

Abstracts

SESSION 1.01: REGULATION AND AUDITING

DATE: FRIDAY, JANUARY 17, 2020

TIME: 10:15 AM–11:45 AM

Does Auditor Involvement Expedite SEC Comment Letter Resolution?

Ryan Ballester

The University of Texas at Austin

Jaime J. Schmidt

The University of Texas at Austin

ABSTRACT: The remediation of Securities and Exchange Commission (SEC) comment letters can impose significant costs on companies. This study examines whether auditor involvement in the SEC comment letter process expedites comment letter resolution. Such a finding would indicate that auditors add value outside of the annual financial statement audit. We measure auditor involvement by identifying whether the audit partner is copied on SEC correspondence, and validate such auditor involvement by showing that audit fees are higher when a partner is copied. First, we document that auditor involvement is more likely when the SEC's comment letter relates to one or more accounting issues and when the audit partner has industry expertise. Then, we show that comment letters that copy the partner, especially a partner with greater experience, have reduced time to resolution. In particular, we show that copying the audit partner reduces the amount of time it takes the company to respond to a SEC comment letter and copying more experienced partners is associated with clearer responses to the SEC and shorter times to reach full resolution. We find no evidence that auditor reputation (e.g., partner titles or working in a firm's national office) affects the likelihood of a company to copy the partner or the likelihood that the SEC will perceive the company's response more favorably. Thus, our findings appear driven by actual rather than perceived auditor value.

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Abstracts

SESSION 1.01: REGULATION AND AUDITING

DATE: FRIDAY, JANUARY 17, 2020

TIME: 10:15 AM–11:45 AM

The Effect of Enforcement on Auditor Conservatism

Mareike Peters-Olbrich

University of Cologne

Selina Orthaus

University of Cologne

ABSTRACT: This paper sheds light on the effect of enforcement on auditor behavior and overall financial reporting quality. Our theoretical model includes a manager with manipulation incentives, an auditor examining the manager's report and an enforcer who publicly announces reporting breaches revealing both, misconduct by the manager and audit failures. As audit evidence might be insufficient the auditor has to choose either a liberal or a conservative strategy towards uncertainty. We find that if enforcement is relatively weak, the auditor is liberal and a further tightening of enforcement increases overall financial reporting quality. In contrast, if enforcement is relatively strict the auditor becomes conservative. Given a conservative auditor, we provide conditions under which stricter enforcement can decrease financial reporting quality even though earnings manipulation by the manager is prevented as auditor conservatism introduces a systematic downward bias into financial reporting.

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SESSION 1.01: REGULATION AND AUDITING

DATE: FRIDAY, JANUARY 17, 2020

TIME: 10:15 AM–11:45 AM

Principles-Based Accounting Standards and Regulatory Enforcement

Mark Paul Kim

University of California, Los Angeles

ABSTRACT: Practitioners claim that rules-based accounting standards provide a safe harbor shield against enforcement risk. In contrast, regulators suggest that principles-based reporting norms better protect preparers and auditors from undue enforcement threat due to its emphasis on substance over form (SEC 2003). I add to this debate by studying a proprietary dataset on accounting inspections from South Korea in conjunction with their mandated adoption of IFRS reporting in 2011. A temporal analysis of this dataset, which archives annual investigative details and enforcement actions relating to accounting allegations, suggests that a shift to a more principles-based regime is associated with (1) increased detection rates of GAAP violations per investigation, (2) larger share price discounts incurred by misreporting firms, and (3) greater declines in their perceived earnings quality. These results are policy relevant in light of the FASB's and IASB's joint proposal advocating a more principles-based approach to standard setting (FASB 2002, 2010).

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Abstracts

SESSION 1.02: AUDIT COMMITTEES

DATE: FRIDAY, JANUARY 17, 2020

TIME: 10:15 AM–11:45 AM

Audit Committee Disclosure of Auditor Reappointment Factors: Vigilant Monitoring or Window Dressing

Herita Akamah

University of Nebraska

Bright Asante-Appiah

Lehigh University

ABSTRACT: Audit committees are responsible for initial and subsequent appointment of the external auditor but are not required to disclose reasons for their choice of the auditor. Investors have raised concerns about the lack of audit committee transparency, particularly considering longer auditor tenure in U.S public companies. In recent years, some firms are voluntarily disclosing factors the audit committee considers when reappointing the external auditor. We investigate whether these disclosures are mere representations of favorable impressions or depict audit committees' vigilant monitoring of the auditor. First, we find that the likelihood of disclosure increases with higher perceived impaired auditor independence, investor activism pressure on the board of directors, and audit committee quality. Next, we find that these disclosures negatively moderate the positive association between egregious financial restatements and audit committee member turnover. Finally, we find that the disclosures decrease the likelihood that the financial statements the auditor is reappointed to audit will be restated in future periods. Our results are robust to several additional analyses, including controlling for endogeneity using propensity-score matching and instrumentation. The evidence is relevant to various stakeholders including the SEC, investors and others interested in audit committee transparency. We provide evidence that although some firms voluntarily disclose auditor reappointment factors to create favorable impressions, overall, these disclosures are more indicative of audit committee substantive monitoring of the external auditor. These findings should be relevant to the SEC that has proposed mandating these disclosures.

Abstracts

SESSION 1.02: AUDIT COMMITTEES

DATE: FRIDAY, JANUARY 17, 2020

TIME: 10:15 AM–11:45 AM

Audit Committee Chair Succession and Financial Reporting Quality

Linda A. Myers

The University of Tennessee

Roy Schmardebeck

The University of Tennessee

Stefan Slavov

The University of Tennessee

ABSTRACT: In this study, we investigate whether audit committee (AC) chair succession and firm-specific experience impact financial reporting quality. We find that firms are less likely to misstate their financial statements when AC chairs are in the first three years of their tenure, suggesting that AC chair renewal is associated with an increase in monitoring. Importantly, we find that this effect is limited to AC chairs who serve on the board prior to assuming the AC chair role. This suggests that AC chair firm-specific experience is an important determinant of AC monitoring. In additional analyses, we find that AC chairs with short or long prior board service improve financial reporting quality relative to AC chairs without board service during the succession period. This supports the view that board service prior to AC chair service is beneficial, however results suggest that lengthy board service is not more beneficial than short board service. These findings should be of interest to boards of directors, external auditors, and other parties interested in corporate governance because they provide new evidence on the characteristics of AC chairs that result in improved financial reporting quality.

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Abstracts

SESSION 1.02: AUDIT COMMITTEES

DATE: FRIDAY, JANUARY 17, 2020

TIME: 10:15 AM–11:45 AM

When Does the Internal Audit Function Enhance Audit Committee Effectiveness?

Jacob Jaggi

The University of Arizona

ABSTRACT: I examine how the audit committee (AC) improves financial reporting reliability by utilizing the internal audit function (IAF) as a resource. By exploiting data in AC charters, I construct novel measures of how and the extent to which ACs utilize IAFs. I first document an improvement in financial reporting reliability (fewer restatements) for firms that introduce an IAF under a NYSE mandate. This reporting improvement is concentrated among firms with ACs that utilize the new IAF significantly. Next, using more precise, hand-coded measures of IAF utilization, I show that the value of the IAF as a resource to the AC increases when (1) the AC meets privately with the IAF to discuss the activities of the IAF and relevant internal audit findings and ensures open communication between them, (2) the AC promotes the independence of the IAF, and (3) AC members are stretched thin with multiple board positions. Finally, I document an economic benefit to utilizing the IAF as a resource in the form of lower loan spreads.

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Abstracts

SESSION 1.03: AUDIT MARKETS 1

DATE: FRIDAY, JANUARY 17, 2020

TIME: 10:15 AM–11:45 AM

Audit Market Competition and Client Portfolio Risk

Daun Jang

California State University, Sacramento

Thomas C. Omer

University of Nebraska–Lincoln

ABSTRACT: This study investigates whether audit market competition influences the risk profile of audit offices' client portfolios and whether an audit office's client risk profile affects the association between audit market competition and audit quality. Economic theory suggests that market competition can affect a company's risk-taking, but there is limited evidence on how audit market competition affects audit offices' client portfolio composition. Two streams of prior research have documented that auditors make portfolio management decisions based on risk avoidance, and that audit market competition affects audit quality, although the results are mixed. We suggest that audit market competition influences audit offices' acceptance of risky clients by reducing the set of available acceptable clients. The increased riskiness of audit offices' client portfolio, in turn, affects audit quality provided by the audit office. We find that audit market competition at both the MSA and MSA-industry levels increases the riskiness of audit offices' client portfolios. Furthermore, results suggest that audit market competition through increases in the audit office's client portfolio risk explains a significant amount of the total effect of audit market competition on audit quality. This study contributes to the prior literature examining how audit offices manage their client portfolio risk and how audit market competition affects that ability and ultimately affects audit quality.

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Abstracts

SESSION 1.03: AUDIT MARKETS 1

DATE: FRIDAY, JANUARY 17, 2020

TIME: 10:15 AM–11:45 AM

The Effects of Demand Uncertainty on the Production of Audit Services

Douglas Ayres

Butler University

Tyler Kleppe

University of Arkansas

Jonathan Shipman

University of Arkansas

Jason W. Stanfield

Ball State University

ABSTRACT: Economic theory suggests that demand uncertainty should influence producer behavior. In this study, we empirically examine the impact that demand uncertainty has on the production of audit services. Auditors must make resource allocation decisions in advance of exact demand being known. Because a large portion of an auditor's capacity-related commitments are fixed and therefore difficult to adjust in the short run, any variability in client demand outcomes likely imposes significant risk on auditors. Our results indicate that both audit price and audit production delay are positively related to a client's uncertainty in demand for audit services. We also find that price and production delay act as substitute mechanisms used to alleviate the pressure that demand uncertainty imposes on auditors. Our study contributes to the growing literature on the underlying economics of the audit market and answers recent calls for analysis of demand-side factors that influence the audit industry.

Abstracts

SESSION 1.03: AUDIT MARKETS 1

DATE: FRIDAY, JANUARY 17, 2020

TIME: 10:15 AM–11:45 AM

Can Audit Industry Market Share be Bought?

