

Auditing Section American Accounting Association

Contents of *Auditing - A Journal of Practice & Theory* Spring, 1996 Volume 15 - Number 1

(Click on the article to see the abstract)

MAIN ARTICLES

- [Escalation of Commitment Among Internal Auditors](#), Richard G. Brody and Steven E. Kaplan, pp.1-15
- [Experience and Auditor's Selection of Relevant Information for Preliminary Control Risk Assessments](#), Jefferson T. Davis, pp. 16-37
- [Procedural Fairness in the Peer and Quality Review Programs](#), Craig R. Ehlen and Robert B. Welker, pp. 38-52
- [The Impact of Competition within the Client's Industry on the Auditor Selection Decision](#), Soo Young Kwon, pp. 53-70
- [Audit Evidential Planning: An Examination of Industry Error Characteristics](#), Mario Maletta and Arnold Wright, pp. 71-86
- [Audit Committee Performance: An Investigation of the Consequences Associated with Audit Committees](#), Dorothy A. McMullen, pp. 87-103
- [Using Base Rate Frequency Perceptions to Diagnose Financial Statement Error Causes](#), Brad M. Tuttle, pp. 104-121

RESEARCH NOTES

- [The Effects of Group Support System Technology on Audit Group Decision Making](#), E. Michael Bamber, Richard T. Watson and Mary Callahan Hill, pp. 122-134
- [An Investigation of Accounts Receivable Confirmation Response Timing](#), Paul Caster and Ram S. Sriram, pp. 135-141
- [Audit Quality and Professional Self-Regulation](#), Julia Grant, Robert Bricker and Rimma Shiptsova, pp. 142-156

Abstract of
Escalation of Commitment Among Internal Auditors
by
Richard G. Brody and Steven E. Kaplan

Standards for the professional practice of internal auditing require objectivity (Institute of Internal Auditors (IIA) 1978). The motivation for the current study is to provide evidence on whether internal auditors' objectivity may be impaired due to the sequential nature of internal audit tasks. Research in psychology demonstrates that personal involvement will be elevated when an individual makes multiple decisions as part of a sequential task and that personal involvement fosters an escalation of commitment to a chosen course of action (Brockner 1992).

This paper reports the results of an experiment examining practicing internal auditors' escalation tendencies. In the context of a budgeting decision associated with an acquisition audit, the number of decisions (e.g., one or two) each subject made was used to manipulate the level of responsibility. The results show that internal auditors who had made an initial and then a final decision engaged in escalation behavior such that they tended not to change their initial decision, and that their final decision was different from a group who only made a final decision. An examination of internal auditors' recalls revealed no significant association between level of responsibility and recall of facts. Internal auditors, however, were found to recall negative facts better than positive facts, independent of level of responsibility.

Key Words: Internal auditors, Escalation, Responsibility, Budgeting.

Data Availability: Data is available from the first author

Abstract of
**Experience and Auditors' Selection of Relevant
Information for Preliminary Control Risk Assessments**
by
Jefferson T. Davis

The ability to recognize and select relevant information (cue selection) in a complex judgment process is a hallmark of superior performance achieved by experienced decision makers. This study examines whether experience influences auditors' approaches to selecting relevant information and whether selection of more relevant information leads to improved judgment performance for preliminary control risk assessments (CRAs). The study emphasizes situational knowledge gained from experience by comparing new audit seniors and experienced audit seniors from a non Big 6 auditing firm. The auditors each made use of their firm's internal control evaluation software as a decision aid. The decision aid was used to enhance external validity and largely control for differences in conceptual (deductively-based knowledge that is usually obtained in ways other than task specific experience such as instruction and consulting a decision aid).

A neural network-based model for predicting auditors' preliminary CRAs was developed that included auditors' selection of relevant information as an integral component of the global judgment process. The model provided a means of measuring auditors' selective attention to relevant internal control (IC) information. Number of relevant cues selected, judgment time and judgment accuracy were also measured.

