



# THE AUDITOR'S REPORT

Volume 23, No. 1, Fall 1999

## AUDITING SECTION/AMERICAN ACCOUNTING ASSOCIATION

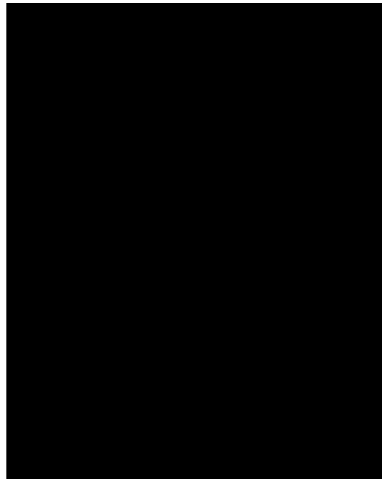
### REPORT OF THE PRESIDENT

A few years ago, computer innovator David Packard expressed his thoughts about the 21st century. "Everywhere I look," Packard noted, "I see the potential for growth, for discovery far greater than anything we have seen in the 20th century." As the Auditing Section begins its 1999–2000 year, we can look back at our past with pride and forward to a promising future.

#### A Look Back

The Auditing Section was born in the last quarter of the 20th century. Over the years, we have grown to a membership now over 1,500 strong. We have given birth to and nurtured to maturity a very successful section journal, *Auditing: A Journal of Practice and Theory*, currently under the leadership of editor Arnie Wright (Boston College). We have established a long-running reputation as one of the most active sections in the AAA, as evidenced by our continuing large number of paper and panel submissions for the annual meeting, which will be directed for the coming year by Robert Ramsay, University of Kentucky. We also have a history of very strong mid-year meeting programs (directed this year by Joanna Ho, UC-Irvine), regional meeting coordinators, and CPE activities (directed this year by Dana Hermanson, Kennesaw State University). And, of course, there is the very popular *Auditor's Report* newsletter, edited this year by Gary Braun (University of Texas at El Paso).

One of the section's strengths is its attention to strategic planning. During the last year, the Executive Committee worked on an update of the Section's strategic management framework: our mission statement, shared values, organization-wide measures, distinctive competencies, and critical activities and initiatives. As our historian's records show, the Section's strategic management framework has significantly evolved over time in response to changes in our environment. As part of our strategic planning efforts, one look back at the past—a reading of our Section bylaws—made the Executive Committee aware that no document lasts forever. There are a number of changes needed to bring our bylaws into the next century. See the article on page 22 about a proposed revision.



Karen Pincus

#### A Look Forward

As we move into the next century, the Section will continue to build on its past, and will build new bridges to the future. In the 1999–2000 year, the Section's website will be re-launched after a redesign to improve usability and make the site easier to keep current. The Communications Committee, headed by Ted Mock, University of Southern California, will be making recommendations about the design and suggesting new guidelines for electronic dissemination.

We will build a bridge to doctoral students with the inaugural offering in January 2000 of an *Auditing Section Doctoral Consortium*, under the leadership of Mike Bamber, University of Georgia. We will also explore building

bridges to other parts of the AAA. One example is a new exploration with the Management Accounting Section about exchanging sessions of mutual interest at our mid-year meetings.

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#### WINTER ISSUE DEADLINE

The deadline for material to be included in the Winter 2000 issue of *The Auditor's Report* is January 21, 2000. The preferred, but not mandatory, format is Word files attached to email messages. Please send all material to the Editor at the address below by that date to ensure timely publication of the issue:

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<http://raw.rutgers.edu/raw/aaa/audit/>

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**President's Report** (continued from page 1)

We will also continue our efforts to build bridges between practice and academia. For example, we will represent the AAA at the October public hearings of the Public Oversight Board's *Panel on Audit Effectiveness*. As another example, efforts are currently underway to appoint a new Practice Advisory Council, building on a successful innovation in our recent past. And as a final example, our Auditing Standards Committee will have a new charge: reacting to the newly-established "Auditing Profession Project Inventory" on a quarterly basis, providing selected projects with a summary of relevant research, helping identify potential academic members for some projects, and sending quarterly emails to Section members highlighting new projects that may be of particular interest. This committee is chaired by Peter Gillett (Rutgers University, New Brunswick), with Kay Tatum (University of Miami) as Vice-Chair.

To welcome the new century in style, the 2000 Mid-Year Meeting in Newport Beach, California, will have an exciting program, including the presentation of a new *Notable Contributions to the Auditing Literature Award*, as well as our well established awards for the outstanding auditing dissertation, outstanding auditing educator, and distinguished service in auditing. The inaugural *Auditing Doctoral Consortium* will also take place in conjunction with the 2000 Mid-Year Meeting. The year after this one marks the Section's 25th anniversary, which will be celebrated in style

at the 2001 mid-year meeting, now being planned by a committee headed by Linda McDaniel (University of North Carolina).

**One Year At a Time**

One last thought about the Auditing Section's 1999–2000 year: With a presidency that lasts only one year, I find I am very dependent on realists. American newspaper columnist Sydney Harris once explained the difference between idealists, cynics, and realists. "An idealist," he wrote, "believes the short run doesn't count. A cynic believes the long run doesn't matter. A realist believes that what is done or left undone in the short run determines the long run." I am grateful to the many realists who are members of the Auditing Section's Executive Committee. Especially to new members President-Elect Stan Biggs (University of Connecticut), Treasurer Mark Beasley (North Carolina State University) and Historian Jack Robertson (University of Texas at Austin) and outgoing members Past-President Barry Cushing (University of Utah), Treasurer Joe Carcello (University of Tennessee) and Historian Jack Krogstad (Creighton University)—and to all the volunteers who work so hard on Section committees.

Karen Pincus  
University of Arkansas

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**SIXTH ANNUAL MIDYEAR  
AUDITING SECTION  
CONFERENCE**

The sixth Annual Midyear Auditing Section Conference and the first Auditing Section Conference in the 21st century will be held in **Newport Beach, California**, on **January 13-15, 2000**. The conference will consist of keynote, plenary and concurrent sessions dealing with a wide variety of contemporary topics related to audit, attestation and assurance practices, education and research. In addition, the inaugural Auditing Section Doctoral Consortium will take place on January 13. More information on this consortium is included in this newsletter.

There will also be a CPE session on the afternoon of January 13. Marilyn Greenstein of Lehigh University and Tom McKee of East Tennessee State University will present "E-Commerce: Implications for Assurance Education and Research."

The conference will be held at the *Newport Beach Marriott*. After a long, thought-provoking day of meetings, Newport Beach is a great place to shop in the comfortable outdoor settings provided by Fashion Island (an upscale shopping center just across the street from the hotel) or to relax on California's sunny beaches. Plus, it's only 20 minutes away from Disneyland—"the happiest place on earth."

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# 2000 Auditing Doctoral Consortium Program

## Thursday January 13, 2000

### Newport Beach Marriot Hotel

The Auditing Section of the American Accounting Association and KPMG are sponsoring an Auditing Doctoral Consortium to be held in conjunction with the Auditing Section's Midyear Conference, January 14-15, 2000, Newport Beach California. The purpose of the Consortium is to stimulate students' research by exposing them to the very latest ideas from leading researchers in auditing, and by providing opportunities for networking with other Ph.D. students interested in auditing, established auditing researchers, and editors of the journals in which they will seek to publish.

I ask you to help in publicizing the Consortium to your Ph.D. students and in supporting and encouraging their attendance. Students may be at any stage in their program and there is no limit on how many students may attend from each school. There is a limit on how many students in total can attend the Consortium and applicants will be accepted on a first come basis.

#### Program

7:00–8:00 a.m.	Breakfast
8:00– 8:15 a.m.	Welcome— E. Michael Bamber
8:15– 9:30 a.m.	William R. Kinney, Jr. Research Opportunities in Assurance Services
9:30– 9:45 a.m.	Break
9:45–11:00 a.m.	Mark E. Peecher—Research Opportunities in Behavioral Auditing
11:00–11:15 a.m.	Break
11:15–12:30	Dan A. Simunic—Research Opportunities in the Economics of Auditing
12:30–1:45 p.m.	Lunch
1:45–3:00 p.m.	Richard M. Tubbs—Methodological Issues in Auditing Research
3:00–3:15 p.m.	Break
3:15–5:15 p.m.	Editors' Panel—Linda S. Bamber, <i>The Accounting Review</i> ; William L. Felix, Jr., <i>Auditing: A Journal of Practice &amp; Theory</i> ; Dan A. Simunic, <i>Contemporary Accounting Research</i> ; Arnold M. Wright, <i>Auditing: A Journal of Practice &amp; Theory</i>
6:00–9:00 p.m.	Auditing Midyear Conference Reception

#### Information

1. The Auditing Doctoral Consortium is sponsored by the Auditing Section of the American Accounting Association and KPMG.
2. Registration for the Consortium is free and for those students wishing to attend the Auditing Midyear Conference (January 14–15) which follows the Consortium (January 13), the Conference registration fee (\$100) is waived.
3. The Consortium is open to all Ph.D. students with an interest in auditing research. The size of the Consortium is limited, so students will be accepted on a first come basis.
4. Students will have one night's lodging paid for at the Consortium/Conference hotel. The cost of additional lodging (\$129 per night, single or double occupancy) is the student's responsibility.
5. Meals will be provided during the Consortium. The Conference also provides breakfast and lunch for attendees, with a reception in the evening.
6. Participants are responsible for their own transportation to and from Newport Beach.
7. For additional information call (706-542-3601) or email (mbamber@terry.uga.edu) Michael Bamber. Register by emailing Michael Bamber. Please provide your name, mail and email addresses, phone and fax numbers, stage/year in program and auditing research interests. Additional information will then be forwarded to you.

# ASB Update as of August 31, 1999

Ray Whittington, DePaul University  
Academic Member of the Auditing Standards Board

The ASB is devoting attention to several projects that deal with issues that continue to be particularly susceptible to academic research. In this update I will focus on two such projects, financial capability (going concern) and the auditor's responsibility to detect fraud. In addition, I will describe a project related to revenue recognition. Please send any questions, comments, or suggestions to rwhittin@wppost.depaul.edu.

## Financial Capability and Going Concern

Recently the ASB attempted to undertake a project to revise SAS No. 59 to improve auditor performance. However, it was concluded that no significant progress could be made in light of the lack of reporting criteria regarding financial capability in generally accepted accounting principles. At the urging of the ASB, a Work Group on Financial Capability was formed to determine if accounting and auditing standards setters should undertake a project to address financial reporting and auditing issues on the topic of financial capability. The working group is composed of representatives of the FASB, the ASB, the Accounting Standards Executive Committee, and the Technical Issues Committee. In an attempt to solicit user input, a Financial Capability Roundtable was held on June 28 that brought together various leaders of the business community. These deliberations have identified the following issues:

- What types of conditions or events should trigger the requirement to disclose information about an entity's financial capability?
- What kinds of disclosures regarding financial capability should be included in financial statements when the threshold is triggered?
- Should all entities be required to disclose information about financial capability or should the requirement only apply to the entities that are experiencing financial difficulties?
- Should the auditing literature continue to require a going concern paragraph in the auditor's report if certain conditions regarding financial capability are present?
- Do the SEC's Management Discussion & Analysis Rules, in requirement and in practice, provide sufficient disclosure related to financial capability, especially in periods immediately preceding the declaration of bankruptcy.

Research related to any of these issues would be valuable to the ASB's eventual consideration of this issue.