Paul Mason

Baylor University

Steve Utke

University of Connecticut

ABSTRACT: Most prior literature assumes that auditors gain market share by developing industry specialization which then attracts new clients. However, recent literature suggests that auditors fall backwards into specialization after serving large industry clients over time. One way an auditor can actively gain industry market share is by acquiring a specialized competitor. Using a unique setting where an auditor acquires a competitor specifically to gain market share, we evaluate the consequences of the acquisition to gain insight into the dynamics of audit industry market share and specialization. Overall, we find little evidence that purchasing a competitor is a successful method for gaining market share. Our results show the number of clients switching to the acquiring auditor increases following the merger, however we find that this is more than offset by an increase in the number of clients switching from the acquiring auditor. Additional analyses show that a poor fit between the acquiring (large) auditor and the acquired clients leads to the loss of many (small) acquired clients. Our study casts further doubt on the likelihood that auditors intentionally develop or obtain industry specialization which then attracts clients, and suggests that even a major purchase of a specialized competitor provides limited benefits for the acquiring auditor's market share or industry specialization.

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Abstracts

SESSION 1.04: RISK ASSESSMENT AND PLANNING JUDGMENTS

DATE: FRIDAY, JANUARY 17, 2020

TIME: 10:15 AM–11:45 AM

The Joint Effects of Rich Data Visualization and Analytical Procedure Categorization on Auditor Judgment

Spencer Anderson

University of Illinois

Jessen L. Hobson

University of Illinois at Urbana-Champaign

Mark Peecher

University of Illinois at Urbana-Champaign

ABSTRACT: We examine how the mere categorization of audit procedures as either risk assessment or substantive analytical procedures influences how auditors interpret and develop audit responses and how more versus less rich data visualization exacerbates this categorization effect. Results from an experiment using audit seniors show that richer data visualization exacerbates the effects of audit procedure categorization in auditors' judgments and decisions. Auditors are more likely to identify client data outliers as high risk when data visualization is more rich, but only when prior audit procedures performed were categorized as risk assessment rather than substantive analytical procedures. Greater data visualization richness also increased (decreased) the specificity and comprehensiveness of auditors' prescribed future tests when the evidence they viewed was categorized as risk assessment (substantive analytical) procedures. Follow-up responses support the notion that auditors view prior audit evidence gathered as more persuasive and sufficient when categorized as substantive analytical procedures and view evidence categorized as risk assessment procedures as more preliminary. We conclude that richer data visualizations in audit procedures can help auditors find data abnormalities and free up mental capacity to consider other information, but that the outcome of this effect on auditor decision processes is conditioned on procedure categorizations.

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Abstracts

SESSION 1.04: RISK ASSESSMENT AND PLANNING JUDGMENTS

DATE: FRIDAY, JANUARY 17, 2020

TIME: 10:15 AM–11:45 AM

The Impact of Ego Depletion and Trait Skepticism on Auditor Decision-Making in a High Accountability Environment

Amy Donnelly
Clemson University

Steve Kaplan
Arizona State University

Jeremy Vinson
Clemson University

ABSTRACT: Recent research finds that ego depletion damages auditor performance (Bhaskar et al. 2016; Hurley 2017; Hurley 2019; Kremin 2014; Mullis and Hatfield 2018). However, prior experimental research on ego depletion has been set in low accountability environments. This is important as Hurley (2015) notes that motivation can counteract the effect of depletion on auditors' judgments and decision-making. We contend that accountability acts as a motivator, altering whether and how depletion impacts auditors' judgments. Specifically, we hypothesize that trait skepticism will be associated with audit judgment when not depleted, but that trait skepticism will not be associated with audit judgment when depleted. Instead, when depleted, we expect audit judgments will be more conservative in an attempt to conform to the presumed views of reviewers. We test our hypothesis with an experiment involving a risk assessment task. Results from the experiment support our hypothesis and provide new insight into whether depletion alters auditor judgments and suggest that depletion does not necessarily damage auditor performance.

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SESSION 1.04: RISK ASSESSMENT AND PLANNING JUDGMENTS

DATE: FRIDAY, JANUARY 17, 2020

TIME: 10:15 AM–11:45 AM

The Impact of Inspection Risk on Audit Effectiveness and Efficiency

Dominic Detzen

Vrije Universiteit Amsterdam

Anna Gold

Vrije Universiteit Amsterdam

Arnold Wright

Northeastern University

ABSTRACT: The auditing profession is heavily regulated. A significant element of this regulation is inspections by oversight bodies where deficiencies in audit work are publicly reported. Recent research suggests inspections may lead to unintended consequences such as excessive documentation, a checklist approach, and over-auditing. By controlling the level of misstatement risks, the purpose of this study is to provide direct evidence on the impact of inspection risks on audit effectiveness and efficiency. We also examine auditor responsiveness to elevated misstatement risks subsequently identified in fieldwork testing. The research design is a 2 (high inspection risk versus low inspection risk) x 2 (low misstatement risk versus high misstatement risk) experiment, where inspection risk (misstatement risk) is manipulated between subjects (within-subjects). One hundred seventy five (175) experienced auditors participated. As hypothesized, the findings indicate that in response to higher inspection risk auditors increase audit hours, and to avoid exceeding the time budget they correspondingly assign fewer audit hours to accounts with lower inspection risk. The latter action can reduce audit quality since despite lower inspection risk the underlying misstatement risks remain. Also, participants allocate fewer additional hours to the account with increased misstatement risk revealed by fieldwork tests the more hours they initially planned for the high inspection risk account. Supplemental analysis indicates that participants with prior inspection experience are prone to decreased responsiveness as a result of inspection risks. In all, our findings suggest inspection risks potentially harm audit efficiency and effectiveness.

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Abstracts

SESSION 1.05: UNDERSTANDING THE CLIENT: CONTROLS AND INFORMATION ENVIRONMENT

DATE: FRIDAY, JANUARY 17, 2020

TIME: 10:15 AM–11:45 AM

Lost in Translation? An Exploratory Analysis of Auditors' Perceptions of the Firms' Tone at the Top

Veena Looknanan Brown
University of Wisconsin–Milwaukee

Christine Earley
Providence College

Kerri-Ann Sanderson
Bentley University

ABSTRACT: This study examines public accounting firms' "tone at the top" with respect to audit quality initiatives from the perspectives of both firm leaders (those who set the tone) and engagement level auditors. Our primary objective is to investigate whether, and to what extent, the tone at the top from leadership regarding audit quality is internalized by engagement auditors as it filters through the firm and the effectiveness of tone at the top communication in conveying the tone throughout the organization. Specifically, we (1) solicit the perceptions of audit firm culture and leadership from the perspectives of audit personnel at the partner and non-partner levels, (2) assess how firm leaders communicate tone at the top through formal and informal communications, and (3) examine the firm work environment and its relation to perceived tone at the top. We employ semi-structured interviews to address our research questions. Participants are from 12 regional and local public accounting firms that audit primarily non-public entities (although some of the firms are also registered with the PCAOB). Each firm provided one audit partner who is considered a firm leader, plus one auditor at rank below partner, for a total of 24 participants. Results indicate that although most firms characterize their tone as being strongly employee- or team-focused (9 of 12 firms in our sample), firm leaders' communication with and support of employees varies across firms. In addition, firms focus on innovation or other values, such as superior client service. Our results have implications for firms, regulators and academics who are interested in examining the link between tone at the top and audit quality.

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SESSION 1.05: UNDERSTANDING THE CLIENT: CONTROLS AND INFORMATION ENVIRONMENT

DATE: FRIDAY, JANUARY 17, 2020

TIME: 10:15 AM–11:45 AM

Internal Audit's Role in the Evaluation of Corporate Governance: Evidence from the Field

Lauren Dreher Cunningham

The University of Tennessee

Christie Hayne

University of Illinois at Urbana-Champaign

Terry L. Neal

The University of Tennessee

Sarah E. Stein

Virginia Polytechnic Institute and State University

ABSTRACT: Corporate governance research focuses primarily on the inputs to an effective governance system, such as board characteristics, executive compensation structures, and investor involvement. However, we know very little about how companies monitor and evaluate their overall corporate governance systems on an ongoing basis. This evaluation process is important because corporate failures are often tied to weaknesses in governance, whether due to poor tone at the top, misaligned compensation incentives, or lack of consistency in corporate policies and procedures. To bridge this research gap, we consider internal audit's role in the evaluation of corporate governance. We interview 29 Chief Audit Executives (CAEs)—who report directly to the audit committee and are responsible for internal audit—to learn how they view the key objectives of corporate governance, evaluate corporate governance on an ongoing basis, and report issues and concerns to the board. While CAEs can provide rich examples and best practices for an ideal evaluation of corporate governance, our data analysis reveals a lack of consensus in current practices within these CAEs' publicly listed companies for evaluating corporate governance. We also shed light on potential discomfort that CAEs feel in reporting issues to the board due to tension in their perceived accountability to senior management and the audit committee. Our findings call for additional research on corporate governance evaluations as well as consideration of standard setting to improve consistency in practices across companies.

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SESSION 1.05: UNDERSTANDING THE CLIENT: CONTROLS AND INFORMATION ENVIRONMENT

DATE: FRIDAY, JANUARY 17, 2020

TIME: 10:15 AM–11:45 AM

The Effects of Auditor Tenure and Predictability of the Client's Information Environment on Auditor Estimates

Jeremy Brian Griffin

The University of Mississippi

Kendall O. Bowlin

The University of Mississippi

Emily Kathryn Hornok

Baylor University

ABSTRACT: We examine the joint effects of auditor tenure and information predictability on auditor judgments. Prior research suggests competing effects of auditor tenure—that auditors affiliate more with their clients as the length of auditor tenure increases, consistent with the concerns of regulators, though auditors also simultaneously develop expertise that leads to more effective audits. As expected, we find that longer auditor tenure causes auditors to develop higher affiliation with their clients, but also that the effect of affiliation on auditor estimates depends critically on the predictability of the client's information environment. Specifically, in less predictable information environments, auditors who affiliate more with their clients generate more accurate estimates than auditors who affiliate less with their clients. In contrast, in more predictable information environments, there is no difference in judgment accuracy between auditors who are more versus less affiliated with their clients. Our results suggest that longer auditor tenure improves audit quality in less predictable information environments.

