Allan Lang
Mississippi State University

Jared A. Eutsler
University of North Texas

ABSTRACT: Equity crowdfunding venture (ECF) is a novel funding mechanism used by early-stage entrepreneurs to raise up to $1 million from the general public, without the registrations and disclosures typically associated with an initial public offering. ECF targets smaller investments from largely unsophisticated investors for ventures that are unproven with limited operational history. We investigate how independent assurance, characteristics of the fundraising pitch, and amateur investor traits impact decisions to invest in an ECF. Specifically, in a 2x2x2 experiment, we manipulate the presence of an audit, forward looking assurance, and the regulatory focus of the pitch. Our results support our hypotheses that audits of historical financial information and assurance of forward looking information increase ECF investors' likelihood to invest. Further, the fit interaction between the regulatory focus (promotion, prevention) of the ECF pitch and investors' traits increases investment. Our study identifies a new context in which an audit can provide value to investors, and we propose a new, value-added service that CPA firms can perform for ECF clients: forward-looking assurance on projected, pro forma financial statements. Overall, this study contributes to accounting literature as it is the first to investigate the influence of financial disclosures in the context of equity crowdfunding.

TABLE FORUM: TABLE 13: BOARD OF DIRECTORS' JUDGMENT
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Boards of Directors' Sanction Judgments: The Effect of Situational Factors

Joseph M. Wall
Marquette University

Jodi Lynn Gissel McDowell
Marquette University

ABSTRACT: This study investigates the influence of situational factors on sanction judgments by members of boards of directors. Board members guide controls processes, including sanction guidance for internal and external rules violations. This study is the first to investigate the decisions of such members in the presence of mitigating circumstances. Based on punishment theory regarding deterrence and retribution, as well as literature on empathy and judgement, an experiment analyzes how variation in history of similar incidents, compensation structure, and reason for violation impacts directors' sanction recommendations. Findings suggest board members focus on history of violations (repeat or first-time offender) and are not influenced by whether the individual received financial benefit or by empathetic situations. This holds true for both sanction type and amount of monetary sanction. Participants emphasize warnings for a first-time offender and fines for a repeat offender. Implications future research and boards relating to punishment guidance are discussed.

TABLE FORUM: TABLE 14: INTERNATIONAL CONSIDERATIONS
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

New European Union Rules on Audits

Alan Reinstein
Wayne State University

Barbara Apostolou
West Virginia University

ABSTRACT: The European Union [EU] has recently altered the environment for auditors of public interest entities. The legislation can impact any company with EU operations regardless of the location of its corporate headquarters. This article summarizes the effects of this legislation, discusses how the auditing profession can respond to this new environment, and provides a number of potential future research topics.

TABLE FORUM: TABLE 14: INTERNATIONAL CONSIDERATIONS
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Communication between Internal Auditor and Auditee in the International Context

Ronja Krane
University of Duisburg-Essen

Marc Eulerich
University Duisburg-Essen

ABSTRACT: The aim of this paper is to analyze the communication of internal auditors and auditees in the international context. We examine the characteristics of communicative actions during the distinct stages of international internal audit assignments, as well as the strategies internal auditors employ to achieve their audit related goals while interacting with auditees of different cultural and linguistic backgrounds. For this purpose, we conduct qualitative in-depth interviews with 24 internal auditors working for 14 globally operating companies. A theoretical bricolage is used to structure and analyze results. Our findings indicate that internal auditors attach great value to collaborative and courteous interactions and either possess the required skills to perform international audit assignments or will be provided with the necessary resources and support to work efficiently and effectively. Overall, we find that while internal auditors are aware of country and culture specific characteristics, the degree to which these differences are deemed important for internal audit work varies. This paper contributes to the literature on the interaction and relationship between internal auditors and auditees and expands our understanding of internal audit work in an international context.

TABLE FORUM: TABLE 15: MATERIALITY
DATE: SATURDAY, JANUARY 13, 2018
TIME: 7:00 AM - 8:15 AM

Filing the Gap: Understanding Materiality from a Jewish Perspective

Eileen Z. Taylor
North Carolina State University

Alan Reinstein
Wayne State University

Shlomo Sawilowsky
Wayne State University

ABSTRACT: ABSTRACT External audit ors use the materiality concept to plan and execute financial statement audits. Despite their careful and measured approach, too often they fail to identify fraud and impending business failures, and thus fail to warn external stakeholders, as, for example, in the lapse of sales practice integrity 2016 Wells Fargo Matter. Auditors should assess how they apply materiality concepts in practice, and not over-rely on stated balances to the qualitative impact of fraud and misstatements. One approach is to review materiality judgments from other cultures that have been practiced and refined over many years. To that end, we explore centuries-old Judaic applications of materiality and provide examples of how these concepts can provide insight on modern auditing guidelines in order to improve auditing judgments.

SESSION 5.02: AUDIT MARKET COMPETITION
DATE: SATURDAY, JANUARY 13, 2018
TIME: 10:15 AM - 11:45 AM

Accounting Firm Association Membership and Audit Firm Growth

Jaehan Ahn
Northeastern University

Herita Akamah
University of Nebraska–Lincoln

Kenneth L. Bills
University of Arkansas

Kristen Kelli Saunders
University of Nebraska–Lincoln

ABSTRACT: In this study, we explore a topic of primary concern to small audit firms – attracting new clientele. A potential avenue available to small audit firms to enhance their visibility and legitimacy among potential audit clients is to join an affiliation of accounting firms known as an accounting association. We examine whether small audit firms with accounting association membership have greater client growth than their peer audit firms without association membership. We separately explore growth in private and public clients. Using hand-collected data, we find that small audit firms with accounting association membership gain approximately 38 percent (5 percent) more private (public) clients over a two-year period than those without association membership. We find that this growth is due to both gaining new entrants into the audit market and winning over clients from competitors. Further, we find that the reputation of an association positively affects the client growth seen by member firms.

SESSION 5.02: AUDIT MARKET COMPETITION
DATE: SATURDAY, JANUARY 13, 2018
TIME: 10:15 AM - 11:45 AM

Big N Auditor Concentration and Investment Decisions

Xudong Li
Monmouth University

Lili Sun
University of North Texas

ABSTRACT: This study investigates whether and how Big N auditor concentration facilitates information transfers among the firms within an industry - the spillover effects of industry peers' accounting information on a company's investment decisions, through enhanced information disclosures and quality. Using a large sample from years 1988 – 2012, we hypothesize and find that a company in an industry with greater Big N auditor concentration is more responsive to its investment opportunities. Further, we hypothesize and find that greater Big N auditor concentration can increase firm investment efficiency, particularly in a way that reduces both the firm's over- and under-investments. Collectively, our findings suggest that Big N auditor concentration generates positive externalities by improving the amount and quality of industry peers' information disclosures and thus facilitating more efficient firm investment decisions. To our best knowledge, this is the first empirical study to investigate the impact of Big N auditor concentration on information externalities in general, and firm investment decisions in particular, and provide large-sample evidence on the association of Big N auditor concentration with corporate investment decisions at the firm-level.

