SESSION 1.02: AUDIT COMMITTEE EXPERTISE AND RESPONSIBILITIES
DATE: FRIDAY, JANUARY 18, 2019
TIME: 10:15 AM–11:45 AM

Do Compelling Director Stock Ownership Requirements Affect Audit Committee Monitoring of Financial Reporting?

Marcy Shepardson
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Indiana University Bloomington

Rani Hoitash
Bentley University

ABSTRACT: We address whether director stock ownership requirements that compel audit committee members to acquire and hold shares in the firms on whose boards they participate improve financial reporting monitoring via decreasing the likelihood of financial statement misstatements. Corporate governance best practices encourage the use of DSORs to align directors' incentives with shareholders' interests. However, not all monitoring tasks are alike and stock ownership mechanisms having beneficial effects on monitoring of firm performance may not similarly improve monitoring of financial reporting. Using a sample of 714 firms that adopt DSORs from 1998 to 2013, we find compelling DSORs—those requiring a change in audit committee ownership behavior—are associated with decreased audit committee member stock sales post-adoption, with no similar effects on share purchases. We find a lower likelihood of financial statement misstatement in firm-years immediately following DSOR adoption, consistent with DSOR adoption affecting audit committee monitoring of financial reporting. Finally, we find that as average audit committee member ownership approaches the required level, both from below and from above up to five times the requirement, the likelihood of misstatement decreases. Said differently, average audit committee ownership that deviates from required levels, both on the downside and upside is associated with lower quality monitoring. Finally, when audit committee member ownership exceeds five times the requirement, monitoring again improves, indicative of long-term focus.

SESSION 1.02: AUDIT COMMITTEE EXPERTISE AND RESPONSIBILITIES
DATE: FRIDAY, JANUARY 18, 2019
TIME: 10:15 AM–11:45 AM

Do Greater Audit Committee Responsibilities Enhance Corporate Governance?

Jacob Jaggi
The University of Arizona

Musaib Ashraf
The University of Arizona

Preeti Choudhary
The University of Arizona

ABSTRACT: Audit committee responsibilities have been increasing over the past two decades, causing some practitioners to warn that overloading audit committees can impair their effectiveness. Using a new measure of audit committee oversight activity based on the length of audit committee charters, we examine how the level of audit committee oversight is associated with financial reporting, internal control, and auditing outcomes. Using our charter-based measure, we provide evidence that audit committee oversight is positively associated with the quality of financial reporting, internal control, and auditing. Our research provides empirical evidence that increasing the scope of audit committee oversight benefits corporate governance.

SESSION 1.02: AUDIT COMMITTEE EXPERTISE AND RESPONSIBILITIES
DATE: FRIDAY, JANUARY 18, 2019
TIME: 10:15 AM–11:45 AM

The Impact of Audit Committee Information Technology Expertise on the Reliability and Timeliness of Financial Reporting

Musaib Ashraf
The University of Arizona

Paul N. Michas
The University of Arizona

Daniel Russomanno
The University of Arizona

ABSTRACT: We examine whether information technology (IT) expertise on audit committees (ACs) impacts the reliability and timeliness of financial reporting, two important financial reporting characteristics. We find a positive association between AC IT expertise and the reliability and timeliness of financial reporting. Specifically, we find a reduction in the likelihood of material restatements and IT-related material weaknesses (which account for 55 percent of all reported material weaknesses) and more timely earnings announcements at firms with AC IT expertise. These findings are robust to controlling for other IT attributes, propensity score matching, propensity score weighting, and entropy balancing techniques. We also mitigate endogeneity concerns with evidence that our findings hold in a sub-sample of firms that all possess overall high-quality IT. Finally, a placebo analysis, falsification tests, and inclusion of industry-year or firm fixed effects support our assertion that the quality of financial reporting is significantly improved by the AC IT expert.

SESSION 1.03: AUDIT PARTNER EXPERTISE AND EXPERIENCE
DATE: FRIDAY, JANUARY 18, 2019
TIME: 10:15 AM–11:45 AM

Engagement Partner's Expertise and Audit Fees: An Archival Study

Jean Bedard
Laval University

Jerome Deschenes
Laval University

Mathijs Van Peteghem
Maastricht University

ABSTRACT: In this paper, we examine the impact of individual audit partners on audit fees. Using a sample of listed companies in France, we estimate a set of audit partner fixed effects. We find that these fixed effects have significant explanatory power for audit fees, confirming our base hypothesis that companies differentially reward individual audit partners. Furthermore, we find that the partners premium increase with the level of the partner industry specialization or professional experience. Overall, these findings show that the companies recognize the differential skills or abilities of individual audit partners and are willing to pay more for these partners.

SESSION 1.03: AUDIT PARTNER EXPERTISE AND EXPERIENCE
DATE: FRIDAY, JANUARY 18, 2019
TIME: 10:15 AM–11:45 AM

The Impact of Audit Partners' First-Hand Experience with Arthur Andersen's Demise on Their Style

Timothy A. Seidel
Brigham Young University

Jeffrey Pittman
Memorial University of Newfoundland

Ling Lei Lisic
Virginia Polytechnic Institute and State University

Feng Guo
The University of Kansas

Mi Zhou
Virginia Commonwealth University

ABSTRACT: The increase in disclosure about the persons conducting audits has led to a steep rise in research examining the role that individual audit partner styles play in audit outcomes. Although recent evidence suggests that individual audit partner styles explain a substantial portion of the variation in audit quality proxies, much less is known about what determines an audit partner's style. Psychology and behavioral economics theories hold that an individual's experiences can have enduring impacts on subsequent behavior. We examine whether auditors' first-hand experience with the Andersen demise affects their auditing style. We find that audit partners who experienced Andersen's demise first-hand impose stricter monitoring of the financial reporting process evident in their clients exhibiting lower absolute discretionary accruals and paying higher audit fees. In another set of results consistent with our predictions, these effects are concentrated among partners who are currently working in non-Big Four audit firms. Additional results imply that these effects are more pronounced among clients of partners who worked in Andersen's Houston office and who were at an earlier career stage at the time of Andersen's demise. Supplementary analyses suggest that both conservative auditing style and client screening play a role in explaining the higher audit quality of partners who experienced Andersen's demise first-hand.

SESSION 1.03: AUDIT PARTNER EXPERTISE AND EXPERIENCE
DATE: FRIDAY, JANUARY 18, 2019
TIME: 10:15 AM–11:45 AM

The Market Premium for Audit Partners with Big 4 Experience

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Northern Illinois University

Kenneth. L Bills
University of Arkansas

Monika Causholli
University of Kentucky

ABSTRACT: This study investigates how non-Big 4 firm audit partners' Big 4 experience is valued by the audit market. The Big 4 audit firms have differentiated themselves as nationally recognized firms for whose services companies are willing to pay a premium. It is unclear, however, whether this reputation follows individual auditors when they move to a non-Big 4 audit firm. We use hand-collected U.S. partner data to examine whether companies pay a fee premium for audit partners with Big 4 experience. We find that non-Big 4 audit partners with Big 4 experience charge a fee premium of approximately 21 percent when they are employed by small, non-second-tier audit firms, but find no evidence of a fee premium for Big 4 experience at the second-tier audit firms. Furthermore, in additional analyses, we find no evidence that audit quality is higher for clients of non-Big 4 audit partners with Big 4 experience than their counterparts without Big 4 experience. Our results are robust to controlling for other partner characteristics.

SESSION 1.04: AUDIT OPINION SHOPPING
DATE: FRIDAY, JANUARY 18, 2019
TIME: 10:15 AM–11:45 AM

Do Companies Shop for Auditors to Conceal Misstatements? Evidence from the Termination of Auditor-Client Engagement during the Misstatement Period

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HEC Montreal

Jing Zhang
The University of Alabama in Huntsville

ABSTRACT: We show that companies that misstate their financial statements successfully engage in auditor shopping to conceal the misreporting; their misstatements would have been discovered faster had they made opposite replace/retain auditor decisions. We also find that the engagement in auditor shopping leads to longer and more severe misstatements. The practice of auditor shopping is more prevalent when the level of competition in the audit market is high. In an extended analysis we find that the presence of a financial expert on the audit committee curbs auditor shopping, while having more powerful CEO facilitates auditor shopping. Finally, the decision to engage in auditor shopping bares detrimental labor market consequences to the CFO, as the likelihood of CFO turnover after the restatement is substantially higher for companies involved in auditor shopping during the misstatement. Overall, our study broaden the literature on opinion shopping by demonstrating that the motivation for an opportunistic auditor dismissal/retention extends beyond opinion shopping.

SESSION 1.04: AUDIT OPINION SHOPPING
DATE: FRIDAY, JANUARY 18, 2019
TIME: 10:15 AM–11:45 AM

Investor Sentiment and Audit Opinion Shopping

Peng Guo
Michigan Technological University

John Daniel Eshleman
Michigan Technological University

Keval U. Amin
Stony Brook University, SUNY

ABSTRACT: Prior research finds that during high investor sentiment periods, managers have stronger incentives to manage earnings and withhold bad news in order to maintain inflated valuations of their firms' stock prices. The purpose of this study is to examine the role of audit opinion shopping in this context. Using the opinion shopping framework of Lennox (2000), we show that internal control opinion shopping is more prevalent when investor sentiment is high. Further tests reveal that the effect of sentiment on internal control opinion shopping is concentrated among "uncertain" or "difficult to value" firms and firms with low institutional ownership. We also examine how the motivation for opinion shopping varies with the level of investor sentiment by comparing the internal control reporting conservatism of the clients' outgoing and incoming auditors. We find that during high sentiment periods, clients' outgoing auditors have a significantly higher reporting conservatism score compared to the incoming auditor. These relationships do not persist during low sentiment periods. Lastly, we document that clients are significantly more likely to undertake downward switches (i.e., Big 4 to non-Big 4 auditor) when sentiment is high. Overall, the results suggest that firms' opinion shopping behavior during high sentiment periods is opportunistic.

SESSION 1.04: AUDIT OPINION SHOPPING
DATE: FRIDAY, JANUARY 18, 2019
TIME: 10:15 AM–11:45 AM

Regulation and Opinion Shopping: Evidence from the U.S. Broker-Dealer Industry

Yu Bai
University of Houston

ABSTRACT: This study examines whether and how regulation affects opinion shopping in a market where incentives for independence are low. Specifically, motivated by the ongoing regulatory focus on the independence issues related to broker-dealer auditing, I examine the potential opinion shopping behavior of broker-dealers and changes in this behavior around recent regulatory interventions to broker-dealer reporting and auditing. Results suggest that broker-dealers engage in both going concern (GC) opinion shopping and internal control (IC) opinion shopping. To shed more light on the potential compromised independence, I use a shock-IV design to examine the effect of auditor switching on subsequent audit opinions. Results suggest that broker-dealers successfully lower the likelihood of receiving a GC (IC) opinion through opinion shopping. Moreover, I find that broker-dealer opinion shopping subsided to a certain extent after PCAOB assumed sole authority to the broker-dealer audit market. Results suggest that this effect is mainly driven by the elimination of the opportunity for broker-dealers to switch to a less regulated auditor. I also find that the broker-dealer opinion shopping activities has significantly reduced after the recent adoptions of new SEC rules and PCAOB attestation standards for the broker-dealer industry. However, this benefit comes at the cost of a dramatic reduction in the frequency of IC audit opinions. Further evidence from testing the association between audit opinion and FINRA enforcement actions suggests that the information value of the IC opinions has significantly decreased after the new rules and standards.

SESSION 1.05: AUDITOR LITIGATION
DATE: FRIDAY, JANUARY 18, 2019
TIME: 10:15 AM–11:45 AM

Attorney Strategy and Experience in Disputes against Auditors: Insights from the Legal Field

Brian Matthew Goodson
Clemson University

Jonathan H. Grenier
Miami University

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Arizona State University

ABSTRACT: This paper examines the relative importance of case facts and plaintiff attorneys' legal strategy in resolution of audit disputes. Based on the untested suggestion in legal research literature, we predict that legal strategy matters more than facts in making decisions that are closer to dispute resolution. We find support for our theoretical model by empirically examining the legal judgments of law faculty, attorneys with significant experience in audit litigation, and law students. Our results indicate that experience in audit litigation matters more in decisions that are more dependent on legal strategy and that these decisions tend to be closer to dispute resolution. We conclude that future research is needed to understand the antecedents and consequences of legal strategy in audit disputes, but that this research requires using experienced attorneys. However, future research is also needed to examine decisions that are less dependent on strategy, and in many cases, this research can be examined using law students, a previously unutilized (in audit litigation research) but readily accessible participant pool. We discuss implications of our findings for audit practice and suggest multiple avenues for future research.