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Abstracts

SESSION 2.01: EXPANDED AUDIT REPORTS

DATE: FRIDAY, JANUARY 17, 2020

TIME: 1:45 PM–3:15 PM

Consequences of the Adoption of the Expanded Auditor's Report: Evidence from Hong Kong

Lin Liao

Southwestern University of Finance and Economics

Miguel A. Minutti-Meza

University of Miami

Yun Zhang

The George Washington University

Youli Zou

The George Washington University

ABSTRACT: Effective on December 2016, the Hong Kong Institute of Certified Public Accountants issued a set of new and revised auditing standards that require a discussion of Key Audit Matters (KAMs). We investigate whether KAMs provide incremental information to investors and if the changes to the auditor's report have indirect consequences for audit fees and audit quality. We implement a difference-in-differences research design, examining two years of data from companies listed in Hong Kong and Mainland China stock exchanges. We do not find evidence that KAMs provide incremental information to investors or that the new rules affect audit fees or quality. Next, we document that variation in the content of KAMs (e.g., types, number, length of the discussion, and company-specific focus) is not consistently associated with incremental information content, audit fees or audit quality. Our findings support some investors' demands for additional and more specific information in the auditor's report.

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SESSION 2.01: EXPANDED AUDIT REPORTS

DATE: FRIDAY, JANUARY 17, 2020

TIME: 1:45 PM–3:15 PM

Do Partners Have Unique Reporting Styles for Key Audit Matters?

Linette M. Rousseau

University of Wisconsin–Madison

Karla M. Zehms

University of Wisconsin–Madison

ABSTRACT: We examine whether audit partners have unique styles for key audit matter (KAM) reporting. We further investigate whether such differences may yield variation in audit fees and report lag. We develop a conceptual model that helps to motivate our expectation that KAM reporting styles at the individual audit partner level will reflect idiosyncratic differences across partners. We use an archival sample of European KAMs, and include fixed effects for audit partner-level and audit firm-level differences. We find within-partner similarities and between-partner differences in KAM reporting volume across clients, while controlling for variation in client and audit firm characteristics. We also find that particularly distinctive partner KAM reporting styles are positively associated with audit pricing and report lag, such that these partners charge on average 18 percent higher audit fees and take about nine days more to sign the audit report as compared to partners with less-distinctive KAM reporting styles.

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Abstracts

SESSION 2.01: EXPANDED AUDIT REPORTS

DATE: FRIDAY, JANUARY 17, 2020

TIME: 1:45 PM–3:15 PM

Informativeness of the Expanded Audit Report: Evidence from China

Bengwee Goh

Singapore Management University

Dan Li

Tsinghua University

Muzhi Wang

Central University of Finance and Economics

ABSTRACT: This study investigates whether the expanded audit report is informative to investors in the setting of an emerging economy. We exploit the recent staggered adoption of the expanded audit report for A+H and A share firms in China. Using both pre-post and difference-in-differences research designs, we find robust evidence that abnormal trading volume and earnings response coefficients (ERCs) are higher, and stock price synchronicity are lower, in the post-adoption periods than in the pre-adoption periods; these results are consistent with investors finding the expanded audit reports incrementally useful in decision making. In additional tests, we find that the expanded audit report is more informative when there is a greater demand of information for decision-making. Specifically, the increases in abnormal trading volume and ERCs, and the decrease in price synchronicity in the post-adoption periods are more pronounced when the firm is a non-SOE firm and when the firm has higher information uncertainty and/or asymmetry. Furthermore, we find some evidence that the expanded audit report is more informative when there are more key audit matters (KAMs) disclosed in the report, when the KAMs are more readable, when the KAMs disclosures have more negative tone, and when the KAMs have lower similarity with industry peers. To the best of our knowledge, our study is the first to document systematic evidence that the expanded audit report is incrementally informative to investors in an emerging economy.

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Abstracts

SESSION 2.02: HUMAN CAPITAL

DATE: FRIDAY, JANUARY 17, 2020

TIME: 1:45 PM–3:15 PM

Internal Control Weaknesses and Financial Upskilling: Evidence from U.S. Job Postings

Janet Gao

Indiana University

Kenneth Merkley

Indiana University Bloomington

Joseph Pacelli

Indiana University

Joseph H. Schroeder

Indiana University Bloomington

ABSTRACT: Ineffective internal control often relates to a lack of qualified personnel with sufficient accounting and technical expertise. In this study, we examine whether firms respond to internal control failures with targeted financial upskilling (i.e., increasing the specific accounting and finance skills demanded from their employee base). Using unique data containing the near universe of job postings, we document significant increases in financial upskilling among employees following a firm's disclosure of an internal control weakness. The upskilling effect we document is not limited to just accounting roles, but also extends to non-accounting personnel that interface with accounting functions, suggesting an important role for all personnel in remediating internal control failures. We further demonstrate that our results are not explained by a general increase in labor demand or other forms of upskilling, including general business or industry skills. Finally, we find that upskilling is associated with a higher likelihood of internal control remediation, especially for firms with restatements. Overall, our findings shed new light on how firms internally respond to ineffective internal controls.

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Abstracts

SESSION 2.02: HUMAN CAPITAL

DATE: FRIDAY, JANUARY 17, 2020

TIME: 1:45 PM–3:15 PM

Flexible CPA Staffing: Implications for Audit Fees and Audit Quality

Hyungjin Cho

Universidad Carlos III de Madrid

Meeok Cho

Seoul National University

Sehee Kim

Seoul National University

Woo-Jong Lee

Seoul National University

ABSTRACT: The provision of audit services is a highly labor-intensive task. In this paper, we analyze monthly CPA (certified public accountants) employment data of each audit firm to assess the implications of CPA staffing for audit pricing and audit quality. Consistent with the prevalence of short-term hires of freelance CPAs during busy season, we find that growth in CPA employment peaks before busy season but drops dramatically to below zero afterward. We further document that the standard deviation of changes in monthly CPA numbers within a year is negatively associated with audit fees, implying that flexible staffing enables audit firms to charge lower fees to clients. By contrast, we find no evidence that flexible staffing impairs audit quality. We conclude that audit firms reduce operating leverage via flexible staffing arrangements and share the benefit with clients without compromising audit quality.

Abstracts

SESSION 2.02: HUMAN CAPITAL

DATE: FRIDAY, JANUARY 17, 2020

TIME: 1:45 PM–3:15 PM

Skill Demands in the Audit Labor Market: Evidence from Job Postings

Charles Ham

Washington University

Rebecca Hann

University of Maryland College Park

MaryJane Rabier

Washington University

Wenfeng Wang

City University of Hong Kong

ABSTRACT: This study examines how the demand for auditor skill sets has changed over the past decade as well as how these changes relate to audit quality and audit fees. Using a novel dataset that contains the near-universe of online job postings by accounting firms from 2007 to 2017, we find that audit firms have decreased their demand for auditors and increased their demand for IT-related personnel. We also find that audit firms are demanding expanded skill sets from their auditors— in addition to financial skills, firms increasingly demand cognitive, social, and IT-related skills. We document substantial variation in the demand for skills not only across audit firms, but also across offices within an audit firm. More importantly, these differences in skill requirements have a significant effect on audit quality. Specifically, clients of audit offices that demand more social and cognitive skills are less likely to experience subsequent restatements. Taken together, our findings provide new insights on the changing dynamics of the auditor labor market and their relation to audit quality.

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Abstracts

SESSION 2.03: AUDIT MARKETS 2

DATE: FRIDAY, JANUARY 17, 2020

TIME: 1:45 PM–3:15 PM

Client Consulting Opportunities and the Reemergence of Big 4 Consulting Practices: Implications for the Audit Market

Elizabeth Cowle

University of Arkansas

Tyler Kleppe

University of Arkansas

James Robert Moon

Georgia Institute of Technology

Jonathan Shipman

University of Arkansas

ABSTRACT: Regulators have expressed concern that revenues from consulting service lines have again become too much of a focus for the Big 4 accounting firms. Since SOX prohibits the provision of many types of non-audit services by auditors to audit clients, accounting firms and many of their clients must likely choose between an auditor-client and a consultant-client relationship. We use a machine learning technique to develop a measure capturing the level of consulting needs of a client (i.e., “consulting opportunities”). We validate our measure using a series of tests and then use it to investigate the ramifications of this shift in focus. We predict and find that our measure relates positively to auditor-client realignment decisions and negatively to Big 4 auditor selection. We also show that auditor turnover rate increases and Big 4 market share decreases faster in markets with more consulting opportunities. Together, our results suggest that the regulatory decision to limit the provision of consulting services to audit clients may have inadvertently provided a mechanism to reduce Big 4 audit market share.

Abstracts

SESSION 2.03: AUDIT MARKETS 2

DATE: FRIDAY, JANUARY 17, 2020

TIME: 1:45 PM–3:15 PM

*Focused (Factory) Auditing as a Competitive Strategy for Small Auditors in the NB4 Market:
Evidence for the Commercial Banking Industry*

Ines Simac

KU Leuven

Marleen Willekens

KU Leuven

ABSTRACT: The objective of this study is to investigate how small audit firms can compete in the Non-Big 4 segment of the audit market. According to the strategic management literature, small firms can survive in a market dominated by large players if they pursue a niche strategy (e.g., Caves and Porter 1977). In this study, we are interested in accounting firms with a “single-industry” niche strategy and refer to these audit firms as focused auditors. An exploratory analysis of the audit market shows that particularly in the banking sector, focused audit firms have a significant presence. For that reason, we use banks as our sample. The empirical results confirm our first hypothesis – that focused auditors are associated with higher audit quality, which translates as lower abnormal loan loss provision accruals. Our second hypothesis is that greater efficiencies allow focused auditors to offer fee discounts, and our audit fee analysis confirms this, even in the case of clients with relatively little bargaining power. We conclude that occupying an industry niche could constitute a key strategy for small auditors seeking to compete in the Non-Big 4 market segment by offering a differentiated product at competitive prices.