## The Auditor's Responsibility for Detection of Material Misstatement Due to Fraud

The ASB recently decided to support the following four proposals to research the effectiveness of SAS No. 82:

- *Assessing the Effectiveness of SAS No. 82*, by Steven Glover, Mark Zimbelman, and Douglas Prawitt of Brigham Young University and Joseph J. Schultz of Arizona State University. Using the prior study by Zimbelman (*Journal of Accounting Research*, Supplement, 1997) as a benchmark, the researchers will attempt, through behavioral experiments, to determine (a) changes in the extent of planned audit testing due to elevated fraud risk, and (b) significant changes in the nature of planned audit testing due to elevated fraud risk.
- *Audit Fraud Risk Assessment Information and Its Relationship to Audit Programs*, by Theodore Mock of the University of Southern California and Jerry L. Turner of Florida International University. The researchers will use archival methodology to study (a) the extent to which fraud risk assessments vary between clients in similar industry groups and over time, (b) the extent to which auditing procedures have been affected by the fraud risk assessment required by SAS No. 82, and (c) the nature of the adjustments in audit programs resulting from differences in fraud risk assessments.
- *The Impact of a Standard Audit Program and Management Strategic Behavior on the Planning of Fraud Detection Procedures*, by Steven K. Asare of the University of Florida and Arnie Wright of Boston College. Using a behavioral experiment, the researchers will examine the effect of a standard program and management diversionary tactics on auditors' effectiveness in designing appropriate fraud-related procedures.
- An untitled proposal by Barbara Apostolou of Louisiana State University and John M. Hassell of Indiana University. This proposal is for a study that will attempt to determine the relative importance of the SAS No. 82 risk factors to practicing auditors using the Analytic Hierarchy Process.

The ASB continues to be interested in other projects that may shed light on the effectiveness of audits in detecting material misstatements due to fraud.

## Revenue Recognition

Revenue recognition is generally considered to be one of the most contentious issues in a financial statement audit, especially as it is applied in certain specialized industries. It has been an issue in many audit failures, and was recently identified by the SEC as a major concern for the profession. As a result, a task force of the ASB has been established to oversee the development of guidance in this area. The first publication of the task force brings together in one source the audit and accounting guidance on revenue recognition from AICPA Audit and Accounting Guides. Its primary objective is to assist auditors in fulfilling

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# CONFERENCE ANNOUNCEMENT and CALL FOR PAPERS

**BDRM CONFERENCE  
TUCSON, ARIZONA  
MAY 19–21, 2000**

The seventh biennial Behavioral Decision Research in Management (BDRM) Conference will be held May 19–21, 2000 at the University of Arizona in Tucson. As in previous years the Conference will include sessions on decision research in Marketing, Accounting, Management, Bargaining and Negotiation, Economics and Games, Decision Analysis and other related issues. The sessions are always fun and stimulating, and May is a great time to visit Tucson and enjoy the Southwest, so mark your calendar now. Accommodations, and most of the sessions, will be at the historic Westward Look Resort. Deadline for symposium proposals and paper abstracts is January 14, 2000.

For more details on the conference, including registration and submissions, please visit our web site at <http://www.bpa.arizona.edu/~map/bdrm>. If this is inconvenient, we can be reached by email: [lordonez@bpa.arizona.edu](mailto:lordonez@bpa.arizona.edu); or [connolly@u.arizona.edu](mailto:connolly@u.arizona.edu); or by mail at:

BDRM Conference  
Department of Management and Policy  
Eller College of Business and Public Administration  
University of Arizona  
Tucson, AZ 85721

Terry Connolly, Lisa Ordóñez  
Conference Co-Chairs

## ASB Update (Continued from page 4)

their responsibilities in auditing the financial statements assertions related to revenue. The publication is an excellent resource for auditing classes and can be obtained from the AICPA Order Department by requesting product number 022506. It also may be downloaded from the AICPA web site.

Now the task force has turned its attention to development of a guide on auditing revenue in certain industries that are not covered by existing AICPA Guides. The focus of this project will be on industry-specific issues that present special audit risks. Industries identified thus far for inclusion are computer software, high technology, service providers, and franchisors.

## 2000 Annual Meeting

The 2000 Annual Meeting will be held on August 13–16 in Philadelphia. The number of sessions allocated to the Auditing Section is related to the number of manuscripts submitted to our section coordinator. Please consider submitting your work for possible presentation at the Annual Meeting.

Submissions must be received by January 13, 2000. A submission fee of \$15, made payable to the American Accounting Association, must accompany each manuscript. Papers should not be submitted that have been either published or accepted for publication, or that will be presented at more than one AAA Regional Meeting during spring 2000.

Further details on submitting a paper to the Annual Meeting will be published in the fall issue of *Accounting Education News*. Submissions should be sent to:

Robert J. Ramsay, Ph.D., CPA  
Doctoral Program Director  
School of Accountancy  
345N Gatton College of Business and Economics  
Lexington, KY 40506-0034  
Ph: (606)257-3702  
Fax (606)257-3654

## Call for Classroom Innovation Articles

“Innovations in the Classroom” is a continuing feature of The Auditor’s Report. Recent examples include articles on CAATs and Electronic Workpapers co-authored by Tim Louwers and an article about online Collaborative Discovery Learning by Faye Borthick.

This feature will continue to be dedicated to disseminating insights gleaned from members (and others) who have had success with innovations (broadly considered) in the auditing classroom, both undergraduate and graduate. For example, some professors have included service learning assignments in the auditing/assurance curricula. An article in that area, as well as many other areas, would be very appropriate.

If you have an idea for a submission please contact:  
Gary Braun  
([gbraun@utep.edu](mailto:gbraun@utep.edu) or 915.747.7742)  
or Mark Taylor  
([mhtaylor@darla.badm.sc.edu](mailto:mhtaylor@darla.badm.sc.edu) 803.777.4387).

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# Examining Corporate Governance Research: Any Consistencies with Calls for Reform?

Mark S. Beasley

Assistant Professor, North Carolina State University

The financial press continues to highlight the importance of the board of directors and audit committee in ensuring effective corporate governance (e.g., *Fortune* August 2, 1999). In many cases, the effectiveness of the board and audit committee in detecting corporate improprieties, including financial statement fraud, is being called into question. For example, an article in the *Wall Street Journal* (July 17, 1998, pp. B1, B5) accuses audit committees as being “toothless tigers.” Public concerns about the effectiveness of board and audit committee governance, particularly concerns expressed by representatives of the Securities and Exchange Commission (SEC), led to the 1998 creation of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (the Blue Ribbon Panel). The Blue Ribbon Panel’s February 1999 report contains ten recommendations calling for changes in audit committee governance, which are currently under evaluation by the New York Stock Exchange and the National Association of Securities Dealers (BRC Report 1999). Furthermore, another series of recommendations for audit committee reform is expected this fall from the National Association of Corporate Directors’ Blue Ribbon Commission on Audit Committees. Clearly, the roles of the board and audit committee as corporate governance mechanisms are under scrutiny.

Researchers are actively examining the roles of boards of directors and audit committees in corporate oversight. Earlier research in economics, finance, and management documents much of the debate supporting many of the current calls for stronger board oversight, which has been expanded in accounting research to address the role of board and audit committee governance over financial reporting.

My objectives in this essay are to review many of the contributions of this stream of research, particularly that in accounting, to emphasize how that research provides empirical validation of many of the current recommendations for board and audit committee reform currently under consideration. Ultimately, a goal of this essay is to raise the visibility of these research findings to benefit practitioners and others in the business community who are affected by or responsible for board and audit committee governance. Another goal of this essay is to spawn future research that can provide further insight into the need for additional changes in board and audit committee oversight.

## Does Board of Director Monitoring Benefit Stockholders?

Research in finance and economics argues that the board of directors serves as an important corporate governance mechanism when stockholders are unable to monitor management on a day-to-day basis. These studies note that stockholders delegate the day-to-day monitoring of top management to boards, given that stockholders generally cannot cost-effectively devote resources on an

individual basis to ensure that management is acting in the stockholders’ best interest. That delegation of responsibility makes the board of directors, both in theory and in practice, the top internal control mechanism within today’s corporation.

Much of the debate documented in earlier research about boards notes that the viability of the board as the top internal control mechanism is directly affected by the extent that outside (i.e., non-management) directors are represented on the board. Outside directors serve as effective monitors of top management, given that their concern about exposure to legal liability and their desire to develop reputations as being top-quality directors provide strong incentives for outsiders to closely scrutinize management on the behalf of stockholders.

Numerous research studies in the economics, finance, and management disciplines confirm the importance of board of director composition in improving the board’s effectiveness during key events affecting the corporation. For example, research shows that stockholders receive higher returns during management buyouts when their boards are dominated by outsiders; management salaries are less likely to be excessive when there are more outside directors on the board; and poorly performing corporations are more likely to see changes in chief executive officer positions when boards are composed of greater percentages of outside directors. These studies, among others, collectively confirm that boards do play an important role in corporate oversight, and that role is affected by the extent of board objectivity and independence from top management.

## What’s the Relation Between the Board and Financial Reporting?

Current auditing professional standards adopt the view that the board plays an important role in monitoring the financial reporting process. Guidance on internal control contained in SAS No. 55 (as amended by SAS No. 78) identifies the board as a critical component of an entity’s control environment, responsible for establishing the control consciousness of the organization. Other standards require that auditors communicate certain matters to the board or its audit committee. Recent changes in auditing professional standards related to the auditor’s responsibility to detect material misstatements due to fraud (i.e., SAS No. 82) emphasize the importance of considering the role of the board in an entity’s internal governance when assessing the risk that material misstatements due to fraud may be present.

Research about financial statement fraud confirms the importance of considering an entity’s control environment, which includes the board of directors, when assessing the risk of financial statement fraud. That research finds that boards of firms committing

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material financial statement fraud are significantly more likely to have smaller percentages of outside non-management directors on the board than no-fraud firms. And, fraud firms are significantly less likely to segregate CEO and Chairman of the Board duties, thereby granting greater power to the one executive who serves in both capacities (Beasley, 1996; DeChow, et al. 1996). More recent descriptive research about companies committing financial statement fraud continues to note that boards of fraud companies are dominated by management or other directors who are closely affiliated with top management (see COSO, 1999). These studies confirm views held by many in practice that assessments of the likelihood of financial statement fraud should include consideration of board composition and independence, among other factors.

### **What's the Role of the Audit Committee?**

While consideration of the board's independence is important, often the board of directors delegates responsibility for oversight of the financial reporting process to an audit committee. Accounting regulators and standards setters often emphasize the importance of the audit committee in the oversight of financial reporting. For example, the National Commission on Fraudulent Financial Reporting (the "Treadway Commission") and the AICPA's Public Oversight Board have confirmed the importance of audit committees in the financial reporting process by issuing calls for newer efforts to strengthen the audit committee's role (NCFRR 1987, AICPA POB 1993).

Several empirical studies in accounting have focused on the voluntary formation of audit committees to identify factors affecting an entity's decision to create an audit committee directly responsible for overseeing the financial reporting process (see Pincus et al., 1989 for example). Collectively these studies suggest that larger companies, who are audited by the Big 8 (now Big 5) and who have bigger boards with greater representation of outside directors, are among the companies more likely to voluntarily form an audit committee.

Some of these studies were able to examine voluntary formations of audit committees because the major U.S. exchanges—the New York Stock Exchange, the American Stock Exchange, and the National Association of Securities Automated Quotation System (NASDAQ)—have not always had requirements for audit committees. While the NYSE requirements have been in effect since 1978, the audit committee requirements for registrants of the NASDAQ National Market were not instituted until 1987, and the requirements for registrants of the NASDAQ Small Cap Market were not instituted until 1998. The evolution of these listing requirements reflects the views of exchange officials that audit committees must serve an important role in the financial reporting process.