SESSION 1.05: AUDITOR LITIGATION
DATE: FRIDAY, JANUARY 18, 2019
TIME: 10:15 AM–11:45 AM

Effects of Data Visualization on Auditors' and Jurors' Judgments

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Oregon State University

Jake Rose
Oregon State University

Kerri-Ann Sanderson
Bentley University

Jay C. Thibodeau
Bentley University

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Victoria University of Wellington

ABSTRACT: We conduct experiments with practicing Big 4 auditors and U.S. jurors in order to concurrently investigate the effects of visualizations of Big Data on audit quality and litigation risk. More specifically, the first experiment with auditors examines whether the emotional vividness of visualizations of data that disconfirm management estimates and the reliability of the underlying sources of such data influence auditors' professional judgments (i.e., assessments of management estimates and their resultant audit planning decisions). The second experiment then examines whether the use of more vivid visualizations of data in audit practice and the reliability of the underlying data sources affect jurors' negligence and damage award decisions. Results from the first experiment indicate that more vivid visualizations enhance auditors' ability to recognize disconfirming evidence and incorporate this evidence into their decisions. That is, auditors who view more vivid visualizations of disconfirming evidence recommend greater reductions to management estimates of reported revenue and increase their budgeted audit hours more than auditors who view less vivid visualizations. In addition, auditors who view more vivid visualizations are more likely to attend to the reliability of data used to create the visualizations. The second experiment finds that using more vivid visualizations in audit practice will not increase litigation risk because jurors do not find auditors to be more negligent when trial evidence includes more vivid, versus less vivid, visualizations of evidence that support a plaintiff's claims. Overall, the experiments reveal that vivid visualizations of data present multiple opportunities to enhance audit quality, and the use of vivid visualizations would not be expected to increase future litigation risk.

SESSION 1.05: AUDITOR LITIGATION
DATE: FRIDAY, JANUARY 18, 2019
TIME: 10:15 AM–11:45 AM

The Effects of Social Identification and Expert Witness Credibility on Juror Judgments of Auditor Negligence

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Auburn University

ABSTRACT: This study examines the effects of a juror's ability to socially identify with a plaintiff in an auditor liability case on their assessments of auditor negligence. Additionally, we examine whether those effects moderate the relation between expert witness credibility and auditor negligence. We conduct an experiment with 316 mock jurors and discover that jurors find auditors more negligent when they are able to socially identify with the plaintiff (i.e., a pension fund) than when they are not able to socially identify (i.e., a bank). Our findings also indicate that jurors are only sensitive to differences in expert witness credibility when they do not identify with the plaintiff. Our results have important implications for the accounting profession and academy, as well as regulators and policymakers, by providing evidence about the impact of plaintiff identity and expert witness credibility on audit litigation outcomes.

SESSION 1.06: THE INFLUENCE OF MANAGEMENT AND BOARDS ON AUDIT JUDGMENT AND PROCESSES
DATE: FRIDAY, JANUARY 18, 2019
TIME: 10:15 AM–11:45 AM

An Analysis of Expectation Gaps between Members of the Board of Directors and Auditors Regarding Attributes Influencing Clients' Auditor Choice Decisions

Martin Schmidt
ESCP Europe

Francis Goddard
ESCP Europe

ABSTRACT: This paper reports the results of a survey of board members and audit firm partners and managers on attributes influencing clients' auditor choice decisions. Based on data from 32 board members and 33 audit firm partners and managers, we find several "expectation gaps" between the importance that board members assign to attributes and the importance that auditors expect board members to assign to the same attributes. The results indicate that board members deem low audit fees, as well as a good relationship with the audit partner to be less important than audit partners and managers expect. We find the opposite for auditor independence and audit quality, which board members assess as more important than audit partners and managers expect. The findings have important implications for auditors, auditees and regulators.

SESSION 1.06: THE INFLUENCE OF MANAGEMENT AND BOARDS ON AUDIT JUDGMENT AND PROCESSES
DATE: FRIDAY, JANUARY 18, 2019
TIME: 10:15 AM–11:45 AM

When Does Developing an Independent Estimate Reduce the Biasing Influence of Management Preferences?

Brian C Fitzgerald
Northeastern University

Christopher J. Wolfe
Texas A&M University

Kecia Williams Smith
Virginia Polytechnic Institute and State University

Brent A. Garza
Texas A&M University

ABSTRACT: For auditing accounting estimates, the Public Company Accounting Oversight Board (PCAOB) acknowledges that independent estimates likely reduce the influence of management bias. Using a series of experiments, we find evidence both confirming and contradicting the PCAOB's assessment of independent estimates. We find that auditors developing an independent estimate after receiving management's preference are, indeed, less susceptible to management bias. However, auditors developing an independent estimate before receiving management's preference, remain susceptible to management bias. Order effects theory explains this behavior. We propose that independent estimates are distinct evidence events, causing step-by-step evidence processing and recency effects, whereby the most recent evidence dominates auditors' final judgment. A supplemental experiment that withholds independent estimate development confirms our proposed theoretical process. Without an independent estimate, auditors switch to end-of-sequence processing and display primacy effects. Our research informs auditing accounting estimates, proposed PCAOB guidance, and the broad influence of audit evidence timing on audit quality.

SESSION 1.06: THE INFLUENCE OF MANAGEMENT AND BOARDS ON AUDIT JUDGMENT AND PROCESSES
DATE: FRIDAY, JANUARY 18, 2019
TIME: 10:15 AM–11:45 AM

Does Auditor Self-Regulatory Depletion Harm Year-End Negotiation Outcomes? The Importance of Considering Managers' Depletion and Individual Attributes

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Tracie Majors
University of Southern California

Adam Vitalis
University of Waterloo

ABSTRACT: Auditor-manager negotiations are critical given managers' incentives to report aggressively and the auditor's role in curbing such aggressiveness thereby jointly impacting audit and financial reporting quality. Using an abstract, incentivized experiment in which student-participants assume roles analogous to managers and auditors, we examine how depletion of auditors' and managers' limited self-regulation resources affects their negotiations and outcomes. We manipulate auditors' and managers' depletion and measure their individual attributes. We predict and find that managers' initial negotiation positions are less aggressive when they are depleted versus non-depleted, but only for lower Dark Triad managers (higher Dark Triad managers' aggressive positions are not impacted by depletion). We also predict and find that auditors negotiate less effectively when depleted, but only for lower Machiavellian auditors (higher Machiavellian auditors do not suffer from depletion). Finally, we find that final agreed-upon values are less aggressive, on average, when managers and auditors are depleted, unless negotiations involve higher Dark Triad managers. Collectively, our findings reinforce concerns that depleted auditors negotiate less effectively, but our interactive design identifies a "silver lining"—this effect may not threaten financial reporting quality if managers are also depleted, which is likely the case during busy times when negotiations occur.

SESSION 2.02: REGULATION AND MONITORING
DATE: FRIDAY, JANUARY 18, 2019
TIME: 1:45 PM–3:15 PM

Accounting Standard Precision, Monitoring Structure, and Misreporting

Li Fang
Iowa State University

Jeffrey Pittman
Memorial University of Newfoundland

Yinqi Zhang
American University

Yuping Zhao
University of Houston

ABSTRACT: Prior research documents wide variation in the precision of accounting standards (rules-based standards (RBS) versus principles-based standards (PBS)). We examine whether financial reporting quality evident in restatements is associated with accounting standard precision and whether the role that non-regulatory monitors and the SEC as the regulator play in the financial reporting process varies with accounting standard precision. Our strong, robust evidence implies that the likelihood of a subsequent financial report restatement decreases as the accounting standards applicable to the firm become more principles-based. This inference is robust to examining exogenous shifts in standard precision arising from accounting standard revisions. Additional analyses suggest that our evidence mainly stems from managers' concerns over second guessing rather than greater litigation risk. We also find that non-regulatory monitors, including independent boards, audit committees, and external auditors, play a more effective role at constraining misreporting when they have the guidance of more detailed rules under RBS, whereas the SEC plays a more prominent role when there is a lack of clear guidance under PBS. Our large-sample empirical evidence suggests a potential trade-off between PBS and RBS: although the average reporting quality measured by misreporting may improve under the more principles-based framework, some of the corporate governance mechanisms carried out by non-regulatory monitors may not function as well under more PBS as under more RBS, potentially reflecting that it is harder for non-regulatory monitors to enforce less precise accounting standards. Contributing to the current policy debate, our results suggest that more intensive regulatory monitoring would be needed to compensate for the potentially weakened monitoring by non-regulatory monitors should the U.S. financial reporting regime move to a more principles-based framework.

SESSION 2.02: REGULATION AND MONITORING
DATE: FRIDAY, JANUARY 18, 2019
TIME: 1:45 PM–3:15 PM

Regulation, Auditor Litigation and Settlements

Lakshmana Krishna Moorthy
Tulane University

Bharat Sarath
Rutgers, The State University of New Jersey, Newark

ABSTRACT: This paper aims to understand the determinants of lawsuits against auditors in securities class action litigation and the settlement pattern by auditors when the suit is not dismissed. The issues we consider are: (i) when are auditors named as defendants (ii) when do auditors choose to settle and (iii) what proportion of the settlement do auditors pay in relation to the settlement by all the other parties; and (iv) differences in settlement strategies among the big-n firms. This paper also examines how the lawsuit and settlement patterns have changed following the enactment of major regulation such as the Private Securities Litigation Reform Act (PSLRA), Sarbanes Oxley Act (SOX). Following prior literature, we first establish that auditors are more likely both to be named and to settle in cases involving restatement of earnings, accusations of violation of GAAP or accounting improprieties. We then show that the likelihood of suit and settlement increase in a measure that we construct measuring the complexity of litigation. We then examine differences in settlement patterns across periods preceding and after the passage of PSLRA and SOX. We find that auditors are named less often in the post PSLRA period (relative to the pre-PSLRA period), settle with the same frequency in both periods but pay less proportional damages. The same set of comparisons show that auditors are just as likely to be sued post-SOX as pre-SOX, but settle with lower frequency and pay the same proportion of damages. Overall this study documents the beneficial role of both PSLRA and SOX on reducing the litigation burden on auditors. With regard to settlement strategies, we document the varying strategies employed by the Big-n firms that settle at different rates, vary in their aggressiveness and time to settle signaling the willingness to fight or cooperate in the settlement.

SESSION 2.02: REGULATION AND MONITORING
DATE: FRIDAY, JANUARY 18, 2019
TIME: 1:45 PM–3:15 PM

Regulatory Uncertainty and Audit Fees: Evidence from Cannabis Legalization and Financial Institutions

James Brushwood
Colorado State University

Curtis Hall
Drexel University

Eric T. Rapley
Colorado State University

ABSTRACT: Since 2014, a number of U.S. states have legalized business activities related to the production, distribution, and use of recreational cannabis. These activities remain illegal at the U.S. federal level, creating significant regulatory uncertainty for businesses located in legalizing states, particularly federally-insured banks. Employing a difference-in-differences approach using a matched sample of banks in legalizing and non-legalizing states, we document an increase in audit fees for banks located in legalizing states after cannabis legalization. This finding suggests that the conflict between state and federal cannabis laws produces regulatory uncertainty affecting audit engagement risk. In supplemental analysis, we find that the documented higher audit fees are concentrated in the subsample of state chartered banks, suggesting that audit fees increased primarily for banks that are more likely to engage in relationships with cannabis-related businesses.

SESSION 2.03: AUDIT OFFICE PRICING AND QUALITY
DATE: FRIDAY, JANUARY 18, 2019
TIME: 1:45 PM–3:15 PM

Dynamics of Audit Pricing at the Office Level: Evidence from Relative Audit Fees and Subsequent Audit Pricing

Xudong Li
Monmouth University

ABSTRACT: This study empirically investigates the dynamics of audit pricing at the local office level. Specifically, it examines the extent to which a client's audit fees relative to its peers within the same office influences subsequent pricing of audit services. We find evidence of a significant association between clients' relative audit fee positions and subsequent period audit pricing. Our results show that relative audit fee positions are negatively associated with the magnitudes of subsequent changes in audit fees. Further, we find that this inverse relationship is probably driven by a reduction in unit audit price for clients with relative high audit that are able to negotiate unit audit fee reductions. Our study suggests that within-audit office relative audit fee positions may play an important role on the decision-making process of audit pricing.

SESSION 2.03: AUDIT OFFICE PRICING AND QUALITY
DATE: FRIDAY, JANUARY 18, 2019
TIME: 1:45 PM–3:15 PM

Implications of Audit Office Resource Allocation Shocks: Evidence from Late 10-K Filings

Stuart Dearden
University of Nebraska–Lincoln

ABSTRACT: Prior literature examines consequences (e.g., negative market reactions, higher subsequent audit fees, and debt covenant violations) audit clients face arising from missed regulatory due dates. These clients likely pressure the auditor to provide additional resources to perform the audit. This paper examines whether an audit office resource allocation shock stemming from late-filing clients is associated with the audit quality of the other timely-filing clients in that audit office. I find that timely-filing clients are more likely to subsequently restate their financial statements when there are late-filing clients in the same audit office. Using audit fees as a proxy for audit effort (resource allocation), I also find evidence consistent with auditors allocating resources from timely-filing clients to late-filing clients. Subsequent tests indicate that office size mitigates the association between late-filing clients and audit quality of the timely-filing clients and that the timely-filing clients are more likely to subsequently dismiss the auditor, even if the client does not eventually restate their financial statements. Taken together, these findings support the argument that the observed relation between misstatements and late-filing clients can be linked, at least in part, to the implications of shocks to office-level resource allocation plans. Thus, my findings highlight an important factor for auditors to consider for their client acceptance and continuance decisions. These findings also have implications for standard setters considering the costs associated with regulatory due dates.