SESSION 5.02: AUDIT MARKET COMPETITION
DATE: SATURDAY, JANUARY 13, 2018
TIME: 10:15 AM - 11:45 AM

Local Competition and Auditors' Use of Non-Audit Services

Nam Ho
Carnegie Mellon University

ABSTRACT: Non-audit services are a key component of an auditor's offerings to their clients. With them, auditors can market their unique expertise and provide advisory services far surpassing the necessities of an audit. In this paper, I study the effect of an auditor's local competitive landscape on their use of non-audit services. My findings show that auditors respond to intensifying competition by increasing their emphasis on selling non-audit services. This response is especially strong when there exists a wide range in the audit qualities being offered by competing firms, audit fees are depressed, or when lowballing is present. The results suggest that non-audit services function as both a differentiation tool for higher quality firms as well as a supplementary revenue stream when audit fees are reduced. Additionally, I find that the use of non-audit services reduces audit quality, regardless of the audit fees paid or the competitive environment.

SESSION 5.03: PCAOB INSPECTIONS
DATE: SATURDAY, JANUARY 13, 2018
TIME: 10:15 AM - 11:45 AM

Do PCAOB Inspection Findings Increase Audit Firms' Litigation Exposure?

Nathan Lundstrom
University of Missouri

Nathan Newton
University of Missouri

Brant Erich Christensen
University of Missouri

ABSTRACT: We examine whether audit firm exposure to regulatory intervention in the form of PCAOB inspection deficiencies influences auditors' litigation risk. We find that negative PCAOB inspection reports are positively associated with the number of subsequent lawsuits faced by the inspected audit firm. Further, negative inspection reports are positively associated with litigation settlement amounts. We find consistent results in a changes analysis, in Big 4 and non-Big 4 firm subsamples, and in a sample of restated and sued Big 4 clients in which we arguably hold audit and financial reporting quality constant. Our results suggest that PCAOB inspections have introduced a new source of litigation risk. Further, given the relatively consistent level of PCAOB deficiencies even among higher-quality firms, it is unclear whether auditors can reduce this new source of litigation risk through the traditional means of increasing audit quality and managing client portfolios.

SESSION 5.03: PCAOB INSPECTIONS
DATE: SATURDAY, JANUARY 13, 2018
TIME: 10:15 AM - 11:45 AM

Effectiveness and Consequences of PCAOB Disciplinary Actions: An Analysis of the Resulting Auditor/Client Dynamic and Audit Quality

Andrew John Imdieke
University of Notre Dame

Matthew James Beck
Michigan State University

Chris E. Hogan
Michigan State University

ABSTRACT: While several aspects of the PCAOB and SOX have been researched extensively, there has been relatively little research on the effectiveness of the PCAOB enforcement process and its consequences in the audit market. We examine the extent to which different types of PCAOB enforcement actions affect audit fees, auditor retention decisions, and financial reporting quality for auditors subject to the PCAOB disciplinary process and their clients. We find that clients of banned auditors subsequently choose larger audit firms and pay higher audit fees while receiving improved audit quality from their subsequent auditors. We further find that clients of censured auditors are penalized when staying with the censured audit firm by an increase in audit fees after the censure, but do not experience a subsequent increase in audit quality. On the other hand, clients who switch auditors after their previous auditor was censured do not see increased audit fees nor a significant change in the audit quality they subsequently receive. This study should help provide evidence as to the effectiveness and consequences of the PCAOB disciplinary process.

SESSION 5.03: PCAOB INSPECTIONS
DATE: SATURDAY, JANUARY 13, 2018
TIME: 10:15 AM - 11:45 AM

SEO Underpricing and PCAOB Inspection Reports: Do Investors Use PCAOB Inspection Information?

William L. Buslepp
Louisiana State University

Lawrence J. Abbott
University of Wisconsin–Milwaukee

Laura Swenson
University of Wisconsin–Milwaukee

James Robert Moon
Georgia State University

ABSTRACT: We examine the link between Public Company Accounting Oversight Board (PCAOB) Inspection Reports and a firm's cost of equity capital. We do so by investigating the relation between seasoned equity offering (SEO) underpricing and PCAOB inspection reports, with a particular focus on the clients of triennially-inspected auditors. SEO underpricing occurs when the SEO's offer price is lower than the prior day's market price of the firm's shares, and it represents 'money left on the table' for issuing firms. SEO underpricing is a non-trivial cost to an issuing firm, and its occurrence is increasing in both frequency and magnitude. We document a statistically and economically significant negative association between SEO underpricing and the use of a triennially-inspected auditor that has received a 'clean' PCAOB inspection report. Our evidence suggests that market participants find the inspection reports informative about audit quality for triennially-inspected auditors. We conduct similar analyses for SEOs administered by firms employing large, annually-inspected auditors and who generally do not document a relation between inspection reports and SEO underpricing, suggesting that the dominant effect is auditor brand name in this environment.

SESSION 5.04: FACTORS AFFECTING AUDITOR JUDGMENT
DATE: SATURDAY, JANUARY 13, 2018
TIME: 10:15 AM - 11:45 AM

Counteracting the Directional Influence of Incentives on Auditor Judgment

Dan Zhou
University of Illinois at Urbana-Champaign

ABSTRACT: Auditing standards require auditors to be objective in their judgment. However, prior research indicates that incentives in the audit environment influence auditors' judgment by motivating them to prefer a particular audit conclusion over others, undermining auditors' objectivity. In this study, I examine the effects of two interventions, intrinsic motivation and accountability, on the directional influence of incentives on auditors' judgment and information processing. I predict and find that increasing the salience of auditors' intrinsic motivation for their job counteracts the directional influence of incentives on auditors' judgment. The counteracting effects of salient intrinsic motivation on audit judgment is achieved through how auditors process information: auditors with salient intrinsic motivation search for relatively more information that contradicts the incentive-consistent audit conclusion and evaluate the information as relatively less supportive of the incentive-consistent audit conclusion than do auditors in the control condition. On the other hand, I find that holding auditors accountable according to relevant auditing standards does not reduce the directional influence of incentives on auditors' information evaluation (consistent with my theory), nor does it mitigate the impact of incentives on auditors' information search (contrary to my theory). The results of this study provide a new perspective on addressing the directional impact that auditors' incentives have on audit quality, a challenging issue that has consistently concerned regulators, practitioners, and academics.