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Abstracts

SESSION 2.03: AUDIT MARKETS 2

DATE: FRIDAY, JANUARY 17, 2020

TIME: 1:45 PM–3:15 PM

Associations and Networks of International Accounting Firms

Xi Ai

The University of Tennessee

Lauren Dreher Cunningham

The University of Tennessee

Xiao Li

Central University of Finance and Economics

Linda A. Myers

The University of Tennessee

ABSTRACT: Small accounting firms join accounting associations and networks (AANs) to gain access to technical resources and accounting personnel in other industries and geographic locations. Bills et al. (2016) find that AANs allow small accounting firms operating in the United States (U.S.) to improve audit quality but Mao et al. (2017) find that similar benefits do not extend to small accounting firms that join AANs in China. Thus, it remains an empirical question whether AAN membership provides benefits to small international accounting firms operating outside of the U.S. Using a difference-in-differences design, we find that, across 24 countries, audit quality improves on average after small international accounting firms join an AAN. We further find that AAN audit quality is not significantly different from Big 4 audit quality for similarly sized clients. These findings have important implications for accounting firms, audit committees, regulators, and investors in international markets.

Abstracts

SESSION 2.04: COMPLEX AUDITOR ESTIMATES AND JUDGMENTS

DATE: FRIDAY, JANUARY 17, 2020

TIME: 1:45 PM–3:15 PM

How Client Advocacy and a (Mis)Matched, Foreign Decision Environment Affect Auditor Judgment

Robin Litjens

Tilburg University

Robert E. Pinsker

Florida Atlantic University

Ferdy van Beest

Nyenrode Business University

ABSTRACT: We investigate differences in auditor judgments when auditors are assigned to an engagement in a foreign country. We predict and find the decision environment of the local firm office (operationalized as either principles-oriented or rules-oriented) will have a direct effect on experienced auditor judgment and will interact with client advocacy to influence an auditor's recommendation on the disclosure of a contingent liability. We find auditors with a higher (lower) level of advocacy and auditors assigned to a matched (mismatched), rules-oriented (principles-oriented) decision environment make judgments that are more (less) favorable to the client. We also find a moderation effect in which the advocacy affects judgment to a greater (lesser) extent in the matched (mismatched), rules-oriented (principles-oriented) local firm office environment. Our results help academics and auditors to understand the issues related to audit quality of a foreign audit engagements and international auditor labor mobility.

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Abstracts

SESSION 2.04: COMPLEX AUDITOR ESTIMATES AND JUDGMENTS

DATE: FRIDAY, JANUARY 17, 2020

TIME: 1:45 PM–3:15 PM

Complex Estimates and Auditor Reliance on Artificial Intelligence

Benjamin Commerford

University of Kentucky

Sean Dennis

University of Kentucky

Jennifer R. Joe

University of Delaware

Jennifer Wang

University of Kentucky

ABSTRACT: Audit firms are investing millions of dollars to develop artificial intelligence (AI) systems that will help auditors execute challenging tasks (e.g., evaluating complex estimates). Audit firms assume AI will enhance audit quality. However, a growing body of research documents “algorithm aversion” – the tendency for individuals to discount computer-based advice more heavily than human advice, although the advice is identical otherwise. Auditor susceptibility to algorithm aversion could prove costly for the profession and financial statements users. Accordingly, we examine how algorithm aversion manifests in auditor decisions using an experiment that manipulates the source of contradictory audit evidence (human specialist versus AI specialist system) and the degree of structure within the client’s estimation process (higher versus lower) for a complex estimate. Consistent with theory, we find evidence that algorithm aversion amplifies the persuasive effect of greater estimation structure, making auditors more likely to discount contradictory audit evidence and accept management’s preferred estimates.

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Abstracts

SESSION 2.04: COMPLEX AUDITOR ESTIMATES AND JUDGMENTS

DATE: FRIDAY, JANUARY 17, 2020

TIME: 1:45 PM–3:15 PM

The Effect of Key Audit Matters and Uncertainty Disclosures on Auditors' Accountability Perception and Fair Value Decisions

Jin Ma

The University of Adelaide

Paul J. Coram

The University of Adelaide

Indrit Troshani

The University of Adelaide

ABSTRACT: We experimentally examine whether and how recent changes to the audit reporting model impact auditor's judgment and decisions. Specifically, we investigate how the effects of the requirements of disclosing key audit matters (KAMs) interact with related management disclosures in the financial statement footnotes to affect auditor's accountability perceptions and subsequent fair value decisions. In an experiment comprising mainly audit partners from Big 4 accounting firms, we find that auditors believe they are less accountable when they have the opportunity to report on the fair value estimates in KAMs disclosures or when management has provided fair value related footnotes. However, despite the lower perceived accountability from either of these disclosures, we find that when both KAMs and footnotes are reported, auditors require greater fair value adjustments. Overall, our results show that the requirements to disclose KAMs does make a difference on auditors' accountability perception and adjustment decisions. These results have important implications for regulators, audit practitioners, preparing entities and users of financial statements.

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Abstracts

SESSION 2.05: GROUP AUDITS: INSIGHTS, STRATEGIES, AND EVIDENCE FOR STANDARD SETTING

DATE: FRIDAY, JANUARY 17, 2020

TIME: 1:45 PM–3:15 PM

Increasing Risk Sensitivity in Group Audits: The Role of Decomposed Processing

Ann Backof

University of Virginia

Brant E. Christensen

The University of Oklahoma

Steven M. Glover

Brigham Young University

Jaime J. Schmidt

The University of Texas at Austin

ABSTRACT: Regulatory inspection reports indicate that auditors do not always sufficiently assess and respond to the risks of material misstatement that arise in a group audit engagement (i.e., an audit of a reporting group that consists of multiple components). In this study, we investigate whether a decomposed risk assessment process, in which quantitative and qualitative risk factors are separately considered, increases auditors' risk sensitivity compared to a holistic approach, in which quantitative and qualitative risks are jointly considered. We find that auditors following a decomposed approach are more likely to categorize qualitatively risky components as individually significant, plan to perform more substantive tests on these risky components (but a similar amount of planned work overall), and set component and group materiality at significantly lower levels. In other words, we find that decomposed processing results in more effective group planning decisions. Our findings should assist standard setters in their revision of the group audit standards.

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Abstracts

SESSION 2.05: GROUP AUDITS: INSIGHTS, STRATEGIES, AND EVIDENCE FOR STANDARD SETTING

DATE: FRIDAY, JANUARY 17, 2020

TIME: 1:45 PM–3:15 PM

Evidence on the Effects of Network Status and Perspective Taking on Component Auditor Testing Strategies

Stephen Kwaku Asare

University of Florida

Herman van Breuk

Nyenrode Business University

Barbara Majoor

Nyenrode Business University

ABSTRACT: Component auditors perform a significant share of the audit of multinational companies but have incentives to satisfy local clients, potentially decreasing audit quality at the group level. We provide experimental evidence on the effects of network status (the group auditor is from the same global audit firm network [GAFN] or unaffiliated) and a prompt to adopt the group auditor's perspective on the extent of component auditors' testing. We hypothesize that a prompt to take the group auditor's perspective increases the effectiveness of the testing strategies for unaffiliated component auditors but decreases the effectiveness for GAFN component auditors. Our hypothesis hinges on the notion that component auditors' default perspective is changed by the prompt, such that unaffiliated auditors anticipate more scrutiny in the group auditor's review of their work and GAFN auditors anticipate less scrutiny. Using 119 experienced auditors, we find that perspective taking decreases testing for GAFN component auditors but has no effect for unaffiliated component auditors. We also show that the differential testing strategy is unrelated to the component auditors' evaluation of the reasonableness of the underlying warranty provision. Our results are important because they show that prompting GAFN auditors to take the group auditor's perspective may reduce group audit quality. Thus, we have identified an important setting where perspective taking (of the group auditor) may have a deleterious effect.

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Abstracts

SESSION 2.05: GROUP AUDITS: INSIGHTS, STRATEGIES, AND EVIDENCE FOR STANDARD SETTING

DATE: FRIDAY, JANUARY 17, 2020

TIME: 1:45 PM–3:15 PM

Evidence-Informed Audit Standard Setting: Exploring Evidence Use and Knowledge Transfer in Group Audits

Kris Hoang

The University of Alabama

Yi Luo

Queen's University

Steven E. Salterio

Queen's University

ABSTRACT: We employ a design science research approach to investigate the efficacy of an academic prepared research synthesis to transfer knowledge to standard setters via a real-time simulation with former standard setters over a twelve-week period. The simulation is of an actual standard setting problem (where standard setters withdrew the first exposure draft due to a lack of consensus). We first determine that nature of the evidence used at the time of the standard setting decisions through examination of extensive archival records. We find that for this issue, standard setters primarily employ practitioners' (including standard setters and task force members) tacit knowledge as the evidence base for setting standards. We find no systematic evidence collection by standard setters, task force members, or responders to the exposure draft, and no employment of academic research in the process. We then investigate our proposed improvement to the process, the use of a research synthesis of academic research that existed at the time of the initial standard setting decisions. Following a design science research approach, we develop and evaluate a prototype research synthesis co-created in a real-time simulation with former standard setters. We evaluate the process of synthesis creation as well as the resultant synthesis pragmatic validity as seen by our former standard setters. Based on this evaluation we conclude that we have created one successful instantiation of the proposed knowledge transfer process. Further, our simulation participants identified other standard setting issues where it could be successfully deployed. We conclude that we have provided strong initial evidence that the research synthesis approach to knowledge transfer can be used to systematically transfer audit research knowledge in the audit standard setting domain.

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Abstracts

SESSION 3.01: AUDITOR JUDGMENT USING ARCHIVAL METHODS

DATE: FRIDAY, JANUARY 17, 2020

TIME: 3:45 PM–5:15 PM

Do Accounting Error Disclosure Decisions Reflect Impaired Auditor Independence?