Recent accounting research provides some evidence confirming this view. Several studies document that the presence of an audit committee is associated with fewer incidences of financial reporting problems. For example, McMullen (1996) finds that entities with more reliable financial reporting (e.g., those absent material errors, irregularities, and illegal acts) are significantly more likely to have audit committees, and DeChow et al. (1996) show that firms subject to SEC enforcement actions are less likely to have standing

audit committees. More recent descriptive research shows that 25 percent of the companies subject to SEC enforcement actions do not have audit committees in place (COSO 1999). These findings collectively suggest that audit committees can have a substantive impact on the quality of the financial reporting process.

### **Does Audit Committee Independence Matter?**

All three major U.S. exchanges address the importance of audit committee composition in their listing requirements. The NYSE requires (and the AMEX recommends) that listed companies have audit committees made up entirely of outside directors. NASDAQ only requires that a majority of the audit committee consist of outside directors for companies trading on the National and Small Cap Markets. Additionally, the Federal Deposit Insurance Corporation implemented new audit committee composition requirements in 1993 mandating the inclusion of independent directors. While these requirements emphasize the importance of having outside directors on the audit committee, they generally leave discretion to the board of directors for selecting who can serve as outside directors on the audit committee.

Such discretion may not always lead to independent audit committees given that merely classifying management and non-management members of the audit committee into insider and outsider director categories, respectively, may not be sufficient. Rather, outside directors should be classified further into one of two categories: independent directors and "grey" directors. An independent director is an outside director who has no other affiliation with top management other than the affiliation from being a director. In contrast, grey directors are outside directors who have some non-board affiliation with the company where they serve as director. Common examples of grey director affiliations include directors who are relatives of top management, former employees of the company, and key customers and suppliers of the company, to name a few.

Research shows that 74 percent of the NYSE firms examined have at least one grey director on the audit committee (Vicknair et al. (1993). Recent descriptive research finds that companies committing financial statement fraud often have audit committees with insiders and grey directors comprising about one-third of the membership on the audit committee (COSO 1999).

These findings highlight the importance of delving further into the relationships that might exist between the company and non-management directors serving on the audit committee as outside directors. Merely excluding managers from service on the audit committee may be insufficient to ensure quality financial reporting.

Current research in accounting is examining the relation between audit committee composition and auditor reporting. Carcello and Neal (1999) find that the likelihood a company in financial distress will receive a going concern modified auditor's report is lower when the percentage of inside or grey directors on the audit committee is higher. These findings suggest that the independence of the audit committee may affect the objectivity and independence of the external auditor.

Academic research and reports in the business press have helped raise the visibility of audit committee members' independence from top management. In March 1999, the Blue Ribbon

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## Corporate Governance Research (Continued from page 7)

Panel recommended that the NYSE and NASD adopt the following definition of independence for purposes of serving on audit committees for listed companies: "Members of the audit committee shall be considered independent if they have no relationship to the corporation that may interfere with the exercise of their independence from management and the corporation" (see Recommendation 1 in the BRC Report 1999).<sup>1</sup> Specific examples of such relationships identified in the BRC Report 1999 would eliminate inside directors and many grey directors from serving on audit committees. In addition to complying with this definition, the Blue Ribbon Panel is also recommending that the NYSE and NASD require listed companies to "have an audit committee comprised solely of independent directors" (see Recommendation 2 in the BRC Report 1999). These changes suggest that U.S. securities markets are moving in a direction consistent with empirical findings documented in corporate governance research. Such research appears to be contributing to these debates.

### Are Audit Committees Knowledgeable in Financial Reporting?

Not only does the composition of the audit committee appear to have an impact, but the audit committee's effectiveness can also be restricted by audit committee member knowledge and experience in financial reporting matters. The BRC Report (1999) notes that "while all members of the audit committee must have the ability to ask probing questions about a corporation's financial risks and accounting...a director's ability to ask and intelligently evaluate the answers to such questions...hinges on intelligence, diligence, a probing mind, and a certain basic 'financial literacy'" (p 25). As a result, the Blue Ribbon Panel recommends that the NYSE and NASD require listed companies to "have an audit committee comprised of a minimum of three directors, each of whom is financially literate" (see Recommendation 3 of the BRC Report 1999). In addition, the BRC panel further recommends "that at least one member of the audit committee have accounting or related financial management expertise" (see Recommendation 3).

Research in accounting is beginning to examine the role of audit committee knowledge and experience in financial reporting matters. These studies support the Blue Ribbon Panel's call for greater financial literacy among those serving on audit committees. For example, descriptive research finds that most (65 percent) of the audit committee members of fraud companies subject to SEC enforcement actions had no apparent work experience in finance or accounting (COSO 1999). Current empirical research about Canadian companies finds that those companies having higher percentages of outside audit committee members with relevant financial reporting and audit committee knowledge and experience tend to be larger, have higher levels of managerial ownership in the company, and have larger boards composed of greater percentages of outside directors than companies with lower proportions of outside audit committee members with such knowledge and

experience. More research, however, is needed to further understand the nature and extent of financial reporting knowledge and experience necessary to contribute to effective audit committee governance.

### Conclusion

Discussions in the general business press and evidence documented by research have raised the visibility of issues impacting board and audit committee effectiveness. That visibility has helped fuel the debate ultimately leading to changes in board and audit committee structure in the last decade, including those proposed changes most recently noted in the BRC Report (1999). The issues are far from resolution, and there is much to learn. For example, little is known empirically about audit committee processes, such as the content of information audit committees receive, the substance of discussions between audit committees and management, internal auditors, and external auditors, and dynamics among members serving on the audit committee. These, and other issues, call for research to help contribute to the debate.

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<sup>1</sup>The report can be viewed on-line at [www.nyse.com](http://www.nyse.com) or [www.nasd.com](http://www.nasd.com).

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## Staff Director of the Public Oversight Board's Panel on Audit Effectiveness Speaks to Auditing Academics at Annual Meeting

David Pearson, professor of accounting at Case Western Reserve University and Staff Director of the Public Oversight Board's (POB) Panel Audit Effectiveness (Panel) was the featured speaker at the Auditing Section Luncheon at the annual meeting in San Diego, CA. Pearson provided comments about the Panel's overall objective of examining whether recent changes in the audit environment and audit process have served to protect the interests of investors. He enumerated a number of the Panel's sub objectives, including (1) the performance of a comprehensive review and evaluation of the way independent audits are performed, and (2) the assessment of the effects of recent trends in auditing on the public interest. Pearson's remarks were divided into two parts: background—matters of organization, objectives, and methods of analysis, and a discussion of the Panel's findings. Essential points of Pearson's comments follow.

### Background

The POB's Panel on Audit Effectiveness came into being at the request of the Securities Exchange Commission. In response, the POB established the panel with members from a number of the professions constituencies. The panel is composed of members with board experience in auditing, accounting and business and includes Shaun O'Malley (Panel Chair and retired Chair of Price Waterhouse LLP), Dennis Chookaszian (retired Chairman and CEO of CNA Insurance companies), Paul Kolton (former Chairman and CEO of the American Stock Exchange and current Chairman of the Steering Committee of the FASB's Business Reporting Research Project), Bevis Longstreth (former SEC Commissioner and Counsel to Debovoise & Plimpton), Lou Lowenstein (Professor Emeritus of Finance and Law at Columbia University), Zoe-Vonna Palmrose (PricewaterhouseCoopers Professor of Accounting at University of Southern California), Aulana Peters (former SEC commissioner, and partner at Gibson, Dunn, & Crutcher), and Ralph Saul (former President of the American Stock Exchange and retired CEO of CIGNA Corp.). The panel has used the profession's audit risk model as a bridge to examining issues of importance and has divided its attention in four broad areas including (1) Auditing Firm Policies/Procedures, (2) Profession Governance, (3) Firm Governance, and (4) Accounting Issues.

With such a broad scope of analysis, the Panel has taken an interactive approach that involves meetings, discussions, and focus groups with the profession's constituencies. The list of contacts with which the Panel is interacting in its work is extensive, and includes large- and small-firm personnel; CFOs and controllers; internal auditors; SEC and POB staff members; forensic auditors; the SEC Practice Executive, Peer Review, and Quality Control Committees; the Independence Standards Board Staff; Auditing Standards Board; Audit Issues Task Force; Big 5 Chairmen; Public Oversight Board; and the International Organization of Securities Commissions. The Panel is also conducting a survey, public hearings (scheduled for October 7 and 8 in New York), research on litigation, and a quasi-peer review. Professor Pearson

indicated that the objective of the survey is to obtain feedback from users, preparers, academics, auditors, and lawyers regarding the value of audits, audits, responsibilities to detect fraud, audit methodologies, effects of non-audit services on audit quality, attracting and retaining personnel, and governance.

### Current Project Status

Professor Pearson indicated that the interactions among Panel members and the constituents noted above had been quite productive and that the Panel had learned a number of insights. Firms had indicated that one of the most pressing issues they face is having the right people with the right skills at the right time to deploy in the field. The audit is an important service, and auditors are moving toward a broader and deeper business understanding with greater focus on risk factors and controls. Firms are indicating that they were making significant investments in methods and tools, and reallocation of audit time and effort to be more effective. The Panel has discovered that the attitudes of most professionals seem to reflect a concern for professionalism and quality, that partner involvement has increased and is more timely, that risk assessment is performed by experienced people, and that more comprehensive work is performed in high-risk areas. The Panel's focus group meetings also raised some concerns including the fact that the audit is viewed by some as a commodity, that pressures associated with clients' earnings can adversely affect the conduct of the audit, that uncertainty had been created by informal SEC rulemaking, and the recruiting and retention were expected to be of significant concern for the foreseeable future.

The final portion of David Pearson's comments focused primarily on the Panel's activities under its "Quasi Peer Review," the purposes of which are to assess (1) the quality of audit work in specific key areas, (2) whether the individuals who performed and reviewed the work have requisite knowledge, skills, and experience, (3) whether the work was performed and reviewed on a timely basis, and (4) to develop ideas for enhancing audit effectiveness. To date, over 100 engagements have been examined.

The activities of each review include an orientation session for both reviewers and reviewees, focus groups with both seniors and managers, interviews with the partner in charge of the firm's audit function, and engagement reviews (two–seven per office on SEC registrant clients), which consist of the reviewee completing a 493-item questionnaire and preparing a description of its audit approach, and its use of analytical review procedures as substantive procedures (five additional areas), and a final debriefing session. The panel hopes to glean perspective about seven different issues through completing the quasi-peer reviews. The seven areas of focus are:

- engagement risk assessment and the linkage to the inherent risk and control environment assessment—overall financial statement level,

*(Continued on page 12)*

## CHANGE IN SUBMISSION PROCESS AND FEE FOR

### *Auditing: A Journal of Practice & Theory*

With recent advances in technology, Arnie Wright, the current editor for *Auditing: A Journal of Practice & Theory*, has changed the submission process so that all manuscripts are to be emailed to him (wrightar@bc.edu) as an attached Word document. To preserve the anonymity of the authors, the cover page and the remainder of the manuscript should be emailed as separate files.

The submission fee should then be mailed to the following address: Professor Arnie Wright, Boston College, Carroll School of Management, Department of Accounting, Chestnut Hill, MA 02167-3808.

