

**AUDITOR EXPERIENCES OF CORPORATE GOVERNANCE IN THE POST
SARBANES-OXLEY ERA**

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Abstract: This study extends Cohen, Krishnamoorthy, and Wright (2002) by examining auditors' experiences in working with corporate governance actors (e.g., audit committee, board, management, other committees) in the post-Sarbanes Oxley era. Thirty audit managers and partners from three of the Big 4 firms participated in the study. Auditors indicate that the corporate governance environment has significantly improved in recent years with audit committees that are more active and diligent and possessing greater expertise and power to fulfill its responsibilities. However, management continues to be seen as a major actor in the corporate governance mosaic. Of some concern, auditors indicate that management is seen as a key driver in determining auditor appointments and terminations. Similar to Gendron and Bédard (2006), results indicate that in many instances, audit committees play a passive role in helping to resolve disputes with management. Finally, the requirements for CEO and CFO certification are reported to have a positive affect on the integrity of financial reporting.

Key words: audit committee, corporate governance, audit process, Sarbanes-Oxley.

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I. Introduction

In the aftermath of major accounting scandals such as Enron and WorldCom and an alarming number of earnings restatements (Palmrose and Scholz 2004; Agrawal and Chadha 2005), there were calls for major reforms in the responsibilities and oversight of management, external auditing, and corporate governance (in particular, the audit committee and board of directors). These calls culminated in the enactment of the Sarbanes-Oxley Act in 2002 (hereafter referred to as SOX). Cohen et al. (2004) describe a framework for understanding the “corporate governance mosaic” in which they discuss the links and the interactions of the principal players involved in financial reporting and they evaluate how the corporate governance mosaic potentially affects the quality of the financial reporting process. It is argued that to be of maximum effectiveness the players in the corporate governance mosaic such as the auditors and the board of directors must work together towards a common objective of promoting high quality financial reporting to the capital markets. The purpose of the current study is to capture the experiences of auditors in their interactions with the audit committee and board in the post-SOX environment. In particular, how do such interactions affect the audit process, e.g., risk assessments and resolution of contentious accounting issues?

The only prior study to address this important issue was conducted by Cohen, Krishnamoorthy, and Wright (2002) (hereafter referred to as CKW). Among a number of findings (to be discussed more fully in the next section) CKW report that auditors generally found audit committees to be ineffective in monitoring the financial reporting

process and to lack sufficient power and financial expertise to confront management to help resolve difficult reporting matters. They also found that auditors often included management as part of the rubric of “corporate governance”. Auditors indicated that without management’s support, strong governance in protecting the interests of shareholders and other stakeholders is not possible. This is potentially problematic if managers act in their own self-interest with little regard to other key stakeholders of the firm. Importantly, CKW captured auditors’ experiences prior to the passage of SOX. Given the dramatic changes in the responsibilities of management, the board, and the audit committee mandated by this Act, it is important to examine whether auditor experiences have changed significantly since then given subsequent corporate governance reforms. We also extend CKW by looking at contemporary issues stemming from SOX such as the impact of the financial statement certification by management and the role of internal auditors.

To address these issues, as CKW (2002), we conducted semi-structured interviews with 30 experienced audit partners and managers from three of the Big 4 firms¹. The advantage of using a qualitative research methodology is that it allows us to probe auditors’ experiences in depth. We find that auditors report the corporate governance environment has considerably improved in the post-SOX era with audit committees that are substantially more active, diligent, knowledgeable, and powerful. As such, auditors indicate corporate governance has a greater impact on the planning and performance of the engagement. Management continues to be seen as a major corporate

¹ Following the results of the CKW (2002) study, we targeted partners and managers as respondents for the current study. Exploratory discussions conducted with practitioners for this study indicated that even in the post-SOX environment, managers and partners would provide the most useful insights into the extent that corporate governance influences the audit process.

governance actor and the driving force behind auditor appointments and terminations. Finally, in many instances, auditors report that audit committees play a passive role in resolving disputes with management, overseeing the outcome.

The remainder of this paper is divided into five sections. The next two sections provide a review of CKW and other relevant studies, followed by identification of the research questions. The following two sections provide a description of the method and present the research findings. The final section is devoted to a discussion of the major findings and their implications for practice and future research.

II. Relevant Research

Prior research provides evidence that strong governance is associated with improved financial reporting quality in terms of a lower incidence of fraud (DeChow et al. 1996; McMullen 1996; Abbott et al. 2000; Beasley et al. 2000; and Farber 2005), fewer restatements (Abbott et al 2004), and lower levels of earnings management (Klein 2002; Xie et al. 2003; and Bédard et al. 2004). Therefore, the nature and strength of corporate governance is expected to impact the audit process (e.g., risk assessments and extent of audit tests), since professional standards dictate that the audit be tailored to the risk of misstatements (SAS 47 1984). Further, corporate governance actors such as the audit committee are responsible for overseeing the quality of financial reporting and the audit and, hence are expected to affect the audit process and audit quality, including ensuring proper resolution of auditor-client disputes (SOX 2002).

Despite the conceptual link, there is limited empirical evidence of the impact of corporate governance on the audit process. To our knowledge, the first study to address this issue was an experiment conducted by Cohen and Hanno (2000), who find that

management control philosophy and governance structure (audit committee and board) affected auditors' preplanning (client acceptance, business risk judgments) and planning judgments (extent and timing of tests). Bedard and Johnstone (2004) investigate the impact of corporate governance risk and earnings manipulation risk on audit planning and pricing decisions. Using archival data, they find a significant effect of earnings manipulation risk on planned audit effort and billing rates and the effect is greater for clients that have heightened corporate governance risk. A recent experimental study (Cohen et al. 2007) is the first to examine the affect of different roles of the board on the audit process. Specifically, they focus on an agency role where the board places attention on monitoring management and a resource dependence role where the board emphasizes proactively assisting management in setting corporate strategy and in helping to provide access to external resources. Cohen et al. find that both board roles affect audit planning judgments (risk assessment and extent of testing).

As noted, CKW is the only prior study that directly captures auditor experiences of their interactions with audit committees and boards of directors and the resulting effects on the audit process. They interviewed 36 auditors (11 seniors, 12 managers, and 13 partners) representing all of the then Big 5 firms. When asked how they define "corporate governance", auditors predominately focused on senior management and the board of directors. Including senior management as part of the corporate governance mosaic is inconsistent with the agency theory prescriptions of independent parties overseeing the actions of management. However, auditors noted that the "tone at the top" is indispensable to sound corporate governance since management may otherwise override controls and/or influence the appointment of an ineffective board and audit

committee. Further, auditors noted they rely heavily on an assessment of corporate governance in client acceptance and planning decisions. Also, they indicate that the importance of governance varies with a number of factors including whether a client is a multinational and the type of industry of the client. Finally, CKW find that auditors' experiences with audit committees were less than satisfactory. Audit committees were often found to lack the financial expertise, power, and skepticism that would make them effective. Instead auditors frequently found audit committees to play a passive, ritualistic role.