The results show that in comparison with new senior auditors, experienced senior auditors exhibited a higher level of selective attention to relevant information. Experienced seniors also exhibited more consistency between the selected relevant information and the CRA response, selected fewer cues, and made their judgments in less time than new senior auditors. These results are consistent with a top-down approach to making CRAs. However, experience did not improve judgment accuracy since both groups were equally conservative in relation to the firm's suggested solution. This judgment response result may be due to experienced seniors' tendency not to rely on controls nor audit through the computer, while the new seniors tended toward over auditing.

Abstract of
Procedural Fairness in the Peer and Quality Review Programs
by
Craig R. Ehlen and Robert B. Welker

The adoption of mandatory practice-monitoring represents an AICPA policy decision that was unpopular with some of its members. The use of fair decision-making procedures may be one way to mitigate the adverse effects of such decisions.

This study examined whether the fairness of decision-making procedures relating to practice-monitoring affects reviewees' commitment to the AICPA or their trust in reviewers. Correlation techniques (LISREL) were applied to questionnaire data from 560 firms subject to either a peer or quality review.

Procedural fairness was associated with both commitment to the AICPA and trust in the reviewer, which suggests that members' sentiments would improve if the AICPA and reviewers adopt a fairer process of decision making. This might be accomplished by adopting procedures that give those most affected by the decisions greater opportunity to express their opinions and concerns to decision makers.

Key Words: Procedural fairness, Practice-monitoring, Peer review, Auditing

Data Availability: Contact the first author.

Abstract of
**The Impact of Competition within the Client's
Industry on the Auditor Selection Decision**
by
SooYoung Kwon

The objective of this study is to examine the effect of the degree of competition within the client industry on the choices of audit firms operating within that same industry. This study considers the demand-side dimension (the client's demand for audit firms different from competitors' audit firms) to understand the nature of competition in the audit industry.

When client firms desire audit firms not associated with competitors, there is a derived demand for selecting audit firms unengaged in the client's or potential client's industry. As the degree of concentration in an industry increases, surviving client firms in that industry will be reluctant to use the same auditors because they do not want to risk the transfer of proprietary information to their competitors.

Under this perspective, the industry structure of clients is likely to affect the structure of audit firms serving the clients in the industry. The results show that as the client industry is more (less) concentrated, the clients' preference to use audit firms different from those of competitors increases (decreases), reducing (increasing) the likelihood that one or few audit firms will dominate the servicing of client firms in the industry.

Key Words: Separation index of audit firms, Industry specialization, Degree of client competition, Auditor selection decisions

Data Availability: The data will be made available upon request to the author.

Abstract of
Audit Evidence Planning: An Examination of Industry Error Characteristics
by
Mario Maletta and Arnold Wright

The importance of industry considerations in the audit process is reflected in both the professional standards and the industry specialization of audit firms. Yet, relatively little research has investigated industry differences in the nature and detection of financial statement errors, despite the fact that a wealth of industry information is contained in audit workpapers. The purpose of this study is to investigate differences in the incidence, magnitude, income effect, cause and method of detection of large, financial statement errors across a broad base of industries utilizing actual audit workpaper information. In addition to providing detailed analyses in each of these areas, the study also identifies and tests several broad propositions concerning the role of regulation on industry error characteristics. The examination is based on a sample of 368 actual audit adjustments across 171 engagements in six industries.

The results indicate significant industry differences in financial statement error incidence, magnitude, income effect, cause and method of detection. The results also reveal that the companies in regulated industries had a lower incidence of error, fewer routine errors and more errors detected using audit procedures based upon internal vs. external evidence than those companies in non-regulated industries.