Reviews will also be transmitted via email. It is expected that electronic submission and review will make the review process easier and more efficient, especially for our international members.

In addition to changes in the submission process, there will also be an increase in the submission fee to \$75 (U.S. dollars) effective January 1, 2000. This change is to make the submission fee consistent with other journals of the American Accounting Association. Please contact Arnie via email if you have any questions on the above changes.

## CALL FOR AUDITING CPE PROPOSALS: 2000 AAA ANNUAL MEETING

The Auditing Section plans to sponsor one or more CPE sessions at the 2000 Annual Meeting of the American Accounting Association. The Section's CPE committee is looking for individuals or groups who are interested in presenting sessions at this meeting.

The committee is also soliciting ideas for possible auditing CPE topics and speakers, either for the 2000 Annual Meeting or for future meetings. Please respond by December 10. Early responses will provide sufficient time to fully develop auditing CPE proposals for submission by the AAA's deadline, which is usually in early January. To submit proposals or ideas, please contact:

Dana Hermanson  
Kennesaw State University  
1000 Chastain Road  
Kennesaw, GA 30144-5591  
Phone: (770) 423-6077  
Fax: (770) 499-3420  
Email: Dana\_Hermanson@coles2.kennesaw.edu

## CALL FOR NOMINATIONS

### AAA Award for Innovation in Accounting Education Funded by the Ernst & Young Foundation

The American Accounting Association requests nominations for the Award for Innovation in Accounting Education.

#### Award Intent

The intent of the award is to encourage innovation and improvement in accounting education. The award will recognize a significant activity, concept, or set of materials. The awardee can be an individual, group of individuals, or institution.

#### Award Criteria

The criteria used by the Selection Committee to judge submissions includes, but is not limited to:

- a. innovation;
- b. educational benefits; and
- c. adaptability by other educational institutions or to other situations.

Nominations may include, for instance, a set of teaching materials, an overall curriculum or program, a creative instructional strategy, or an insightful teaching approach. The innovation should have been implemented so that evidence of its success can be evaluated.

Nomination letters are encouraged from individuals who are aware of innovative work done by others, as well as from those involved with the innovation. The nomination letters should include the name(s) of the individuals or institution involved and a

brief description of the innovative work, and be submitted no later than January 12, 2000. The Committee will request application materials from nominees.

#### Award Process

To be considered for the Award for Innovation in Accounting Education, completed application materials must be received from nominees by February 18, 2000. Submissions should include nine copies and should contain:

- a. a brief description of the design, development, implementation, use, and evaluation of the innovation; and
- b. evidence of the successful results of the innovation, its benefits and adaptability.

#### Mailing Address

Nomination letters and application materials should be sent to: Professor Sherry Mills, Department of Accounting, College of Business Administration and Economics, Box 30001, MSC 3DH, New Mexico State University, Las Cruces, NM 88003-0001.

#### Award Presentation

The awardee will be announced in the *Accounting Education News* and presented with the award, which consists of a plaque and \$5,000, at the 2000 AAA Annual Meeting. The Ernst & Young Foundation will fund this award.

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## Candidates for Auditing Section Officers

### Candidates for Vice President-Academics (President-Elect)

#### E. Michael Bamber

E. Michael Bamber is a professor at the J. M. Tull School of Accounting, Terry College of Business at the University of Georgia. He received his Ph.D. from Ohio State University in 1980 and has also taught at Duke University, the University of Florida and Indiana University. At the University of Georgia his primary teaching responsibilities include auditing and a doctoral seminar in behavioral accounting research.

Mike currently serves as an associate editor of the *Journal of Accounting Literature* and he is also on the editorial boards of *Auditing: A Journal of Practice & Theory*, *Accounting Horizons* and *The Accounting Review*. His research focuses on the study of auditors' decision making, where both the psychology of human judgment and organizational behavior theory provide relevant research frameworks. Mike's research has appeared in several AAA journals including *The Accounting Review*, *Auditing: A Journal of Practice & Theory*, *Accounting Horizons*, *Behavioral Research in Accounting*, *Journal of Information Systems*, and *Issues in Accounting Education*. He has also published in *Accounting*, *Organizations and Society*, *Contemporary Accounting Research*, *Journal of Accounting Research*, and *The CPA Journal*.

Mike has served on a number of Auditing Section Committees. He is currently chairing the (inaugural) 2000 Auditing Doctoral Consortium, and he has served as chair of the Southeast Auditing Section, and as a member of the Research Committee and Outstanding Dissertation Award Committee. He also contributed to the joint AICPA and Auditing Section monograph *Auditing Practice, Research, and Education: A Productive Collaboration*. Mike has participated on a number of AAA committees, most recently serving on the 1998 Doctoral Consortium Committee.

#### Joseph V. Carcello

Joseph V. Carcello, Ph.D., CPA, CMA, CIA is an Associate Professor in the Department of Accounting and Business Law at the University of Tennessee. Joe received his Ph.D. from Georgia State University. His research has investigated going-concern reporting, audit service quality, financial fraud, and audit committee performance and has been published in journals such as the *Journal of Accounting Research*, *Contemporary*

*Accounting Research*, *Auditing: A Journal of Practice & Theory*, *Accounting Horizons*, *Behavioral Research in Accounting*, *Journal of Accountancy*, *Strategic Finance*, and *Internal Auditing*. He is currently on the editorial boards of *Auditing: A Journal of Practice & Theory* and *Issues in Accounting Education*, and has previously served on the editorial boards of *Accounting Horizons* and *Journal of Management Accounting*.

Joe is the co-author of a funded research study by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission titled, *Fraudulent Financial Reporting: 1987–1997, An Analysis of U.S. Public Companies*. In addition, he is part of a team that has been retained by the Auditing Standards Board to study SEC enforcement actions against auditors for purposes of making recommendations to improve the audit process. Joe is the academic representative on the Independence Standards Board's task force, Accepting Employment with an Audit Client. He has taught continuing professional education courses for two of the Big 5 accounting firms, AICPA, Institute of Internal Auditors, Institute of Management Accountants, and the Tennessee and Florida Societies of CPAs. Joe is a past recipient of the Robert Beyer Gold Medal for his performance on the Certified Management Accountant examination. He has received research grants from COSO, KPMG, and the Institute of Internal Auditors.

Joe served as Treasurer of the Auditing Section between 1997 and 1999. He also served as liaison from the Auditing Section to the AAA Annual Meeting Planning Committee during the three-year period ending in 1999. Joe was the Secretary of the Auditing Section's Future Audit, Attestation, and Assurance Services task force between 1994 and 1997. He also is currently chairing the AAA's Environmental Screening Committee.

### Candidates for Secretary

#### Audrey A. Gramling

Audrey A. Gramling, Ph.D., CPA, CIA is an assistant professor and PricewaterhouseCoopers Faculty Fellow in the Calloway School of Business and Accountancy at Wake Forest University. Prior to joining the faculty at Wake Forest University she was a faculty member in the Department of Accountancy at the University of Illinois in Urbana-Champaign. She received her Ph.D. from the University of Arizona in 1995 and also holds degrees from the University of Toledo and Georgia State University. Before obtaining her Ph.D., Audrey worked as an auditor at Deloitte & Touche (then Deloitte,

(Continued on page 12)

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## Candidates (Continued from page 11)

Haskins & Sells) in Atlanta, GA and as an internal auditor at Georgia Institute of Technology.

Audrey is a member of the Auditing Section of the AAA, the AICPA, and the Institute of Internal Auditors (IIA). She is currently a member of the Research Committee of the Auditing Section of the AAA. Audrey is also a member of the IIA Piedmont Triad chapter where she is the chairperson of the Academic Relations Committee. She is also a member of the IIA's International Academic Relations Committee. Audrey currently serves on the Review Board of the *International Journal of Accounting*.

Audrey teaches courses in auditing and assurance services and financial accounting at Wake Forest. Her research investigates both internal and external auditing issues, with a focus on decision behavior of auditors, audit firm industry specialization, and other factors affecting the market for audit and assurance services. Her research results have been published in several academic and professional journals including *Auditing: A Journal of Practice & Theory*; *Accounting Horizons*; *Journal of Accounting, Auditing & Finance*, *Internal Auditing*, and *Issues in Accounting Education*. She has received research grants from the Institute of Internal Auditors and KPMG Peat Marwick.

### Greg Trompeter




Greg Trompeter is an Associate Professor in the Department of Accounting, at Boston College. As of January 1, 2000 he will also be the Department Chair. Prior to his position at Boston College, Greg served on the accounting faculty at the University of Notre Dame. Greg holds degrees from Illinois State University and the University of Wisconsin–Madison. His primary teaching responsibilities are in the area of financial accounting. He has also taught courses in financial statement analysis and ethics. His primary research interests include issues related to auditor independence, audit judgment, and the economics of the markets for auditing and consulting services. Greg has published in a number of academic journals including, *The Accounting Review*, *Contemporary Accounting Research*, and

*Auditing: A Journal of Practice & Theory*. He is currently the Co-Principal Investigator on a large curriculum development and research grant from the General Electric Fund. He has served the Auditing Section in a number of capacities including the Northeast Regional Chair of the Auditing Section, a Co-editor of the “Have you seen...?” column in *The Auditor's Report*, and a member of the nominating committees for the Editor of *Auditing: A Journal of Practice & Theory* and for section officers. In addition, Greg is on the editorial board of *Issues in Accounting Education*.

## Candidate for Vice President-Practice

### Abraham D. Akresh



Abraham D. Akresh, CPA, CGFM is assistant director in the Accounting and Information Management Division of the U.S. General Accounting Office. He manages various quality control projects, including updating GAO's *Financial Audit Manual*, conducting an annual inspection of GAO's quality control system for financial audits, and preparing for peer review. Under Mr. Akresh's direction, GAO received unqualified opinions on its first two peer reviews and no letter of comments on the 1998 peer review. Mr. Akresh also helps staff members solve difficult problems in audit methodology, audit sampling, computer assisted auditing, review of information systems controls, and contracting with CPA firms.

Mr. Akresh was Distinguished Adjunct Professor at The American University, where he taught auditing and accounting information systems. Before joining GAO, Mr. Akresh was the National Director for Auditing and a partner of Laventhol & Horwath. He was Chairman of the AICPA Task Force that developed the Audit Guide, *Audit Sampling*. Mr. Akresh has served for many years on the editorial board of *Auditing: A Journal of Practice & Theory*. He has had articles published in *The Journal of Accountancy*, *The CPA Journal*, *Corporate Accounting*, and *The Internal Auditor*. He has conducted seminars for, and served on committees of, numerous professional organizations.

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## Staff Director Speaks (Continued from page 9)

- inherent risk and control environment assessment—overall financial statement level,
- fraud risk assessment and fraudulent financial reporting,
- key audit areas such as inherent risk assessment at the account or transaction level, internal control risk assessment at the account or transactions level, the linkage between risk assessments and substantive tests, and design and performance of substantive tests,
- completing the audit,
- audit committees, and

- personnel assigned to the engagement and changes in the engagement in recent years.

In wrapping up his comments on the Panel's activities, David discussed some of the implications of the Panel's finding for auditing educators and noted that the results of the Panel's survey would be posted on the AICPA web site this fall. More information on the Panel a downloadable version of its survey can be found at <http://www.sec.gov/news/audpanel.htm>; or <http://www.aicpa.org/>. Professor Pearson indicates that the Panel's final report is expected by late spring 2000 with an exposure draft out by late spring. The Panel plans to meet with several of the profession's constituents (e.g., AICPA, SEC, POB, etc.) in disseminating results of the Panel's work.