While providing a number of insights on the interactions between auditors and other corporate governance actors, it is important to reiterate that the CKW study captured auditors' experiences prior to the enactment of SOX. With the significant expanded responsibilities and an environment of heightened concerns for financial reporting quality brought on by SOX, the current study re-examines this issue to determine whether and to what extent auditors' experiences have changed since CKW. That is, has the landscape changed significantly and do the auditors report experiences that indicate the reforms have achieved their intended objectives? For instance, are the disconcerting findings of CKW regarding ineffectual audit committees still reflective of the current situation? The objective of this study is to answer these questions and to extend the CKW study by providing evidence on other important issues affected by SOX, as described in the following paragraphs and accompanying research questions.

III. Research Questions

As discussed, when asked to define corporate governance, CKW found that auditors placed management in the foreground of corporate governance. Given the dramatic changes of SOX in the responsibilities of other corporate governance actors and its emphasis on the financial oversight responsibilities of the board and the audit committee, our first research question examines whether this perception has changed significantly.

Research Question (RQ) 1: How do auditors define corporate governance?

To strengthen the independence of auditors, SOX gives the audit committee the authority to appoint and terminate the external auditor and to determine auditor compensation. Despite this requirement, evidence from a survey of audit committee members and other executives suggest that CFOs continue to have the greatest influence over auditor retention (KPMG 2004). Further, Gendron and Bédard (2006) argue that you can not think of governance simply in terms of the input and output measures of different regulatory requirements. For example, Gendron and Bédard (2006, 227) illustrate that audit committees, at times, may not play that decisive a role in the decision to continue with the existing auditor. Therefore, an important issue is whether auditors' still have experiences consistent with management having the primary influence in regard to maintaining a relationship with the auditor or whether SOX has fundamentally affected the audit committee's power in hiring/firing the auditor.

RQ 2: What are auditors' experiences regarding the influence of the audit committee in the appointment and termination of the external auditor in relation to other parties such as management and the board?

CKW provided evidence of the impact of corporate governance on the audit process (planning, field-testing, and review phases) and whether this varied across engagements. Given the passage of SOX this impact may have changed significantly in recent years with a recognition of the expanded role and responsibilities of governance actions and potential differences in the impact of governance in various settings (e.g., between industries, high versus low engagement risk clients). To explore this, we examine the following research question.

RQ 3: What are auditors' experiences regarding the influence of corporate governance on the audit process?

SOX places significantly greater responsibilities on the audit committee to oversee financial reporting, the audit process, and internal controls. To fulfill these responsibilities SOX also attempts to bolster the independence and credentials of the audit committee by requiring all members to be independent and disclosure of whether or not there is at least one financial expert on the committee. With such requirements, companies are expected to enhance the quality of audit committees and the power given to them. Further, it is reasonable to expect that audit committees are more active and diligent in responding to their elevated responsibilities. This is corroborated by Gendron et al. (2004) who found that effective audit committee meetings have value beyond mere symbolism and that audit committee members ask diligent questions to establish their perceived effectiveness. Thus, an important issue is whether there has been significant change in the negative experiences of auditors with audit committees as reported previously in CKW. Finally, SOX requires the audit committee to establish procedures and oversee the handling of reports by employees of suspected fraud or unethical

behavior (“whistleblowing”). Collectively, these developments suggest the following research question:

RQ 4: What are auditors’ experiences with interactions with the audit committee? How effective are audit committees in promoting quality financial reporting, sound internal controls, and overseeing employee whistleblowing of financial reporting related issues?

CKW found that auditors perceived that audit committee members often lacked the expertise to do their job. Further, the audit committee was seen as having little real power in fulfilling its responsibilities to oversee management. However, with the passage of SOX, there appears to be greater emphasis on increasing the knowledge base and independence of the audit committee. This leads us to investigate the next research question.

RQ5: Do audit committees have sufficient expertise and power to serve as an effective monitor of the financial reporting process?

As discussed previously, the board plays a number of critical roles in promoting sound financial reporting, including assigning qualified members and providing requisite authority to the audit committee. Other committees such as the nominations and compensation committee also play significant roles in appointing qualified members to the board and establishing management incentives that affect the potential for earnings management and taking excessive business risks (Beasley 1996; Klein 2002; Xie et al. 2003). This raises the issue of the extent to which the auditor interacts with the board and/or committees other than the audit committee, as examined in the following question.

RQ 6: Beyond their interactions with the audit committee, what are auditors’ recent experiences with the board? Do auditors consider the composition and work of other committees besides the audit committee?

The role of internal auditors has been elevated in recent years, especially with SOX Section 404 requiring management to assess the strength of internal controls over financial reporting (Asare et al. 2003; COSO 2004). Internal auditors are expected to play a significant role in ensuring compliance with this SOX mandate. Felix et al. (2005) find that when auditors do not provide non-audit services, they are more likely to rely on the work of the internal auditor than if they provide such services, if internal auditors are perceived as competent. Further, Asare et al. (2003) find that internal auditors' fraud risk assessments and planning judgments are affected by management incentives and the quality of the audit committee, suggesting a complex interplay. Thus, it is important to examine auditor experiences in recent years in working with internal auditors.

RQ 7: What are auditors' experiences with the effects of SOX on interactions with internal auditors?

An additional requirement of SOX is management certification of the financial statements (section 302). However, there is debate about whether, in fact, certification impacts management's behavior in promoting sound financial reporting (Nyberg 2003). In an experiment, Mayhew and Murphy (2003) find that certification alone does not reduce misreporting; only when public certification and social persuasion (completion of an ethics seminar) are combined is reporting quality improved.

RQ 8: What are auditors' experiences with the effects of management certification of the financial statements?²

²One controversial requirement of SOX (section 201) is the prohibition of certain non-audit services such as internal auditing. Most of the research does not find that non-audit services impair auditors' objectivity in fact or appearance (Higgs and Skantz 2006; Romano 2004; Larcker and Richardson 2004; Kinney et al. 2004; Ashbaugh et al. 2003; Frankel et al. 2002). In an additional exploratory question, we asked participants to indicate if the restriction with respect to prohibition of non-audit services resulted in a change in their ability to work with management to resolve important matters impacting the audit process or audit quality. The majority of the auditors perceived that the prohibition of many non-audit services did

IV. Method

Consistent with the approach used in CKW, we employed a semi-structured interview approach to address the research questions discussed in the previous section. We conducted interviews in 2006 with 11 managers and 19 partners from the assurance practice in the U.S. Northeast offices of three of the Big 4 firms.³ Partners (managers) had an average of 19 (9) years of auditing experience. We excluded audit seniors from this study since CKW indicates that seniors have little or no direct interaction with the audit committee or the board of directors. Further, while audit seniors need to be sensitive to a client's corporate governance structure and develop the skills necessary to assess the effectiveness of audit committees and boards, the impact of a client's corporate governance in decisions with respect to the audit process are typically made at the manager/partner level (Cohen et al. 2007). In addition, partners and managers also consider the effectiveness of governance in the client acceptance process and when considering resolution of accounting disagreements with management (Gibbins et al. 2001); aspects that are important in understanding the effect of recent governance reforms on audit practice. Finally, discussions with practitioners suggested that to gain an understanding of corporate governance an auditor needs to achieve a minimum rank of a manager.

not have an adverse effect on the audit process or audit quality. Given the exploratory nature of this interview question, the issue is not addressed as a separate research question in this study.