SESSION 5.04: FACTORS AFFECTING AUDITOR JUDGMENT

DATE: SATURDAY, JANUARY 13, 2018
TIME: 10:15 AM - 11:45 AM

An Investigation of Auditors' Judgments when Companies Release Earnings before Audit Completion

Lori Shefchik Bhaskar
Indiana University Bloomington

Patrick E. Hopkins
Indiana University Bloomington

Joseph H. Schroeder
Indiana University Bloomington

ABSTRACT: Over two-thirds of public companies now announce earnings prior to (versus with, or after) audit completion. We expect this practice has potential to increase pressure in auditor/ client negotiations over post-announcement audit adjustments. We report results of a controlled experiment with audit partners and senior managers that indicates auditors are significantly less likely to require audit adjustments for aggressive financial reporting when earnings have been released (versus drafted). Further, we test and find this effect can be fully mitigated with strong audit committee effectiveness (i.e., including idealistic, but achievable, characteristics that are likely currently lacking in average committees) or with higher auditor professional identification. Our process-model tests suggest released earnings causes auditors to adopt directional goals to avoid adjustments, leading to biased decision processing and lower judgment quality. Our study provides evidence on the importance of high-quality auditors and audit committees in promoting high-quality financial reporting.

SESSION 5.04: FACTORS AFFECTING AUDITOR JUDGMENT
DATE: SATURDAY, JANUARY 13, 2018
TIME: 10:15 AM - 11:45 AM

When Does Relevant Information Weaken Auditor Evidence Assessments? An Exploration of the Averaging Effect

Tamara A. Lambert
Lehigh University

Marietta Peytcheva
Lehigh University

ABSTRACT: Auditing standards task auditors with collecting sufficient appropriate evidence as they form audit judgments. Cognitive psychology documents a robust finding in which people evaluate a bundle of relevant, directionally consistent evidence by averaging their weighting of each component. This results in the bundle being assigned less weight than the strongest evidence item alone. We experimentally examine whether this averaging effect occurs in an audit context and explore a potential moderator. In three independent mini-cases, we ask auditor participants to make judgments about internal controls, going concern, and fraud risk, and present them with unfavorable audit evidence relevant to each judgment. We manipulate: whether we present a single strong evidence item or bundle it with a weaker evidence item; and, whether the auditor's initial impression of the client's state is favorable versus unfavorable, such that the unfavorable evidence will either confirm or disconfirm the initial impression. We find robust evidence that experienced auditors succumb to the averaging effect by making more strongly unfavorable judgments in response to the single evidence item than the bundle, and that this bias is reduced in the presence of evidence that disconfirms an initially favorable impression. We compare and contrast the averaging effect to the dilution effect, which involves the weakening of judgments by irrelevant information. We conduct a second experiment to provide evidence regarding whether the distinction between averaging and dilution is meaningful for an audit context. We find audit workpaper preparers distinguish between relevant evidence that is weak and irrelevant evidence in their workpaper documentation choices, and are more likely to document the former.

SESSION 5.05: PROFESSIONAL SKEPTICISM
DATE: SATURDAY, JANUARY 13, 2018
TIME: 10:15 AM - 11:45 AM

Cognitive Dissonance and Auditor Professional Skepticism

Ruwan Adikaram
University of Minnesota, Duluth

Julia L. Higgs
Florida Atlantic University

ABSTRACT: Professional skepticism is critical to audit quality. In an empirical investigation of Nelson's (2009) model of professional skepticism, this study explores how cognitive dissonance can influence the relationship between professionally skeptical (PS) judgment and PS action. In an experiment using attitude change as a proxy measure of cognitive dissonance (CD), professional auditor participants experience CD when they fail to take appropriate PS action in line with high PS judgment. CD leads auditors to lower ex-post risk assessments and to revise upward their view about the effectiveness of low diagnostic audit tests. Results also show that CD leads to exaggerated ex-post self-assessment of professional skepticism. We demonstrate a specific mechanism of how incentives can lower audit quality via a breakdown between PS judgment and PS action. This research can benefit both researchers and practitioners by better understanding how low PS actions can occur even when auditors exhibit high PS judgment.

SESSION 5.05: PROFESSIONAL SKEPTICISM
DATE: SATURDAY, JANUARY 13, 2018
TIME: 10:15 AM - 11:45 AM

Examining the Impact of Audit Firms' Use of Skepticism Feedback in Auditor Training

Aaron Saiewitz
University of Nevada, Las Vegas

Mary Kate Dodgson
Northeastern University

Marcus M. Doxey
The University of Alabama

ABSTRACT: In response to PCAOB concerns about auditors' professional skepticism, certain international auditing firms use the Hurtt Professional Skepticism Scale ("HPSS"; Hurtt 2010) to help auditors improve their professional skepticism. This practice involves providing feedback on their trait (i.e., inherent or natural) skepticism levels as measured by the HPSS, along with instructions to increase their skepticism if they are low in trait skepticism. To test the efficacy of the firms' training approach, we conducted an experiment in which 240 auditing students responded to the HPSS and, one week later, examined two simulated accounts receivable confirmation exceptions. We varied whether participants receive HPSS score feedback and/or instructions to increase their skepticism. We find the audit firms' practice of providing score feedback and instructions leads participants to improve their skeptical actions and judgments. However, the HPSS itself does not predict skeptical behavior in our setting, suggesting the feedback may not be accurate. Together, these findings imply the firms' practice is useful, but may need a more predictive skepticism measure.

SESSION 5.05: PROFESSIONAL SKEPTICISM
DATE: SATURDAY, JANUARY 13, 2018
TIME: 10:15 AM - 11:45 AM

When Auditors' Skeptical Judgments Do Not Lead to Skeptical Actions

Erin Michelle Hawkins
Clemson University

ABSTRACT: Auditors are required to maintain professional skepticism through the course of an audit engagement. Professional skepticism is maintained through both skeptical judgment and observable skeptical behavior (skeptical action). However, auditors who exhibit professional skepticism in judgment do not always exhibit professional skepticism in action. The present study examines whether social presence alters the likelihood of auditors acting on skeptical judgments by utilizing an experimental setting where participants interact with a hypothetical client using four different communication mediums varying in social presence. Results suggest that auditor-client interactions high in perceived social presence inhibit auditors from acting on skeptical judgments compared to auditor-client interactions that are low in perceived social presence. Results extend literature on auditor-client interactions, professional skepticism, and communication medium while also informing regulator concern over inappropriately applied, or even absent, professional skepticism.