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# Introducing Electronic Workpapers into the Audit Classroom

By Tim Louwers and Andrew Roberts

To improve their usefulness, audit workpapers should be numbered, referenced, initialed, dated, reviewed (“ticked and tied”), approved, and then initialed by the reviewer. These tasks have traditionally consumed large quantities of audit effort, which could be spent more productively on more critical aspects of the audit. Further, while an audit report barely covers a page, audit workpapers can easily fill many binders. Those binders usually end up in a numbered box in a storage facility with numerous similar boxes containing audit workpapers from other engagements, rarely to be seen again.

One effective tool that can reduce the time spent on the tasks noted above, as well as the storage space requirements of hard-copy workpapers, is electronic workpapers. It is now possible to create, share, edit, review, correct, approve, and finalize workpapers without the “paper.” Implementing electronic workpapers can result in improved utilization of auditors’ time and reduced storage costs.

This article describes how students can be introduced to electronic workpapers by involving them in the actual development of their own electronic workpapers. When students develop their own workpapers, they gain a much better understanding of how workpapers work (e.g., the interrelationships among workpapers), how they can be electronically enhanced, and how they relate to the overall audit engagement.

On the most basic level, implementing electronic workpapers involves utilizing three key tools: (1) software applications, (2) reference functions, and (3) cross-referencing/linking capabilities. The primary applications necessary to implement electronic workpapers include word processing, spreadsheet, and data manipulation software. Word processors (e.g., *Word*, *WordPerfect*) have replaced handwriting as the most efficient way to prepare audit reports, memos, letters, and other documents. Spreadsheets (e.g., *Excel*, *Lotus 1-2-3*) provide an excellent means for footing data, creating charts and graphs, and performing other calculation-intensive tasks. Data manipulation software (e.g., *IDEA*, *ACL*) allows auditors to import large data files and thoroughly analyze them for a large variety of trends and/or indicators. These applications have been developed specifically for the audit function. Reference tools generally include a centralized location for data storage and retrieval, and large databases containing the collective knowledge of an entire audit staff—past and present. Finally, linking and referencing capabilities are perhaps two of the most convenient and timesaving features of an electronic workpaper package.

While many accounting/consulting firms have developed their own proprietary versions of electronic workpaper packages, the task of automating workpapers does not necessarily require the purchase of a large, expensive software package. Microsoft’s *Office* (versions 97 and higher) suite allows users to insert “hyperlinks” into any document created using the *Office* package, providing the same functionality as is common on the World Wide Web and adding a new dimension to audit workpapers and

reports. The hyperlinks manifest themselves as references within a document which link the present section of that document to relevant sections of other documents, providing the user with the ability to quickly switch back and forth between related material spread across numerous documents/files. In the next section, we discuss ways that students can develop their own electronic workpapers.

## Techniques for automating workpapers using Microsoft Office

As noted earlier, electronic workpapers can be extremely useful for efficient updating and review of workpapers. Traditional cross-referencing techniques involve referencing (usually with red pencil in the workpaper margin) the location of evidence supporting the figures or comments on the workpaper. For example, an auditor examining a client’s bank reconciliation would reference the amount representing the “Balance per Bank” to another workpaper containing the confirmation received from the bank.

The workpaper reviewer must find the referenced workpaper to ensure that the amounts and conclusions on the workpaper are appropriately supported. In most cases (as in the bank reconciliation example), the referenced workpapers are located within the same functional area. There are other cases, however, when the related workpapers may involve two or more functional areas (e.g., the examination of long-term debt area may also reference the bank confirmation) that may involve more than one binder for hard-copy workpapers. With electronic workpapers, provided that the supporting documentation is also an electronic document, the reviewer need only click on the linked reference to pull up the supporting documentation (e.g., a scanned version of a bank confirmation).

### A. Linking Workpapers

With Microsoft *Word*, linking two or more related workpapers is a relatively straightforward task. Links can be established to cross-reference workpapers such that a click on the reference will take the reader/reviewer to the referenced page, rendering the traditional red page number references in the text margins obsolete. For example, the following steps will link two documents in Microsoft *Word*:

- First highlight the item of interest like an amount (e.g., “Balance per Bank”) or comment for which a reference is necessary.
- Next, under INSERT, click on HYPERLINK (or Control-K).
- In the dialogue box (labeled “Link to file or URL” in *Office 97* or “Type the file or Web page name” in *Office 2000*), simply type in the name of the file (*Office* workpaper document) to be linked.

An alternative method for cross-referencing and linking documents in *Word* is to insert the object (e.g., the supporting document) on the summary page.

(Continued on page 14)

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## Electronic Workpapers (Continued from page 13)

- Click INSERT then OBJECT.
- When the dialog box appears, select the 'Create from File' tab to allow the choice of file to be referenced.

These linking capabilities, intrinsic in all automated workpaper packages, greatly reduce the audit effort necessary to review workpapers.

### B. Reviewing Electronic Workpapers

Other features of the Microsoft *Office* suite also facilitate workpaper review. For example, it is possible to quickly manage and maintain electronic workpaper files using Microsoft *Office* functions.

- To become familiar with the properties (date created, date and time last edited, etc.) of any *Office*-created workpaper, click FILE then PROPERTIES.
- When the properties dialog box appears, choose the SUMMARY tab. There are spaces to type in the document title, subject, author, manager, company, category, keywords, and comments. An auditor can decide which information should appear on each document, and then decide where it should be entered in this box. This location would also be appropriate for an auditor or reviewer to insert comments or sign-off on a document.
- The properties box can be customized in many ways (see for example, the CUSTOM tab under PROPERTIES); however, it is important to standardize its use with a written policy. If everyone within a firm uses their own unique properties 'system', this box will become useless.
- The STATISTICS tab under PROPERTIES also lists the revision number, the original creator, and the time spent editing the document—useful information for grading purposes.

After the properties have been entered, they can be viewed without opening the document:

- Find the document on 'My Computer' with Windows Explorer.
- Highlight and right-click on the icon.
- Select PROPERTIES. This same dialog box will appear in read-only form so that a reviewer can check on the status and progress of a document.

These *Office* functions allow a reviewer to check the status of workpapers in order to manage the engagement in an efficient manner.

### C. Inserting Comments in an Electronic Workpaper

The final tool that we want to highlight here is annotation. In an Office 97 document, an annotation is a comment attached to selected text (or numbers) within the document.

- To place an annotation into the document, place the cursor at the location for which the comment is appropriate.
- On the menu select INSERT.
- Next select COMMENT.
- A window will appear to type the comment. This feature is

particularly useful when reviewing a document. The reviewer can make remarks for the auditor directly in the document, then use the PROPERTIES' comment section to notify the auditor that an annotation should be seen. This tool can also be used for inserting footnotes for financial statements.

These electronic "review notes" facilitate communication between reviewer and workpaper preparer through the placement of comments in the area of concern.

In this article, we have highlighted three electronic workpaper functions (linking workpapers, reviewing workpapers, and adding comments) that are common in most proprietary audit software packages. After briefly discussing and illustrating these features in the classroom, we usually send two-student teams to gather information on the Internet for a potential client (see the planning exercise in the Appendix). More importantly, the teams are required to document their findings using electronic workpapers that they themselves have created. The assignment can be completed over a weekend, but is dependent on students' familiarity with the Internet. Feedback from students has been positive; while students are generally familiar with the basic features of Microsoft's *Office* suite, they have not explored some of the more useful features of the software package. The assignment also exposes the students to a number of useful sites on the World Wide Web.

*Tim Louwers teaches Auditing and IS Auditing at Louisiana State University. Andrew Roberts, a recent graduate of LSU, is an Internal Auditor with Professional Resources International in South Bend, Indiana. The authors wish to acknowledge the helpful comments of Barbara Apostolou, Kenny Reynolds, and Mark Taylor on an earlier version of this article.*

## APPENDIX

NAME (print) \_\_\_\_\_

### Audit Planning in an Electronic Environment

The following assignments are worth a total of six points. Grades will be based upon content, depth of analysis, and presentation. I anticipate grades to be in the following range:

Beyond expectation	6 points (A)
At expectation	5 points (B)
Average	4 points (C)
Below average	0–3 points (D/F)

I expect each team to turn in a computer disk in the form of electronic workpapers (**LINKED** documents, annotated comments, etc.). I suggest a planning memo linking each of the assignments to the summary.

(Continued on page 15)

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## Electronic Workpapers (Continued from page 14)

Bill Gates has approached your firm to perform a financial audit of his software company. While you are trying to convince Bill that your firm is the right choice, it is important to ensure that his company doesn't represent a significant risk to your firm or its other business. Some specific concerns include whether your firm has the time and expertise to do the audit, whether your personnel are independent of the client, and whether the potential client, because of litigation or dishonest management, may be a time bomb waiting to explode. To address these concerns, perform the following audit tasks:

- A. Perform analytic procedures on Microsoft's **income statement**. Highlight those accounts that (due to their nature or due to material changes) may represent areas of heightened audit risk (areas where material misstatements or fraud may be lurking). (You do not need to explain the changes—instead you plan to bring these analytic procedures to the planning meeting with Bill to justify your high fees).

**Microsoft**                      [www.microsoft.com](http://www.microsoft.com)

- B. Part of analytic procedures involves making comparison with industry standards or with competitors. Download into a word processing package the **income statement** (only!) of one of Microsoft's competitors from the SEC's EDGAR site. You do not need to perform any analytic procedures—you can do that at a later date if the engagement is accepted.

**SEC**                                      [www.sec.gov](http://www.sec.gov)

- C. You know that Microsoft uses a local area network to link all of its corporate computers together. Since your firm has limited experience with auditing local area networks, download an audit program and customize it using word processing software for the Microsoft engagement (put Microsoft's name on the top, its fiscal year-end, etc.). You do not need to contact Microsoft directly—it might put your firm in a bad light—instead you can make further changes to the program as necessary when the fieldwork begins.

### Auditors Sharing Audit Programs (ASAP)

[www.auditnet.org](http://www.auditnet.org)

- D. You have heard rumors of Microsoft's ongoing litigation. Litigation represents a significant risk to the fair presentation of a company's financial statements and could result in an "audit failure" (and subsequent litigation against your firm). Do a search on the web and download **one** article that best describes the state of Microsoft's litigation. Your grade will be based on the timeliness of the article, its content, and its brevity.

**AltaVista**                              <http://www.altavista.com>

**Excite**                                      <http://www.excite.com>

**Infoseek**                              <http://www.infoseek.com>

**Lycos**                                      <http://www.lycos.com>

**Yahoo!**                                      <http://www.yahoo.com>

**Webcrawler**                              <http://www.webcrawler.com>

- E. Another concern for your firm is whether it has sufficient industry expertise to conduct the audit. It would be good to find out whether any new accounting or auditing standards have been issued with respect to the computer industry in the past two years. List any new standards and their topics that have been issued since 1/1/98.

**AICPA**  
[www.aicpa.org](http://www.aicpa.org)

**Financial Accounting Standards Board**  
[www.fasb.org](http://www.fasb.org)

**IIA**  
[www.theiia.org](http://www.theiia.org)

**ISACA**  
[www.isaca.org](http://www.isaca.org)

- F. Your firm has three independence concerns that might prevent it from accepting the Microsoft engagement. Each should be treated as an independent event. These questions may represent "gray" areas, so note if there is any conflicting guidance on these issues.
- Josephine E. is a manager in the Houston office of your firm. She owns 100 common shares of Microsoft. Your Seattle office will perform the Microsoft audit. Is your firm still independent? Cite the section in the AICPA Code of Professional Conduct.
  - Your firm owns the Microsoft office building and leases the entire building to the Microsoft Company for a \$1 million annual payment. Is your firm still independent? Cite the section in the AICPA Code of Professional Conduct.
  - Your firm performed actuarial consulting services for Microsoft and billed the company in the amount of \$150,000 in March eighteen months ago. Is your firm still independent? Cite the section in the AICPA Code of Professional Conduct.