³ Since the impact of the financial reporting reforms resulting from SOX and regulatory agencies (e.g., the stock exchanges) is expected to be pervasive across all of the Big 4 firms, we do not expect any differences in responses among participants from the various firms. Our review of the transcripts from the interviews confirms this expectation.

The interviews were structured around 19 questions⁴ with the objective of corroborating and extending CKW by examining the impact of recent governance reforms on the audit process. Accordingly, we identified key questions examined by CKW relating to significant findings, e.g., experiences with the audit committee. We also reviewed the following sources to identify significant current issues for additional interview questions: literature on recent legislative and regulatory reforms (e.g., SOX); academic accounting research; and professional literature including recent changes in auditing standards (e.g., PCAOB AS 2, 2004). In order to ensure external and internal validity of the questions, two audit partners and several academic researchers (not associated with this study) independently evaluated the questions for clarity, completeness, and relevance.

The interviews were conducted by at least one member of the research team at the offices of the audit firm and each interview took approximately 45 minutes to one hour to complete. Interview questions were emailed to the participants ahead of time to allow sufficient time for them to reflect upon their experiences in responding. The instrument contained an explicit instruction that participants should refrain from discussing the questions or their response to the questions with their colleagues. Subjects were informed that the purpose of the study was to examine the impact of recent corporate governance reforms on the audit process. Subjects were also told that the objective of the study was to obtain *their experiences* with audit clients, and hence there are no right or wrong answers to the questions. Further, as is customary in such studies, participants were informed that their responses would be held in strict confidence. Consistent with CKW and Hirst and Koonce (1996), when auditors' responses to interview questions required

⁴ Contact authors for a copy of the instrument.

that we pursue them in order to gain a more complete understanding, we did so before returning to the interview questionnaire. With permission from participants, interviews were audiotaped to ensure completeness and accuracy. Tapes were later transcribed by a research assistant. All interviews were coded by two members of the research team with an average initial inter-coder agreement of 88 per cent. The researchers attempted to reconcile all disagreements, with remaining unresolved disagreements reconciled by a third member of the research team.

V. Results

Definition of Corporate Governance (RQ 1)

Despite the importance placed on corporate governance in academia and practice in the recent years, there is still no universally accepted definition of corporate governance and there is even greater divergence of views on what is considered “good governance.” Hence, consistent with CKW, we did not offer participants a definition of governance, but rather asked that the auditors provide us their definition.

Table 1 summarizes the results with regard to participant’s definition of corporate governance and its role in the audit process. Auditors’ definition predominately focused on the board (67%) and the management (67%). While this is lower than the perceptions of auditors who included senior management in their definition of corporate governance in CKW, some might argue that the inclusion of senior management in the rubric of governance is a reflection of the continued influence of management in the governance process in the post-Sox era and is inconsistent with the prescriptions of agency theory which emphasizes the independent oversight of the management as the cornerstone of effective governance.

---Insert Table 1 about here---

Noting the importance of the board in achieving effective governance, one partner stated that a board is a “buffer between the management and shareholders.” Another partner noted: “corporate governance is the tone of the organization set not only by management but set by the board and the process by which they engage management with respect to the on goings of the company.” Noting the role of the management, one partner stated: “at the end of the day ...it is really management that is going to make things work or not work. I mean the audit committee or board certainly can over time do a lot to affect them, but I really do think it is management to do the right thing or not”. Emphasizing the role of the CEO in the governance structure, another partner noted: "What that CEO does on a day in and day out basis, sends a much stronger message to everyone in the organization than what is written on an ethics policy, or the corporate governance website or anything like that."

Sixty percent of the auditors identified control environment/corporate culture in their definition of governance. This is consistent with the notion of governance espoused both in academic literature and in practice where the monitoring role of the board and the overall control environment and corporate culture are emphasized as fundamental to achieving effective governance.

Finally, only 34% and 30% of the participants respectively included the audit committee and control activities in their definition of corporate governance. Given the increased importance of the audit committee in the post-Sox era, this result is somewhat surprising since a greater percentage of auditors in CKW included the audit committee in their definition of corporate governance.

Appointment and Termination of External Auditors (RQ 2)

In the aftermath of Enron, WorldCom and other audit failures, ensuring auditor independence has been at the front-and-center of legislative and regulatory reforms. The underlying intent behind the reforms is to ensure that the decision to appointment/reappoint and dismiss auditors rests solely with the independent audit committee. Auditors were asked to share their experiences on who *actually* has the most *influence* in the re/appointment and dismissal of auditors in a public company. They were also informed that the *actual influence* refers to the substance of the decision to hire and fire auditors, and not necessarily what is required by law. In order to further understand the extent of this influence, auditors were also asked to specify the percentage influence that they believe the following stakeholders have with respect to the decision to hire and fire auditors: audit committee, management (CEO, CFO), board of directors, stockholders, and others.

When asked who has the most influence in decisions with respect to hiring and firing the auditor in a public company, the audit committee and management were identified respectively by 93% and 97% of the participants. Further, the mean percentage influence assigned to the management at 53% was higher than that assigned to the audit committee (41%). As expected, auditors indicated the board and the stockholders play a marginal role with respect to decisions about engaging audit services.

Noting that management is still a dominant player with respect to decisions regarding audit services, one manager stated: “I would say without a doubt, management. Clearly the law stipulates that it is the responsibility of the audit committee. We acknowledge that readily in our engagement letters so that it’s clear from a contractual

standpoint that we understand that and presumably the audit committee understands that but I would say point of fact that the group of individuals who hold the most influence over the appointment decision and retention would be management.” A similar comment was made by a partner who noted: “From what I’ve seen in the last year, and I’ve been in several clients where they’ve changed auditors, it’s management driving the decision. Management is unhappy with the auditors for whatever reason, it drives the decision. It’s the leading force behind the decision for the company to change auditors. They make the recommendation, the audit committee probably has been aware with management’s issues with auditors but ultimately it’s management driving the decision.” An interesting observation made by some partners is the increased role of the CEO in auditor appointment/dismissal decisions. One partner noted: “But I will say over the last several years what is interesting CEOs are much more involved in this process now than before. I think CEOs always kind of figured that’s the CFO’s prerogative but I think they’ve had a lot of issues with the firms over the last several years. I think CEOs are starting to realize, the audit firm can have a significant impact in my business.”

