



**American
Accounting
Association**

THE AUDITOR'S REPORT

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AUDITING SECTION / AMERICAN ACCOUNTING ASSOCIATION

Have you Seen... ?

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"The effects of organizational fairness and commitment on the extent of benefits Big Four alumni provide their former firm" By D. N. Herda and J. J. Lavelle. *Accounting, Organizations and Society* 2011 36: 156-166.

This paper uses social exchange theory to explore why some Big 4 alumni choose to support their former firm more than others. The authors survey 1154 former employees of Big 4 accounting firms and find that post-employment citizenship is driven by a continuing social exchange relationship and that this relationship partially mediates the effect of organizational fairness on post-employment citizenship. The authors conclude that fair treatment of employees and the resulting social exchange relationship developed with the organization during employment can continue to accrue benefits to the organization post-employment. They recommend that audit firms should evaluate and monitor the perceived fairness of their organizational practices such as mentoring, goal-setting, training, scheduling, and performance evaluation so that they can reap benefits both from those currently employed with the firm and from those who have left the firm as well.

"Exploring the role of country and client type on the auditor's client risk assessments and audit planning decisions" By M. De Martinis, H. Fukukawa, and T. J. Mock. *Managerial Auditing Journal* 2011 26:(7) 543-565.

This study uses proprietary data collected from audit engagement working papers of Australian public sector clients and Japanese private sector clients to examine whether country and client type affect auditor's client risk assessments, subsequent audit planning decisions, and audit planning responsiveness to client risk assessments. Findings indicate that country and client type do impact risk assessments and planned total audit hours, but they do not moderate audit planning responsiveness to client risk assessments. The authors acknowledge that a limitation of their study is the confounding of country and client type and call for future research to better distinguish the cause of observed differences in risk assessments and audit planning decisions.

"The impact of E-Business on the audit process: An investigation of the

factors leading to change" By A. Kotb and C. Roberts. *International Journal of Auditing* 2011 15: 150-175.

This study uses semi-structured interviews and a survey to explore audit implications for electronic business (e-business) entities. The respondents, which include both financial and IT auditors, perceive that e-business affects auditors' reliance on IT controls (e.g., firewalls, encryption), uncertainty (e.g., loss of paper trail, invisibility of data flow), use of real-time information systems (e.g., web-based integrated systems) and security (e.g., web-based systems may be accessible to the public). The authors conclude that while the basic principles and essential practices underlying the financial audit of an e-business entity are no different than those applying to other business types, the financial model may need to be adapted to incorporate the unique features of e-business. The authors call for future research exploring the technology-centric nature of e-business and how it changes a company's risk profile, the process of adopting new knowledge and skills in an e-business environment, and the extent to which e-business is adequately covered in university and professional education.

"The effect of SOX on small auditor exits and audit quality" By DeFond, Mark L. and Clive S. Lennox. *Journal of Accounting and Economics* 2011 (Volume 52, Issue 1): 21-40.

The authors find that over six hundred audit firms with fewer than 100 SEC clients exit the market following passage of SOX. The exiting auditors are lower quality compared to the non-exiting auditors. Furthermore, clients of existing auditors receive higher quality auditing from successor auditors, as reflected by a greater likelihood of receiving going concern opinions. These findings imply that the PCAOB inspections improve audit quality by incentivizing low quality auditors to exit the market.

"Voluntary audits and the cost of debt capital for privately held firms: Korean Evidence" By Kim, Jeong-Bon, Dan A. Simunic, Micahel T. Stein and Cheong H. Yi. *Contemporary Accounting Research* 2011 (Volume 28, Issue 2): 585-615.

Using a sample of privately held companies in Korea with either no audit or voluntary audits, the authors find compared with private companies that do not purchase audit, interest cost savings at private companies with voluntary audits range from about 56 to 124 basis points. However, there is no significant difference in interest cost savings between Big 4 and non-Big 4 audits. Further, a first-time audit status change from no audit to voluntary audits leads to a greater reduction in cost of debt than a first-time audit status change from no audit to mandatory audits, implying that voluntary audits enhances the credibility of financial statements more than mandatory audits.