**AICPA**  
[www.aicpa.org](http://www.aicpa.org)

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# CALL FOR PAPERS

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University Maastricht  
The NanYang Technological University and  
The University of New South Wales

## Present the Year 2000 International Symposium on Audit Research

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AMERICAN ACCOUNTING ASSOCIATION

### About the Symposium

The sixth annual International Symposium on Audit Research (ISAR) will be hosted by the Maastricht Accounting and Auditing Research and Education Center (MARC) of the University Maastricht and will be held on July 7 and 8, 2000. ISAR has been formed from a merger of two previous audit research symposia: the University of Southern California (USC) Audit Judgment Symposium and the Maastricht Audit Research Symposium. Starting in 1997, an international consortium of universities began taking turns co-hosting ISAR. These universities are the University of Southern California, University Maastricht, Nanyang Technological University, and the University of New South Wales.

### Scope of Topics

The scope of ISAR is intended to be broad and includes research papers and panels that deal with economic and behavioral aspects of auditing and assurance. Papers that utilize any of a broad range of research methodologies will be considered. General topics of interest include research relevant to practice issues such as providing assurance services, litigation, regulation and international matters. Judgment and decision making topics can include any aspect relating to auditor behavior, such as financial and social incentives, cross-cultural differences in audit judgments, risk-based audit planning, decision aids, alternative models of evidential reasoning and expertise. Economic-based topics can include national and international issues relating to regulation of audit and assurance services markets, audit quality, auditor choice, and auditor service production.

### Papers May be Submitted for Possible Journal Publication and/or Presentation

Selected papers (subject to formal AJPT review) presented at the conference will be published in a special issue of *Auditing: A Journal of Practice & Theory*. If you wish your paper to be considered for publication in AJPT, please so indicate and mail an AJPT submission fee of \$US 50 (\$US 75 after January 1, 2000) to Dr. Arnold Wright, Editor, AJPT; Carroll School of Management; Boston College; Chestnut Hill, MA 02176-3808, USA. We expect to publish approximately 8 papers in the special AJPT issue and to select an additional 6 to 8 papers for presentation-only at ISAR 2000.

### Submit Your Paper by January 15, 2000

Academic papers relating, but not limited to, the stated topics are welcome. Papers must be written in English. If papers are to be considered for publication in AJPT, they must so indicate. The deadline is January 15, 2000. Submit author's name(s), affiliations, full address, telephone, fax, and email address on title page and specify the contact author. Authors will be notified of the review committee's decisions by March 30, 2000. Revised versions of the papers that will be presented at ISAR 2000 will be due by May 31, 2000.

### Venue and Hotel Accommodations

The Symposium will be held in the five-star Hotel Maastricht Crowne Plaza. This hotel is along the river Maas in the center of the city. In addition, accommodation for participants is also reserved in the four-star Hotel Beaumont close to the Symposium Venue.

### Submission of Papers

To be eligible for presentation-only or for possible publication in AJPT, manuscripts must follow the "Instructions to Authors" published in *Auditing: A Journal of Practice & Theory*. Please pay particular attention to the format and length requirements—*manuscripts should not exceed 7,000 words*. Be sure to include in your paper the author(s) affiliation(s), the contact author's email address, an abstract and keywords. Papers that are submitted for presentation-only will not be published in formal proceedings and thus may be submitted to any appropriate journal.

### Paper Submission Deadline and Requirements

Papers should be submitted electronically in HTML, RTF, Adobe Acrobat, Word or Word Perfect formats. Papers (and, where appropriate, related research instruments) must be received by January 15, 2000 and should be sent to Professor Steven Maijoor at the following email address: e.vanaernsbergen@marc.unimaas.nl. Please contact us at this address if you are unable to submit your materials electronically.

### Further Information

Further information concerning the Symposium including manuscript preparation instructions can be obtained by visiting our webpage at <http://caarnet.ntu.edu.sg/cn/isar/> or by contacting Professor Ted Mock at [Tmock@sba2.usc.edu](mailto:Tmock@sba2.usc.edu). If you would like details on early registration for the Symposium, please write or email:

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# HAVE YOU SEEN...?

Troy Hyatt, Seattle University, and Brad Reed, University of Southern Illinois—Edwardsville

**“The Influence of Auditor Change and Type on Audit Fees for Municipalities,”** by B.W. Chase, *Research in Governmental and Nonprofit Accounting*, (Vol. 10, 1999): 49–63.

This paper studies the relationship of auditor change and auditor type on audit fees for counties in Virginia using both cross-sectional and time-series tests. Auditors are classified as one of three types: Big 6, a specific regional firm that specializes in the public sector, and all others. Results from the cross-sectional tests suggest a fee premium for Big 6 firms and a fee discount for the regional specialist. In addition, results indicate that changes among auditor types may be obscuring the significance of indicator variables representing an initial engagement when testing audit fees. The time-series analysis indicates a significant negative effect on audit fees from a change in auditor. Further, the variables used to control for the effects of changing auditor type are also significant. These results suggest the potential importance of controlling for changes in auditor type when researching the effects of initial engagements on audit fees. The study’s focus on one type of municipality from one state, with a limited number of auditor changes (nine), provides opportunities for future research.

**“Audit Fees and Nonaudit Fees in the Governmental Sector: A Self-Selection Analysis,”** by R.J. Elder, S.C. Kattelus, and E.B. Douthett, Jr., *Research in Governmental and Nonprofit Accounting*, (Vol. 10, 1999): 65–86.

This study examines the relationship between audit and nonaudit fees for a sample of 165 Michigan municipalities. A self-selection model is used, similar to the one used by Abdelkhalik (1990), and includes Big 6 and non-Big 6 audit firms. The authors find significant differences between purchasers and non-purchasers of additional (i.e., consulting) services. Results suggest that purchasers have less experienced and less qualified financial officers. In addition, purchasers tend to have more audit adjustments than non-purchasers. Consistent with previous private sector research, the authors find a positive relationship between audit fees and nonaudit fees. The authors suggest that the reason for this relationship is a result of the underlying differences between purchasers and non-purchasers of the additional services, which cause clients to self-select into these two groups. Consistent with prior public sector research, when the analysis is restricted to Big 6 firms, the relationship between audit fees and nonaudit fees is negative. The authors provide possible reasons for this auditor-type difference and offer suggestions for future research.

**“The Impact of Hypothesis Set Size on the Time Efficiency and Accuracy of Analytical Review Judgments,”** by S. Bhattacharjee, T. Kida, and D.M. Hanno, *Journal of Accounting Research*, (Vol. 37, No. 1, 1999): 83–100.

This paper investigates the effect of requiring auditors to generate and test hypothesis sets of different sizes on efficiency and accuracy. Sixty auditors, assigned to one of four treatment conditions, were asked to determine the true cause of fluctuations in a client’s financial statements during the analytical review stage. Although the auditors were allowed to generate and test as many total hypotheses as they wished, three of the treatment conditions asked the auditors to begin by generating and testing a specific number of hypotheses, either one, three, or six. The fourth treatment condition imposed no restriction on the subjects with respect to the size of the initial hypothesis set. Results indicate that auditors who began with three hypotheses spent less time on the task and were at least as accurate as the other groups. Many differences among the groups were found, including the total number of hypotheses tested, time spent on generating the initial hypothesis set, time spent on generating subsequent hypotheses, and time spent evaluating each hypothesis. The paper concludes with numerous suggestions for future research.

**“Auditor Attention to and Judgments of Aggressive Financial Reporting,”** by F. Phillips, *Journal of Accounting Research*, (Vol. 37, No. 1, 1999): 167–189.

This paper uses an experiment to investigate factors that affect how auditors attend to evidence and how they rate the probability of aggressive financial reporting in their clients’ financial statements. Participants in the experiment included 100 seniors and managers from all of the Big 6 firms. Results suggest that auditors were more attentive to evidence (measured as the number of pieces of evidence generated during a free recall exercise) which was indicative of aggressive reporting in a financial statement account when that account was judged to have a high, as opposed to a low, risk of misstatement. In addition, increased attention was paid to potentially aggressive reporting in low-risk accounts only when the auditors had previously reviewed evidence that corroborated misstatement risk for a high-risk account. Post-hoc analyses suggest that different cognitive processes led to these results. The study’s results have implications for the order in which audit work is scheduled and may also have similar implications for financial analysts and others.

**“What Do Industry-Specialist Auditors Know?”** by I. Solomon, M.D. Shields, and O.R. Whittington, *Journal of Accounting Research*, (Vol. 37, No. 1, 1999): 191–208.

This paper tests two hypotheses: (1) industry-specialist auditors have a greater quantity of knowledge of financial statement errors and nonerror factors for their industry of specialization, relative to other industries and (2) industry-specialist auditors have

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**Have You Seen...?** (Continued from page 17)

more accurate knowledge of the frequency of financial statement error and nonerror explanations for unexpected fluctuations for their industry of specialization, relative to other industries. Two experiments are used to test these hypotheses, each using a different method to elicit the auditors' knowledge. Experiment 1 uses Heiman's (1990) judgment-change method and experiment 2 uses cued recall. Each experiment employs a 2 x 2 design in which financial institution and healthcare specialist auditors are asked to make judgments for both financial institution and healthcare clients. Experiment 1 provides support for H1 for both error and nonerror knowledge and for H2 for nonerror knowledge only. Experiment 2 provides support for both H1 and H2 for nonerror knowledge only. Reasons for the differences in results across experiments, as well as lack of results related to error knowledge, are discussed. In addition, a discussion of several limitations is included, suggesting many avenues for future research.

**“Accountability Effects on Auditors’ Performance: The Influence of Knowledge, Problem-Solving Ability, and Task Complexity,”** by H. Tan and A. Kao, *Journal of Accounting Research*, (Vol. 37, No. 1, 1999): 209–223.

In this paper the authors study whether knowledge, problem-solving ability, and task complexity moderate the relationship between accountability and auditor performance. Hypotheses are tested using an experiment with 105 auditors (managers, seniors, and staff) from two Big 6 firms in Singapore. Level of task complexity (three levels) is used as a within-subjects variable and accountability (two levels) is used as a between-subjects variable. Knowledge and problem-solving ability are measured based on tests taken by the subjects. In the low-complexity task, accountability did not improve performance. In the medium-complexity task, accountability improved performance only for those subjects who possessed the requisite knowledge. Finally, in the high-complexity task, accountability improved performance only when subjects possessed both the requisite knowledge and a high problem-solving ability. The authors conclude that for accountability to affect performance, there must be a match between the demands of the task and the attributes of the person performing the task.

**“The 150-hour Rule,”** by C.J. Lee, C. Liu and T. Wang, *Journal of Accounting and Economics* (Vol. 27, No. 2, 1999): 203–228.

This paper uses an analytical approach to analyze the impact of the 150-hour rule on the auditing profession. Based on the paper's framework, the following consequences of the 150-hour rule are recognized: (1) audit clients are worse off because they will be required to pay higher audit fees due to the decreased supply of CPAs, (2) individuals who received the CPA designation prior to the 150-hour rule but who are not offering audit services, may elect to enter the audit market due to the higher fees obtainable due to the 150-hour rule, (3) due to the entrance of these pre-rule CPAs into the audit market, the average audit quality in the market may be lower after the implementation of the rule, and (4)

some less wealthy post-rule CPA candidates who would otherwise get into the audit market will stay out of the market.