The influence of the management in auditor appointment and dismissal decisions seems to increase when the CEO is dominant on the Board. One partner noted: “...where the CEO is also Chair then there is more influence to management.” Collectively, these results seem to indicate that despite the recent legislative and regulatory reforms, in substance, management continues to play a critical role in decisions with respect to hiring and firing auditors.

While the influence of the management was consistently echoed by the participants, some auditors reflected the view that decisions with respect to engaging

audit services is a collaborative process that involves both the management and the audit committee. One partner noted: "...the last 20% of the actual selection process is more collaborative between management and audit committee and I think the first 75 or 80% is driven by management going out for proposal, interviewing, doing background information on the accounting firm." Another partner noted: "...So in terms of the audit committee making the initial decision, I think it still lies with management, but I think the ultimate decision in terms of ok if management wants to or doesn't want to, having that ultimate decision as to what happens I think there is a significant amount of influence that the board and the audit committee has."

Corporate Governance and the Audit Process (RQ 3)

CKW found that governance information was used throughout the audit process, with the following participant percentages: 100% in the audit planning stage, 54% in the field-testing stage, and 20-22% in manager/partner review stage. Given the increased oversight by the board and audit committee in the post-SOX era, we asked participants if the nature and extent of the use of corporate governance in the various phases of the audit process (planning, field-testing, and review) has changed over the last 5 years. We also asked auditors to comment on whether the role and importance of corporate governance varies across engagements and if so, whether auditors seek and utilize information relating to corporate governance based on the risk profile of the engagement and the nature of the industry in which the client operates.

With respect to the planning and field-testing phases, 97% and 59% of the auditors respectively indicated that these phases of the audit process have changed in the last 5 years with respect to the use of corporate governance information. Similarly, 57%

indicated that the last 5 years has seen a significant change with respect to manager or partner review as it relates to the use of corporate governance information.

One manager summarized the changes well with the following: "...I think in the planning phase we obviously consider [corporate governance] a lot more [than]...we did before, but there's a bigger focus on those aspects of corporate governance now. If we think that there's a good corporate governance then the extent to which we will do the field work will be lessened and the extent to which the manager and partner will review the work papers is also reduced, and we think that there's not enough corporate governance, sometimes that kicks it into a riskier category for us and there's a lot more review." (brackets added) Similarly, a partner noted: "...because of the increased focus on governance and more documentation on what's going on we absolutely incorporate more of the company's governance and thought process in our planning phase." These observations are also consistent with Cohen et al. (2007) who report that auditors' control risk assessments were higher when the board was considered weak with respect to its agency or its resource dependence role, than for the parallel strong condition. Further, their results indicate that when the board was stronger on both the agency and resource dependence dimensions, control risk assessments were the lowest and auditors decreased planned audit effort, while audit effort was increased when boards were weak on either or both the agency and resource dependence dimensions.

A number of participants reported that the increased interaction with the audit committee resulting from SOX and the related regulation has resulted in a greater focus by the audit committee on matters related to the audit process. One partner stated: "Well I think the governance players meaning particularly the audit committee, who we report to

and has direct supervision responsibilities under the Sarbanes-Oxley law, they clearly have a lot more clearly defined responsibilities that relate to our work. And they're spending more time looking at it. We're spending more time with them talking about issues." This seems to be a significant shift from the results reported in CKW where auditors characterized their meetings with the audit committee as a passive reporting significant audit issues, rather than an active two-way, proactive interaction with the audit committee. Some participants noted that the audit committee is also taking a more proactive role with respect to audit risk assessment and the related audit planning decisions. One manager noted: "Management comes to us with a plan, the audit committee will look at that plan, review it, approve it and then it will get turned back to management to have actions that are then held accountable to the standards that the audit committee has given."

There was a divergence of views on whether the role and importance of corporate governance varies across engagements. Most participants noted that corporate governance is important in every engagement, but some noted that the role and importance of corporate governance varies based on the risk profile of the engagement, the nature of the industry, and other factors. Specifically, 69% and 46% of the auditors respectively noted that the role and importance of corporate governance varies based on the risk profile of the engagement and the nature of the client's industry. Interestingly, almost all of the participants in the CKW study indicated that the role and importance of corporate governance varies based on the risk profile of the engagement while approximately three quarters of the CKW participants perceived that governance varies by the nature of the industry. It is unclear why these percentages have declined, but one

potential reason may be that post-SOX, corporate governance is viewed as important, regardless of client-specific factors, and hence relatively fewer subjects stress its further importance based on risk, industry, or other factors.

Many participants stressed the importance of corporate governance with respect to the audit process for all engagements. One partner noted: “No, from my view a public company is a public company. They all sort of have the same overall goal and objective in governance and whether it’s a life science company or consumer business company or technology company they should all be sort of focused on the same kinds of thing around ethics and integrity from my view.” Another partner noted: “So if you are in a high tech company, share the same corporate governance [issues as] the most low tech, conservative, safe business environment because corporate governance is about duties and obligations to the shareholders, so it should be the same.” (bracket added)

With respect to the importance of corporate governance based on the risk profile , one partner noted: “But I do think that the risk profile definitely plays into it and if you have a company that’s not been in complex transactions...things are pretty much going along they’re not under a lot of pressure from Wall Street...corporate governance it may not be of importance as a higher risk type of company or a company that’s in different industries where there is a lot of risk and the complexity of transactions that people are doing.” Noting the importance of the industry, one partner stated: “First it’s a company in an industry that’s not matured, that’s growing that’s doing it’s own acquisitions and growing double-digits at least, that kind of thing. Having a good audit committee that can step up to management and say slow down you’re overreaching your capabilities here, you can’t do the next acquisition until you slow down and absorb what you’ve got.”

Overall, it appears that most auditors perceive that corporate governance is relatively equal in importance across most firms with a minority of respondents perceiving some variability based on risk and industry type.

Interactions with the Audit Committee (RQ4)

Table 2 summarizes the results of auditors' interactions with the audit committee, the board and internal auditors as well as other issues brought up by SOX. The earlier study conducted by CKW found that auditors typically met only two to three times a year with the audit committee. In this study, we found that in the post-SOX era the activity has dramatically expanded to an average of over six times a year. In addition to the frequency of the interactions, the substance of the interactions has changed. As one partner noted, "One of the things that's facilitated their understanding of what's really going on is the ability to have an executive session with the auditor. Obviously that allows the audit committee to speak freely as well as the auditor about different types of issues and situations that need to be discussed." In the prior study, CKW concluded that by and large it was a passive affair with auditors merely reporting results to the audit committee. In contrast, the meetings are currently seen as more give and take. One partner noted, "The easiest way to describe that is 5, 7, 8 years ago the audit committee wanted you to come in and say everything is ok and that's all they wanted to hear and so you really basically say ok clean opinion, there no issues anymore. Today what I find audit committees saying is ok you're coming to me saying this company is conservative or not conservative or the numbers are good or bad, what do you mean by that, what is the quality of earnings." This change can be explained by audit committee members seeing their role more as watchdogs and taking their duties and responsibilities very seriously.