SESSION 2.03: AUDIT OFFICE PRICING AND QUALITY
DATE: FRIDAY, JANUARY 18, 2019
TIME: 1:45 PM–3:15 PM

Moving to Less Contaminated Audit Offices and the Likelihood of Misstatement

Yuzhou Chen
University of Nebraska–Lincoln

Thomas C. Omer
University of Nebraska–Lincoln

ABSTRACT: This study investigates whether companies have a lower likelihood of misstatement after changing to a less contaminated audit office. An audit office change is labeled as a "less contaminated audit office change" when the contamination score (Swanquist and Whited 2015) of the successor audit office is lower than that of the predecessor audit office one year before the change. We document that the likelihood of misstatement is significantly lower after companies move to less contaminated audit offices. We find that this effect exists in both the short-term and long-term. We also find that audit offices with lower contamination scores, as a successor audit office, have an incremental effect in decreasing the likelihood of misstatement. Additional analyses indicate that a lower likelihood of missing internal control weaknesses, not reduced income-increasing accruals, is one potential reason for the lower likelihood of misstatement after companies move to less contaminated audit offices. The results suggest that companies successfully improve the credibility of their financial reports.

SESSION 2.04: AUDIT PRICING
DATE: FRIDAY, JANUARY 18, 2019
TIME: 1:45 PM–3:15 PM

Audit Fees and CEO Network Centrality

Salim Chahine
American University of Beirut

Yiwei Fang
Illinois Institute of Technology

Iftekhar Hasan
Fordham University

Mohamad Mazboudi
American University of Beirut

ABSTRACT: We introduce the well-established concept of social network centrality to the auditing literature. We argue that CEO network centrality increases the CEO bargaining power in audit fee negotiations since high network centrality brings influence and power to CEOs within their social networks. We find that audit fees are lower in firms managed by CEOs with high network centrality. This is slightly more pronounced when a firm constitutes a greater share of an auditor's industry clientele. Interestingly, we also find that audit quality does not deteriorate when audit fees are lower if the firms have more central CEOs. We further document the influence high-centrality CEOs have on the audit decisions of their social peers. For example, we show that less central (i.e., peripheral) CEOs are likely to hire auditors that do work for firms with CEOs enjoying high levels of network centrality. Together these results suggest that high network centrality reflects a bargaining power CEOs can use to lower their audit fees.

SESSION 2.04: AUDIT PRICING
DATE: FRIDAY, JANUARY 18, 2019
TIME: 1:45 PM–3:15 PM

Clustering in Audit Fees as a Signaling Device? An Empirical Analysis

Liesbeth Averhals
KU Leuven

Tom Van Caneghem
KU Leuven

Marleen Willekens
KU Leuven

ABSTRACT: This study examines clustering in audit fees. Specifically, using audit fee data, we explore the occurrence of specific price endings (odd and round price endings in particular). We expect price clustering to be present in the market for audit services because external auditing is a credence service and specific price endings might be used by auditors as a signaling device. Following price (quality) image effect theory, we expect that non-Big 4 (Big 4) auditors are more likely to use odd (round) pricing to signal higher value for money (quality). Using a data set including both pre- and post-disclosure audit fees of private clients, we find round prices (i.e., prices ending in '000') and half-round prices (i.e., prices ending in '500') to prevail and occur significantly more often than would be normally expected. Interestingly, differences in price clustering are observed among different auditor types. For example, round prices are significantly more prevalent among Big 4 auditors (and PwC in particular) and half-round prices are significantly more prevalent among second-tier auditors. These results suggest that Big 4 and second-tier auditors use (half-)round prices to signal quality. Our results further indicate that clustering is significantly more prevalent after mandatory disclosure of audit fees.

SESSION 2.04: AUDIT PRICING
DATE: FRIDAY, JANUARY 18, 2019
TIME: 1:45 PM–3:15 PM

When Press Talks, Do Auditors Listen? Implications of Negative Media Sentiment for Audit Pricing

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Florida International University

Hasibul Chowdhury
The University of Queensland

Kartick Gupta
University of South Australia

ABSTRACT: We investigate the role of the business press in the auditor's assessment of a client's business risk. We argue that negative press coverage affects audit effort as well as audit pricing by increasing auditors' litigation and reputation risk, by signaling clients' lower future profitability, and by affecting investors' perception about the auditor. We use a novel dataset that analyzes the contents of, and provides sentiment scores for, every news item in real-time. Results from a level regression as well as a unique difference-in-differences test indicate that audit fee increases with negative media sentiment. Additional analyses reveal that, as a consequence of negative media sentiment, audit quality increases; and the widely documented lowballing disappears. Our results are robust to alternative definitions of sentiment score and alternative specifications of audit fee models. Overall, we provide new insights into the role of the business press as an information intermediary.

SESSION 2.05: IMPROVING AUDIT QUALITY
DATE: FRIDAY, JANUARY 18, 2019
TIME: 1:45 PM–3:15 PM

Prompting More Relevant and Reliable Audit Evidence Ideation with a Counterfactual Mindset

Elizabeth Altiero Poziemski
University of Central Florida

ABSTRACT: Due to regulatory pressure to provide unpredictability in audits (AS No. 13, PCAOB 2010a; IFAC 2009) and the rapid pace of business change, audit firm leadership has increasingly called for greater creativity in their auditors (Arning 2013; Chipman 2013). As engagement team partners attempt to implement this directive, a challenge they are likely to encounter is design fixation (Jansson and Smith 1991). That is, knowledge of how an account or transaction was audited in the past will block new ideas from coming to mind. Relying on associative memory theory (Nijstad and Stroebe 2006), I predict and find that priming a counterfactual mindset improves the quantity, relevance, and reliability of audit evidence ideation when auditors plan familiar audit areas. I find the benefits of a counterfactual mindset on ideation are robust to the source of the design fixation (i.e., own knowledge vs. an inherited example). Supplemental analyses suggest that the improved list of audit evidence resulting from a counterfactual mindset subsequently allowed auditors to generate more efficient audit programs for familiar audit areas.

SESSION 2.05: IMPROVING AUDIT QUALITY
DATE: FRIDAY, JANUARY 18, 2019
TIME: 1:45 PM–3:15 PM

The Need for Cognition and Goal Priming in Complex Audit Judgments

Emily Elaine Griffith
University of Wisconsin–Madison

Kathryn Kadous
Emory University

Donald R. Young
Indiana University

ABSTRACT: Auditing encompasses complex judgment tasks that require critical thinking. We predict that auditors' need for cognition (NFC), a well-established measure of one's dispositional tendency to engage in and enjoy effortful thinking, is positively associated with better judgment performance in complex audit judgment tasks. We further predict that priming auditors with an accuracy goal will improve complex judgments, particularly for lower NFC auditors who are less likely to spontaneously engage in critical thinking. We find support for our predictions in our experimental study. Higher NFC auditors are more likely than lower NFC auditors to identify diagnostic information contrary to management's position and are less likely to justify management's position. Priming with an accuracy goal improves lower NFC auditors' judgments by reducing their justification of management's position. This study identifies an important auditor trait that is associated with higher judgment quality in complex audit judgment tasks, and it demonstrates the benefits of goal priming, both in practical application and in research designs.

SESSION 2.05: IMPROVING AUDIT QUALITY
DATE: FRIDAY, JANUARY 18, 2019
TIME: 1:45 PM–3:15 PM

Empowering Auditors to Pursue Fraud during Evidence Evaluation

Ashley Austin
University of Richmond

Tina Carpenter
The University of Georgia

Margaret H. Christ
The University of Georgia

Christine Marie Nielson
The University of Georgia

ABSTRACT: ABSTRACT: Auditors struggle to respond skeptically to fraud, reducing audit quality. This problem is particularly prevalent during the evidence evaluation phase of the audit, when auditors face the most intense time constraints. Empowerment theory suggests people overcome constraints and produce higher quality work when they feel empowered (i.e., capable of navigating the course of their work). Based on this theory, we develop an intervention that combines a professional skepticism charge code with supervisor support. Using an experiment, we predict and find that when fraud is present during evidence evaluation, auditors with our intervention recognize a greater number of fraud evidence items and identify procedures that effectively target fraud, but when fraud is absent, these auditors are, appropriately, no more likely to perform more work than other auditors. This study contributes to theory and practice as our theory-driven intervention improves auditors' performance in an area where they have been deficient in practice.

SESSION 2.06: LEARNING FROM EACH OTHER
DATE: FRIDAY, JANUARY 18, 2019
TIME: 1:45 PM–3:15 PM

Learning from Others' Deficiencies: How Group Affiliation and Selection Basis Jointly Affect Auditors' Effective Use of Inspection Feedback

Kamber Vittori Hetrick
Northeastern University

ABSTRACT: Abstract: Both external and internal inspectors typically select audit engagements to inspect using a risk-based approach (i.e. they pick those they predict are more likely to have deficiencies). While reducing the amount of resources needed to find audit deficiencies, this approach can perversely influence the behavior of non-inspected auditors who read the inspection feedback. Using social identity theory and attribution theory, I predict that auditors' effective use of inspection feedback depends on whose engagements are inspected (more vs. less closely affiliated auditors) and how the engagements are selected (risk vs. random basis). I predict and find that auditors identify more strongly with the inspected auditors when inspections are risk-based or pertain to more closely affiliated auditors (e.g., same office). This stronger identification triggers defensive attributions, decreasing the perceived value of the report, and reducing the degree to which they employ corrective action that addresses inspector feedback in their own audits. Random selection is more neutral in nature, reducing identification and improving incorporation of inspection feedback, but only when the feedback is for less closely affiliated auditors. Implications for auditors, audit firms, and regulators are discussed.

SESSION 2.06: LEARNING FROM EACH OTHER
DATE: FRIDAY, JANUARY 18, 2019
TIME: 1:45 PM–3:15 PM

Communication is a Two-Way Street: Analyzing Approaches Undertaken to Enhance Audit Research Knowledge Transfer to Policymakers

Steven E. Salterio
Queen's University

Kristina J. Hoang
The University of Alabama

Yi Luo
Queen's University

ABSTRACT: We investigate different approaches to transferring audit research knowledge to audit standard setters from the past 50 years. These approaches taken by audit academics range from writing traditional research articles, to sitting on standard setting boards and task forces, to producing "literature reviews" in teams on topics identified by standard setters. Based on theories of communication, we classify each approach and evaluate its likelihood of effective knowledge transfer. Our analysis suggests that the "literature reviews" approach has potential for effective knowledge transfer between audit academic researchers and standard setters. We provide evidence supporting this theory-based conclusion from two studies. Our first study, a team based simulation, shows that literature reviews produced through the PCAOB-AAA Auditing Section Project can be employed as a basis to evaluate existing standards and suggest changes. Our second study, a citation analysis of PCAOB exposure drafts, shows indirect evidence of audit research knowledge transfer, especially in more recent PCAOB standard setting. We present ways to make the "literature reviews" approach more effective by describing how research syntheses are produced in other evidence-based settings where academic research knowledge transfer has taken place.

SESSION 2.06: LEARNING FROM EACH OTHER
DATE: FRIDAY, JANUARY 18, 2019
TIME: 1:45 PM–3:15 PM

Learning from Errors: An Interview Study Among Dutch Auditors

Oscar Van Mourik
VU University Amsterdam

Anna Gold
VU University Amsterdam

Philip Wallage
University of Amsterdam

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Northeastern University

ABSTRACT: Despite the presence of quality control measures at audit firms, results from inspections by regulators suggest that auditors, as all humans, make errors during their work. Further, inspection reports reveal that errors can reduce audit quality, and inadequate handling of errors may cause them to be repeated. This paper contributes to the auditing literature by examining how auditors and audit firms deal with auditor-committed errors, how auditors learn from errors and the extent to which propositions from the error-handling literature are recognized by auditors in practice. This literature proposes two primary strategies that organizations can use to deal with errors: error prevention and error management. An error prevention strategy is used to minimize errors ex ante, while an error management strategy serves to limit negative consequences and enable learning from errors by stimulating openness about errors and their causes. The most prominent result of our analysis of 22 unstructured interviews with Dutch auditors is that auditors recognize the importance of openness as a key measure to improve error management; however, in practice, error prevention concerns prevail and auditors have a fear of being blamed, resulting in a lack of openness and learning from errors.

SESSION 3.02: EXTERNAL FACTORS INFLUENCING AUDIT QUALITY
DATE: FRIDAY, JANUARY 18, 2019
TIME: 3:45 PM–5:15 PM

Auditor-Related Provisions in Private Loan Agreements, Audit Fees, and Audit Quality

Jacob Jaggi
The University of Arizona

Lin Cheng
The University of Arizona

Paul N. Michas
The University of Arizona

Jeffrey W. Schatzberg
The University of Arizona

ABSTRACT: Employing a large sample of private loan agreements from 2000-2013, we examine lenders' demand for audit information and the role of auditors in debt contracting beyond traditional audit opinions. We provide direct evidence that lenders value audit information and often specify multiple auditor-related provisions in privately negotiated loan agreements. We also examine audit fee and audit quality implications for the borrower. Using both levels and changes analyses, we find that auditor-related provisions are associated with higher audit fees, which is consistent with auditors responding to the litigation risk these provisions impose. In cross-sectional tests, we find evidence that the increase in audit fees associated with auditor-related provisions is concentrated in samples where the risk of third-party litigation is greater. Finally, we find no evidence that auditor-related loan provisions lead to higher audit quality for borrowers. Our study answers DeFond and Zhang (2014), who call for a deeper understanding of the factors that drive the demand for auditing in a private contract setting, where supply and demand are not mandated by regulation. We also provide new insight to the literature by examining the supply-side impact these auditor-related provisions have on audit fees and audit quality and by improving our understanding regarding the role of non-client third-party liability in determining audit fees.