Chenxi Lin

The University of Kansas

ABSTRACT: Accounting errors distort the information conveyed to financial statement users and may result in substantial financial losses. When misstatements are identified, it is crucial that error disclosures be appropriate. Prior literature has shown that companies have a strong incentive to manage earnings and avoid restatements, but it is unclear how auditor incentives impact error disclosure decisions. I examine whether factors that may affect auditor independence – such as client importance, audit office industry expertise, audit office growth, and audit market competition – are associated with accounting error disclosure decisions. Using 5,087 accounting errors disclosed in annual financial statements from fiscal year 2006 to 2017, I find that economically important clients are more likely to disclose errors through revisions or adjustments rather than restatements, and that they also are more likely to disclose larger errors through revisions or adjustments. In addition, auditors with industry expertise are less likely to permit disclosure of accounting errors through revisions or adjustments relative to restatements, and they also are less likely to permit larger errors to be disclosed through revisions or adjustments. Both of these findings are strongest in audit offices with negative growth and in audit market with high competition. My findings provide evidence that auditor incentives impact how accounting errors are disclosed. Auditors are more likely to cater to management's opportunistic error reporting preferences when the economic bond is stronger and when the office is experiencing pressure from negative growth or competition. However, auditors that are more subject to reputation concerns are less likely to allow opportunistic error reporting. My findings should be viewed as important by investors and regulators who are interested in understanding the drivers of accounting error reporting decisions.

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Abstracts

SESSION 3.01: AUDITOR JUDGMENT USING ARCHIVAL METHODS

DATE: FRIDAY, JANUARY 17, 2020

TIME: 3:45 PM–5:15 PM

The Effects of Confirmation Bias on Auditors' Risk Assessments: Archival Evidence

Cory A. Cassell

University of Arkansas

Stuart Dearden

University of Nebraska–Lincoln

David Michael Rosser

The University of Texas at Arlington

Jonathan Shipman

University of Arkansas

ABSTRACT: Experimental research in accounting provides extensive evidence that auditors' judgments are negatively affected by the use of heuristics. However, there is little research investigating whether the negative effects of using heuristics manifest in practice and survive the quality control processes that regulators and audit firms have in place to mitigate them. In this study, we focus on one such heuristic – confirmation bias – and identify a setting where the effects of auditors' use of this heuristic are likely to manifest. Our findings indicate that auditors with previous experience auditing a client with a history of low risk followed by an increase in risk do not adequately respond to the higher level of risk. Consistent with expectations, we find that this effect is mitigated when the risk increase is likely to violate auditors' reasonableness constraint, when the client is highly visible or has high institutional holdings, and when the auditor is a Big Four or industry specialist auditor. Our study complements prior experimental research by providing evidence that auditors' use of heuristics has an economically significant effect on auditor judgments in practice and that the negative effects of using heuristics can survive the quality control processes that audit firms have in place.

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Abstracts

SESSION 3.01: AUDITOR JUDGMENT USING ARCHIVAL METHODS

DATE: FRIDAY, JANUARY 17, 2020

TIME: 3:45 PM–5:15 PM

The Effect of Social Identity on the Financial Reporting Aggressiveness of Former Auditors

Eric Condie

Georgia Institute of Technology

Kara Obermire

Oregon State University

Timothy Andrew Seidel

Brigham Young University

Michael S. Wilkins

The University of Kansas

ABSTRACT: In this study, we leverage social identity theory to study the financial reporting behavior of chief financial officers (CFOs) with prior auditing experience. Social identity theory suggests that the values learned within a profession are likely to influence behavior after an individual leaves the profession. Our tests indicate that, on average, CFOs who were former auditors report less aggressively than CFOs without previous auditing experience. Thus, the public accounting social identity – which should include a mindset that values ethical, conservative, and transparent financial reporting – appears to persist when auditors take high-level positions in industry. However, we also find that the reporting behavior of prior-auditor CFOs becomes more aggressive over time as the salience of their public accounting experience decays. Auditors appear to adjust effort similarly, as audit fees are lower for clients with prior-auditor CFOs but increase as the CFOs' time away from public accounting increases. Overall, our study provides support for social identity theory in a new setting and offers important insights regarding how public accounting socialization impacts the financial reporting behavior of top executives.

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Abstracts

SESSION 3.02: PCAOB INSPECTION AND REGULATION

DATE: FRIDAY, JANUARY 17, 2020

TIME: 3:45 PM–5:15 PM

Are All PCAOB Inspection Deficiencies Created Equal?

Andrew A. Acito

Virginia Polytechnic Institute and State University

James Joseph Anderson

Michigan State University

Matthew James Beck

The University of Kansas

ABSTRACT: We investigate whether a shift in the PCAOB's focus towards identifying deficiencies in auditors' internal control assessments affected the informativeness of Big 4 firms' inspection reports. We find that while total PCAOB-identified audit deficiencies are initially positively associated with client misstatement likelihood, they are negatively associated with client misstatement likelihood after the shift in focus in 2010. Further, we find that control-related audit deficiencies are negatively associated with misstatement likelihood both before and after 2010. Additional testing indicates the PCAOB's risk-based selection process likely drives the observed negative relation between control-related audit deficiencies and misstatement likelihood, but we continue to find evidence that control-related audit deficiencies are less indicative of poor audit quality than other audit deficiencies. Our results have implications for understanding the informativeness of inspection reports and are particularly timely given that the PCAOB is currently considering changes to its inspection process and reports.

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Abstracts

SESSION 3.02: PCAOB INSPECTION AND REGULATION

DATE: FRIDAY, JANUARY 17, 2020

TIME: 3:45 PM–5:15 PM

Does the PCAOB International Inspection Access Affect Voluntary Disclosure? Evidence from Management Forecast Accuracy

Lijun Lei

The University of North Carolina at Greensboro

Sydney Qing Shu

Miami University

Wayne B. Thomas

The University of Oklahoma

ABSTRACT: We investigate the change in management forecast accuracy around the Public Company Accounting Oversight Board's (PCAOB) initial access to inspect auditors of U.S.-listed foreign firms. We expect that inspection access will increase auditors' scrutiny of their clients' financial reports and thereby improve the underlying information set used by managers to make forecasts. Consistent with these expectations, we find that managers make more accurate earnings forecasts following PCAOB inspection access. Furthermore, the improvement in forecast accuracy is more pronounced for firms whose reported earnings appear to have been affected most by inspection access (i.e., those with reduced abnormal accruals, corrected internal control material weaknesses, and non-fraud restatements). While prior research provides evidence that more stringent audits improve decisions of external stakeholders (e.g., investors and creditors), our study provides additional evidence on the decisions of another important stakeholder—managers.

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Abstracts

SESSION 3.02: PCAOB INSPECTION AND REGULATION

DATE: FRIDAY, JANUARY 17, 2020

TIME: 3:45 PM–5:15 PM

PCAOB Revolving Door, Audit Fees and Audit Quality

Jagan Krishnan
Temple University

Jayanthi Krishnan
Temple University

Steven Maex
Temple University

ABSTRACT: The so-called “revolving door” for employees moving between the Public Company Accounting Oversight Board (PCAOB) and the firms it regulates has received heightened scrutiny in recent years. Much of this attention has stemmed from revelations in 2017 that former PCAOB personnel hired by a Big Four auditor, schemed with PCAOB employees to misappropriate confidential information relating to the PCAOB’s planned inspections of the auditor. We examine whether the hiring of PCAOB employees affects audit fees and audit quality. Using client-level data for audits conducted by large audit firms from 2010 to 2016, we find that audit fees are higher and material restatements are less likely as the number of legacy PCAOB employees at a given audit firm increases. These results suggest that the presence of former PCAOB employees, while potentially providing a channel for inspection-process bias induced through regulatory capture, are beneficial to firm initiatives to improve audit quality.

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Abstracts

SESSION 3.03: ENGAGEMENT OF AUDIT FIRMS

DATE: FRIDAY, JANUARY 17, 2020

TIME: 3:45 PM–5:15 PM

The Effect of Independent Directors' Reputation Incentives on Auditor Choice

So Yeon Kwack

City University of Hong Kong

Jong-Hag Choi

Seoul National University

Yuyan Guan

City University of Hong Kong

Hua Feng

Xi'an Jiaotong University

ABSTRACT: We examine whether independent directors' reputation incentives have an impact on the firm's auditor choice. We find that firms with a higher proportion of independent directors with low reputation incentives are more likely to hire Big 4 auditors or auditors with industry expertise. Such evidence is consistent with higher agency conflicts increasing the demand for greater third-party assurance: as directors allocate less time and energy to firms of low reputational value, the agency conflicts of these firms increase, which in turn increases the demand for high-quality audit. We further show that the relation between independent directors' reputation incentives and a firm's demand for high-quality audit weakens with firms with strong governance mechanisms, but strengthens when firm issue large amount of equities. In addition, we document that high-quality auditors play a more important role in increasing the financial reporting quality for firms with concerns of weak independent directors' reputation incentives.

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Abstracts

SESSION 3.03: ENGAGEMENT OF AUDIT FIRMS

DATE: FRIDAY, JANUARY 17, 2020

TIME: 3:45 PM–5:15 PM

Uninformed Shareholders and the Efficacy of Proxy Voting: Evidence from Auditor Ratification

Cory A. Cassell

University of Arkansas

Tyler Kleppe

University of Arkansas

Jonathan Shipman

University of Arkansas

ABSTRACT: We investigate the influence and implications of uninformed shareholder participation in the proxy voting process. Using the auditor ratification vote – a setting where assessing the appropriateness of the voting decision is arguably much easier relative to other proxy vote settings – we find that, on average, shareholder votes against auditor ratification are not associated with audit failures (restatements) but are strongly associated with investment performance (stock returns). However, using institutional ownership as a proxy for the extent to which the voting base is likely to be informed, we find evidence that the auditor ratification vote is more informed (i.e., driven by factors that reflect auditor performance) when institutional ownership is higher. Finally, we find that the probability of auditor dismissal is increasing in the proportion of votes against auditor ratification, regardless of the level of institutional ownership. Collectively, our results suggest that some auditors are dismissed for factors unrelated to auditor performance. More generally, our results suggest that votes cast by uninformed shareholders likely limit the efficacy of proxy voting as a governance tool.