This is illustrated in the comments made by one partner, “I think the role of the audit committee there as holding management to the fire in ensuring that management has done what they need to do to maintain that effective internal control environment and to challenge management as to whether it really is effective or not and it’s part of their responsibility as audit committee members.”

---Insert Table 2 about here---

With respect to the issues discussed at audit committee meetings, approximately two thirds of the respondents indicated that they discussed accounting and auditing issues, 47% and 43% indicated that they discussed the audit plan and results of the audit respectively, and 23% and 27% respectively stated that they discussed audit risk and the quality of the accounting personnel employed by the client. As an illustration of the importance placed on discussing accounting and auditing issues, one manager remarked, “one of the key communications with audit committees is what are the judgments in the financial statements, what are the estimates, what are the quality of earnings. Those are 3 of the key things that I communicate every quarter to my audit committee and usually what you’ll do is we’ll have a sheet of bullet points, here are the findings, focusing on those 3 key points, judgments, estimates, quality of earnings.” Another auditor stated: “when you take a step back and you have to kind of look at the risks, a lot of the risks come from judgments and estimates that you made and there’s a range of acceptable answers. The key is to be able to communicate what the range of acceptable answers is, where does the company fall into that range of acceptable answers, and how does that compare to peer groups in other companies.”

It also appears that audit committees are less concerned with lowering audit fees than in ensuring that there are sufficient resources devoted to the audit. As one manager commented about what the audit committee is saying in relation to fees, “We also have a responsibility to make sure that you as our auditors feel like you have and are receiving the proper audit fee to enable you to do the work that you really think you need to do, so I need you to look across the table and look me in the eye and you tell me that this fee that you’re proposing is going to allow you to do the work that you need to do. There’s just enough of that mindset change that they are cognizant of the fact that it’s really in their best interest not to be trying to pinch us too much on the work that we need to do.”

The next set of questions asked respondents about the impact of the interaction with the audit committee on various phases of the audit process. 53% and 56% of the respondents indicated the discussions affected the audit risk assessment and program planning process respectively. This is similar to what was found in CKW. As one partner noted, “If we’re in dialogue with an audit committee throughout the year or throughout the audit process and we don’t get a comfortable feeling that the audit committee is not taking it seriously that obviously impacts our risk assessment.” This implies that if the audit committee is perceived to be a rubber stamp for management, then perhaps risk of the client will be evaluated as higher.

About half of the respondents indicated that discussions with the audit committee did not help resolve disputes with management. As one partner stated, “I mean if we have disagreements with management and we need the audit committee to help resolve them, we’re in a problem and in fact we have a client who doesn’t want to be working with us because we don’t understand; they don’t understand their role.” Similarly, another partner

mentioned, “I think most committees have an expectation that it’s our job and management’s job to work out what the issues are to make determination to what’s appropriate. That they will be brought the results as opposed to needing to be referees of fights.” These responses suggest that the audit committee expects disputes to be resolved before it comes to them. These results are similar to the findings of Gendron and Bédard (2006), with respondents in general indicating that the auditor and management try to resolve issues before it comes to the attention of the audit committee.

In contrast, a partner who believed that the discussions did help argued that, “in the course of the discussions with the audit committee we were reporting on adjustments not recorded and the audit committee chairman said, I don’t think so, I think we should record known errors-that this is a departure from GAAP. So we want you to go back and record that adjustment and we don’t care if it takes 2 days to run it all the way through the financials and so forth. We think you should do it.” Another interesting comment made by another partner referred to how management today is not hiding behind the shield of materiality to persuade the audit committee of the virtue of their position. As he stated regarding the role of audit committees, “They usually do not get involved in resolving contentious accounting issues, that’s usually resolved with the management and then brought to the committee with the resolution and maybe the various alternatives that were discussed. ... one thing I will point out though, is that management is much less willing to take an item to the audit committee today and say, boy my view is A, the auditor’s views is B, it’s not material so we’re going with view A and the auditors are ok with that because it’s not material.”

With the requirement of SOX 404 that auditors evaluate the controls of a company, the next question examined the role of the audit committee in connection to controls. Eighty-eight percent of the respondents indicated that the audit committee played an important role in providing an oversight function over controls. For example one partner was explicit with the connection and influence of SOX 404 stating, “So they had a significant impact in terms of one, the overall control environment they play a role in that and two their role in making sure that 404 got done and that it got done right.” This is confirmed by another partner’s remarks, “the trend I will say is clearly audit committees are on the hook so clearly they are pressing for improving controls.” Thus, it appears that SOX 404 has clearly had a positive influence on the audit committee’s role in conjunction with controls. In contrast, this monitoring function was not mentioned in the pre-SOX study by CKW.

Participants in CKW indicated that the role of governance was expected to increase in the immediate future. This is borne out in this study with over half indicating that discussions with the AC impacts audit decisions with respect to risk assessment and program planning. Further, 38% indicate that audit committees now ask a lot of questions during their interactions with them. As a partner mentioned, “the audit committee will say to us we’re curious about the internal controls around expense reimbursements for the CEO and the CFO and other senior executives and how loose are the controls around that, how tight are they, we’d like you to spend some more time there. So that might not be a material area that we would focus on in the context of an audit of a large company but we could get some direction from the audit committee, so that is one example. The audit committee just could by virtue of them being more involved in the company than us say

I'm really concerned about this area of our business and they might not have come up in our planning process so we could conceivably change our approach or modify our approach for the comment that was made. So I think that's how they would influence the extent of the scope."

Further, other respondents gave examples of how the interactions have changed in terms of the types of questions the audit committee asks. One partner also talked about how much the interactions have changed over the past five years by looking at how the audit committee interacts with management by stating, "Audit committees challenge management, they look at management, they ask questions of management whereas in the old days it was much more focused on the auditors. So it is very even. Audit committees are much more serious today than they used to be. They clearly, they challenge us as they always did, but they challenge management much more than they did before and with very few exceptions. It's a completely different view than it was pre-Sarbanes. And that to me is the biggest benefit of the entire Sarbanes-Oxley act."