SESSION 3.02: EXTERNAL FACTORS INFLUENCING AUDIT QUALITY
DATE: FRIDAY, JANUARY 18, 2019
TIME: 3:45 PM–5:15 PM

Outsourced External Audit Work and Audit Quality

Carol Dee
University of Colorado Denver

Katherine Gunny
University of Colorado Denver

Ayalew A Lulseged
The University of North Carolina at Greensboro

ABSTRACT: We examine whether audit quality is reduced when part of the audit is conducted by auditors other than the audit firm signing the audit report ("other" or "participating" auditors) which typically occurs in a multinational group audit. Prior literature suggests group audits could face difficulties in coordinating work across multiple countries and legal jurisdictions. PCAOB concerns over audit quality when participating auditors are involved led to a requirement that audit firms disclose their use of participating auditors on Form AP. Consistent with concerns of the PCAOB, we find audit quality is lower when participating auditors are involved in the engagement compared to those without participating auditors. In analyses on a sample limited to engagements with participating auditors, we find having more than one participating auditor leads to lower audit quality relative to having only one participating auditor. We find no evidence to suggest that the percentage of the audit conducted by participating auditors influences audit quality. Other than the legal origin of the participating auditor, we find no evidence to suggest participating auditor characteristics (i.e. affiliated with the lead Big 4 auditor; not registered with the PCAOB; inexperienced with SEC clients of their own; or domiciled in a country that does not allow PCAOB inspections) influence audit quality. Lastly, we find higher audit fees for engagements that use more than one participating auditor, suggesting group audits entail a higher risk premium and increased costs to coordinate.

Session 3.02: EXTERNAL FACTORS INFLUENCING AUDIT QUALITY
DATE: FRIDAY, JANUARY 18, 2019
TIME: 3:45 PM–5:15 PM

The Effect of Growth on Financial Reporting and Audit Quality: Evidence from Economic Shocks to Banks

Sarah B. Stuber
Michigan State University

ABSTRACT: Periods of rapid growth caused by shocks to a firm's operating environment represent a potential threat to financial reporting quality by presenting challenges to both the firm and its auditor. Despite the ubiquity of economic changes little is known of the extent to which these changes affect financial reporting and audit quality. Using exogenous economic shocks to local banks from oil and natural gas discovery and extraction, I find that financial reporting quality, measured by loan loss estimate quality, is lower in a period of rapid bank growth due to management's underreaction to the positive economic shock. I also find that auditors with a combination of both task-specific and industry-specific expertise are more successful in mitigating this deterioration compared to auditors with general, Big 4 or industry-specific expertise alone. The findings suggest that a combination of industry and task-specific auditor expertise is needed to combat deterioration in financial reporting quality resulting from a positive economic shock.

Session 3.03: BOARD AND AUDIT COMMITTEE ACTIVITY AND FINANCIAL REPORTING QUALITY
DATE: FRIDAY, JANUARY 18, 2019
TIME: 3:45 PM–5:15 PM

The Association Between Audit Committee Overboarding, Audit Committee Responses, and Financial Reporting Quality in the Decade After SOX

John Kyle Castonguay
Hofstra University

ABSTRACT: The Sarbanes-Oxley Act (SOX) added a multitude of financial oversight responsibilities to the audit committees of public companies, leading to concerns amongst regulators and the investing community that audit committees that were overboarded with members serving on multiple other board seats would be unable to effectively monitor the companies they represented. I find that these concerns are undue. More overboarded audit committees have adequately adjusted to their increased workloads in the decade since SOX to such a degree that they have lower misstatement frequencies than less overboarded committees. By contracting in additional auditor effort or retaining higher quality auditors, overboarded audit committees have found responses that aid in their monitoring. These responses lead to positive financial reporting outcomes when audit committees accept the limitations imposed by being overboarded. Overall, I find that more overboarded audit committees are able to remain effective monitors of the financial reporting process.

Session 3.03: BOARD AND AUDIT COMMITTEE ACTIVITY AND FINANCIAL REPORTING QUALITY
DATE: FRIDAY, JANUARY 18, 2019
TIME: 3:45 PM–5:15 PM

The Association Between Board Risk Oversight and the Risk of Material Misstatement

Mark S. Beasley
North Carolina State University

Allen D. Blay
Florida State University

Christina Lewellen
North Carolina State University

Michelle McAllister
Northeastern University

ABSTRACT: Corporate governance failures in the early 2000s and the financial crisis that emerged in 2008 have contributed to heightened expectations for the board of directors to strengthen its oversight of the firm's risk management processes. Thought leaders (COSO 2013, 2017, ISO 2018; NYSE 2004; SEC 2010) stress the importance of board risk oversight processes; however, we know little about what boards actually do to fulfill their risk oversight responsibilities. Most of the existing research has focused on the association between certain board of director input characteristics (e.g. member composition, independence, expertise, tenure, etc.) and a variety of financial reporting related outcomes. Studies have called for additional examination of what boards actually do to fulfill their oversight roles (e.g. Cohen, Krishnamoorthy and Wright 2017; Beasley, Carcello, Hermanson, and Neal 2009). Our study responds to this need by utilizing proxy disclosures about the board's role in risk oversight, instituted by the SEC in 2010, to examine whether boards more engaged in risk oversight processes are associated with a lower risk of material misstatement (RMM) in the financial statements, while controlling for board input characteristics documented by prior studies. We find that boards more engaged in risk oversight are positively associated with two avenues for mitigating RMM: effective internal control over financial reporting and higher auditor quality. In addition, we find that boards with more extensive risk oversight processes are associated with fewer actual instances of materially misstated financial statements.

Session 3.03: BOARD AND AUDIT COMMITTEE ACTIVITY AND FINANCIAL REPORTING QUALITY
DATE: FRIDAY, JANUARY 18, 2019
TIME: 3:45 PM–5:15 PM

The Effect of Audit Committee Deliberations on Financial Reporting Quality: Evidence from Audit Committee Minutes

Michelle Draeger
Colorado State University

ABSTRACT: Using a unique sample of minutes from universities' audit committee meetings, I examine which audit committee deliberations are associated with financial reporting quality. This is important because audit committees are responsible for overseeing the integrity of the firm's internal controls over financial reporting, accounting and reporting practices, financial statements, and external auditors. However, little is known about the nature of their deliberations, because this information is not available for publicly-traded companies. In contrast, this information is available for many universities, which are operating more like for-profit entities as the competition for students increases and financial resources become more scarce. I first identify the topics of deliberation contained within these minutes. I then examine which specific audit committee deliberations are associated with the likelihood of severe deficiencies in internal control, my proxy for financial reporting quality. I find that internal audit and financial statements are the two most frequently discussed audit committee topics. The discussions that have the strongest negative association with the likelihood of internal control deficiencies are those that address internal controls, internal audit, and the audit committee charter. These discussions continue to remain significant even after controlling for proxies commonly used to capture audit committee effectiveness. My results provide useful information regarding audit committee deliberations, information that is typically unavailable, and aid our understanding of how audit committees influence the quality of firms' financial reporting outcomes.

Session 3.04: AUDIT PARTNER CHARACTERISTICS AND AUDIT QUALITY
DATE: FRIDAY, JANUARY 18, 2019
TIME: 3:45 PM–5:15 PM

Does the Gender of Audit Partners Matter? Evidence from the Adoption of Rule 3211

Viet Tuan Pham
The University of Texas at San Antonio

Jie Hao
Texas Tech University

Meng Guo
The University of Texas at San Antonio

ABSTRACT: In this paper, we investigate whether the gender of audit partners impacts the audit outcomes and clients' reporting behaviors after the adoption of the PCAOB Rule 3211. We focus on the gender effects on the audit practices based on the notion that females are more risk intolerant and are more concerned about their professional reputations. We find that audit quality of female audit partners improves compared with that of male audit partners after the adoption of the identification rule. We also find an increase in audit fees of clients with female audit partners after the adoption. Additionally, there is an increase in the level of audit efforts of female audit partners than that of their male counterparts. However, we do not find evidence that a female audit partner's client exhibits greater conservatism than that of a male audit partner's client. Moreover, this study synthetically considers the impact of the interaction among female audit partners, female CFOs and female audit committee members on the rule 3211 adoption. We find that the presence of female CFOs attenuates the gender effect on the audit report lags after the adoption of rule 3211. The presence of female audit committee members attenuates the gender effect on both audit fee and audit report lags after the adoption of rule 3211.

Session 3.04: AUDIT PARTNER CHARACTERISTICS AND AUDIT QUALITY
DATE: FRIDAY, JANUARY 18, 2019
TIME: 3:45 PM–5:15 PM

Do School Ties between Audit Partners and Clients Impact Audit Outcomes? Evidence from the United States

Chan Li
University of Pittsburgh

Lauren Carse Reid
Wake Forest University

Nam Ho
Brock University

Feng Guo
Iowa State University

ABSTRACT: Using recently disclosed U.S. audit partner data, we examine the effects of school ties between audit engagement partners and client executives/board members in the United States. We consider a partner and the client to share a school tie if the engagement partner attended the same university as the top executives or the board members of the client they serve. We fail to find evidence of impaired audit quality when there is a school tie between partners and executives/directors. In fact, we find some evidence to suggest that audit quality is higher when partner-client ties are present. This result seems to indicate that school ties facilitate better knowledge and information transfers between partners and clients. Furthermore, we find lower audit fees charged in the presence of a school tie, suggesting greater audit efficiencies.

Session 3.04: AUDIT PARTNER CHARACTERISTICS AND AUDIT QUALITY
DATE: FRIDAY, JANUARY 18, 2019
TIME: 3:45 PM–5:15 PM

Opening Up the 'Black Box' of Audit Firms:
The Effects of Audit Partner Ownership on Audit Adjustments

Clive Lennox
University of Southern California

Xi Wu
Central University of Finance and Economics

ABSTRACT: Audit engagement partners face conflicting incentives. On one hand, they are motivated to provide high quality audits in order to protect their firms' reputations and avoid regulatory sanctions but, on the other hand, they also need to please their clients in order to increase their firms' revenues. We argue that these conflicting incentives become apparent when comparing the equity ownership of partners who conduct audits (i.e., 'engagement partners') and partners who are responsible for monitoring audit quality (i.e., 'review partners'). We predict that review partners are motivated to monitor audit quality more closely when they have larger ownership stakes. In contrast, engagement partners have stronger incentives to please their clients when they have larger ownership stakes. Consistent with these predictions we find that the associations between audit adjustments and partner ownership are: 1) significantly positive for review partners, and 2) significantly negative or insignificant for engagement partners. These results are obtained after controlling for company fixed effects and audit firm fixed effects as well as time-varying characteristics of companies and audit partners. Our findings suggest that larger ownership stakes motivate review partners to monitor audit quality more closely, while larger ownership stakes do not motivate engagement partners to deliver higher quality audits.

Session 3.05: AUDITOR BIASES
DATE: FRIDAY, JANUARY 18, 2019
TIME: 3:45 PM–5:15 PM

Examining the Sleeper Effect in Auditors' Evaluations of Audit Evidence

Jenny McCallen
The University of Georgia

Christopher P. Agoglia
University of Massachusetts Amherst

Bradley Bennett
University of Massachusetts Amherst

ABSTRACT: Current auditing standards require auditors to consider qualifications of the source (e.g., credibility and competence of management) in assessing the quality (e.g., reliability and sufficiency) of audit evidence, especially in subjective audit areas. However, while auditing standards stress the importance of the evaluation of management, they do not prescribe how auditors should effectively identify and incorporate relevant information about the source into evidence evaluation. Psychology research highlights that credibility is multi-dimensional and, more importantly, competence is context-specific. That is, an expert in one area may lack the necessary knowledge and background in other areas. Recent research in psychology has identified a phenomenon called the "sleeper effect for the source", which explains how a weak message's persuasiveness can increase over time if it is delivered by a credible source. Using an experiment, I find that current auditing practices regarding management competence assessments result in auditors ignoring context-specific competence and relying on weak audit evidence when provided by a credible source (i.e., a sleeper effect). This effect results in reliance on overall source credibility assessments instead of consideration of a source's context-specific competence during evidence evaluation. Further, an audit documentation intervention designed to assist auditors in identifying and incorporating context-specific competence into evidence evaluations moderates the sleeper effect.

Session 3.05: AUDITOR BIASES
DATE: FRIDAY, JANUARY 18, 2019
TIME: 3:45 PM–5:15 PM

Auditors and Social Media Use: Does Fear of Missing Out Affect Audit Quality?

Stephen Kuselias
Providence College

John Lauck
Louisiana Tech University

Summer Williams
Westfield State University

ABSTRACT: Social media continues to grow in popularity and recent survey data suggests that auditors use it habitually. Early research suggests that social media content tends to focus on rewarding experiences, which can leave users with a fear that they are missing out (FOMO). While FOMO has been linked to negative outcomes, it is unknown how FOMO might affect auditors as they complete audit tasks. Using an experiment that holds social media usage constant, we rely on social comparison theory to test how social media content impacts auditors' performance on audit related tasks. We find that auditors who view peer posts of rewarding experiences are less likely to collect and evaluate audit evidence than those that do not view such content. In a further test of our theory, we also demonstrate that evidence collection and evaluation is improved when auditors view posts made by other accountants in a professional setting alongside the social posts of nonaccountant peers. In support of social comparison theory, we find that auditors' unfavorable comparisons with their peers leads to increased negative affect, in turn causing the reduction in audit evidence collection and evaluation. Our findings suggest that viewing social media content can affect the collection and evaluation of audit evidence and, therefore, have important consequences for audit quality. As such, our results have implications for practitioners, academics, and regulators.