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Abstracts

SESSION 3.03: ENGAGEMENT OF AUDIT FIRMS

DATE: FRIDAY, JANUARY 17, 2020

TIME: 3:45 PM–5:15 PM

Auditor Choice in Commonly Owned Firms

Young Hoon Kim
Texas A&M University

ABSTRACT: When a company is interconnected with other companies through common ownership, the company's decision making is affected by common owners' incentives to internalize externalities among investees. I argue that common owners have incentives to induce their investees to use the same auditor because it helps to internalize positive externalities arising from higher audit quality and comparability and mitigates common agency problems. Consistent with my expectation, I find that commonly owned companies are more likely to choose the same auditor. I find similar results by exploiting a quasi-experimental setting: changes in common ownership due to the acquisition of financial institutions. Further analyses reveal that investees' use of the same auditor enables common owners to effectively monitor the auditor, which results in higher audit quality at the portfolio level. Lastly, cross-sectional test results are consistent with common owners' incentives and abilities affecting investees' choice of the same auditor. My study sheds light on how common ownership, an increasingly important ownership structure, influences auditor choice and ultimately the financial reporting outcome.

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Abstracts

SESSION 3.04: AUDIT-RELATED INSIGHT FROM NOVICE JUDGMENTS

DATE: FRIDAY, JANUARY 17, 2020

TIME: 3:45 PM–5:15 PM

Participant Selection in Behavioral Audit Research: Perceptions from Academics and Insights from Interns and Supervisors

Erin Michelle Hawkins

Clemson University

Marsha Keune

University of Dayton

Kristen Kelli Saunders

University of Nebraska–Lincoln

ABSTRACT: As behavioral audit research has become increasingly valued by regulators, standards setters, and practitioners, it also has become less prominently represented in academic journals. Understanding that multiple participant-related drivers could be responsible for this concerning trend, our study uses 113 survey responses from active behavioral audit researchers to understand their participant-related perceptions. Academics generally view selecting the appropriate level of participants for a study as judgmental and do not perceive consensus in best practices for this important decision. The majority of respondents have experienced ex-post second-guessing of their participant selection choices by editors, referees, and other critics. They view justifying novice auditor participants as difficult and have less optimism regarding the publication likelihood of novice auditor studies and the value that their peers place on the work of these auditors. Not surprisingly, recruiting professional participants is also viewed as challenging. We discuss the implications of these perceptions and inform perceptions related to selecting and defending participants by summarizing prior literature. In addition, we inform the appropriate use of novice auditors by reporting survey results from interns and supervising auditors on the tasks and responsibilities that interns commonly perform. In these ways, this study aims to foster future research in auditing.

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Abstracts

SESSION 3.04: AUDIT-RELATED INSIGHT FROM NOVICE JUDGMENTS

DATE: FRIDAY, JANUARY 17, 2020

TIME: 3:45 PM–5:15 PM

Fraud Inquiries: The Influence of Question Phrasing and Rapport on Client Reporting

Megan Marie Jones

Xavier University

ABSTRACT: Auditors currently conduct management inquiries during the planning phase of the audit with the goal of modifying the audit plan to address any risks identified, including those pertaining to fraud. The audit standard, AS 2110, describing the fraud inquiries currently includes the word fraud. However, the Center for Audit Quality (CAQ) warns that using the word fraud during discussions with management may hinder conversation. This study aims to explore whether avoiding or mentioning the word fraud impacts the likelihood of an employee to report fraud to an inquiring auditor. The study also examines whether the question type (open-ended or closed) and rapport between the auditor and client influence reporting behavior. Results from an experiment using Amazon Mechanical Turk participants indicate that avoiding the word fraud increases the likelihood of reporting when closed type questions are used and the auditor lacks rapport with the client. Practically, this suggests that auditors lacking rapport with the client and using the inquiries from the standards (closed type questions that mention the word fraud), may be able to increase the likelihood of reporting by simply avoiding the word fraud. Results also indicate that in this same setting mentioning the word fraud does not appear to reduce the likelihood of reporting as long as the auditor has built rapport with the client. As tips are the most common form of fraud detection, it is critical that inquiring auditors are conducting interviews using the most effective method.

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Abstracts

SESSION 3.04: AUDIT-RELATED INSIGHT FROM NOVICE JUDGMENTS

DATE: FRIDAY, JANUARY 17, 2020

TIME: 3:45 PM–5:15 PM

Auditing Non-GAAP Measures: Signaling More Than Intended

Spencer Anderson

University of Illinois

Jessen L. Hobson

University of Illinois at Urbana-Champaign

Ryan David Sommerfeldt

University of Illinois at Urbana-Champaign

ABSTRACT: Companies regularly issue non-GAAP measures in order to communicate firm-specific information that does not fit within the mold of GAAP (Generally Accepted Accounting Principles) reporting. However, these non-GAAP measures sometimes have little meaning to investors or are even misleading, causing some to question whether auditors should play a role in the reporting of non-GAAP measures. We run an experiment to provide ex-ante evidence on the effect of auditing non-GAAP measures. Specifically, we present participants proxying for nonprofessional investors with a non-GAAP measure that is either useful or less useful for making investment decisions, and either audited or not audited. We find that when participants view a non-GAAP measure that is useful, they appropriately use the non-GAAP measure in their investment-related judgments, regardless of whether the non-GAAP measure is audited. When the non-GAAP measure is less useful, participants should not use the non-GAAP measure in their investment-related judgments. However, we find that while participants appropriately do not use a less useful non-GAAP measure when it is not audited, participants inappropriately use the less useful non-GAAP measure in their investment-related judgments when it is audited. Mediation results provide evidence consistent with audits affecting investors' reliance on non-GAAP measures when the non-GAAP measure is less useful. Overall, our results are consistent with audits of non-GAAP measures signaling more than is intended and have implications for regulators regarding the role of auditors in non-GAAP reporting.

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Abstracts

SESSION 3.05: MANAGING AUDITOR BEHAVIOR

DATE: FRIDAY, JANUARY 17, 2020

TIME: 3:45 PM–5:15 PM

A Matter of Perspective: Mitigating the Outcome Effect in Auditor Performance Evaluations

Owen Brown
Baylor University

Melanie I. Millar
Baylor University

ABSTRACT: Prior research shows that the outcome effect in auditor performance evaluations can create a disincentive to exercise professional skepticism. We experimentally demonstrate that perspective taking improves this evaluation process by significantly reducing the influence of the outcome effect. In a common audit setting in which a staff auditor exhibits appropriate skeptical behavior but identifies no misstatement, supervising auditors prompted to take the perspective of the staff auditor prior to conducting a performance review evaluate the staff's performance higher than auditors not prompted to consider the staff's perspective. Importantly, we also find that perspective taking equalizes auditors' propensity to appropriately rate staff performance as "above expectations" when proper skepticism is exhibited, regardless of the audit outcome (misstatement present or absent) resulting from the skeptical behavior. We provide confirming evidence that perspective taking has the cognitive effect of increasing supervisor attention to the staff's decision process and the affective effect of increasing supervisor empathic concern for skeptical staff who identify no misstatement. However, it is the cognitive effect of perspective taking, not the affective effect, that serves to mitigate the outcome effect. Overall, we demonstrate that audit firms can use perspective taking to help properly align reward structures with desired auditor behavior.

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Abstracts

SESSION 3.05: MANAGING AUDITOR BEHAVIOR

DATE: FRIDAY, JANUARY 17, 2020

TIME: 3:45 PM–5:15 PM

A Field Study of the Effects of Eliminating Time Entry on Audit Timeliness and Related Auditor Perceptions

Erin Michelle Hawkins
Clemson University

Andrew H. Newman
University of South Carolina

Jesse C. Robertson
University of North Texas

Chad Matthew Stefaniak
University of South Carolina

Jeremy Vinson
Clemson University

ABSTRACT: In their audit practices, public accounting firms traditionally use a billable time entry (BTE) model to assist in budgeting engagements, evaluating personnel, and determining audit fees. While this approach has benefits, prior research has identified drawbacks such as time budget pressure and ensuing incentives to underreport time. However, relatively little research examines alternative budgeting models. We conduct a multi-method field study to examine the effects of an alternative, No-BTE model that a large, regional public accounting firm recently implemented on a trial basis. The results from proprietary audit engagement data indicate the No-BTE model increases the duration of financial statement audits. Survey results indicate auditors who participated in the no-BTE model trial program perceive that it can improve elements of audit quality. In addition, the no-BTE model reduces apprehension over performance evaluations, improves work-life balance, and increases motivation to provide value-added services to clients. Thus, both the firm that implemented the no-BTE trial program and other interested firms should evaluate the additional time it took to complete audits with potential benefits such as increased audit quality and additional fees from value-added services. We offer implications for practice and suggestions for future research on this novel approach to auditing.

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Abstracts

SESSION 3.05: MANAGING AUDITOR BEHAVIOR

DATE: FRIDAY, JANUARY 17, 2020

TIME: 3:45 PM–5:15 PM

Promoting Proactive Auditing Behaviors

Mark Peecher

University of Illinois at Urbana-Champaign

Michael Ricci

University of Florida

Dan Zhou

University of Illinois at Urbana-Champaign

ABSTRACT: Auditors work in complex, dynamic environments where complete directives are often unavailable. Thus, in order to achieve high quality audit outcomes, auditors need to think and act proactively. For example, auditors should proactively respond to unanticipated risks, coordinate effectively with clients, and develop the talent of junior auditors. We experimentally examine whether there are common conditions that encourage auditors to engage in a range of distinct proactive behaviors. Drawing on literature on employee proactivity, auditor tacit knowledge, and regulatory focus theory, we predict and find that auditors with more autonomy are more proactive, but only when they have both higher tacit knowledge and a focus on achieving positive job outcomes (rather than avoiding negative job outcomes). Our contributions include introducing the proactivity construct to the auditing literature, identifying antecedents to auditor proactivity, and advancing the management literature by providing evidence about how determinants of proactivity interact.