As part of SOX, protection is supposed to be provided to whistleblowers who file allegations about fraud and other financial matters with the audit committee. This requirement leads to our questions that deal with the role the audit committee plays with regards to the whistleblowing activity. Eighty-seven percent of the respondents perceived that the audit committee provided effective oversight over the whistleblowing process which suggests that the audit committee has taken on this responsibility with appropriate diligence. For example, one manager stated, "And in another instance, somebody on the board came to the audit committee and said I think there was fraudulent reporting back three years ago. And the board immediately brought us into the discussion. There was

lots of discussion between management, audit committee, and the rest of the board of directors to address what he had said.” Another manager remarked on how the auditing firm ran tests on the whistleblowing process. He stated, “For what it’s worth, one of the things we do when we do our evaluation of the governance, we’d actually log a call into the whistle blower hotline, we’ll say this is a test this is [XYZ firm] calling please report that you got this, received this, and they actually do. We did it one time like three days before a meeting and the audit committee chair said I just wanted to let you know I got your message in the whistle blower hotline.” (bracket added). However, other respondents indicated that nothing of substance has been brought to a whistleblowing hotline. As one manager stated, “Sarbanes-Oxley would tell you that if there have been no reports to a whistle blower hotline that might be a big hint that the control environment is weak. Many of my clients would say it’s indicative that there’s a strong control environment because no one has anything to report. So who knows?”

Expertise and Power of the Audit Committee (RQ 5)

One of the striking findings of CKW was that auditors reported their experiences indicated audit committees lacked both the financial expertise and the power to serve as an effective oversight over management. Further, even though audit committee members were seen as appropriately independent according to existing regulation, their independence did not translate to actions. In contrast, we found that 93% of the respondents reported that the audit committee had sufficient expertise and 96% note that AC member have sufficient power to hold management accountable for the integrity of the financial reporting process. As an example of the change in the power dynamic, one managing partner of a large office remarked, “And one of the board members just looks

down the table and said that's not the way it is anymore, they're (internal audit) reporting to us and that was the end of discussion. Now that was an example of power being used by the audit committee that pre-Sarbanes management would've said this is the way it's going to be like it or not. So audit committees wield a lot of influence today on management. I think management is a little bit back on their heels versus being very aggressive. So you see that change in tone. You know, as an auditor we love that because it puts balance, it puts perspective, it puts more integrity into the process."

In contrast, a minority of respondents felt that at times management still had the upper hand. As one partner noted, "I do think that companies that have a strong CEO and the company is performing very well then there's typically a balance of power that is shifted towards management." Approximately, three quarters of the respondents believed that in their experiences, AC power and expertise varied by industry and/or the size of the company which would suggest that there is a better matching of the financial sophistication of the audit committees with the financial complexity of the companies within which they are serving. However, in some smaller companies and for firms in the technology and other knowledge-intensive industries, the change in composition of audit committee membership post-SOX has brought less of a change in the power hierarchy. One partner reflecting on his high tech practice said, "And then the other times, you've got kind of the money guys on the board, their agenda is just different than necessarily the best corporate governance and the best quality I think. So again that's a broad brush to paint but when you do your risk factors, your risk assessments [always remember] who's on the board, where are they coming from, and to me that's usually a red flag if your board consists of mostly finance driven field people, you step back and say how

much stewardship is this board going to get and this audit committee going to get... You know, well lets get through it because ...we won't be able to do this transaction." Finally, having some cross section of expertise was viewed favorably by some respondents. For example, one partner mentioned the virtue of diversity in background stating, "Within the company, yes, there can be a wide range of financial savviness of the audit committee members, but a good audit committee- not everyone has to be financially savvy, a good cross-section. I have some audit committee members where, I got some attorneys that are on the audit committee that aren't really financially savvy but boy do they ask some great questions."

The final question examined changes respondents believed had occurred in the ability of audit committees to ask effective and probing questions. In the CKW study, audit committee members were viewed as passive and merely asked perfunctory questions. In contrast, almost all respondents in the current study perceived that audit committee members asked more difficult questions both of the auditor and of management. As an example of the increased ability of the audit committee to work with the auditor, one partner noted "One of the things that's facilitated their understanding of what's really going on is the ability to have an executive session with the auditor. Obviously that allows the audit committee to speak freely as well as the auditor about different types of issues and situations that need to be discussed." In response to the change in the audit committee's willingness to confront management, a regional director of the audit practice remarked, "Yes, yes, yes over and over again. They're very active, very proactive and the questions just don't come to the auditors anymore they come to

management.” These responses suggest that a monumental change has come to at least the audit committee’s approach and in what their perceived role is.

Interactions with the Board and other Subcommittees of the Board (RQ6)

Besides the change in auditors’ interactions with the audit committee we were also interested in the auditors’ interaction with the board and other subcommittees of the board. CKW found almost no interaction with the board or with other committees of the board. Today it appears that auditors evaluate the work of specific committees of the board, with a special focus on the compensation committee of the board. Excessive managerial compensation has received much adverse press which has resulted in changes in the disclosures for executive compensation (SEC 2006). Accordingly, it is not surprising that besides the audit committee, the committee which has received the most scrutiny by auditors is the compensation committee. As one manager noted, “The compensation committee we definitely consider because they’re setting the salaries and bonuses, the bonus structures. So that’s a key control that we consider in, when we’re looking at the audit because you’re always concerned what the drivers are for the bonuses.” Thus, consistent with the principles outlined in SAS 99 (2002) on fraud, it appears that auditors are appropriately considering the compensation committee because the work of this committee could highlight red flags that may point to irregularities.

Interactions with the Internal Auditors (RQ7)

The internal audit function is seen as a potentially strong component of the corporate governance mosaic especially since the passage of SOX (Cohen et al. 2004; COSO 2004). Over eighty percent of the respondents indicated that the role of the internal audit function has changed over the past five years and that the extent that

auditors rely on the internal auditors has also increased considerably. One way that the internal audit function has changed has been in the area of controls and SOX 404 testing. As one manager commented, “In the last few years all the internal audit departments that we’ve seen have been working on getting the client up to speed on controls and making sure that the controls are in place and operating effectively.” This is reinforced by the comments of another manager who remarked, “And now the internal auditors really spend, in my experience, probably 90% of their time doing something 404 related, whether it’s documenting the processes, documenting controls, doing the actual testing for the company. So that’s been a huge change.”

A number of respondents also commented how the internal audit function now frequently reports directly to the audit committee which has helped strengthen the independence and reliability of the work generated by the internal audit function. One partner discussed his firm’s reliance on the internal audit function, “So there’s been a big increase in terms of the work and our use of their work to satisfy our 404 obligations. It’s been a big change. It’s required a lot more coordination between us and them and a lot more evaluation of their competency and making sure really that they know what they’re doing.”