In summary, the study provides insights concerning industry differences in financial statement error characteristics which have implications for audit risk assessment and the determination of appropriate audit strategies. For example, the fact that regulated companies were found to have a smaller percentage of routine errors suggests that a greater emphasis on judgment issues and unusual transactions may be suitable for regulated companies. Finally, the findings also contribute to the development of industry error databases and, through the testing of propositions, provide an initial step for future research to build upon in developing theoretical models of industry error characteristics. Ultimately, continued research in this area has the potential to lead to more efficient and effective auditing.

Key Words: Financial statement errors, Industry differences, Error incidence, Error detection, Error cause.

Data Availability: Data used in this study are available upon request from the authors.

Abstract of
**Audit Committee Performance: An Investigation of
the Consequences Associated with Audit Committees**
by
Dorothy Ann McMullen

Audit committees have become a major means for companies to monitor the reliability of the financial reporting process. Despite the increase in support and responsibilities of audit committees, there is little empirical evidence documenting how well they accomplish their objectives. The results of studies that examined differences between companies with and without audit committees have been inconclusive, suggesting the need for additional research. This study provides evidence concerning whether audit committees are associated with a reduced incidence of errors, irregularities and other indicators of unreliable financial reporting.

To determine if the presence of an audit committee is associated with financial reporting reliability, five potential consequences of audit committees are identified, involving the occurrence of errors, irregularities and illegal acts. This study uses the following variables as measures of these consequences: shareholder litigation alleging management fraud, quarterly earnings restatements, SEC

actions, illegal acts, and auditor turnover involving an accounting disagreement. Five separate treatment samples are compared to randomly selected control samples.

Results of random approximation tests support the association between the presence of an audit committee and more reliable financial reporting. For all five financial reporting consequences, the audit committee variable is significant, even in the presence of other company-specific variables that could affect the quality of financial reporting. These results provide evidence that firms with reliable financial reporting (i.e., the absence of errors, irregularities and illegal acts) are more likely to have audit committees. These results have implications for regulators, such as the Securities and Exchange Commission (SEC) and the various stock exchanges, as they attempt to formulate future corporate governance policy.

Key Words: Audit committees, Financial reporting problems

Data Availability: Data used in the study are available upon request.

Abstract of
**Using Base Rate Frequency Perceptions to
Diagnose Financial Statement Error Causes**
by
Brad M. Tuttle

There are many situations during diagnostic reasoning in the audit process in which it is more appropriate to consider frequency information related to narrow subpopulations of errors rather than more general base rates. In terms of this paper, a population refers to errors encountered with a particular type of client (i.e., manufacturing) and subpopulation refers to a subset of the population. This study investigates whether auditors use frequency perceptions appropriate to the relevant subpopulation of errors when diagnosing financial statement errors.

Auditors evaluated a common list of financial statement errors in the presence or absence of account fluctuations. In the absence of an account fluctuation, perceived population base rates influence how typical the subjects viewed the errors. When the errors were considered in relation to unexpected account fluctuations, the evaluations were influenced by base rate perceptions associated with the subpopulation of errors that are consistent with the fluctuations. Moreover, in the presence of an account fluctuation, subsequent recall of the errors was positively related to their perceived subpopulation base rate rather than their perceived population base rate. These results have implications to both researchers and practitioners. They support the premise that auditors use subpopulation frequency perceptions in specific circumstances, rather than more general population base rate perceptions.

Key Words: Error frequency, Base rates, Auditor diagnosis

Data Availability: Contact the author.

Abstract of
**The Effects of Group Support System Technology
on Audit Group Decision Making**
by

E. Michael Bamber, Richard T. Watson, and Mary Callahan Hill

The purpose of a Group Support System (GSS) is to facilitate group decision making and to share information and expertise within a group. In an experimental setting, 24 four-person groups of practicing auditors were used to examine a GSS's potential to improve audit decision making. The experiment confirms that group decision making increases consensus and leads to a more complete problem-analysis. Moreover, the results suggest that a GSS maintains the benefits of group decision making over individual decision making. In addition, compared to face-to-face (traditional) groups, GSS groups undertook a more thorough analysis of the problem and GSS group members exhibited a higher acceptance of the group decision. The results support the auditing potential of GSSs and provide some tentative insights for when and how a GSS could be employed in auditing.