SESSION 6.02: NON-AUDIT SERVICES, AUDIT TIMING
DATE: SATURDAY, JANUARY 13, 2018
TIME: 2:00 PM - 3:30 PM

All My Rowdy Friends: The Effect of Super Bowl Hosting on Audit Timing

Matthew Crook
The University of Tulsa

Tamara A. Lambert
Lehigh University

Brian Walkup
The University of Tulsa

James D. Whitworth
University of South Florida

ABSTRACT: Using the Super Bowl as an exogenous distraction to auditing firms located in the same Metropolitan Statistical Area (MSA) as the Super Bowl's host city, we examine the impact of a disruptive shock to the auditing process. Given the magnitude of hosting the Super Bowl, combined with the game falling during the audit "busy season" this results in an ideal setting for a natural experiment. We use data on Super Bowl host cities from 2000-2015 to show that firms with auditors headquartered in the hosting MSA experience both statistically and economically significant decreases in the timeliness of financial reporting and increases in audit fees. Firms experience increases in financial reporting lags of 3.11percent (1.85 days), 2.98 percent (1.46 days), and 1.65 percent (1.21 days) for their audit report, earnings announcement, and 10-K filings, respectively. As auditing firms must either absorb the cost of these additional delays internally, or pass them to the firm being audited, we find that the cost passed to the client is an average 6.77 percent ($31,159) increase in audit fees. Our results should be of interest to regulators, auditors, investors, and academics, as our findings suggest both a timeliness consequence and financial consequence to publicly-traded companies in the local MSA hosting the Super Bowl.

SESSION 6.02: NON-AUDIT SERVICES, AUDIT TIMING
DATE: SATURDAY, JANUARY 13, 2018
TIME: 2:00 PM - 3:30 PM

Auditor-Provided Non-Audit Services: Economic Bonding, Knowledge Spillover, or Both?

Andrew John Imdieke
University of Notre Dame

Thomas C. Omer
University of Nebraska–Lincoln

Erik Beardsley
University of Notre Dame

ABSTRACT: This study examines whether audit quality varies with different levels of auditor-provided non-audit services (NAS). The effect of NAS on audit quality has been a long-standing debate among academics and regulators. One view is that NAS can strengthen the economic bond between the auditor and client, jeopardizing auditor independence, while another view is that NAS creates knowledge spillover, improving audit quality. Consistent with many insignificant results reported in prior studies, we do not find an association between NAS and audit quality at the conditional mean of the distribution of NAS as a percentage of total fees at the audit office level. However, because the effects of knowledge spillover and economic bonding likely vary throughout the distribution of NAS, we examine these constructs over the distribution of NAS rather than just the conditional mean. The results indicate that a moderate level of NAS is associated with better audit quality than both low and high levels of NAS, providing evidence that both knowledge spillover and economic bonding can affect audit quality.

SESSION 6.02: NON-AUDIT SERVICES, AUDIT TIMING
DATE: SATURDAY, JANUARY 13, 2018
TIME: 2:00 PM - 3:30 PM

Non-Audit Services and the Timeliness and Reliability of Earnings Announcements

Chris E. Hogan
Michigan State University

Michelle L. Nessa
Michigan State University

Joseph H. Schroeder
Indiana University Bloomington

ABSTRACT: This paper examines the association between non-audit services (NAS) and the timeliness and reliability of earnings announcements. While most companies release earnings before the audit is complete to provide timely information to the market, earnings announcements issued before audit completion are less reliable. If NAS generate knowledge spillovers that improve audit efficiency, firms that purchase NAS will be able to satisfy the market's demand for timely information without sacrificing the information's reliability. We find tax NAS are associated with shorter earnings announcement lags, more complete audits at the earnings announcement, and lower likelihood of an earnings revision, consistent with tax NAS increasing audit efficiency. In subsequent analyses, we do not observe significant associations between tax NAS and discretionary accruals or misstatements, indicating our main findings are not due to impaired independence. Our results provide evidence of a positive externality with important capital market implications arising from tax NAS.

SESSION 6.03: AUDITOR REPORT CHANGE, AUDITOR MATERIALITY
DATE: SATURDAY, JANUARY 13, 2018
TIME: 2:00 PM - 3:30 PM

Direct Measures of Auditors' Quantitative Materiality Judgments: Properties, Determinants and Consequences for Audit Characteristics and Financial Reporting Reliability

Preeti Choudhary
The University of Arizona

ABSTRACT: For a large sample of audits carried out during 2005-2015 by eight large accounting firms and inspected by the PCAOB, we provide evidence on the properties of auditors' quantitative materiality judgments and the consequences of those judgments for financial reporting. We find that auditors' quantitative materiality judgments do not appear to result only from applying conventional rules-of-thumb, specifically, 5% of pre-tax income, but instead are associated with qualitative factors suggested by authoritative guidance and with size-related financial statement outcomes (income, revenues and assets); weights placed by auditors on these outcomes vary with client characteristics such as financial performance. Using non-authoritative guidance in audit-firm policy manuals, we construct a materiality measure (materiality looseness) that is comparable across varying client sizes. We find that looser materiality is associated with fewer audit hours and lower audit fees, supporting the construct validity of this measure. We also find that looser materiality judgments are associated with lower amounts of detected errors and a greater incidence of restatements, highlighting the importance of these decisions for financial reporting reliability.

SESSION 6.03: AUDITOR REPORT CHANGE, AUDITOR MATERIALITY
DATE: SATURDAY, JANUARY 13, 2018
TIME: 2:00 PM - 3:30 PM

Does Company Reporting of Non-GAAP Earnings Result in Less Conservative Auditor Materiality Judgments? Evidence from the U.K.

Nicholas Jennings Hallman
The University of Texas at Austin

Jaime J. Schmidt
The University of Texas at Austin

Anne Margaret Thompson
University of Illinois at Urbana-Champaign

ABSTRACT: Does company reporting of non-GAAP earnings result in less conservative auditor materiality judgements, as measured by auditors' determination of quantitative materiality thresholds? Using a sample of audit reports issued to Premium Listed companies on the London Stock Exchange for FY 2013-2014, we find that more than 50 percent of auditors relying on a profit-before-tax materiality benchmark use adjusted (non-GAAP) profit-before-tax as their benchmark and these non-GAAP adjustments result in a less conservative audit (i.e., higher materiality amount) 92 percent of the time. We find that auditors' adjustments are significantly more persistent than managers' adjustments, suggesting that (1) the adjustments are not "one-off" as often described by the client and its auditor, and (2) auditor materiality thresholds are not always based on true underlying earnings. Finally, we find that auditors' reliance on non-GAAP rather than GAAP earnings keeps estimation uncertainty in complex estimates below materiality 23 percent of the time which likely reduces the extent of procedures auditors perform over complex estimates. In sum, our findings suggest that company reporting of non-GAAP earnings results in less conservative auditor materiality judgments which could negatively impact audit quality.