The Impact of Management Certification (RQ8)

One key element of SOX is the certification of the financial statements by top management (Section 302). The rationale for the provision is that the very act of certification increases the accountability of management. In this study, approximately 68% of the respondents indicated that the requirement has had a positive impact on the integrity of the financial reports but only a minority (20%) believed that the requirement

ultimately had an effect on the audit process. To illustrate how auditors have an appreciation for the perceived increase of accountability, one partner stated, “I think it’s made a very big impact. It was very easy for people to say well I wasn’t involved in that, I didn’t know anything about that. That’s poor leadership and poor management. I think that certification requires them to be involved and most people take that requirement very seriously. Sign your name to the certification makes a big difference. So I think it’s added a lot to the process in that there’s more involvement at the CEO level.” Auditors also indicated that the certification has placed the onus for the quality of the financial reporting process squarely on management. This is eloquently expressed by a partner who commented, “It’s nice to be able to go to the management, the CEO or CFO and say if we got an issue here I’m putting it on your lap, it’s on your lap now and you tell me how you’re going to conclude before I conclude because you have to conclude as management before I conclude on your financial statements. They take that responsibility very seriously. I think it’s been nothing but positive. I won’t say for every company it’s raised the bar dramatically but it’s a positive thing.”

Although only a minority of respondents reported that management certification affected the audit process, there were some exceptions. It appears that at least for some companies, management and the CFO are trying to avoid questionable accounting issues. As one partner said about his clients, “CFOs are, I believe, particularly in larger companies, get closer to the numbers now than they did before. They want to understand what the issues are. They don’t want to have unrecorded adjustments on their score sheet as it were, on the summary of adjustments because they know they’re going to get picked at from the audit committee. So I think it has brought the CFOs closer to the audit

process than they used to be in the past, and that again is really good. They want to be involved in it they just don't want to delegate it down to controllers and VP finances and assistant controllers. They want to understand it.”

Finally, we asked subjects if they wanted to add anything else on the subject of corporate governance. The majority who did respond brought up the issue of ethics. One partner discussed how he resigned from an engagement because he perceived that there were ethical problems with one of his clients. Discussing the resignation, the partner stated, “evaluating integrity: just over a gut instinct like that that bothered me. I just said something smells here, it stinks so we resigned and in the process of resigning what was amazing was everyone in management was trying to cover their butts that it wasn't them and the things they told us were unbelievable.” It appears that this is a widely held sentiment that so much of what constitutes ethics comes from instinct. As a manager put it, “Discussions with people are key. You just can't audit in a room. You have to go out and you have to talk to people. And you have to have the skills to be able to talk to people ask the first question, listen to the response, and ask the second question and ask the third question. And so when you're doing that, a lot of the way you view ethics is, I view ethics is, what have people told me in the past and in hindsight, did what they tell me in the past, was it true....It's what's the trend of working with the people and the working relationship that you have with the people that kind of judge the ethics that they have. ...The ethical tone of the organization.” Other respondents indicated the need to stand firm against pressures by management to let small matters slide by. As a partner stated, “Sometimes there are people who try to get around small things and say “can't you just let that go”, and you have to tell them that this doesn't mean you have reasonable

controls. They will say nothing will happen and you just have to tell them something will happen.” Thus, it appears that raising the ethical sensitivity and awareness of auditors is important in the socialization process that inevitably occurs in the auditing profession.

VI. Summary and Discussion

As part of the corporate governance mosaic, auditors play an important role in working with other actors such as the audit committee and board of directors to ensure quality financial reporting. CKW report auditors’ experiences in this process. They note that auditors consider the quality and efforts of corporate governance within the firm in their risk assessments and program planning. However, of concern, auditors indicated that audit committees were generally found to be ineffectual. Importantly, CKW captured the experiences of auditors pre-SOX. With significant reforms since that time, particularly the enactment of the Sarbanes-Oxley Act in 2002, this study extends CKW to determine the extent to which the environment has changed.

The primary finding of the current study is that auditors’ experiences indicate dramatic changes in the corporate governance environment since CKW. Table 3 highlights the similarities and differences between the findings in CKW and the findings in this study. Auditors see the board and the control environment as important actors in the governance structure of a firm. Nonetheless, management continues to be viewed as a significant part of corporate governance and still the driving force in determining auditor appointment and termination. Corporate governance plays a greater role in influencing the audit process across engagements than in prior years with audit committees considerably more active and diligent. Audit committees are seen as having sufficient expertise and power to fulfill their responsibilities with members playing important roles

in overseeing internal controls, focusing on reporting quality, ensuring audit fees are sufficient, identifying risks, asking challenging questions, and overseeing the whistleblowing process. Interestingly, though, only about half of the auditors felt the audit committee played an important role in resolving auditor disputes with management.

---Insert Table 3 about here---

Auditors report greater consideration of the activities of committees other than the audit committee, such as the compensation committee. Reliance on internal auditors has increased, particularly in the area of internal controls where internal auditors have shifted emphasis in response to SOX Section 404. Finally, auditors indicate the CFO and CEO certification requirements of SOX have had a positive effect on the integrity of financial reporting, although little impact on the audit process itself in that auditors must continue to test management assertions.

In all, this study finds a significantly stronger corporate governance environment than in the pre-SOX era. This development is a very positive one for auditors, who have gained allies such as the audit committee, the board, and, in many cases, management in promoting quality financial reporting and sound internal controls. The results suggest that at least according to the experiences of auditors, a lot of the provisions of SOX appear to be working. This also suggests that attempts by business lobbies to reduce the requirements of SOX may have the potential to weaken the protection of the public interest which is a cornerstone of the accounting profession. This study reports auditors' experiences; future research is needed to corroborate the findings using alternative methods such as behavioral or archival studies. For instance, how effective are audit committees in identifying and resolving reporting problems? Also, does CFO and CEO

certification improve the quality of financial reporting? Further, of concern, many auditors in this study note that audit committees play a passive role in helping to resolve disputes. If this is corroborated by other studies, why is this the case? Management is still seen by auditors as the driving force in auditor appointments and terminations, despite the SOX mandating this authority to the audit committee. Does this mitigate the intent of SOX in ensuring auditor independence? In addition, auditors continue to report limited involvement with the board or other committees than the audit committee. Why is this so and is it a problem in leveraging with other corporate governance actors? Finally, this study is based on the reported experiences of auditors who because of increased fees may have a vested interest to view many of the reforms of SOX as being effective. A future study may interview audit committee chairs and other members of the audit committee and board to examine if the experiences of audit committee chairs are different than that of auditors.