**“The Market Reaction to Auditor Resignations,”** by J. Dunn, D. Hillier and A. P. Marshall, *Accounting and Business Research*, (Vol. 29, No. 2, 1999): 95–108.

This study examines the market's reaction to auditor resignations for a sample of United Kingdom companies. In contrast to prior research in this area, this paper examines only situations where the auditors involved explicitly state that they are resigning office. The authors argue that when the auditor explicitly resigns there is a high probability that there has been a breakdown in the relationship between the auditor and management. The paper finds a negative market reaction to the auditor resignation indicating that auditor resignations are informative corporate events. Additionally, the authors find that the magnitude of the market's reaction is related to the size of the resigning audit firm. The study finds that when a Big 6 audit firm resigns, the market's reaction is more negative than when a non-Big 6 audit firm resigns. The authors conjecture that the loss of a Big 6 auditor could indicate to the market that the auditee is suffering a greater loss of credibility.

**“From Contract to Speech: The Courts and CPA Licensing Laws 1921 – 1996,”** by P.A. Mills and J.J. Young, *Accounting Organizations and Society* (Vol. 24, No. 3, 1999): 243–262.

This paper traces the development of laws aimed at restricting and/or enhancing competition between CPAs and the uncertified, and importantly, how courts have influenced the reshaping of the CPA's economic jurisdiction. The paper shows that the courts have played an important role in deciding issues such as who can be called a CPA, who can be called an accountant and when can a CPA be called a CPA. The paper shows that neither the courts nor the legislatures resisted state regulation of accounting. The early licensing legislation did not prevent the uncertified from providing accounting services but rather from using the CPA designation. The courts often described such accounting licensing laws as protective of the public welfare and as a valid exercise of the state's police power. Although the courts had no difficulty in restricting use of this exclusive designation of the licensed, the courts consistently refused to reserve specific types of work to CPAs. Recently, with the courts' emphasis upon the freedom of commercial speech, the courts have delimited the exclusivity of the CPA jurisdiction. The authors contend that due to the changing market for accounting-type services, and the courts' willingness to limit the exclusivity of the CPA jurisdiction, the significance of the CPA designation is slipping away. Because of these changes, regulation can no longer be seen as a boon to the profession. These changes indicate that a profound restructuring of the accounting jurisdiction lies in the future.

**“Empirical Analysis of the Economic Demand for Auditing in the Initial Public Offerings Market,”** by M. Willenborg, *Journal of Accounting Research* (Vol. 37, No. 1, 1999): 225–238.

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## CALL FOR PAPERS

### FIFTH SYMPOSIUM ON ETHICS IN ACCOUNTING

The Professionalism and Ethics Committee of the AAA invites papers for the Fifth Symposium on Ethics in Accounting, to be held immediately preceding the 2000 AAA Annual Meeting in Philadelphia. While papers examining any aspect of ethics in accounting are always welcome, due to the current importance of the issue (and given the Philadelphia meeting location), we hope to devote at least one session to the issue of **independence** in the accounting profession. At the author's discretion, papers will also be considered for publication in *Research on Accounting Ethics*.

#### Scope and Aims of Symposium

The purpose of the symposium is to explore various aspects of ethical decision making in an accounting context. The symposium will provide an opportunity for researchers and practitioners interested in ethics in an accounting setting to exchange information, to network, and to discuss emerging issues.

#### Location and dates

The symposium will be held in Philadelphia immediately prior to the AAA Annual Meeting. The meetings will be held in the main convention hotel, or within a convenient walking distance from the hotel.

#### Details for paper submission

One (1) copy of the completed manuscript should be transmitted as an attached Word file to Tim Louwers ([louw@lsu.edu](mailto:louw@lsu.edu)) on or before **March 1, 2000**. To preserve the anonymity of the review process, please remove any references to authors on the cover page or in the body of the paper.

A non-refundable submission fee of \$10 (made payable to the American Accounting Association) should be submitted concurrently to:

Tim Louwers, Department of Accounting, CEBA 3101, Louisiana State University, Baton Rouge, LA 70803, (225) 388-6233

Please indicate in your submission cover letter whether you want your submission to be concurrently considered for publication in *Research on Accounting Ethics*. Professor Bill Schwartz (Editor of *Research on Accounting Ethics*) has again graciously waived the journal submission fee.

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#### Have You Seen...? (Continued from page 18)

This study examines the demand for auditing services in the initial public offerings market. Due to the numerous informational asymmetries that exist in the initial public offerings market, this provides a natural setting for studying the demand for audit services. The study tests the demand for auditing arising from both informational signaling and insurance signaling perspectives. The results support both roles for auditing, though the evidence in support of an insurance signaling role seems particularly strong. The paper focuses on small initial public offering deals because nonnational auditors are concentrated in this market, and therefore a broader range of auditor sizes can be evaluated.

**“City Markets as a Unit of Analysis in Audit Research and the Re-Examination of Big 6 Market Shares,”** by J.R. Francis, D.J. Stokes and D. Anderson, *Abacus* (Vol. 35, No. 2, 1999): 185–206.

The authors of this paper examine the Big 6 market shares of the audit market at the city level in contrast to auditor market shares analyzed at the national level as has been done in previous research. The authors obtain city market share data by reading the audit reports for all companies listed in the NAARS database. The article reports that in 1988 and 1990, the audit firm that had the largest share of the national audit market, had the largest share of the city-specific audit market in only a minority of cities, 27 percent and 36 percent respectively. The authors find that this pattern holds true

for large and small cities. Due to the differences between a firm's share of the national audit market and the firm's share of a city's audit market, research based only on a firm's share of the national market often obscures important relationships in the audit market. For example, the authors show how a city-level market share analysis enhances the understanding of the 1989 audit-firm mergers creating Ernst & Young and Deloitte & Touche.

**“An Analysis of Settlement and Merit Under Federal Securities Law: What Will be the Effect of the Reform of 1995?”** by J.A. Holloway, D.E. Ingberman, and R.R. King, *Journal of Accounting and Public Policy* (Vol. 18, No. 1, 1999): 1–30.

This article uses a game-theoretic model to examine settlement incentives under two different legal regimes: the Securities Exchange Act, 1934 and the Private Securities Litigation Reform Act of 1995. The article uses the same game-theoretic model to assess the correspondence between settlements and merits for the two legal regimes. The game-theory model used shows that under both legal regimes the negotiation process between the plaintiffs and defendants ends in settlement rather than litigation. However, the model shows that the two legal regimes elicit different negotiation strategies on the part of the plaintiff, which, in turn, precipitates different settlement/merit disparities. The model shows that under the Private Securities Litigation Reform Act of 1995, equilibrium settlements reflect the underlying merits of the case, under a broader range of parameters.

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## CALL FOR RESEARCH FROM THE SEC

Members of The American Accounting Association have long been instrumental in accounting standards setting and regulation by providing useful perspectives for consideration of evolving issues. A number of important issues that can influence the usefulness and integrity of financial reporting now demand the concerted efforts of our best minds. Proper resolution of these issues can ensure that our capital markets continue to function efficiently and remain the envy of the world.

Therefore, research papers are invited on a number of issues facing the Securities and Exchange Commission. Submitted papers will be considered for recognition at a potential conference that will bring together members of standards-setting groups, regulators, preparers, users, and academics. The conference would permit the various participants in our financial markets to share perspectives on a wide range of topical issues.

Interested parties may submit research on any of the topics listed below, or on topics that are of similar interest. The reviewing committee will provide first consideration to papers received by March 1, 2000. Research on these topics, previously published or not, is welcome at any time. Please send completed papers to: Academic Fellow, Office of the Chief Accountant, Securities and Exchange Commission, Washington, DC 20549-1103. Any questions regarding research may be submitted to Dick Dietrich at 202-942-4400.

### Auditing

In the past few years the press has reported numerous cases of misstated financial statements. Investors have lost tens of billions of dollars in these cases. As a result, the Commission staff is interested in research that may provide recommendations that, if implemented, could improve the effectiveness of audits. Potential topics include:

- The 1999 report of the Committee of Sponsoring Organizations (COSO) entitled *Fraudulent Financial Reporting: 1987-1997, An Analysis of U.S. Public Companies*, reported that 83% of the cases reviewed involved the CEO or CFO. These cases typically involved an override of controls by senior management. These actions by management and the resulting internal control weaknesses were not detected by the auditors. Yet, audit firms are adopting audit approaches based increasingly on the testing of controls. What is the effectiveness of audit procedures based on (a) testing of controls, (b) testing of account balances, or (c) analytical procedures? What steps could auditors have taken that would improve their ability to detect management's override of internal accounting controls? Do management's reports on internal controls provided to investors provide a benefit? What audit committee policies or procedures have a positive influence on the effectiveness of internal controls?
- What is the relationship between the duration of the auditor/client relationship and audit failures? Do new auditors contribute to discovery of facts that should have been uncovered by predecessor auditors?

- Is there a pattern of omitted and necessary audit procedures or other characteristics that are associated with audit failures (lawsuits, enforcement actions) which, if corrected, would have prevented the audit failures?
- What key factors influence an auditor's decision-making process when confronted with difficult and contentious accounting issues?
- How do audit partners' evaluation and compensation arrangements influence their judgments and behavior?
- How do auditors assess materiality? Is their methodology consistent with the approach markets use to assess materiality?
- Do accounting standards calling for recognition or measurement of subjective or discretionary events, such as the standards for asset impairments and restructuring charges, give rise to financial data that cannot be audited? What changes in the auditing or accounting standards might provide improvements?
- What changes to the profession's current quality control processes, including peer review, could be made to strengthen and enhance its effectiveness?
- What structural changes to the relationship between auditors, management, shareholders, the board of directors, and other constituencies might enhance the audit process?

### Auditor Independence

The business of accounting firms has been evolving at a quickening pace from a provider of audit and attest services to a provider of a wide range of other financial and consulting services (e.g., compensation planning, valuations, business planning, investment advice, strategy development, and information systems consulting, etc.). Audit partners thus become a potential gatekeeper charged with a responsibility for the distribution channel (client) through which the firm provides many services to the client. As a result, potential topics regarding auditor independence include:

- How does the existence of the partner's gatekeeper function impact independence and the regulation of auditors?
- What factors are considered by users of financial statements when assessing whether or not auditors are independent?
- Do users of financial statements consider nonaudit services provided by auditors to impair auditor independence? How would public filing disclosure of all nonaudit services being provided the client by the accounting firm affect investors' perceptions regarding auditor independence?
- What is the relationship between factors that investors perceive to impair independence and factors that auditors believe actually impair independence?
- How does the "materiality" of a financial or family relationship affect investors' views about auditor independence?
- What relationships with a member, including the partner, of an engagement team, or audit firm, would impair the independence of that member (e.g., the existence of a business

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## Call for Research from the SEC (Continued from page 20)

relationship between a sibling, cousin, or more distant family member and an employee or officer of an audit client)?

- Financial service firms are acquiring CPA firms. Under some arrangements, partners and staff of the CPA firm become employees of the acquirer and are then “rented” back to the CPA firm for audit engagements. What business relationships between the audit client and the acquiring firm, its officers, and employees, will impair independence?
- Some have argued that mandatory auditor rotation could provide benefits by having a new set of “eyes” look at the financial reporting periodically. Others have argued that mandatory rotation results in initial audits with audit personnel who are less experienced on the registrant’s issues. What effect would mandatory rotation of auditors have on actual or perceived auditor independence?