Key Words: Multi-auditor decision making, Group Support System, Consensus, Disclosure decision.

Data Availability: Data used in this study are available upon request.

Abstract of
An Investigation of Accounts Receivable Confirmation Response Timing
by
Paul Caster and Ram S. Sriram

Auditors routinely mail first and second accounts receivable confirmation requests and they use second request evidence in the same manner as first request evidence no real distinction is made regarding the timing of responses. Yet survey literature suggests that response timing patterns may exist that can be exploited to extract additional information from existing evidence. Is it appropriate for auditors to assume that confirmees who respond quickly (e.g., to first requests) are basically similar to those who respond more slowly (e.g., to second requests)? Or, is it possible that auditors may improve the efficiency and effectiveness of the confirmation procedure by separately analyzing responses to first requests compared to responses to second requests?

Data from a previously performed confirmation reliability field experiment were reexamined to determine if any response timing pattern is present. The results of this analysis found that transaction volume was related to the timing of response in the direction expected, i.e., higher transaction volume increases response time. However, the presence of errors, error size and error direction did not impact response timing. A relationship with any of the latter three variables would have suggested that separate analysis of first request and second request responses is more appropriate.

In addition, analysis of quick, but inaccurate replies revealed new information about confirmee behavior in processing auditors' requests for confirmation of accounts receivable. Prior confirmation studies assumed that most inaccurate replies resulted from confirmees simply signing and confirming account balances without checking their corresponding accounts payable files. However, the non-random pattern of errors indicates a different explanation for inaccurate replies. Apparently, confirmees perform some level of investigation, but they are more inclined to confirm as correct balances that contain small, understatement errors than any other types of errors.

Key Words: Auditing, Accounts receivable, Confirmation, Evidence, Missing data, Nonresponse, Response bias, Response timing

Data Availability: Partial data from the experiment is available from the first author, but the complete data set is not available due to a confidentiality agreement.

Abstract of
Audit Quality and Professional Self-Regulation: A Social Dilemma Perspective and Laboratory Investigation
by
Julia Grant, Robert Bricker and Rimma Shiptsova

While the concept of audit quality is broad, it can ultimately be defined in terms of the probability that material financial misstatement, if it exists, will be identified and, if necessary, reported by the audit firm. Consideration of audit quality raises questions about effective and efficient ways to obtain beneficial levels of audit quality, including possible roles for various regulatory regimes.

This paper models auditing as a multiperson social dilemma, in which the fees earned by auditors depend on the audit quality provided by all auditors in prior periods. In this setting, firms can signal quality only as a member of a group. The defining characteristic of the social dilemma is that audit firms are best off in a single period by providing a low-quality audit, but all firms are best off in a multiperiod setting when all provide high quality audits.

A series of laboratory experiments is conducted to gather data on multiperiod cooperative decisions in settings without regulation and with professional self-regulation. The data analysis demonstrates the difficulty of obtaining a high level of audit quality without a regime of voluntary self-regulation. Low-quality auditing dominates in an unregulated laboratory setting, while availability of a self-regulatory coalition effectively raises both average quality level and the consistency with which high-quality auditing is provided.

These results strongly support one role for professional organizations such as the Securities Exchange Commission Practice Section and the AICPA. Such organizations can improve the quality of auditing when there exist effective, quality ensuring mechanisms such as fines and sanctioning powers.

Key Words: Audit quality, Professional self-regulation, Social dilemma

Data Availability: Detailed experimental results are available from the authors.



Return to [Journals and Newsletters](#) or [Auditing Section Home Page](#)



[E-mail The Webmaster](#)

UPDATED *October 23, 1998*