Session 3.05: AUDITOR BIASES
DATE: FRIDAY, JANUARY 18, 2019
TIME: 3:45 PM–5:15 PM

The Negative Impact of Investigation Effort on Auditor Adjustments

Steven J. Kachelmeier
The University of Texas at Austin

Dan Rimkus
The University of Texas at Austin

ABSTRACT: We explore whether audit effort impairs auditor willingness to impose accounting adjustments. We theorize that investigation effort creates a mental investment that imposes a loss mindset when evidence is unfavorable. This loss framing makes the auditors more willing to forego adjustments. We test this theory with a laboratory experiment in which student participants make an effort choice to discover underlying risk information. We present the same risk information to participants who do not make an effort choice, with both groups given the opportunity to reduce risk. We find that participants who exert effort adjust risk less than participants who receive the same information without effort. Separating the effort and adjustment decision between a pair of auditors eliminates this difference, although it reduces adjustment overall because participants are averse to imposing the cost of adjustment on another auditor. These findings should be of interest to audit firms and regulators.

Session 3.06: THE IMPACT OF MANAGEMENT COMMUNICATION AND IMPRESSIONS ON THE AUDIT
DATE: FRIDAY, JANUARY 18, 2019
TIME: 3:45 PM–5:15 PM

Sounds Good to Me: How Communication Mode and Framing Affect Audit Quality

Mary Parlee Durkin
University of San Diego

S. Jane Jollineau
University of San Diego

Sarah Lyon
University of San Diego

ABSTRACT: In the audit process, audit associates seek explanations from clients, follow-up to corroborate or refute these explanations, and document their findings. Throughout these interactions with the client, auditors must focus on the task at hand and maintain their professional skepticism. This paper examines whether (i) communication mode (face-to-face or email) and (ii) the frame of the client's response (as explanation or fact) affect the ability of auditors to appropriately assess the quality of client communications and follow-up when necessary. We use professional auditors and conduct a 2x2 between-participants experiment. We find that auditors receiving a face-to-face response from the client that is framed as an 'explanation' assess the response as higher quality than auditors in the other three conditions. As a result, these auditors are less likely to follow-up with additional questions, likely impairing audit quality and increasing audit risk. We attribute the decrease in auditor performance to distractions causing the auditors to accept the client's story at face value rather than applying appropriate skepticism. Our recommendations are that auditor associates (a) use email communication where feasible and (b) prime themselves to listen for 'facts' and ask the client to respond with 'facts' when face-to-face meetings are unavoidable or otherwise desirable.

Session 3.06: THE IMPACT OF MANAGEMENT COMMUNICATION AND IMPRESSIONS ON THE AUDIT
DATE: FRIDAY, JANUARY 18, 2019
TIME: 3:45 PM–5:15 PM

The Effect of Auditors' Informal Communication in The Audit Environment on Financial Reporting Outcomes

Emily Kathryn Hornok
The University of Mississippi

ABSTRACT: I examine the effect of auditors' ongoing, informal communication with managers and other auditors on financial reporting outcomes in a laboratory experiment in which participants in the roles of auditors and managers interact in a stylized audit setting. My 2×2 between-subjects design manipulates whether the auditors are able to communicate with either, neither, or both the manager and other auditors. I find that when the auditor and manager communicate, they each develop a social bond, which increases the manager's feeling of accountability towards the auditor, causes the manager to make more honest representations to the auditor, and leads the auditor to assess the manager's representations as more honest. Additionally, while the auditor's communication with other auditors creates a social bond among auditors, this bond neither reduces the strength of the auditor's bond with the manager nor reduces the effect of that bond on the auditor's assessments of the honesty of the manager's representations. My study highlights the importance of the social nature of auditing and its impact on financial reporting outcomes and has implications for practitioners and regulators.

Session 3.06: THE IMPACT OF MANAGEMENT COMMUNICATION AND IMPRESSIONS ON THE AUDIT
DATE: FRIDAY, JANUARY 18, 2019
TIME: 3:45 PM–5:15 PM

The Effects of First Impressions and Supervisor Preference on Auditors' Risk Assessments

Darin Kip Holderness
West Virginia University

Alyssa Sui Jing Ong
West Virginia University

Mark Foster Zimbelman
Brigham Young University

ABSTRACT: This study examines how first impressions and supervisor preference for effectiveness or efficiency influence auditors' risk assessments. Auditors form first impressions as they interact with client personnel while gathering audit evidence. Prior first-impression research suggests that individuals' first impressions influence their subsequent judgments through a subconscious process that makes it difficult to avoid biased judgments associated with them. In a typical auditing context, in which the time pressures of the auditing environment may induce a focus on efficiency, we expect a positive (negative) first impression to decrease (increase) auditor objectivity and cause auditors to become less (more) sensitive to misstatement risk. Our findings from an experiment with practicing auditors support this expectation. Importantly, we extend prior psychology research that suggests first impression biases are difficult to avoid and find that the effects of first impressions are mitigated when an audit supervisor expresses a preference for audit effectiveness. Given that client inquiry is an important component of the audit, these findings have important implications for auditor effectiveness.

PLENARY PAPER PRESENTATION
DATE: SATURDAY, JANUARY 19, 2019
TIME: 8:30 AM–10:00 AM

Company Valuation Specialists' Interactions with Management and Auditors: A Field Study

Kyrre Kjellevold
Norwegian School of Economics

ABSTRACT: Management often relies on specialists for valuing complex fair value measurements (FVMs), auditors frequently rely on those FVMs as audit evidence, and the PCAOB has documented persistent problems in the audit of FVMs. Based on in-depth interviews of Norwegian audit partners and company valuation specialists, I provide evidence on how audit teams interact with company specialists, how company specialists view the work of auditors and auditor specialists, and the extent of pressure company specialists' experience to conform to management measurement bias. The findings indicate that auditors' lack of valuation knowledge and auditor specialists' lack of asset-specific expertise, lead to deficiencies in their understanding of how assumptions used in FVMs are interrelated and result in auditors focusing on the minutia of the individual assumptions at the expense of a "big picture" view. The findings further suggest that company specialists are not immune to management pressure and I document several tactics management employs to inflate their specialist assisted FVMs. Management pressure is highest for non-financial level 3 FVMs. These results corroborate and explain recent findings in financial archival literature on the reliability of FVMs and enhances our understanding of the audit quality deficiencies documented by the PCAOB and other regulators.

PLENARY PAPER PRESENTATION
DATE: SATURDAY, JANUARY 19, 2019
TIME: 8:30 AM–10:00 AM

Revealing Oz: Audit Firm Partners' Experiences with National Office Consultations

Sanaz Aghazadeh
Louisiana State University

Mary Kate Dodgson
Northeastern University

Yoon Ju Kang
University of Massachusetts Amherst

Marietta Peytcheva
Lehigh University

ABSTRACT: Engagement teams often engage in national office consultations (hereafter, "NOC") on accounting and auditing matters to ensure appropriate audit conclusions. Recent Big 4 audit firms' transparency reports indicate an emphasis on collaboration during these consultations. Yet, it is unclear what this approach entails and what factors have contributed to this explicit emphasis. We interview 22 highly experienced Big 4 audit firm partners (12 engagement partners and 10 national office partners) to gain an understanding of the current consultation dynamic that takes place both between the national office and engagement teams and between the national office and clients. Using institutional theory to interpret our results, we find that audit firms scaled back on client collaboration as an immediate response to SOX, and recently have gravitated back toward a more collaborative approach (consistent with the pre-SOX era). We explore likely outcomes for the auditor-client relationship and audit quality, and we further discuss implications for regulators, practitioners, and researchers.

PLENARY PAPER PRESENTATION
DATE: SATURDAY, JANUARY 19, 2019
TIME: 8:30 AM–10:00 AM

Overseeing the External Audit Function: Evidence from Audit Committees' Reported Activities

Brian Bratten
University of Kentucky

Monika Causholli
University of Kentucky

Valbona Sulcaj
University of Kentucky

ABSTRACT: Although one of the most crucial responsibilities of audit committees is overseeing the audit process we know very little about how audit committees fulfill this role and how their oversight impacts the financial reporting process and investor perceptions. Recently, in response to calls for more transparency, many firms have increased their disclosure of information about audit committee activities related to their role in overseeing the external audit process. Using a novel dataset that summarizes reported audit committee activities, we create a composite measure that captures the extent of the audit committee's oversight of the audit process. We then examine whether the extent of audit committee oversight is related to financial reporting quality, audit fees and whether it is informative to investors in capital markets. Our results show that firms with audit committees who take a more active role in overseeing the external auditor are associated with better financial reporting quality and pay higher audit fees. Further, we report limited evidence that the market reacts positively to disclosures regarding the audit committees' activities consistent with the oversight improving financial reporting quality. Our results provide important insights to the oversight role of audit committees on financial reporting and the market perception associated with active audit committees.

Session 4.02: AUDIT COMMITTEE RELATIONSHIPS
DATE: SATURDAY, JANUARY 19, 2019
TIME: 10:15 AM–11:45 AM

Audit Committee Interlocking and Internal Controls over Financial Reporting

Ahmad Hammami
Concordia University

Alexey Lyubimov
Concordia University

ABSTRACT: We investigate the relationship between audit committee interlocking and the effectiveness of internal controls over financial reporting (ICFR). Agency theory (Fama and Jensen, 1983) suggests that external directors improve the board of directors' monitoring of the firms they serve. Interlocked audit committee members are directors that serve on multiple firms' audit committees, and thus are able to transfer their experience and knowledge. However, currently we do not know whether this common practice is beneficial. Using public U.S. firms, we contribute to the corporate governance literature by showing that companies that are interlocked at the audit committee level with other companies that have effective ICFR, are more likely to have effective controls themselves. We relate our results to the transfer of interlocked members' positive knowledge and expertise across the firms they serve, hence a "positive contagion" effect. Furthermore, we do not find a significant relationship between interlocking with companies with ineffective controls and control effectiveness. As such we do not observe a "negative contagion" effect of being connected to a company with ICFR problems. We attribute this to the fact that audit committee members do not have an incentive to allow and spread control weaknesses across the firms they serve, as well as the fact that internal controls weaknesses are easily visible to the public from the 10-k, which would damage the reputation of the director. Overall, our results provide evidence that interlocked audit committee members are important elements in improving certain aspects of firms' corporate governance.

Session 4.02: AUDIT COMMITTEE RELATIONSHIPS
DATE: SATURDAY, JANUARY 19, 2019
TIME: 10:15 AM–11:45 AM

Audit Committee Reputation Incentives: How Do Key Audit Committee Directors Allocate Monitoring Effort Across Multiple Directorships?

Terry L. Neal
The University of Tennessee

Justin Short
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ABSTRACT: Using a sample of audit committee chairs and financial experts that serve on multiple audit committees from 2004-2014, we examine whether the reputation incentives for these directors are associated with audit committee effectiveness at the firms they serve. Reputation incentives theory suggests that these directors will allocate relatively more monitoring effort to the firms in their portfolio that offer them a greater opportunity to enhance their reputation as a monitor (higher reputation incentives) and allocate less monitoring effort to the other firms they serve. Consistent with reputation incentives theory, we find that audit committee effectiveness is lower at firms that offer these directors relatively lower reputation incentives as compared to firms that offer them relatively higher reputation incentives. Further, these results are driven by smaller firms that likely depend more on director effort and input. Our findings should be of interest to boards, investors, and regulators considering the implications of director service on multiple boards.

Session 4.02: AUDIT COMMITTEE RELATIONSHIPS
DATE: SATURDAY, JANUARY 19, 2019
TIME: 10:15 AM–11:45 AM

Shareholder Activism and Changes in Audit Committee Composition

Tom Adams
University of Connecticut

Thaddeus Andrew Neururer
The University of Akron

ABSTRACT: We examine whether governance related shareholder activism is associated with changes in audit committee composition. Audit committees are the "ultimate monitors" of firms' financial reporting processes. The SEC is interested in whether audit committees have financial experts and prior research has documented benefits associated with accounting-specific financial expertise. Governance activism expresses investors' dissatisfaction with corporate governance; audit committees are an important corporate governance mechanism. Therefore, we predict that one, and as of yet unexplored, way for a firm to react to activism is to improve its audit committee. We document a positive association between governance activism —and specifically, accounting, audit, and financial reporting related governance activism—and increases in audit committee accounting-specific financial expertise. This association is strongest when a firm concurrently announces a restatement or experiences an internal control failure. We contribute to the literature by documenting an important determinant of audit committee composition.

Session 4.03: AUDIT PARTNER QUALITY
DATE: SATURDAY, JANUARY 19, 2019
TIME: 10:15 AM–11:45 AM

Audit Partner Life Cycle and Implications for Audit Quality

Yang Xu
The University of Queensland

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UNSW Sydney

Roger Simnett
UNSW Sydney

ABSTRACT: This study investigates how audit partners' performance changes at various stages of their professional life cycle in the light of human capital theory. We argue that 1) as audit partners become more experienced, they gradually lose their motivation to continue investing in their human capital, and thereby deliver lower audit quality; and 2) partners, who become directors and consultants after they retire from the audit firms, have higher incentives to invest in their human capital than their peers, and thereby provide higher quality audit services. We find partner life cycle is positively associated with audit fees and the absolute value of total accruals, and curvilinearly associated with the likelihood to issue going-concern opinions. The associations differ for Big N and non-Big N partners. We also find some evidence for the impact of post-retirement work on partner performance. Specifically, Big N partners who engage in director or consulting roles charge higher fees than their non-working colleagues. To our knowledge, this is the first study to provide a cost-benefit analysis of compulsory early retirement policies for accounting firms.