"Did the Waste Management audit failures signal lower firm-wise audit quality at Arthur Andersen?" By Cahan, Steven, Wei Zhang and David Veenman. *Contemporary Accounting Research* 2011 (Volume 28, Issue 3): 859-891.

This paper examines Arthur Andersen's audit quality in the 10 years before the collapse of Enron. Using three empirical measures of audit quality, the authors find no overall evidence suggesting that Andersen's audit quality was lower relative to the Big 4 in the pre-Enron

period. However, among high litigation risk clients, Andersen clients had larger absolute and positive discretionary accruals and were more likely to meet or just beat analysts' earnings forecasts than Big 4 clients in the period after the spin-off of Andersen consulting from Andersen. These results imply that the greater pressure on selling consulting services or cutting costs may have caused lower audit quality at Andersen in the aftermath of Andersen Consulting's departure.



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Have You Seen These Instructional Resources?

By the 2011-2012 Education Committee
of the Auditing Section of the AAA

Jason MacGregor, Chair – Baylor University
Rick Lillie, Vice-Chair – California State University Santa Bernardino
Allen Blay- Florida State University
Karen Hooks – Florida Atlantic University
Michael Shaub – Texas A&M University

A Comparison of U.S. Auditing Standards with International Standards on Auditing, *CPA Journal* April 2011

Provides information on the five principle areas of difference in US GAAS, PCOAB AS and IAASB ISAs. Available from the *CPA Journal*.

Ethics Toolkit, Ethics Resource Center

Collection of useful ethics tools. Available online at <http://www.ethics.org/page/ethics-toolkit>.

Concept Release on Auditor Independence and Audit Firm Rotation, PCAOB, August 2011

Concept release seeking input on independence issues, including audit firm rotation.

Available online at http://pcaobus.org/Rules/Rulemaking/Docket037/Release_2011-006.pdf

Britain's Auditing Oligopoly: The 48-Year Itch, *The Economist*, May 2011

Article regarding the Office of Fair Trading's investigation of the competitiveness of the British audit oligopoly. Available online at http://www.economist.com/blogs/schumpeter/2011/05/britains_auditing_oligopoly.

Hooplah, Inc.: Applying Audit Sampling Concepts to Tests of Controls and Substantive Testing in the Revenue Cycle, in Beasley, et al., *Auditing Cases: An Interactive Learning Approach*, 5th ed. Available from Pearson.

New to the 5th edition of this widely used case book is a comprehensive and challenging audit sampling case that requires students to apply both statistical techniques as well as judgment. The case is divided into two parts that can be used separately in discussions of Tests of Controls and Substantive Testing of Accounts Receivables.

The Central Florida Emphysema Foundation Audit: A Case Study of Personal and Professional Responsibility published in *Issues in Accounting Education* Notes 26 (2), 71 (2011)

This case study is a practical exercise based on a real-world experience and is designed to elicit open class discussion on a variety of topics, including the following: Auditing procedures and fact finding, technical treatment of an accounting issue, professional judgment and decision-making, professional ethics and integrity, management of an audit engagement/practice management, and self-reliance and perseverance.

Care for Kids, Inc. Deloitte Trueblood Case Series 10-6

This very short case that is suitable for an in-class example addresses the common, but less regularly seen in cases, situation of a specific control weakness that is greater than unimportant, but less than material. The case requires students to classify the control weakness in an AS5 framework and leads to a lively class discussion about the different classifications of control weaknesses and the sufficiency of limited evidence. Available at http://www.deloitte.com/view/en_US/us/About/university-relations/Deloitte-Foundation/0ac1264f0b0fb110VgnVCM100000ba42f00aRCRD.htm

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