TABLE 1: DEFINITION AND ROLE OF CORPORATE GOVERNANCE

	Total	
	n=	30
DEFINITION OF CORPORATE GOVERNANCE		
<i>Stakeholders included in the definition</i>		
Management	20	67%
Board	20	67%
Audit Committee	10	34%
Control Environment/Corp. culture	18	60%
Control Activities	9	30%
Other	2	7%
CLIENT ACCEPTANCE/CONTINUATION		
<i>Most Influence on Hiring/Firing Auditor</i>		
Audit Committee	28	93%
Management (CEO, CFO)	29	97%
Board of Directors	2	7%
Stockholders	0	0%
<i>Percentage Influence on Hiring/Firing Auditor (mean)</i>		
Audit Committee	41	
Management (CEO, CFO)	53	
Board of Directors	5	
Stockholders	1	
Other	0	
AUDIT PROCESS		
<i>Nature and extent of the use of Corp Gov Info in Audit Phases changed in the last 5 yrs?</i>		
Planning phase (audit scope)	28	97%
Field-testing	17	59%
Manager or Partner Review	16	57%
<i>Role and Importance of Corp Gov vary across engagements?</i>		
Based on risk profile of the engagement?	18	69%
Based on the nature of the industry?	11	46%

Note: Since not every subject responded to every question, the calculation of percentages is based on the total number of individuals responding to a particular question.

**TABLE 2: INTERACTION WITH THE AUDIT COMMITTEE,
BOARD, AND INTERNAL AUDITORS**

	Total	
	n=	30
INTERACTION WITH THE AUDIT COMMITTEE		
<i>Frequency of meetings</i>		
Mean number of meetings per year (see note 2)	6.4	
<i>Issues discussed</i>		
Audit plan	14	47%
Audit Risk	7	23%
Results of audit	13	43%
SAS 61 and other mandated items	10	33%
Auditor Independence	3	10%
Accounting/Auditing Issues	20	67%
Compliance-Related Issues	4	13%
Audit Fees	4	13%
Disagreements with management	5	17%
Earnings releases, MD&A, etc.	2	7%
Internal Control & Control Environment	5	17%
Accounting Personnel	8	27%
Other	13	43%
<i>Impact of discussions with AC on:</i>		
Audit risk assessment	16	53%
Audit program planning	15	56%
Resolution of contentious issues	14	52%
Type of audit report	4	16%
<i>Role of AC in establishing and maintaining controls</i>		
	23	88%
<i>Changes in the last 5 yrs w.r.t. AC interactions</i>		
Upfront planning	4	14%
Lots of questions...anything they need to know?	11	38%
Focus on audit risk	3	10%
Focus on fraud risk	0	0%
Whistle blower program	2	7%
Other	16	55%
<i>Whistleblowing and AC</i>		
Whistleblowing by client employee?	14	56%
ACs effective w.r.t. fraud whistleblowing?	20	87%

**TABLE 2: INTERACTION WITH THE AUDIT COMMITTEE,
BOARD, AND INTERNAL AUDITORS (Continued)**

	Total	
	n=	30
<i>AC Financial Expertise</i>		
Does AC have sufficient financial expertise?	25	93%
AC financial expertise vary by industry, size, or other factors?	12	75%
Is the difference between the most and least qualified AC member significant?	18	86%
<i>AC Power</i>		
Sufficient power to confront management?	23	96%
AC Power vary by industry, size, or other factors?	9	75%
<i>Change in the last 5 yrs w.r.t. level of AC effectiveness in monitoring and asking difficult questions?</i>	23	96%
INTERACTION WITH THE BOARD AND SUBCOMMITTEES		
<i>Specific changes in the last 5 yrs w.r.t board effectiveness in monitoring financial reporting</i>	11	50%
<i>Consider composition and work of committees other than AC?</i>	23	82%
Specify committees:		
Compensation	13	43%
Governance	3	10%
INTERACTION WITH INTERNAL AUDITORS AND MANAGEMENT		
<i>Role of IAs changed in the last 5 years?</i>	20	83%
<i>Nature and extend reliance on IA work changed over the last 5 years?</i>	22	85%
<i>Impact of Sarbox certification requirements on:</i>		
Integrity of financial reporting	15	68%
The audit process	4	20%

Notes:

1. Since not every subject responded to every question, the calculation of percentages is based on the total number of individuals responding to a particular question.
2. For participants who provided a range for the number of meetings, the mid-point of the range was used for the purpose of computing the mean number of meetings.

TABLE 3: CORPORATE GOVERNANCE AND THE AUDIT PROCESS--PRE AND POST-SOX

Issue	Pre-SOX (Cohen et al. 2002)	Post-SOX (Current Study)
Definition of Corporate Governance	Focused primarily on senior management, board, and control environment/corp culture. Secondary importance to the audit committee (AC).	Focused primarily on board, management, and control environment/corp culture. Lower emphasis on AC relative to pre-SOX.
Appointment and termination of external auditors	Governance considered important in client acceptance decisions.	Management has the greatest influence in decisions relating to hiring/firing auditor, exceeding that of the audit committee or the board.
Use of corporate governance info in the audit process	Very High in the audit planning phase; Moderate in the field-testing phase; and Low in the manager/partner review phase.	Very High in the audit planning phase; Moderate in the field-testing phase and manager/partner review phase.
Importance of Corporate Governance based on client's risk profile and industry	Almost all (majority) respondents considered risk profile (industry).	Majority (minority) of respondents consider risk profile (industry).
Frequency of meetings with the AC	2-3 times a year.	Over 6 times a year.
Primary issues discussed at AC meetings	Audit plan; and Results of the audit.	Audit plan; Results of the audit; Accounting/Auditing Issues; and SAS 61 and mandated/compliance-related issues.
Impact of discussions with AC on phases of the audit process	Audit Risk Assessment; Audit Program Planning.	Audit Risk Assessment; Audit Program Planning; and Resolution of contentious issues.
Role of AC in establishing and maintaining controls	Not asked.	A significant majority of respondents indicate that AC has a significant role.
Whistleblowing and AC	Not asked.	A significant majority of respondents indicate that AC is effective with respect to fraud whistleblowing.

**TABLE 3: CORPORATE GOVERNANCE AND THE AUDIT
PROCESS--PRE AND POST-SOX [continued]**

Issue	Pre-SOX (Cohen et al. 2002)	Post-SOX (Current Study)
AC Financial Expertise	AC members lacked financial expertise.	AC members have sufficient financial expertise; AC financial expertise varies by industry, size, and other factors; and Significant variance across AC members w.r.t. to financial expertise.
AC power to confront management	AC lacked sufficient power.	AC has sufficient power, but this power varies by industry, size, etc.
AC effectiveness in monitoring w.r.t. financial reporting	AC perceived to be typically passive, ineffective, and asking perfunctory questions.	AC perceived to be proactive, have a higher level of effectiveness, and asking probing and difficult questions.
Interaction with the entire board	Rarely met with the board.	Limited interaction with the board.
Committees of the board	Not asked.	Increased focus on the compensation committee.
Interaction with internal auditors	Internal audit function not emphasized.	Increased reliance on the internal audit function.
Impact of SOX certification requirements on integrity of the financial reporting process and the audit process	Not asked.	Positive impact on the financial reporting process but little or no impact on the audit process.

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