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Abstracts

SESSION 4.01: AUDITOR-CLIENT (MIS)ALIGNMENTS

DATE: SATURDAY, JANUARY 18, 2020

TIME: 10:15 AM–11:45 AM

Auditors are Known by the Companies They Keep

Jonathan Cook

Public Company Accounting Oversight Board

Zachary Kowaleski

University of Notre Dame

Michael Minnis

The University of Chicago

Andrew Gordon Sutherland

Massachusetts Institute of Technology

Karla M. Zehms

University of Wisconsin–Madison

ABSTRACT: We study the role of reputation in auditor-client matching. Using 1.2 million employment rec-ords from US broker-dealers, we find that broker-dealer clients of the same auditor have similar financial adviser misconduct profiles. Our estimates indicate that variation in client misconduct behavior is nearly half as important as variation in client size in explaining matches. Auditors adjust their portfolios when presented with new information about client behavior, and those with the most significant reputation concerns are least likely to deal with high misconduct cli-ents. Finally, we find that an auditor’s reputation for accepting high misconduct clients predicts their new clients’ future misconduct. Together, our results present new evidence on how reputation affects audit relationships, and the consequences of auditors’ reputation concerns for client behavior. Our results also indicate an unintended consequence of audit mandates: non-discerning auditors emerge to serve clients with low endogenous demand for auditing.

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Abstracts

SESSION 4.01: AUDITOR-CLIENT (MIS)ALIGNMENTS

DATE: SATURDAY, JANUARY 18, 2020

TIME: 10:15 AM–11:45 AM

Audit Partner-Client Strategic Alignment

Kris Hardies

University of Antwerp

Marie-Laure Vandenhaute

Vrije Universiteit Brussel

Karla M. Zehms

University of Wisconsin–Madison

ABSTRACT: We provide evidence on audit partner—client strategic alignment, and consider how alignment decisions differ depending on whether they occur in connection with new-client acceptance versus existing-client rotation. We define audit partner—client strategic alignment as the degree of similarity between an audit partner’s prior experiences and a prospective client’s characteristics that will affect the audit. We analyze 13,223 firm-year observations from Belgium during the period 2008–2014 in which each client engagement experiences a partner change. We report evidence of strategic alignment whereby audit partners possessing prior experience with clients that are large, financially risky, publicly traded, and requiring IFRS expertise assortatively match via strategic alignment with clients possessing those characteristics or requiring such expertise. Most notably, these associations are more pronounced for audit partner—client strategic alignment involving new-client acceptance as compared to existing-client rotation. Our results therefore provide insights relevant to regulations concerning audit partner and audit firm rotation.

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Abstracts

SESSION 4.01: AUDITOR-CLIENT (MIS)ALIGNMENTS

DATE: SATURDAY, JANUARY 18, 2020

TIME: 10:15 AM–11:45 AM

A Match Made in Heaven? An Examination of Big 4 Misaligned Clients

Scott N. Bronson

The University of Kansas

Robert Pawlewicz

University of North Dakota

Joseph H. Schroeder

Indiana University Bloomington

ABSTRACT: This study examines audit inputs and outcomes for misaligned clients of the Big 4 public accounting firms. Regulators and academics have expressed concerns about the market concentration and power of the Big 4, especially for misaligned clients. We examine whether misaligned clients of the Big 4 receive incrementally different audit quality or pay differential audit fees than aligned clients in the Big 4 portfolio. We present evidence that misaligned clients receive higher audit quality, as captured by the likelihood of material misstatements. Additionally, we present evidence that the Big 4 exhibit increased independence, as measured by the likelihood of receiving a going concern modification for financially distressed companies, for misaligned client compared to aligned clients. We also present evidence that in return for the higher audit quality, misaligned clients pay significantly higher audit fees than aligned clients in the Big 4 portfolio. The combined results indicate regulator and academic concerns related to Big 4 market concentration and power are not borne out in the cross-section of Big 4 clients.

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Abstracts

SESSION 4.02: AUDIT AND FIRM FINANCING

DATE: SATURDAY, JANUARY 18, 2020

TIME: 10:15 AM–11:45 AM

The Role of Assurance in Equity Crowdfunding

Monika Causholli

University of Kentucky

Evisa Bogdani

University of Kentucky

W. Robert Knechel

University of Florida

ABSTRACT: Equity crowdfunding (ECF) refers to the process of raising capital by selling securities through the internet to small, non-accredited investors. The ECF market is regulated by the SEC and the requirements include provision of assured financial statements. Assurance can be provided in one of three ways: certification by management, or an audit or review by an independent accountant. We utilize the ECF setting to examine whether assurance facilitates capital formation. We find that firms that provide either reviewed or audited financial statements are more likely to reach their target capital, attract a greater number of investors, and raise more capital relative to firms that only provide management-certified financial statements. We do not find evidence that equity crowdfunding campaigns accompanied by audited financial statements are more successful than those with reviewed financial statements. Our findings provide evidence on how assurance facilitates capital formation in a new type of capital market.

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Abstracts

SESSION 4.02: AUDIT AND FIRM FINANCING

DATE: SATURDAY, JANUARY 18, 2020

TIME: 10:15 AM–11:45 AM

Financial Constraints, Audit Fees and External Financing

Ahmet Kurt

Bentley University

Rani Hoitash

Bentley University

Udi Hoitash

Northeastern University

Mary Becker

Canisius College

ABSTRACT: Building on Simunic's (1980) argument, we maintain that assurance provided by external auditors is an economic good that becomes more valuable yet expensive in the face of financial constraints. Supporting our thesis, we find that financially constrained firms pay higher audit fees (but purchase less non-audit services) and have their audit reports completed sooner than financially unconstrained firms. We also find that the positive relation between audit fees and financial constraints is stronger when assurance of the financial statements of capital seeking firms by auditors is more important, i.e., when external monitoring by analysts and institutional investors is low. Further, supporting the argument that greater audit assurance can help financially constrained firms facilitate their access to capital markets, we find that equity-seeking constrained firms raise more future equity financing when they pay higher versus lower audit fees. Finally, consistent with the information signaling role of audit fees in equity markets, we document that investors' reaction to the announcement of seasoned equity offerings is positively associated with pre-offering audit fees of constrained, but not unconstrained, firms. We conclude that although financially constrained firms need to ration cash, funds spent on auditing have positive implications for constrained firms' future financing capacity.

Abstracts

SESSION 4.02: AUDIT AND FIRM FINANCING

DATE: SATURDAY, JANUARY 18, 2020

TIME: 10:15 AM–11:45 AM

Are Federal Grant Recipients Accountable for their Use of Taxpayer Dollars? Evidence from Single Audits

Bethany Brumley

University of Illinois at Urbana-Champaign

Anne Margaret Thompson

University of Illinois at Urbana-Champaign

Oktay Urcan

University of Illinois at Urbana-Champaign

ABSTRACT: Single audits are intended to be the primary accountability mechanism for Federal grants to state and local governments and non-profit organizations. We test longstanding concerns that Federal agencies do not use Single audit reports when awarding funding and whether revisions to the Uniform Guidance in 2013 improved monitoring and use of Single audits. We find no evidence that the Federal agencies reduce awards to state and local governments based on Single audit reports either before or after the revised Uniform Guidance. Among nonprofits and local schools, unclear financial statement (compliance) audit reports are associated with lower subsequent expenditures prior to (after) the revised Uniform Guidance. However, this change is due to award recipients monitoring their sub-recipients more closely rather than due to stronger direct monitoring by Federal agencies. Our results indicate that the revised Uniform Guidance had little impact on Federal agencies' monitoring of award recipients and suggest that state and local governments in particular have limited accountability for their federal expenditures.

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Abstracts

SESSION 4.03: AUDITING COMPLEX ESTIMATES

DATE: SATURDAY, JANUARY 18, 2020

TIME: 10:15 AM–11:45 AM

Opportunistically Reporting Contingent Litigation Losses When Firms Expect to Just Meet Earnings Forecasts

Eric R. Lohwasser

Colorado State University

Hsihui Chang

Drexel University

Hsin-Yi Huang

Feng Chia University

ABSTRACT: We find firms faced with earnings that are expected to just meet analyst forecasts are more likely to only disclose litigation loss contingencies instead of accruing them, claiming that the litigation event falls below the qualitative thresholds necessitating accrual. Consistent with earnings management, we find that this behavior is reduced when: 1) the firm's auditors have experience in auditing litigation contingencies, 2) the firm's auditors have expertise concentrated in the defendant's industry, and 3) firms are externally monitored by a larger number of analysts. Alternative specifications, cross-sectional tests, and matching procedures are considered. Results support the recently adopted PCAOB audit guidance, AS 2501, calling for increased professional skepticism toward management bias and opportunism when auditors evaluate subjective estimates.

Abstracts

SESSION 4.03: AUDITING COMPLEX ESTIMATES

DATE: SATURDAY, JANUARY 18, 2020

TIME: 10:15 AM–11:45 AM

Auditing the Fair Values of Investment Securities: Do Expert Auditors Respond to Cues Indicative of Greater Risk?

Chris E. Hogan

Michigan State University

Sarah E. Stein

Virginia Polytechnic Institute and State University

Sarah B. Stuber

Texas A&M University

ABSTRACT: We examine whether expert auditors are better able to constrain errors in fair value estimations of investments, and in particular, when presented with cues suggesting a heightened risk of material misstatement. Situations where auditor professional skepticism can be heightened is a focus of the PCAOB's recently issued standard on auditing estimates. Using security-level fair value estimates for property and casualty insurers, we examine two different types of auditor expertise (Big 4 and local-level industry expertise) and the interaction of these expert auditors with four different cues highlighting enhanced risk of misstatement (opportunistic fair value level classification, internal as opposed to third-party pricing method, prior period inflation in the aggregate investment portfolio, and prior period bias in another significant estimate). We find that auditors with greater expertise reduce both inflation and deflation of fair values. Moreover, the auditor's ability to effectively identify and incorporate information from the cues varies based on the type of cue and auditor expertise, with both Big 4 and local-level industry experts constraining fair value errors in the presence of cues in many circumstances.

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Abstracts

SESSION 4.03: AUDITING COMPLEX ESTIMATES

DATE: SATURDAY, JANUARY 18, 2020

TIME: 10:15 AM–11:45 AM

How Much Do Financial Statement Auditors Affect Income Tax Reporting?