Session 4.03: AUDIT PARTNER QUALITY
DATE: SATURDAY, JANUARY 19, 2019
TIME: 10:15 AM–11:45 AM

Do Investors Care Who Did the Audit? Early Evidence of the Informativeness of Form AP

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The University of Alabama

James Gregory Lawson
The University of Alabama

Thomas James Lopez
The University of Alabama

Quinn Thomas Swanquist
The University of Alabama

ABSTRACT: In 2017, the PCAOB mandated the disclosure of lead audit partners and other audit participants for U.S. public companies. We investigate whether these disclosures are informative to investors. Our initial tests show no evidence of an incremental market response, measured using abnormal trading volume and number of trades, around the disclosure of partner identity or other auditor participation. We extend our investigation to examine investor responses to partner changes, high levels of outside participation, and participation from auditors outside PCAOB jurisdictions. Even in these subsamples, we find no significant market response. Further, the precision of our estimates indicates that these disclosures had no meaningful economic effect on investor trading behavior. Our findings are robust to alternative specifications and to measuring informativeness using bid-ask spreads. Overall, the evidence suggests that the initial partner and other audit participant disclosures have not significantly impacted capital markets.

Session 4.03: AUDIT PARTNER QUALITY
DATE: SATURDAY, JANUARY 19, 2019
TIME: 10:15 AM–11:45 AM

Engagement Partner Quality, Costs of Capital, and Valuation

Kose John
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Min Liu
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ABSTRACT: Accounting theory predicts that the clients of higher quality auditors should enjoy lower costs of capital and have more predictable future cash flows, therefore, having higher values. However, empirical evidence on whether and how the audit quality at the engagement partner (EP) level influences the clients' costs of capital and values is scarce. Therefore, employing five proxies for the EP quality (characterized by size and industry specialization), and analyzing 414-739 EPs from the United Kingdom, we examine and find, consistent with the theoretical predictions, that the clients of high-quality EPs generally enjoy lower costs of capital and have higher values. The former effect is mainly due to the markets' perception that high-quality EPs improve their clients' accruals quality. The effect of EP quality on clients' value is the improvement in the prediction of future cash flows and reduction of discount factors. The results are not sensitive to controls for the industry, year, client, and audit firm fixed effects, to alternative measurements of EP quality and clients' value, and to a median regression method. Our additional analyses on the effect of EP quality on debt covenants show that the loan contracts of clients of high quality EPs are less likely to require collateral assets, with larger amount of facilities and lower loan spread over LIBOR. Our results suggest that audit quality at the EP level benefits clients.

Session 4.04: WORKING BETTER WITH EACH OTHER: COLLABORATIVE, GROUP, AND AUDIT TEAM DYNAMICS
DATE: SATURDAY, JANUARY 19, 2019
TIME: 10:15 AM–11:45 AM

Collaborating with Competitors: Mechanisms That Mitigate Coopetitive Tensions Among Member Firms in Accounting Associations and Networks

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Sarah E. Stein
Virginia Polytechnic Institute and State University

ABSTRACT: When faced with resource constraints, organizations may seek assistance through the formation of interorganizational relationships with other entities that are traditionally viewed as competitors. In the accounting industry, small firms often align themselves with other firms to form accounting associations and networks ("AANs"). However, AANs create a paradoxical environment in which member firms face simultaneous incentives to foster cooperative relationships while also protecting core competencies that could increase the competitiveness of their rivals. We conduct 45 interviews with accounting firm partners, AAN leadership, and other professionals to investigate the mechanisms that mitigate tensions in this setting. Our findings, informed by coopetition and IOR theory, indicate that AAN member firms are willing to share resources and expertise with rival firms because of the transactional mechanisms (i.e., contractual agreements, governance structure, member firm selection, and monitoring processes) and relational mechanisms (i.e., trust, social ties, and reciprocity) in place. Importantly, transactional and relational mechanisms appear to be complementary in this setting since transactional mechanisms inspire confidence among cooperating firms and allow for the development of relational mechanisms over time. Our research enriches existing accounting literature, provides a new perspective for practitioners, and contributes to an emerging theory of coopetition.

Session 4.04: WORKING BETTER WITH EACH OTHER: COLLABORATIVE, GROUP, AND AUDIT TEAM DYNAMICS
DATE: SATURDAY, JANUARY 19, 2019
TIME: 10:15 AM–11:45 AM

Global Group Audits: The Perspective of U.S. Group Audit Leads

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ABSTRACT: Regulators are concerned about the quality of group audits due to poor inspection results, recent enforcement actions against component auditors, and the significance of these audits to the global economy (e.g., IAASB 2015; PCAOB 2016a). In response, we aim to obtain a better understanding of global group audits as experienced by U.S.-based global group audit leads. Our data represent qualitative survey responses from 148 group audit leads (i.e., senior managers) on their perceptions of highly challenging and non-challenging global group audits. In challenging group audits, group auditor respondents routinely find fault with their component auditor counterparts, perceiving that work performed and/or documentation provided is not sufficient, not appropriate and/or not communicated timely, to comply with U.S. standards and reporting deadlines. In some cases, they perceive that the component auditor is unwilling (i.e., exercises resistance) and/or unable (e.g., due to resource constraints, inadequate training in U.S. standards) to comply; in others, that the component auditor is willing and able, but misunderstands group instructions. Noticeably this perspective is not self-reflective, as group auditors almost exclusively attribute issues to component auditors. While this perspective appears myopic, it provides insights into flaws of the global firm model of cooperative arrangements employed by the Big 4 firms, which is largely unacknowledged in regulatory discussions and the academic literature. To ensure audit quality on global group audits, it is imperative that sociocultural, regulatory, and institutional differences across member firms are addressed.

Session 4.04: WORKING BETTER WITH EACH OTHER: COLLABORATIVE, GROUP, AND AUDIT TEAM DYNAMICS
DATE: SATURDAY, JANUARY 19, 2019
TIME: 10:15 AM–11:45 AM

The Effect of Staff Auditor Reputation and Reputation Management on Audit Quality Enhancing Actions

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ABSTRACT: We report the results of two experiments that examine whether having a good professional reputation facilitates performing quality audit work. Auditors have a professional obligation to conduct quality audits. However, research has demonstrated that audit quality enhancing actions (e.g., speaking up about issues, making client inquiries, exhibiting skepticism) come with associated potential personal costs. Drawing upon the Theory of Reputation in Organizations as well as Social Presentation Theory, we predict that auditors perceive that the risks associated with these actions vary based on the perceived reputation of the actor (i.e., lower risks associated with engaging in these actions when the auditor has a positive reputation), and that these perceptions will influence their decisions to act. We provide evidence that, when faced with an anticipated budget overage, auditors anticipate greater benefits to actively managing the supervisor's expectations when the auditor has a more positive reputation with the supervisor, thus making that auditor less likely to engage in dysfunctional behavior to meet the budget. We also provide evidence that a positive reputation causes auditors to exhibit skeptical actions. Taken together, our experiments provide evidence that the quality of an auditor's work is influenced by their perceived reputation with their supervisor.

Session 4.05: PROFESSIONAL SKEPTICISM
DATE: SATURDAY, JANUARY 19, 2019
TIME: 10:15 AM–11:45 AM

Client Data Files and Auditor Skepticism: How Do "Dirty Files" Influence Auditors' Skeptical Judgments and Actions?

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ABSTRACT: Auditors receive an abundance of data files from audit clients when performing audit work. These files may have differing characteristics (e.g., contain irrelevant information or errors) that may influence the ease of use and interpretation by an auditor. Depending on the perceptual fluency of client provided data files (i.e., how "dirty" the files are), auditors may resort to heuristic processing when assessing the files, resulting in skeptical judgments and actions that lead to over-auditing. This paper reports two experiments examining whether two characteristics of client provided data files, the presence of minor errors (absent or present) and information load (low or high), influence auditors' perceptual fluency, skeptical judgments, and actions. We theorize and report that higher information load decreases perceptual fluency more when minor errors are present (Experiment 1), and this same combination increases auditors' skeptical judgments and actions (Experiment 2). While minor errors should raise auditors' concerns, greater information load should not. Together our study contributes to the literature on professional skepticism by presenting an alternative issue to those raised by regulators (i.e., too much skepticism rather than too little) that can occur when auditors struggle to interpret large amounts of data in client provided files. Our results provide several important practical implications for audit firms, audit clients, and regulators. Importantly, while access to increased amounts of client data may have many benefits, both audit firms and clients need to be wary of the potential suboptimal balance of effectiveness and efficiency that could affect audit quality.

Session 4.05: PROFESSIONAL SKEPTICISM
DATE: SATURDAY, JANUARY 19, 2019
TIME: 10:15 AM–11:45 AM

Root Cause Analysis and its Effect on Auditor Skepticism and Judgment in an Integrated Audit

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ABSTRACT: This study evaluates whether applying root cause analysis (RCA) to a client misstatement affects auditors' identification and assessment of underlying control issues and materiality judgments. We also test whether auditor cognitive style moderates these effects given prior findings that a mismatch between task structure and cognitive style undermines performance. We randomly assigned 147 auditors to four RCA treatments (No RCA, Unstructured RCA, Structured "5 Whys" RCA, Structured "Fishbone" RCA). Results indicate that auditors using (not using) structured RCA are more (less) likely to identify control-related root causes and judge the misstatement to be more (less) material. We also find that the assessed severity of the control deficiency mediates RCA's effect on materiality judgments. Finally, the materiality judgment results reveal a significant interaction between structured RCA method and auditor cognitive style, suggesting the importance of allowing flexibility in the specific RCA structure applied in practice.

Session 4.05: PROFESSIONAL SKEPTICISM
DATE: SATURDAY, JANUARY 19, 2019
TIME: 10:15 AM–11:45 AM

How Do Auditors Move from Skeptical Judgment to Skeptical Action? A Field Study

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ABSTRACT: Professional skepticism is clearly an important and timely topic in the practice and regulation of auditing. Insights into auditor efficacy associated with skeptical action may be gained by applying a seminal theory of behavior and action, Bandura's self-efficacy construct within Social Cognitive Theory, within the audit context. This study uses a multiple-interview design to explore the exercise of professional skepticism in the field by eight experienced auditors. An auditor who is skeptical about the facts and circumstances of a client may not always manifest that skeptical judgment as skeptical action. The analysis specifically examines when and how skeptical judgments lead to skeptical actions. Our evidence suggests that the expected efficacy of skeptical actions is increased by the presence of three primary factors: (1) the support/collectivism within the audit team, (2) the preparation/homework of the auditor, and (3) the quality of the relationship with the client counterpart. These three themes are further illustrated by specific actions that can be taken by an auditor. The study contributes to our understanding of how auditors make decisions that influence skeptical actions during the course of the audit, the resources and strategies employed to do so, and the motivations that underlie skeptical actions.

Session 4.01: MARKET REACTIONS TO AUDIT PROCESSES
DATE: SATURDAY, JANUARY 19, 2019
TIME: 1:45 PM–3:15 PM

Audit Process, Private Information, and Insider Trading

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John Kepler
University of Pennsylvania

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Daniel Jeffrey Taylor
University of Pennsylvania

ABSTRACT: Corporate insiders are typically aware of audit findings prior to the general public. We examine whether corporate insiders exploit this information advantage, and trade based on private information about audit findings. We focus our analysis on insider trading around the audit report date. We find a pronounced spike in insider trading in a short window around the audit report date; that audit reports containing a modified opinion trigger intense insider selling; and that abnormal levels of insider trading disappear shortly before the report is publicly disclosed. Highlighting the non-public nature of the audit findings at the time of the audit report date, we find no evidence of a capital market reaction around this date. Collectively, our results suggest insiders at multiple firms exploit features of the audit process for personal gain.

Session 5.01: MARKET REACTIONS TO AUDIT PROCESSES
DATE: SATURDAY, JANUARY 19, 2019
TIME: 1:45 PM–3:15 PM

Do Investors Care about Negative Business Press Coverage of Big 4 Accounting Firms?

Matthew Stephen Ege
Texas A&M University

Dechun Wang
Texas A&M University

Nina Xu
Texas A&M University

ABSTRACT: We examine whether equity investors respond to negative business press coverage of the Big 4. We find that the extent of negative business press coverage of a Big 4 is associated with a higher percentage of votes against auditor ratification, lower earnings response coefficients for clients, and negative client abnormal returns on the day of news release. The extent of Big 4 negative business press coverage is also associated with a lower probability of gaining new clients and with a decrease in misstatement likelihood in the following year, suggesting that the affected auditor seeks to restore its reputation by increasing audit quality. Overall, this evidence is consistent with the business press playing a role in shaping the information environment of the Big 4 and suggests that the business press affects investors' perception of the value of an audit.