SESSION 6.03: AUDITOR REPORT CHANGE, AUDITOR MATERIALITY
DATE: SATURDAY, JANUARY 13, 2018
TIME: 2:00 PM - 3:30 PM

Is More Always Better? Disclosures in the Expanded Audit Report and their Impact on Loan Contracting

Vlad Andrei Porumb
University of Groningen

Yasemin Zengin Karaibrahimoglu
University of Groningen

Reggy Hooghiemstra
University of Groningen

Dick de Waard
University of Groningen

ABSTRACT: Starting October 2013 auditors of premium listed firms in the UK are mandated to prepare an expanded audit report. In this report auditors provide details on audit procedures, main risks of material misstatement (RMMs), and materiality thresholds. We analyze if the increased audit disclosure reduces private lenders' monitoring costs and shapes loan contracting. Our evidence suggests that the introduction of the expanded audit report is associated with improved lending terms for adopting firms relative to matched samples of non-adopting US and UK firms. The analyses of expanded audit reports in the post-adoption period show that borrowers with more RMMs are perceived to be riskier, which translates into less favorable loan contracting terms. Additional tests indicate that uncertainty in the tone of the disclosures reduces the negative impact of the number of RMMs on lending terms. Taken together, our results indicate that the expanded audit report disclosures contain relevant information, which shapes loan contracting.

SESSION 6.04: THE EFFECT OF AUDIT QUALITY
DATE: SATURDAY, JANUARY 13, 2018
TIME: 2:00 PM - 3:30 PM

Banking (in)stability: Are Auditors a Cause or a Cure?

Matthew James Beck
Michigan State University

Allison Nicoletti
University of Pennsylvania

Sarah Barron Stuber
Michigan State University

ABSTRACT: Ensuring the stability of the financial system is a top goal for regulators and policymakers. Despite the critical role depositors play in financial system stability, research on the importance of financial reporting information and auditor assurance to depositors is largely absent from accounting literature. In this study we examine how auditors influence depositor behavior by increasing monitoring efficiency, and also by acting as a channel to spread bank run contagion in the event of a bank failure. Using a sample of audited and unaudited banks, we find that depositors significantly change their response to financial statement information in the presence of an auditor or trusted auditor. We also find that when the reputation of an auditor is damaged through association with a bank failure, other clients of the failed bank's auditor experience a decrease in uninsured deposits and an increased likelihood of large uninsured deposit withdrawal. Overall, our findings are consistent with depositors valuing the presence and reputation of the auditor and demonstrate that an auditor can improve financial system stability by facilitating more efficient monitoring, but can also contribute to financial system instability by acting as a channel to spread bank run contagion.

SESSION 6.04: THE EFFECT OF AUDIT QUALITY
DATE: SATURDAY, JANUARY 13, 2018
TIME: 2:00 PM - 3:30 PM

Does Audit Quality Impact the Profitability and Information Content of Insider Trades?

Paul N. Michas
The University of Arizona

Nathan Chad Goldman
The University of Texas at Dallas

Daniel Russomanno
The University of Arizona

ABSTRACT: Extant literature on insider trading finds insiders systematically profit from trading their firms' stock, which contributes to agency costs. This study examines whether stronger audit quality (a) mitigates the rents extracted through insider trading, and (b) reduces the information content of insider trades about future earnings news. Using seven commonly applied measures for audit quality [i.e., big-four auditor, number of clients (total and above the median), audit fees (total and average), and industry expertise at the city and national level)], we find a significant reduction in insider trading profits associated with stronger audit quality for six of the seven measures. These findings are robust to alternative research designs (i.e., difference-in-difference and propensity score matching) to correct for possible selection bias and endogeneity. Finally, we find the volume of net insider sales (purchases) is less informative of future negative (positive) abnormal returns around earnings announcements with four of the five size-based measures and the city-level industry competency-based measure for stronger audit quality. We contribute to the audit and insider trading literature by presenting causal evidence consistent with audit quality mitigating the moral hazard problem associated with insider trading. Specifically, our findings suggest stronger audit quality lowers shareholder agency costs that arise from insider trades by reducing the earnings-related information asymmetry between insiders and outsiders at the time of insider trades.

SESSION 6.04: THE EFFECT OF AUDIT QUALITY
DATE: SATURDAY, JANUARY 13, 2018
TIME: 2:00 PM - 3:30 PM

Tax Avoidance, Horizontal Agency Conflicts and High-Quality Auditing in Private Firms

John Christian Langli
BI Norwegian Business School

Marleen Willekens
KU Leuven

ABSTRACT: In this paper we investigate whether horizontal agency costs associated with concentrated ownership, CEO ownership and family ownership affect tax avoidance in private firms and whether high-quality auditing ameliorates these agency costs thereby enhancing tax avoidance. We rely on the theoretical framework developed by Desai and Dharmapala (2006) that embeds the tax sheltering decision within an agency context, and emphasizes the importance of interactions between rent diversion and tax sheltering. We argue that horizontal agency conflicts arising from ownership patterns in private firms hinder tax avoidance, but that high-quality auditing can ameliorate these agency costs leading to more tax avoidance, ceteris paribus. We use a large sample of Norwegian firms from 2000-2014 and our results provide support for the hypotheses that horizontal agency costs associated with ownership patterns in private firms hinder tax avoidance but that high-quality auditing ameliorates these agency conflicts and enhances tax avoidance in private firms.

SESSION 6.05: FACTORS AFFECTING AUDITOR JUDGMENT II
DATE: SATURDAY, JANUARY 13, 2018
TIME: 2:00 PM - 3:30 PM

Ego Depletion and Evidence Integration while Auditing Complex Estimates

Emily Elaine Griffith
University of Wisconsin–Madison

Jacqueline S. Hammersley
The University of Georgia

Patrick J. Hurley
Northeastern University

ABSTRACT: Auditors face significant difficulties integrating audit evidence, which is a critical component of effectively auditing complex accounting estimates. The cognitive complexity involved in integrating evidence likely contributes to these difficulties. Further, auditors are often susceptible to ego depletion – a reduced ability or willingness to use self-control to effectively regulate decision-making – that can impede performance on cognitively complex tasks. In an experiment involving professional auditors, we examine whether a decision aid designed to reduce cognitive complexity helps auditors process evidence in a way that improves their judgments and decisions about complex estimates. We find that our decision aid causes depleted auditors to appropriately refine more assumptions within a client's discounted cash flow (DCF) model. As auditors appropriately refine more assumptions, they increase their likelihood of integrating evidence; evidence integration leads to lower reasonableness assessments regarding a biased estimate and increases urgency in auditors' follow-up actions taken in response to the estimate. Our study contributes to our understanding of the processes used in auditing complex estimates, how auditors integrate specialists' evidence, and how decision aids can enhance the performance of depleted auditors.