## Accounting and Financial Disclosure

The foundation of the U.S. capital markets is high quality transparent financial reporting and disclosures. This provides investors information necessary to assess market risks and make efficient capital allocation decisions. Yet, chairman Levitt’s 1998 *Numbers Game* speech raised concerns about trends in financial reporting that, if left unchecked, could impact the quality of financial reporting. Accordingly, financial reporting topics include:

- The U.S. capital markets use a quarterly financial reporting model to provide timely reporting of information to investors. Many foreign countries use a semiannual model. Some people advocate a “continuous” reporting approach. Yet others believe a continuous approach would result in greater pressure on management to “make the numbers.” What are the cost/benefits of these different approaches to investors and management and what are the implications for corporate governance? Are there currently processes built into the financial reporting system that could be changed without reducing transparency? If so, what are they and how should they be changed?
- What financial data do investors and analysts use that is currently not provided in filings with the SEC?
- The FASB is currently examining the use of non-GAAP performance measures. How do investors and analysts currently use such measures?
- What economic effects (e.g., on managers, shareholders, sellers) are related to the accounting method used to account for a business combination? Why do managers prefer one method over another?
- How do sell-side and buy-side analysts adjust their earnings forecasts, models, and stock recommendations for acquired intangibles and subsequent amortization expense? How do they use cash earnings measures and GAAP earnings measures with respect to those adjustments?
- How do analysts adjust their models for goodwill or for the accounting method (purchase vs. pooling) used to account for a business combination?
- What information regarding intangible assets do investors and

analysts believe is useful and necessary for making informed investments decisions? What data and disclosures are used by analysts that are not currently included in the financial statements or other required disclosures?

- How do initially reported amounts and disclosures vary from subsequent actual results when accounting is based on discretionary triggers (e.g., management plans for restructurings or impairment of assets)?
- How do financial analysts and investors use market risk disclosures? Are market risk disclosures priced? Are there disclosures being made that are not used, or are additional disclosures required? Do the market risk disclosures alter a firm’s approach to risk or cause competitive harm?
- The market risk disclosure requirements provide choices as to presenting risk exposure. Which of the methods, including assumptions, provides users with the most useful information?

## International

The Commission staff is currently assessing the quality of international accounting standards. The need for improvements in the worldwide financial reporting structure that will be needed for a rigorous implementation and enforcement of these accounting guidelines, including the quality of auditing, auditing standards and quality control procedures is also being studied. Research on the following topics would benefit the staff:

### International Accounting

- What factors should be considered to determine whether a standard is “high quality”?
- When companies using IASC standards trade on non-US exchanges, is their cost of capital different from companies using domestic GAAP on those exchanges? Do those markets assess a premium for information prepared on the basis of IASC standards?
- What factors impede a non-US company’s access to US capital markets?
- How do analysts respond to and use reconciliation data in Form 20-F?
- How comparable is financial reporting between public non-US companies currently using IASC standards both in US and non-US markets?
- What are typical footnote disclosures by companies currently using IASC filings (a) in non-US countries, (b) in US filings using reconciliation and (c) similar US GAAP filings?
- What information that is not included in the statements or footnotes do buy-side analysts request from non-US firms who prepare financial statements using IASC standards?
- What firm characteristics (e.g., size, industry, location, capital structure) are associated with choices among existing alternatives permitted by IASC standards? Are some alternatives chosen more frequently than others?
- Is the information provided by the IASC’s allowed revaluation alternative for accounting for fixed assets value relevant?

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# AUDITING SECTION BY-LAWS

## I. Name of Organization

The name of this organization is the Auditing Section of the American Accounting Association.

## II. Status of the Organization

This organization has the status of a Section within the American Accounting Association (“AAA”), a nonprofit association incorporated under the laws of the state of Illinois. These by-laws explain the status of the Auditing Section with relation to the AAA. Any conflict between these by-laws and any rules or regulations of the American Accounting Association shall be resolved in favor of the parent organization.

## III. Purpose of the Organization

The purpose of the Auditing Section of the AAA (“Section”) is to foster excellence in the teaching, research, and practice of auditing and other assurance services. The Section’s strategic framework is expressed in a Mission Statement, which is periodically updated and published.

## IV. Membership

1. Any AAA member or associate member in good standing who supports the Mission and Goals of this Section can be enrolled as a regular member or as an associate member, respectively, upon payment of annual dues to the Administrative Secretary of the AAA, or other representative of the Section so authorized.
2. All members are eligible to vote, hold offices, participate in all activities of the Section, and be entitled to all its other privileges. Associate members are eligible to participate in all activities of the Section and are entitled to all its other privileges except those of voting and holding office.
3. The Section’s Executive Committee can propose the amount and type of annual dues and the payment schedule subject to approval by the membership present at the Sections’s annual business meeting. Associate members’ dues are set by the AAA’s Executive Committee.

## V. Officers and Duties

1. The duties and terms of office are consistent with those the AAA specifies for officers of Sections. These are as follow:

A. **President**—The President serves a one-year term. The duties of the President are:

1. to direct the affairs of the Section and carry out its programs with the advice of the Executive Committee;
2. to preside at all Section meetings and Executive Committee meetings;

B. **Vice-President—Academic**—The Vice-President is elected for a one-year term and, upon completion of this term as Vice-President, automatically becomes President. The duties of the Vice-President are:

1. to direct the affairs of the Section and/or preside at Section meetings in the event the President is unable to serve;
2. to appoint the Historian;
3. to perform whatever other duties the President might assign.

C. **Vice-President—Practice**—The Vice President from Practice is elected for a two-year term and is not eligible for immediate reelection. The duties of the Vice-President from Practice are:

1. to direct the affairs of the Section and/or preside at Section meetings in the event that the President and Vice-President—Academic are unable to serve;
2. to perform whatever other duties the President might assign.

D. **Secretary**—The Secretary is elected for a two-year term and is not eligible for immediate reelection. The duties of the Secretary are:

1. to supervise the keeping of records of Section meetings, policies, and procedures;
2. to provide information and guidance for the Section’s Newsletter;
3. to work in liaison with AAA personnel regarding all facets of Section membership.

E. **Treasurer**—The Treasurer is elected for a two-year term and is not eligible for immediate re-election. The duties of the Treasurer are:

*(Continued on page 23)*

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## Call for Research from the SEC *(Continued from page 21)*

- What disclosures regarding significant risks and uncertainties precede significant events reported in the financial statements prepared with IASC standards?
- How rigorously applied is the existing IASC standard on business combinations? What is the quality and implementation comparability of the existing IASC standard on business combinations?
- How do IASC standards compare with US standards on dimensions of comparability, transparency, quality, and full disclosure?

## International Auditing

- What significant differences exist between US and international auditing standards?
- Does the application of non-US GAAS affect market valuation?
- How do auditor independence regulations vary among major countries?
- What quality control standards, including internal and external inspection, exist for auditors in major countries?
- What method(s) are used to enforce international audit standards and how do these methods impact compliance with international auditing standards in comparison to the methods impact on enforcing U.S. auditing standards?

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## Auditing Section By-Laws (Continued from page 22)

1. to work with AAA personnel relative to collection and disbursement of Section funds;
2. to provide financial information for the Section's Newsletter;
3. to report to the membership at the Section's annual business meeting on the financial affairs of the Section.

**F. Past President**—The Past President serves for one year immediately following his or her term as President. The duties of the Past President are:

1. to serve as a full member of the Executive Committee;
2. to consult and advise with the other officers

**G. Historian**—The Historian serves a two-year term as an officer and is designated as an *ex-officio*, non-voting member of the Executive Committee. The duties of the Historian are:

1. to maintain an up-to-date history of Section activities;
2. to maintain and update the Section's *Operating Manual*;
3. to provide historical perspective at Executive Committee and Section business meetings and aid in providing continuity to the Section.

**H. Editor of Auditing: A Journal of Practice and Theory**—The Editor is responsible for the administration, publication, and content of *Auditing: A Journal of Practice and Theory* subject to cost constraints imposed by the Executive Committee. The term of the Editor is three years. The Editor cannot serve successive terms.

During the second year of the Editor's term, the Executive Committee selects an Editor-Elect for the following year. The Editor-Elect, during the term as Editor-Elect, performs only those functions assigned by the Editor.

In the event that an Editor decides not to complete the three-year term, he or she should inform the President at the earliest possible time in order to allow the Executive Committee to designate an Editor-Elect to serve for the remainder of the Editor's term.

2. Each officer begins serving his or her term at the time of the Auditing Section Luncheon at the Annual Meeting of the American Accounting Association.
3. The President, Past President, the Vice-Presidents, Secretary, Treasurer and Historian constitute the Executive Committee. They are responsible for directing the affairs of the Section and formulating the plans, policies, rules, and procedures they consider necessary to achieve the Section's Mission and Goals. The President and three other voting officers constitute a quorum.
4. The Nominating Committee of the Section is comprised of the most recent Past President of the Section and two immediate past Regional Chairs. The current year's Nominating Committee appoints two Regional Chairs to serve on the following year's Nominating Committee. The Nominating Committee is chaired by the immediate Past President of the Section. The Nominating Committee places two or more names on the ballot for each Section office becoming

vacant with the possible exception of the office of Vice-President from Practice. The Nominating Committee, at its discretion, may place only one name on the ballot for Vice-President from Practice. The Nominating Committee announces to the Section members nominees for offices of Vice-Presidents, Secretary, and Treasurer at least three weeks before the annual meeting. All nominees must be members in good standing of the Section at that time. Nominations may also be made from the floor in accordance with Robert's *Rules of Order* (Newly Revised). The Nominating Committee cannot nominate a member from itself. Nominating Committee members are eligible for nomination from the floor at the annual business meeting.

5. The election of officers is held during the annual business meeting. The results of the election are certified and announced by the Secretary.
6. The officers are authorized to initiate and carry out projects in keeping with the Section's Mission and Goals. Disbursements may be authorized by the President or the Treasurer. Disbursements larger than \$500 must be approved by the President.
7. The Executive Committee may appoint committees and task forces and may make similar assignments appropriate to achieve the Section's Mission and Goals.
8. The Section may decide to co-sponsor audit symposia by a majority vote of the Executive Committee. Decisions regarding the publication of symposia papers are delegated to the Editor(s) of *Auditing: A Journal of Practice and Theory*.
9. Each year, each officer transmits a report to the membership in an appropriate fashion.

## VI. Meetings

1. The annual business meeting and any other meetings of the Section are held at such time and place as determined by the Section's Executive Committee. Notice of the time and place is given to members, by mail or other means before such meetings, unless other means of satisfactory notice can be applied. A quorum at duly-called meetings consists of the members present.
2. The program for the annual business meeting of the Section is the President's responsibility.
3. For purposes of conducting all general and special meetings of the Section, *Robert's Rules of Order* (Newly Revised) apply in cases where the by-laws do not specify a procedure.

## VII. Fiscal Year of the Section

The Section's fiscal year is September 1–August 31, matching the fiscal year of AAA.

## VIII. Amendments

Amendments to these by-laws may be submitted at any time by any member or group of members to the President and by the President to the membership at the next annual business meeting or, at the discretion of the Executive Committee, by the vote of two-thirds of the members who return ballots in a mail referendum. Notice of by-law amendments to be presented for membership vote is given at least three weeks before the annual business meeting. Amendments are adopted by two-thirds favorable vote of the Section membership in attendance.

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