Session 5.01: MARKET REACTIONS TO AUDIT PROCESSES
DATE: SATURDAY, JANUARY 19, 2019
TIME: 1:45 PM–3:15 PM

Market Reaction to "Bad" News: Does the CFO Gender Matter? Evidence from Auditor Resignations

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Florida International University

Md Safayat Hossain
Florida International University

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ABSTRACT: This study examines whether investors respond to the announcement of negative news differently conditional upon CFO gender. We use auditor resignation announcements as a proxy for negative news and use cumulative abnormal returns (CAR) following a standard event study method to measure market response. We find a statistically significant difference between firms with female CFOs that receive this negative news compared to firms with male CFOs. Although it appears at first glance that firms with female CFOs obtain positive CARS while firms with male CFOs obtain negative CARs, when testing whether each subsample is statistically different from zero we find that we cannot reject the null hypothesis with firms with female CFOs while we can with firms with male CFOs. We provide consistent evidence using univariate and multivariate tests after controlling for firm fundamentals, testing three different event windows around the announcement date as well as different market reaction methods, and using a full sample as well as a matched-pair sample. Our study concurs with many gender studies that show that gender diversity is an efficient corporate governance mechanisms where having females in the top executive position of a firm is considered desirable by the market and this positive perception is reflected by mitigating the negative consequences of the firm when receiving "bad news".

Session 5.02: ARCHIVAL STUDIES OF AUDITOR BEHAVIOR
DATE: SATURDAY, JANUARY 19, 2019
TIME: 1:45 PM–3:15 PM

Auditor Responses to Shareholder Activism

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The University of Kansas

Adi Masli
The University of Kansas

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The University of Kansas

ABSTRACT: This paper investigates how auditors respond to shareholder activism against their clients. Specifically, we test whether confrontational activism impacts three aspects of the auditor-client relationship: going concern opinions, internal control opinions, and audit fees. We find that auditors are more likely to issue first-time going concern opinions and adverse internal control opinions to clients that are experiencing confrontational activism. In both instances, however, the outcomes seem to reflect increased auditor diligence (i.e., higher quality reporting) rather than purely reflecting increased auditor conservatism. We also find that audit fees are substantially higher in the presence of confrontational activism. The most likely explanation for our findings across all three audit outcomes is that the increased scrutiny associated with activist campaigns increases auditors' concerns about reputational damage and litigation risk. Consistent with this notion, we find that targets of confrontational activism are more likely to experience accounting-related lawsuits. Overall, the results of this paper identify a number of relationships that may be important to activists, target firms, and auditors.

Session 5.02: ARCHIVAL STUDIES OF AUDITOR BEHAVIOR
DATE: SATURDAY, JANUARY 19, 2019
TIME: 1:45 PM–3:15 PM

How Does U.S. Multinational Firms' Foreign Corruption Risk Affect Auditor Behavior?

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The Hong Kong Polytechnic University

Mark Ma
American University

Jeffrey Pittman
Memorial University of Newfoundland

ABSTRACT: This study examines how U.S. multinational firms' foreign corruption risk affects audit behavior. Auditors are required by the Foreign Corrupt Practices Act of 1977, Auditing Standard 2405 and other security laws to assess the risk and probability that a public firm's management bribes a foreign government official. If the auditors follow such rules, we would observe a positive association between foreign corruption risk and audit effort. However, on the other hand, prior literature suggests that a firm may gain significant economic benefits through foreign bribery. Such economic benefits (e.g., permits to open new stores) reduces an auditor's perceived business risk of the firm, leading to audit risk and audit effort. Therefore, the effect of foreign corruption risk on auditor behavior is an empirical research question. Using a sample of U.S. multinational firms from 2000 to 2014, we find that foreign corruption risk is negatively associated with audit fees and the probability of receiving a going concern opinion. Also, higher foreign corruption risk is associated with lower bankruptcy risk. Further, the negative effects of foreign corruption risk on audit fees and going concern opinions are more pronounced for firms with stronger political connections and those with weaker governance. Overall, auditors do not seem to respond to foreign corruption risk as required by the FCPA. Our findings have significant implications for the PCAOB, which is currently considering whether there is a need to provide better guidance to auditors regarding their responsibilities with respect to clients' possible illegal acts.

Session 5.02: ARCHIVAL STUDIES OF AUDITOR BEHAVIOR
DATE: SATURDAY, JANUARY 19, 2019
TIME: 1:45 PM–3:15 PM

The Use and Characteristics of Component Auditors: Implications for U.S. Audits

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ABSTRACT: This paper investigates the common, yet previously opaque, practice of using non-U.S. audit firms (commonly referred to as component auditors) to conduct portions of audit work for U.S. public companies. Since the U.S. lead auditor ultimately accepts full responsibility for the resulting audit opinion, regulators have expressed concern for the transparency and quality of audits using component auditors. Employing data disclosed in the newly-mandated PCAOB Form AP, we find that this practice is most common amongst large clients with complex international operations. Consistent with regulators' concern, we find that the percentage of audit hours conducted by component auditors is associated with lower audit quality (i.e., material weakness disclosures and restatements), longer audit delay, and higher audit fees, but that not all component auditors are created equal. Specifically, work performed by component auditors that are more competent, operating in countries with strong rule of law, and in countries with greater English language proficiency is not associated with adverse audit outcomes. Overall, these findings suggest that the use of component auditors is not uniformly detrimental to the resulting audit and that Form AP disclosures can help interested parties better assess the potential for adverse audit outcomes.

Session 5.03: FINANCIAL REPORTING QUALITY & AUDITING
DATE: SATURDAY, JANUARY 19, 2019
TIME: 1:45 PM–3:15 PM

Common Auditors in Mergers and Acquisitions: The Impact on Post-Acquisition Financial Reporting Quality and Audit Fees

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The University of Tennessee

Linda A. Myers
The University of Tennessee

Kathleen Schuchard
The University of Tennessee

ABSTRACT: Prior studies document improvements in pre-acquisition outcomes when acquirer and target firms engage the same audit firm. We extend this literature by examining whether the advantages of engaging a common auditor translate into post-acquisition benefits. We find that common auditors improve post-acquisition financial reporting quality as evidenced by a decreased likelihood of misstatement following these acquisitions (relative to acquisitions without a common auditor). In subsequent tests, we find that the effect of common auditors is driven by those sharing the same office. In addition, consistent with same-office common auditors providing synergies to the audit engagement, we find that engaging same-office common auditors results in smaller post-acquisition audit fees for the combined entity. In additional analyses, we find that the effects of common auditors on financial reporting quality and on audit fees are more pronounced when the acquisition is more material (i.e., the target is large relative to the acquirer). Together, our findings suggest that common auditors provide important post-acquisition benefits to the acquirer, and that this effect is driven by same-office common auditors.

Session 5.03: FINANCIAL REPORTING QUALITY & AUDITING
DATE: SATURDAY, JANUARY 19, 2019
TIME: 1:45 PM–3:15 PM

Internal Audit Competency Changes in Response to Financial Reporting Quality Failures

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ABSTRACT: Limited data availability on the internal audit function (IAF) has constrained research on the topic. This study uses unique, manually collected data from LinkedIn on internal audit personnel that overcomes certain limitations of previous survey-based data. Using this longitudinal data, we test whether IAF competency improves after financial reporting failures. We find a significant increase in IAF competency in the year following material weakness and restatement disclosures. Importantly, we document that the increase in competency is not uniform across firms and is greater in firms with higher audit committee commitment toward the IAF, lower audit committee accounting expertise, and when the CFO lacks accounting expertise. These findings suggest that while there is no regulatory oversight governing the IAF, certain audit committees and executives recognize its value. Regulators that have focused on improving financial reporting quality by enhancing oversight over external auditors and audit committees should consider focusing on the IAF.

Session 5.03: FINANCIAL REPORTING QUALITY & AUDITING
DATE: SATURDAY, JANUARY 19, 2019
TIME: 1:45 PM–3:15 PM

The Effect of Auditor-Provided Regulatory Advisory Services on Financial Reporting Quality: Evidence from the Dodd-Frank Act

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The Ohio State University

Amy Genson Sheneman
The Ohio State University

ABSTRACT: In 2010, the Dodd-Frank Act increased regulatory requirements to strengthen the safety and soundness of the financial system. These requirements resulted in banks investing significantly to develop regulatory models, improve internal reporting, and create operational monitoring to meet the new guidelines. This paper examines whether assistance by the bank's external auditor with meeting the new regulatory guidelines (regulatory advisory services) influences financial reporting quality, measured as the validity of the loan-loss provision, earnings persistence, and benchmark-beating. Using a difference-in-differences design, we find that banks hiring their external auditor to provide regulatory advisory services are associated with a decline in financial reporting quality. Further, this relation is more pronounced for banks experiencing greater regulatory pressure and for banks with less effective audit committees. Taken together, our results are consistent with regulator concerns that financial reporting quality diminishes when external auditors also serve in an advisory capacity.

Session 5.04: BIG DATA AND TECHNOLOGY ISSUES
DATE: SATURDAY, JANUARY 19, 2019
TIME: 1:45 PM–3:15 PM

The Impact of the Type of Cybersecurity Assurance Service and Cybersecurity Incidents on Investor Perceptions and Decisions

Rebecca Renae Perols
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ABSTRACT: In response to increased cybersecurity risk and demand for information about organizations' cybersecurity risk management programs, the American Institute of Certified Public Accountants (AICPA) recently released a cybersecurity risk management examination service. Similar to a previous AICPA IT-related assurance service called WebTrust, cybersecurity examinations face competition from less comprehensive and costly voluntary assurance service alternatives. Research examining the failure of WebTrust shows that information users do not recognize the value of the more comprehensive assurance services relative to the less costly alternatives (Mauldin and Arunachalam 2002; Gendron and Barrett 2004). In this study, I examine the effect of the type of cybersecurity assurance service on investor perceptions and decisions. I also examine how these effects differ depending on whether a prior cybersecurity incident was reported. Contrary to the WebTrust setting, I find that investors are more willing to invest in the presence of a cybersecurity risk management examination than in the presence of a less comprehensive cybersecurity assurance service. I also find that investor perceptions of assurance quality mediate the relation between type of cybersecurity assurance service and willingness to invest.

Session 5.04: BIG DATA AND TECHNOLOGY ISSUES
DATE: SATURDAY, JANUARY 19, 2019
TIME: 1:45 PM–3:15 PM

Does Data Ambiguity Lead to Suboptimal Auditor Judgment and Decision-Making?

Travis P. Holt
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Auburn University

ABSTRACT: This study examines the effects of data ambiguity found within unstructured data on auditor judgment and decision-making. Additionally, we examine whether those effects are moderated by time budget pressure. We conduct an experiment with 120 auditors and find that auditors presented with more ambiguous data, such as emails or visualizations, provide more conservative risk assessments and write-down recommendations in an inventory obsolescence setting than those auditors presented with data in an unambiguous memo format. Our findings also indicate that time budget pressure moderates the effects of data ambiguity resulting in the most conservative auditor judgments and decisions when presented with ambiguous data in a high time budget pressure environment. Overall, our results suggest that the ambiguity associated with the use of big data may lead to audit inefficiencies.

Session 5.04: BIG DATA AND TECHNOLOGY ISSUES
DATE: SATURDAY, JANUARY 19, 2019
TIME: 1:45 PM–3:15 PM

Investors' Judgment and Decisions after a Cybersecurity Breach: Understanding the Value Relevance of Cybersecurity Risk Management Assurance

Patricia Navarro
University of Central Florida

ABSTRACT: This study investigates how voluntary cybersecurity risk management assurance affects non-professional investors' judgments and decisions based on whether such assurance violate or conform to users' expectations. I predict and find that companies that engage in voluntary cybersecurity risk management assurance receive higher stock price valuations and more favorable investor assessments of management credibility. Moreover, I find that investors' assessments of management credibility and stock price valuations are more extreme in the presence of positive and negative violations. Further analysis reveals that investors' perceived benefits of assurance-as-insurance and perceived accountants' cyber-expertise are important determinants of investors' decision behavior. Further analysis also sheds light on the benefits and potential penalties associated with a firm's in-house cyber-risk management practices. The results have implications for both regulators currently engaged in developing cybersecurity disclosure requirements and professionals providing voluntary assurance services. This study adds to the literature and theory exploring the value relevance of voluntary assurance services.

Session 5.04: BIG DATA AND TECHNOLOGY ISSUES
DATE: SATURDAY, JANUARY 19, 2019
TIME: 1:45 PM–3:15 PM

The Data Analytics Transformation: Evidence from Auditors, CFOs, and Standard-Setters

Ashley Austin
University of Richmond

Tina Carpenter
The University of Georgia

Margaret H. Christ
The University of Georgia

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ABSTRACT: Data analytics is transforming our global markets. Spending on analytics is expected to grow approximately 70% by 2020. We investigate the use of data analytics throughout the financial reporting process by companies, external auditors, and standard-setters. We use interviews to examine how these groups use data analytics and how its use affects their interactions. We find companies and their auditors have introduced data analytics and report benefits to financial reporting and audit quality. However, challenges exist related to the lack of standards, obtaining the right skillset, financial investment, and capturing accurate data. While our interviewees believe that analytics has strengthened the client-auditor relationship, we identify potential future conflicts with the audit fee model and auditor independence. Using socio-technical theory to interpret our results, we find that data analytics will likely continue to change companies' and auditors' practices. However, lack of regulatory guidance and implementation costs present considerable hindrances to diffusion.