SESSION 6.05: FACTORS AFFECTING AUDITOR JUDGMENT II
DATE: SATURDAY, JANUARY 13, 2018
TIME: 2:00 PM - 3:30 PM

The Influence of Professional Identity and Outcome Knowledge on Auditor Judgment

Anna J. Johnson
Bradley University

Julia L. Higgs
Florida Atlantic University

Karen L. Hooks
Florida Atlantic University

Veena Looknanan Brown
University of Wisconsin–Milwaukee

ABSTRACT: In response to a Public Company Accounting Oversight Board (PCAOB) 2007 inspection report, Deloitte notes, "[p]rofessional judgments of reasonable and highly competent people may differ as to the nature and extent of necessary auditing procedures, conclusions reached and required documentation" (30). The PCAOB (2012) argues that inspection deficiencies should not be characterized as differences in professional judgments. Using social identity theory, we examine whether role identity influences experts' judgments. We provide a hypothetical judgment made by a lead engagement partner (LEP) and measure the degree in which participants assigned to other review roles (engagement quality review partner (EQRP), internal quality reviewer (IQR), or a PCAOB inspector (Inspector)) agree with the LEP. We predict EQRPs (Inspectors) will agree (disagree) more than the other identities and in-group reviewers will agree more with LEP judgment than out-group reviewers. Interesting, controlling for theory-based covariates, we find the IQRs disagree more than those in both the EQRP or inspector roles. Also, as predicted, we find outcome knowledge impacts expert judgment.

SESSION 6.05: FACTORS AFFECTING AUDITOR JUDGMENT II
DATE: SATURDAY, JANUARY 13, 2018
TIME: 2:00 PM - 3:30 PM

Auditor Inquiry: The Influence of Client Message Framing on Auditors' Judgment

Jeremy Vinson
Clemson University

Byron Pike
Minnesota State University Mankato

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University of St. Thomas

ABSTRACT: Audit inquiry is the most predominate procedure used by financial statement auditors to gather audit evidence. Inquiry, relative to other audit procedures, is subject to manipulation from client personnel in that an explanation can be framed either positively or negatively. We utilize psychology theory on attribute framing and belief-adjustment to examine the influence of message framing by the client during audit inquiry on auditor judgment. In an experiment, we manipulate the valence of the message frame at the beginning (positive or negative) and ending (positive or negative) of a simulated audit inquiry, while holding the message content constant. We find that elements of both theories impact auditors' inquiry judgments and decisions. Supportive of attribute theory, we find auditors are subject to a confirmation bias when judging reasonableness and persuasiveness of the client's explanation. Alternatively, we find auditors are subject to a recency bias when judging the likelihood of material misstatement in the account, which affects their evidence gathering choices and is supportive of belief adjustment. Overall, auditors did not incorporate all framing equally.

SESSION 7.02: ACCOUNTING STANDARDS AND AUDIT QUALITY
DATE: SATURDAY, JANUARY 13, 2018
TIME: 4:00 PM - 5:30 PM

Accounting Standard Precision, Corporate Governance, and Accounting Restatements

Li Fang
Iowa State University

ABSTRACT: Prior research documents wide variation in the precision of accounting standards (rules-based versus principles-based accounting standards). We examine whether financial reporting quality evident in restatements is associated with accounting standard precision and whether the role that various internal and external monitors play in the financial reporting process varies with accounting standard precision. Our strong, robust evidence implies that the likelihood of a subsequent financial report restatement decreases as the accounting standards applicable to the firm become more principles-based. This inference is robust to examining exogenous shifts in accounting standard precision caused by accounting standard revisions. Additional analyses suggest that our evidence mainly stems from managers' concern over second guessing, rather than greater litigation risk or greater auditor effort when managers have more latitude under the more principles-based standards (PBS). We also find that independent boards and audit committees, external auditors, and financial analysts are more effective at constraining financial misreporting at firms relying more on rules-based accounting standards (RBS) than firms relying more on PBS. Our large-sample empirical evidence suggests that U.S. firms, on average, do not exhibit a greater incidence of financial misreporting under PBS where managers have greater latitude and exercise more professional judgment in the accounting treatment of economic events. However, some of the internal and external corporate governance mechanisms currently in place may not function as well under more PBS as under more RBS. Our results have important policy implications to the current debate on moving the U.S. financial reporting regime toward a more principles-based framework.

SESSION 7.02: ACCOUNTING STANDARDS AND AUDIT QUALITY
DATE: SATURDAY, JANUARY 13, 2018
TIME: 4:00 PM - 5:30 PM

An Empirical Investigation of Auditors' Reaction to Rules vs. Principles Based Accounting Standards

Avishek Bhandari
Florida Atlantic University

Babak Mammadov
Florida Atlantic University

S. Hamidreza Vakilzadeh
Florida Atlantic University

ABSTRACT: This study examines the association between the rules-based accounting standards and auditors' fees and likelihood of receiving going concern opinion. Our results suggest that auditors perceive firms relying more on principles-based standards to be less risky, which is why audit fee is lower. Furthermore, we determine that probability of receiving going concern opinion reduces as firms rely more on principles-based standards because these firms structure transactions that benefit the firm as opposed to achieving certain economic outcome. This research contributes to the debate about the nature of accounting standards. Our study is also relevant for investors and regulators as the results suggest that financial statements prepared using more principles-based standards better reflect the economic performance of the firm.