Session 6.01: AUDITOR EXPERTISE AND EXPERIENCE
DATE: SATURDAY, JANUARY 19, 2019
TIME: 4:00 PM–5:30 PM

Auditor Expertise for Client Complexity and Audit Quality

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ABSTRACT: We examine office-level auditor expertise for complex engagements and audit outcomes. We suggest that auditors that are considered experts in complex audits use that knowledge from one engagement to another, even when the engagements are otherwise not similar. We calculate a new measure of office-level auditor expertise for complex engagements using client characteristics, and examine the relationship between our measure of complexity expertise and client restatements. Our findings suggest that clients of complexity expert auditors receive higher quality audits in the form of a lower likelihood of subsequent finan cial reporting restatements. In additional analysis we find an incremental effect for complexity expert auditors over industry specialist auditors, a substitution effect for client-specific knowledge gained with long auditor tenure, and that our results hold primarily for complex clients. Finally, we report that complexity expert auditors experience engagement efficiencies in the form of lower audit fees. Our results are robust to the inclusion of firm fixed effects or the implementation of an entropy balanced propensity score method.

Session 6.01: AUDITOR EXPERTISE AND EXPERIENCE
DATE: SATURDAY, JANUARY 19, 2019
TIME: 4:00 PM–5:30 PM

Does Investment Bankers' Prior Experience in Public Accounting Reduce Earnings Management in IPO Firms?

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ABSTRACT: We examine whether firms undertaking an initial public offering (IPO) exhibit less earnings management when individual investment bankers have prior experience in public accounting. Although auditors are primarily responsible for providing external monitoring of the financial reporting process, individual bankers also have strong incentives to improve accounting quality in firms going public. We predict a negative relation between public accounting experience and IPO firms' earnings management given that working as an auditor fosters individual bankers' accounting expertise and conservative personalities. In exploiting unique disclosures of investment bankers' identities and characteristics in China, our analysis indicates that individual bankers with early-career experience as auditors constrain issuer firms' earnings management through both accruals and real activities. Consistent with expectations, we find that this evidence is more pronounced if the audit firm that employed the future investment banker is larger; has expertise in the industry in which the IPO firm operates; is permitted to audit listed companies; and was previously subject to a regulatory sanction. Collectively, our analysis implies that public accounting practice experience is valuable for financial intermediaries, particularly when this experience stems from working at a high-quality audit firm.

Session 6.01: AUDITOR EXPERTISE AND EXPERIENCE
DATE: SATURDAY, JANUARY 19, 2019
TIME: 4:00 PM–5:30 PM

The Value of Auditor Industry Specialists

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ABSTRACT: This paper uses demand estimation techniques to quantify the value of auditor industry specialists. In the first step, we derive the first order demand for auditor industry specialist at the office and national level. We also consider interdependencies between industry specialization at different levels and with audit office size. We find that clients experience a positive value of industry specialization. Further, we observe substitutive effects between industry specialization at the office and national level. In the second step, we use counterfactual analysis to elicit the total value that clients obtain from auditor industry specialists. We find that the total value is between 3.2 and 5.4 million. US Dollars for industry specialization at the office and national level, respectively. This figure is much smaller than the brand value of Big 4 audit firms. However, it is larger than the value of being audited by a larger audit office. Further, it can be considered to be economically significant because about 5% of the clients of auditor industry specialists would switch to non-specialists if the value of industry specialists got lost.

Session 6.02: DISTRESS, RESTATEMENTS, AND AUDITOR OPINIONS
DATE: SATURDAY, JANUARY 19, 2019
TIME: 4:00 PM–5:30 PM

Do Accounting Estimates Inform Assessments of Company Failure?

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ABSTRACT: Accounting estimates are prevalent throughout today's financial statements, yet we know relatively little about the contexts in which they are informative. This study investigates whether accounting estimates that cast doubt on a company's future earnings potentially inform assessments of company failure. We use the deferred tax asset valuation allowance to operationalize accounting estimates and measure company failure using subsequent bankruptcy filings and a broader measure of failure that also considers exchange delistings for financial reasons and poor credit ratings. Using a sample of U.S. public companies from 2004 through 2015, we find an association between accounting estimates and the likelihood of company failure. A going concern opinion does not fully mediate this association, suggesting that accounting estimates convey information incremental to that conveyed in a going concern opinion. Cross-sectional analyses reveal that the mediating effect of a going concern opinion is less when companies are more distressed, have weaker external information environments, and lower quality financial reporting, and when estimates are more conservative. Our research should be of interest to standard setters, as they continue to consider the role of accounting estimates in financial reporting; auditors, as they consider information relevant to going concern assessments; and, academics and investors interested in understanding the information contained in the deferred tax asset valuation allowance.

Session 6.02: DISTRESS, RESTATEMENTS, AND AUDITOR OPINIONS
DATE: SATURDAY, JANUARY 19, 2019
TIME: 4:00 PM–5:30 PM

Interim Restatements and the Year-End Audit

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ABSTRACT: Interim restatements make up approximately 16% of all restatements from 2004-2015, yet little research investigates their effect on the year-end audit. While annual restatements indicate a low quality audit was performed, an interim restatement could reflect high audit quality as interim restatements correct mistakes before year-end. Further, auditor offices detecting interim restatements could signal high quality audit offices. To test the implications of interim restatements, we first compare the year-end audit fees and audit quality of clients with interim restatements to clients without interim restatements (clean clients). We find auditors charge clients with interim restatements an audit fee that is approximately 21.65%, or $280,000, higher, on average, and perform year-end audits that are either of similar or lower quality. Second, we compare clean clients of offices issuing interim restatements (affected offices) to the clean clients of offices without interim restatements (unaffected offices). We find clean clients in affected offices receive similar or weakly significant worse quality audits compared to the clean clients of unaffected offices. We find the lower audit quality result is concentrated in affected Big N offices whose quality is significantly worse than unaffected Big N offices, while affected non-Big N offices perform significantly higher quality audits compared to unaffected non-Big N offices. Overall, we interpret these results as evidence that interim restatements signal a lower quality year-end audit and a lower (higher) quality Big N (non-Big N) audit office.

Session 6.02: DISTRESS, RESTATEMENTS, AND AUDITOR OPINIONS
DATE: SATURDAY, JANUARY 19, 2019
TIME: 4:00 PM–5:30 PM

Non-GAAP Earnings and Auditors' Going Concern Opinions

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ABSTRACT: We examine the role of non-GAAP earnings in auditors' going concern assessments, focusing on firms with a GAAP loss but a non-GAAP profit (i.e., a non-GAAP switch to profit). If auditors consider non-GAAP switches as informative about future loss reversals, they will be less likely to issue a going concern opinion relative to other GAAP loss firms. Using both manager-reported and analyst-reported non-GAAP earnings, we find that auditors are less likely to issue a going concern opinion when there is a non-GAAP earnings switch. However, this result disappears for manager-only non-GAAP switches, suggesting that auditors react skeptically to manager-reported non-GAAP switches unless confirmed by analysts. We also find that the weight auditors' place on non-GAAP switches in their going concern assessments is generally consistent with the weight implied by a bankruptcy prediction model. Overall, our evidence indicates that auditors incorporate credible signals of non-GAAP switches into their going-concern assessments.

Session 6.03: AUDIT QUALITY AND OFFICE GROWTH
DATE: SATURDAY, JANUARY 19, 2019
TIME: 4:00 PM–5:30 PM

Audit Office Growth: Examining the Determinants

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ABSTRACT: This study examines the determinants of audit office growth, and focuses on strategic client portfolio decisions made by offices. While auditors are clearly motivated to grow, prior studies have examined the consequences of that growth rather than the determinants. I find that a diversified client portfolio is associated with higher office growth, holding other city and office characteristics constant. Additional analysis suggest the growth is stemming from higher industry-specific growth in the industries of specialization. Therefore, the diversified strategy hinges on gaining a certain level of specialization in the industries served by the office. I show the effect of diversification on office growth is more pronounced in diversified and volatile cities, while the effect of specialization on industry-specific growth is more pronounced in regulated industries, and attenuated in innovative industries.

Session 6.03: AUDIT QUALITY AND OFFICE GROWTH
DATE: SATURDAY, JANUARY 19, 2019
TIME: 4:00 PM–5:30 PM

Stressed About Money: The Effect of Employee Financial Pressure on the Quality of Accounting Practices

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ABSTRACT: This study investigates the effect of employee financial pressure on work performance quality in accounting setting. Despite the prevalence of financial pressure and stress among employees, few studies attempt to analyze its implications on employee performance. Stress factors that cause anxiety results in emotional exhaustion and reduced job performance. The conservation of resources theory (COR; Hobfoll 1989) predicts that anxiety and financial stress decrease performance level of employees because anxiety drains individuals' physical, cognitive and psychological resources, which affects employees' work quality. Motivated by the conservation of resources theory, I expect that employee financial pressure negatively affects the quality of accounting practices. Consistent with this prediction, I determine that employee financial pressure is positively associated with material internal control weaknesses and restatements. The results are statistically and economically significant. The results continue to hold after addressing the managers' financial stress. I conduct additional analyses to address endogeneity issues using two-stage least squares regression and the inferences remain the same.

Session 6.03: AUDIT QUALITY AND OFFICE GROWTH
DATE: SATURDAY, JANUARY 19, 2019
TIME: 4:00 PM–5:30 PM

The Effects of Audit Market Concentration and Auditor Reputation on Audit Quality: Evidence from Government Auditors

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ABSTRACT: We investigate how a high degree of audit market concentration and auditor reputation affects audit quality. Using audit adjustments to student loan loss provisions in government audits to construct a new measure for excessive audit conservatism, we show that an audit market monopoly leads to excessively conservative audit adjustments to the provisions, and thus, to lower audit quality. We also examine the effect of a positive shock to auditor reputation on audit quality. We find that before the reputation increase, monopolistic auditors require more conservative, yet not excessively conservative adjustments than auditors in a competitive market. However, after the reputation increase, the adjustments become excessively conservative. This result suggests that the combination of enhanced audit market concentration and high auditor reputation leads to excessive auditor conservatism. Using a non-monopolistic setting, we also find that auditors with more market power are more likely to include explanatory language references in their audit report, even though these references do not contain incremental information. Thus, we are able to extend our findings to a competitive market. Our study has implications for the ongoing debate regarding the impact of reduced competition in the audit market and its effect on audit quality.

Session 6.04: EMERGING ISSUES IN AUDIT QUALITY
DATE: SATURDAY, JANUARY 19, 2019
TIME: 4:00 PM–5:30 PM

Coaching Today's Auditors: When Do Workpaper Reviewers Professionally Develop Their Preparers?

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ABSTRACT: Audit workpaper review is a quality control mechanism intended to detect preparer errors in the short-term and professionally develop preparers in the long-term. Currently, it is unclear as to what factors drive reviewers to professionally develop (or not develop) their preparers. Furthermore, whether error detection and professional development complement or compete during supervisory review is not known. As audit teams become more global, new contextual factors are introduced into the audit environment that may influence a supervisor's review quality. In this study, we investigate how the preparer's office location (local vs. international) and the likelihood of preparer recurrence affect the reviewer's propensity to focus on the professional development of the preparer. We find that reviewers identify more with preparers from their local (vs. international) office and, as a result, focus more on professionally developing local preparers. We also observe that, regardless of office affiliation, reviewers are more apt to coach preparers who are likely (vs. unlikely) to recur the next year because they anticipate reaping future personal benefits from recurring preparers. Finally, we find that reviewers who focus more on developing preparers are also more likely to detect errors in preparer audit documentation.

Session 6.04: EMERGING ISSUES IN AUDIT QUALITY
DATE: SATURDAY, JANUARY 19, 2019
TIME: 4:00 PM–5:30 PM

Management Perceptions of Audit Quality

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ABSTRACT: Audit quality is an important topic for auditors, regulators, and academics. We survey members of management to better understand their perspective on audit quality and how they view auditors' ability to demonstrate it on their engagements. Management's views on audit quality are important because of the key role they assume in coordinating audit engagements. They are also perceived as a critical voice in the hiring and firing of auditors; thus, auditors have incentives to understand how management evaluates their work. We find that management defines audit quality primarily through the characteristics of the auditor, the audit processes used on an engagement, and the outcomes of the audit. When asked how auditors demonstrate audit quality, however, management focuses predominately on auditor characteristics and processes, while largely ignoring the outcomes of the audit. In addition to surveying management about audit quality, we also obtain feedback on management's perceptions of the relevance of the CAQ's Audit Quality Indicators. Management perceives the indicators related to auditor characteristics and processes as most relevant to determining audit quality. Outcome measures, such as PCAOB inspection reports, are viewed as least informative.

Session 6.04: EMERGING ISSUES IN AUDIT QUALITY
DATE: SATURDAY, JANUARY 19, 2019
TIME: 4:00 PM–5:30 PM

The Impact of Firm Affiliation on Accountants' Error Reporting Decisions: An Experimental Investigation

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ABSTRACT: Recent regulatory and professional developments have increased the frequency with which public accountants work and interact with professionals from other accounting firms. Findings from archival studies in accounting indicate that when the same firm provides both audit and non-audit tax services, financial reporting outcomes are better than when different firms provide these services, which is attributed to knowledge spillover effects. We add to this literature and posit that in addition to intrafirm knowledge spillover, there may be interfirm rivalry effects when clients retain accountants from different firms to perform audit, tax, and/or consulting services, and we examine whether the communication decisions of professional accountants could be biased in a manner consistent with competition. We conduct two experiments in settings where professional services are commonly split among different firms: the provision of non-audit tax services and the completion of a group audit. We find that, when clients retain different accounting firms to perform professional services, accountants share or withhold information about possible financial statement errors in ways that protect their competitive advantage over rivals, although the specific effects differ between the audit and tax settings. Our results have important implications for financial reporting quality and provide new insights regarding the effects of interfirm collaboration.