SESSION 7.02: ACCOUNTING STANDARDS AND AUDIT QUALITY
DATE: SATURDAY, JANUARY 13, 2018
TIME: 4:00 PM - 5:30 PM

Does Mandatory IFRS Adoption Affect Audit Effort and Its Effectiveness to Constrain Earnings Management? Evidence from Italy

Kenneth J. Reichelt
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Dechun Wang
Texas A&M University

Tatiana Mazza
Free University of Bozen-Bolzano

Stefano Azzali
University of Parma

ABSTRACT: We examine the effect IFRS adoption has had on audit effort, hourly billing rates, and the effectiveness of audit effort to constrain earnings management. While there is a rich literature on the costs and benefits of IFRS adoption, it is unclear whether IFRS adoption affects the efficiency of the audit engagement, and the effectiveness in constraining earnings management. We find that following Italy's adoption of IFRS, audit hours increased while the hourly rate did not significantly change, suggesting that audit effort (in audit hours) increased following IFRS adoption. Consistent with prior literature (Caramanis and Lennox 2008), we find more audit effort is associated with less abnormal accruals. More importantly, after Italy adopted IFRS, audit hours were less associated with lower abnormal accruals, suggesting that the IFRS adoption dampened the auditor's effectiveness to constrain managers from inflating earnings. Collectively, our empirical analysis suggests that IFRS lead to an increase in audit effort with an unintended consequence of weakening its effectiveness to constrain earnings management.

SESSION 7.03: AUDIT RISKS, AUDIT OPINIONS, AND DISCLOSURES
DATE: SATURDAY, JANUARY 13, 2018
TIME: 4:00 PM - 5:30 PM

Big 4 Auditors, Litigation Risk, and Disclosure Tone

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Ling Lisic
Virginia Polytechnic Institute and State University

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University of Nebraska–Lincoln

Ivy Zhang
University of Minnesota

ABSTRACT: We examine the effect of Big 4 auditors on management's use of optimistic language in audited financial reports. While regulators and practitioners consider the audit of disclosures to be increasingly important, empirical evidence of an auditor's effect on management's qualitative disclosure choices is limited. Focusing on the notes to the financial statements, which are the primary disclosure item subject to audit, we find that the tone of the qualitative footnote disclosures is significantly more reflective of bad economic news in the presence of a Big 4 auditor compared with a non-Big 4 auditor. This Big 4 effect on footnote disclosure tone is more pronounced for the subsample of companies with high litigation risks. Our inferences continue to hold for matched samples constructed using coarsened exact matching and entropy balancing to control for inherent differences between clients of Big 4 and non-Big 4 auditors. In contrast, when we examine Management's Discussion and Analysis, which is not subject to audit, we do not find a Big 4 effect on the sensitivity of its tone to bad news. Our results are consistent with higher litigation exposure motivating Big 4 auditors to constrain management's use of optimistic language while auditing financial reports. This research provides new evidence to the ongoing regulatory discussions regarding the value of auditing disclosures.

SESSION 7.03: AUDIT RISKS, AUDIT OPINIONS, AND DISCLOSURES
DATE: SATURDAY, JANUARY 13, 2018
TIME: 4:00 PM - 5:30 PM

Audit Procedures and Financial Statement Quality: The Positive Effects of Negative Assurance

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Jaewoo Kim
University of Rochester

William R. Kinney
The University of Texas at Austin

Edward Owens
Emory University

ABSTRACT: Can independent financial statement "reviews" (that limit audit verification procedures to confirmatory data analytics and inquiries) economically improve financial statement quality? The answer is important to assess quality and cost-effectiveness of CPA firm services as a function of audit inputs and to separately evaluate the effects of review procedures from the combined effects of internal control and detailed testing that comprise "full audits." To find out, we obtain management-prepared private company financial statements and statements resulting from CPA firm compilations (no verification procedures), reviews, and audits, plus data on CPA service fees. Applying common reporting quality and fraud proxies, we find compiled statements exhibit significantly higher quality than management-prepared statements and reviews are significantly higher than compilations and somewhat lower than audits, although reviews are not statistically distinguishable from audits when using some accruals-based quality proxies. To explore possible cost-effectiveness of CPA firm assurance relative to compilations, we estimate that our private firms' cost of debt averages 120 (149) basis points lower for reviews (audits), while incremental-to-compilation fees for a review (audit) are approximately 100% (400%). Overall, our results indicate limited-procedure reviews may be a cost-effective alternative to compilations, audits, or mandated audits (recently allowed by the SEC for small crowdfunding offerings), and also that confirmatory data analytics and inquiries warrant research to enhance stand-alone reviews and mechanism design of procedures for full audits.

SESSION 7.03: AUDIT RISKS, AUDIT OPINIONS, AND DISCLOSURES
DATE: SATURDAY, JANUARY 13, 2018
TIME: 4:00 PM - 5:30 PM

The Impact of Crash Risk on Auditors' Going Concern Opinion Decisions

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Temple University

Jayanthi Krishnan
Temple University

Xin Zhao
Temple University

ABSTRACT: We examine whether clients' crash risk impacts auditors' going concern opinion (GCO) decisions. Unlike other non-financial market variables such as stock return and volatility, which measure financial distress and have been shown to be associated with the issuance of a GCO, recent research suggests that crash risk can proxy for the degree of "bad news hoarding" by managers. We posit that the heightened audit risk associated with withheld negative information likely makes auditors more conservative in their GCO decisions. Using a sample of distressed firms for the period 2001-2014, we find that a company's current-year crash risk is positively associated with the auditor's propensity to issue a GCO for that year. However, this association exists only in the post-2008 financial crisis period, suggesting that auditors have become sensitive to stock price crash risk in their GCO decisions after the crisis. In addition, we find that Type I errors (GCOs not followed by subsequent bankruptcy) increase when auditors incorporate the crash risk into their GCO decisions. We find no evidence that Type II errors (bankruptcies not preceded by GCOs) are associated with crash risk.

SESSION 7.04: EFFECTS OF AUDIT REGULATION
DATE: SATURDAY, JANUARY 13, 2018
TIME: 4:00 PM - 5:30 PM

Short Horizon for Audit Partner and Earnings Quality: Evidence from a Dual-Rotation Regime

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Stefano Azzali
University of Parma

Kenneth J. Reichelt
Louisiana State University

ABSTRACT: Despite regulators' intention to use mandatory auditor rotation to promote professional skepticism and improve audit quality, frequent mandatory partner rotation can introduce a tenure horizon problem and impede earnings quality. While there is rich literature on auditor rotation, very few exist on the effect of a dual-mandatory rotation regime. We hypothesize that earnings quality is lower because shorter horizons for audit partner limit their audit investments and do not let them to acquire enough client-specific knowledge. Using data from Italy, we find that clients whose auditors have short horizons, due to dual rotation regulations, deliver lower earnings quality. Our findings provide insights for academics and regulators in evaluating auditor rotation strategies in their countries, especially in the European Union, where member states are implementing both mandatory audit-partner and audit-firm rotation.

SESSION 7.04: EFFECTS OF AUDIT REGULATION
DATE: SATURDAY, JANUARY 13, 2018
TIME: 4:00 PM - 5:30 PM

Did the Permanent Exemption from Internal Control Audits Affect Small Firms' Management Reporting on Internal Control?

Jayanthi Krishnan
Temple University

Lu Lu
Temple University

ABSTRACT: The Dodd-Frank Act of 2010 permanently exempted small companies (non-accelerated filers, NAFs) from compliance with Section 404(b) of the Sarbanes-Oxley Act, which requires auditors' attestation on their clients' internal control over financial reporting. NAFs are required to comply only with Section 404(a), which requires management reports on internal controls and consequently, these reports are the only available information about the NAFs' internal control quality. We examine the trends in ineffective internal controls reported by managements over the period surrounding the Dodd-Frank Act, and document a phenomenon hitherto unnoted in the literature: There was a discontinuity in the trend in the proportion of ineffective internal control management reports in 2010, with an increase in the post-Dodd-Frank years. The exemption was granted after several postponements of the effective date for compliance with Section 404(b). Consequently, throughout the period 2007-2010, NAFs were expecting to be required to comply with Section 404(b). After the permanent exemption in 2010, the auditors' attestation was no longer a forthcoming "threat". We investigate whether the removal of this threat of a Section 404(b) audit resulted in a change in management Section 404(a) reporting in the post-exemption period. Our multivariate tests indicate that in the post-exemption period, non-accelerated filers are more likely to report ineffective internal control over financial reporting than they did in the pre-exemption period. In addition, non-accelerated filers are less likely to remediate previously disclosed internal control weaknesses in the post-exemption period.

SESSION 7.04: EFFECTS OF AUDIT REGULATION
DATE: SATURDAY, JANUARY 13, 2018
TIME: 4:00 PM - 5:30 PM

Spillover of Regulatory Enforcement Against Small Audit Firms

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American University

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Arizona State University

ABSTRACT: One of the PCAOB's primary regulatory mechanisms is its ability to enforce audit firms' compliance with PCAOB and SEC rules. Once settled, PCAOB enforcement activities are publicized with the intent to serve a deterrence function for other auditors. However, the effect of public enforcement on competing audit firms has not been empirically investigated. We hypothesize that when an audit firm is publicly sanctioned by the PCAOB, there is a spillover effect on competing audit firms in the local market such that these competing firms will increase their audit quality. Importantly, none of these competing audit firms were subjected to PCAOB enforcement. Thus, PCAOB enforcement against an audit firm is exogenous to the competing treatment audit firms in our study. We find that non-sanctioned audit firms with audit clients in the same MSA as a sanctioned firm, improve their audit quality post-enforcement as captured by a lower incidence of client misstatement and a higher incidence of reported internal control deficiencies. We also find that these non-sanctioned auditors charge higher audit fees post-enforcement relative to pre-enforcement revelation. These results have implications for the PCAOB's intent to made disciplinary proceedings public prior to settlement.

SESSION 7.05: THE EFFECTS OF REGULATORY OVERSIGHT/ACCOUNTABILITY
DATE: SATURDAY, JANUARY 13, 2018
TIME: 4:00 PM - 5:30 PM

The Effect of Anticipated Inspection Focus on Audit Effort

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Jennifer McCallen
University of Massachusetts Amherst

ABSTRACT: This study examines the effect of anticipated inspection focus on audit effort. We find that anticipation of inspection focus on a specific area (that does not have high risk of material misstatement) leads auditors to increase audit effort in that area. Our results show that this ultimately leads to a decrease in audit effort difference between high vs. normal risk accounts. This is concerning as, to the extent that auditors put greater focus on inspection risk, as opposed to the actual risk of material misstatement, audit quality will suffer. We also examine the effect of implementing an auditor judgment rule (AJR) and find that the effect of AJR on audit effort depends on the level of current inspection risk. This study answers the call for more research on how PCAOB inspections affect the audit process and our findings would likely be of interest to regulators and standard setters.

SESSION 7.05: THE EFFECTS OF REGULATORY OVERSIGHT/ACCOUNTABILITY
DATE: SATURDAY, JANUARY 13, 2018
TIME: 4:00 PM - 5:30 PM

The Influence of Inspection Focus on Auditor Judgments in Audits of Complex Estimates

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ABSTRACT: The Public Company Accounting Oversight Board (PCAOB) seeks to influence auditor behavior and judgments through its inspections. I conduct an experiment that studies how an inspection's focus on procedural implementation versus judgment quality influences an auditor's mindset, which in turn affects auditor judgments. I study mindset effects on an auditor's evaluation of a complex estimate when the estimate is aggressively biased versus unbiased to interpret the effects of mindset on auditor judgments under different contexts. Drawing on mindset theory, I predict and find a conditional indirect effect of inspection focus on auditor judgment through mindset. I find judgment-focused deficiencies activate a deliberative mindset, characterized by objective information processing, while procedure-focused deficiencies lead to an implemental mindset, characterized by selective information processing. I find deliberative auditors assess a biased estimate as less reasonable than implemental auditors, but are not conservative in their judgments over an unbiased estimate. However, I also find evidence suggesting deliberative auditors are overly cautious in their decision-making. This study contributes to literature examining how regulators can influence auditor judgments through the inspection process and the effects of mindsets on auditor judgments and decisions.

SESSION 7.05: THE EFFECTS OF REGULATORY OVERSIGHT/ACCOUNTABILITY
DATE: SATURDAY, JANUARY 13, 2018
TIME: 4:00 PM - 5:30 PM

How Do Third-Party Examinations Affect Decision Quality? An Interactive Experiment

Brent A. Garza
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ABSTRACT: Using an interactive laboratory experiment, I investigate how third-party examinations affect decision quality for ill-structured tasks. I find that when examiners focus more on the quantity of work performed by the examinees and the examiners document their preliminary assessment of the examinees' judgment before conversing with them about their work, examiners request examinees perform greater amounts of the procedure they (i.e., examiners) rate as more diagnostic but not more of the procedure rated as less diagnostic. Examiners' behavior is consistent with confirmation bias. Second, I find that examinees perform the additional work requested after the examination and, over time, learn to perform some of it before. Third, this additional work generally improves examinees' decision quality. In supplemental analyses, I examine the tradeoffs between performing procedures of differently-rated diagnosticities on decision quality. While results suggest that better decision quality occurs when examinees use a combination of the procedures, examiners seem to over-request—and, thus, examinees over-perform—procedures that examiners rate as more diagnostic. Therefore, while third-party judgment examinations can improve decision quality for ill-structured problems, they may not do so to the greatest extent possible. The theory and results of this study have implications for both accounting and non-accounting areas where judgments on ill-structured problems are evaluated by third parties as well as psychology theory on confirmation biases.