Allison Koester

Georgetown University

Bridget Stomberg

Indiana University Bloomington

Brian Matthew Williams

Indiana University Bloomington

Junwei Xia

Indiana University Bloomington

ABSTRACT: This paper examines the influence of financial statement auditors on their clients' discretionary financial reporting choices. We use an econometric technique from the labor economics literature that captures the magnitude of individual parties' influence on an outcome of interest. Focusing on discretion over income tax reporting, we estimate that audit offices explain eleven percent of the variation in tax contingency reserves (a highly subjective tax account), after controlling for time-varying company characteristics and year, industry, and manager fixed effects. In contrast, audit offices explain less than four percent of the variation in taxes paid (a less subjective tax account). This econometric technique permits the extraction of estimated audit office fixed effects, which allows us to document the magnitude of each audit office's fixed effect and to explore factors associated with these amounts. We find some evidence that audit offices that provide more tax non-audit services to their clients are associated with relatively larger client tax reserves, whereas audit offices that are industry experts for more of their clients are associated with relatively smaller client tax reserves. As the number of complex and subjective estimates in financial statements grows over time, our study provides important evidence on the magnitude of the auditor's role in determining reported financial statement amounts.

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Abstracts

SESSION 4.04: AUDIT ESTIMATES AND ADJUSTMENTS

DATE: SATURDAY, JANUARY 18, 2020

TIME: 10:15 AM–11:45 AM

Auditor Judgment in a Multiple Accountability Setting: The Effects of Power Level and Justification Timing

Amy Donnelly
Clemson University

Bonnie Jean Brown
University of Missouri–Kansas City

David Donnelly
University of Missouri–Kansas City

ABSTRACT: Auditors must often justify their decisions to multiple important parties, such as audit firm members and clients, who may have conflicting preferences. This study experimentally investigates how a difference in the power levels of two accountability sources (audit supervisor and client contact) with conflicting preferences, and a difference in justification timing impact auditor decision-making. Drawing on accountability theory (Tetlock 1999) and construal level theory (Liberman and Trope 1998), auditors' decisions are expected to differ based on whether the accountability sources are of relatively equal power, or there is a significant difference in power level between the two parties. Furthermore, the timing of the justification (i.e., whether the auditors' must immediately justify their decisions to an accountability source or justify their decisions at some point in the future) is expected to influence auditors' decisions. Consistent with expectations, the results of this study indicate auditors' decisions vary depending upon whether a power difference exists between accountability sources. Auditors more closely align their decisions with the preferences of the more powerful party when there is a difference in power level between the two sources. In addition, auditors align their decisions with the preferences of the party to whom they must justify their decisions at some point in the future, as opposed to aligning their decisions with the preferences of the party to whom they must immediately justify their decisions. Overall, this study adds to our theoretical understanding of auditor decision making within a multiple accountability setting and has implications for practice as well. Accountability to an important client may influence auditor judgment, potentially raising audit quality concerns. Firms may counter this effect by strategically increasing the salience of the final audit superior review during the audit engagement to reduce the influence of client power on auditor judgment.

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Abstracts

SESSION 4.04: AUDIT ESTIMATES AND ADJUSTMENTS

DATE: SATURDAY, JANUARY 18, 2020

TIME: 10:15 AM–11:45 AM

The Effect of Audit Procedure Extent and Precision on Auditors' Skeptical Judgments and Actions

Sarah A. Judge

University of South Carolina

ABSTRACT: In the current paper, I investigate how the extent and precision of an audit procedure influence auditors' responses to errors. I predict and find that as the extent of an audit procedure expands, auditors will be more likely to recommend audit adjustments. However, this effect is moderated by the presence of false positives such that increases in extent only increase the likelihood of recommending audit adjustments when false positives are absent. The effect of extent on likelihood judgments is mediated by auditors' reliability judgements. The results suggest that while audit procedures with expanded extents are beneficial, this benefit is reduced when expanding the extent exposes auditors to more false positives.

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Abstracts

SESSION 4.04: AUDIT ESTIMATES AND ADJUSTMENTS

DATE: SATURDAY, JANUARY 18, 2020

TIME: 10:15 AM–11:45 AM

Interactive Auditor-Client Negotiations: Investigating the Roles of Blame and Conservatism

Richard Hatfield

The University of Alabama

Curtis Mullis

Georgia State University

Ken T. Trotman

UNSW Sydney

ABSTRACT: In this study we consider how social interactions that occur during negotiations between auditors and their clients can impair compliance with regulatory guidance regarding the posting of material misstatements. Specifically, we consider how the direction and accumulating nature of misstatements influence agreed upon adjustments to the financial statements. To test the effect of these characteristics, we construct experimental dyads consisting of audit partners and financial officers, allowing them to interact via a web-based instrument, to reach a mutually agreed upon audit adjustment. As predicted, these misstatement characteristics alter the positions of the negotiators and negotiated outcomes. Specifically, auditors impound a sense of blame when negotiating accumulated audit differences, given their role in passing on adjustments in the past, leading to smaller agreed-upon adjustments. Further, dyads determine smaller adjustments when considering an income increasing, versus decreasing, difference due to financial officers' perception of auditors' lack of concern over income increasing adjustments. Additionally, we describe the content of the communications between auditor and client management participants to demonstrate how these parties strategically use the manipulated differences in the negotiation context in efforts to persuade the other party. Finally, we provide evidence that this interactive setting provides different inferences than would be obtained from a traditional, non-interacting, experimental setting.

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Abstracts

SESSION 5.01: AUDIT OPINIONS AND PARTNER IDENTIFICATION

DATE: SATURDAY, JANUARY 18, 2020

TIME: 1:45 PM–3:15 PM

Do Clients Reward or Punish Audit Offices for Issuing Going Concern Modified Opinions

Michael Ettredge
The University of Kansas

Xudong Li
Monmouth University

Qiyang Lian
The University of Kansas

Lili Sun
University of North Texas

ABSTRACT: This study examines the effect of the aggregated number of going concern opinions (GCOs) an office issues on its subsequent changes in market shares at the metro level. In theory, the number of GCOs issued each year at office level provides information about 1) an office's willingness to tolerate clients in poor financial health under its current office acceptance and retention policies, and 2) an office's tendency to avert legal and reputational risk by issuing GCOs. Those clients with incentives to "seek risk tolerance" will be attracted to an office with more GCOs, whereas those clients with incentives to "avoid GCO receipt" will be repelled from an office with more GCOs. Therefore, the impact of GCOs issued by an office on its market shares should depend upon the net effect of its clients' (and potential clients') managers' incentives to "seek risk tolerance" versus to "avoid GCO receipt". Analyzing a large sample of U.S. audit offices from year 2000 to year 2017, we find that an office's GCOs issuance is associated with a reduction in local market shares, more client dismissals, and fewer new client acquisitions in the subsequent year. This penalizing effect of office-level GCOs holds for only non-Big 4 offices, consistent with the notion that Big 4 clients on average are healthier and thereby do not make office affiliation decisions on the basis of offices' GCO issuances. Additional analysis of auditor dismissal at the client level supplements the main results. Taken together, our results suggest that financially weak clients' incentives to "avoid GCO receipt" dominate their incentives to "seek risk tolerance", resulting in a reduction of market shares among non-Big 4 offices issuing more GCOs.

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Abstracts

SESSION 5.01: AUDIT OPINIONS AND PARTNER IDENTIFICATION

DATE: SATURDAY, JANUARY 18, 2020

TIME: 1:45 PM–3:15 PM

Fair Value Opinion Shopping or Unbiased Reporting?

Minjae Koo

University of Houston

Yuping Zhao

University of Houston

ABSTRACT: Insurers frequently change the pricing sources of their fixed income securities. We study the causes and consequences of the pricing switch. We hypothesize that pricing switch could be driven by both managerial opportunism to inflate fair value estimation (i.e., FV opinion shopping) and/or managerial effort to more faithfully report the value of assets (i.e., unbiased reporting). We categorize pricing switches as upward switches — where the firm switches to a new source that prices the security at a higher level than the current pricing source does, and downward switches — where the opposite occurs. We find that upward switches can be explained by both unbiased reporting and FV opinion shopping, whereas downward switches are mostly driven by unbiased reporting. Further, the manager is less likely to correct a prior upward bias than a downward bias, and is more likely to exacerbate a prior upward bias than a downward bias. Pricing switch exhibits a pattern more consistent with FV opinion shopping when it is engaged by insurers with strong concerns for regulatory capital and for securities with high probability of other-than-temporary impairments (OTTI). Next, we examine the consequences of pricing switch from three perspectives. First, pricing switch leads to a more favorable fair value estimation, especially for securities that are priced based upon level 1 and level 2 inputs. However, FV opinion shopping via upward switches is mitigated by the presence of regulatory financial examination and Big 4 auditors. Second, upward switch effectively reduces both the likelihood and the magnitude of OTTI recognition, especially for securities with high probability of impairment. Third, the auditor charges higher investment-related audit fees for upwardly switched securities. Such audit fee increases further depend on whether the pricing switch seems justified. Fourth, the credit rating agency assigns greater credit risks on upwardly switched securities. In sum, we provide evidence that the manager strategically changes the pricing source of fixed income securities in order to achieve certain reporting objectives, and that there are certain costs associated with FV opinion shopping.

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Abstracts

SESSION 5.01: AUDIT OPINIONS AND PARTNER IDENTIFICATION

DATE: SATURDAY, JANUARY 18, 2020

TIME: 1:45 PM–3:15 PM

Do Investors Find Audit Partner Identification Useful? Evidence from the KPMG “Steal the Exam” Scandal

William L. Buslepp

Louisiana State University

Lawrence J. Abbott

University of Wisconsin–Milwaukee

Russell Barber

Louisiana State University

Pradeep Sapkota

Louisiana State University

ABSTRACT: On April 11, 2017, the Securities and Exchange Commission (SEC) announced charges against KPMG LLP – arising from their participation in a scheme to misappropriate and use confidential information relating to the Public Company Accounting Oversight Board’s (PCAOB) planned inspections of KPMG. The incident was colloquially labeled the KPMG ‘steal the exam scandal.’ We use this setting to investigate if the market finds information concerning individual partner identity useful. Since KPMG withheld the names of the audit partners who were involved in the scandal, the market was unable to distinguish between rotation-induced audit partner turnover and regulatory-related, audit partner terminations. Following information economics models of non-disclosure, we predict that the market would use information about KPMG audit partner turnover as evidence of regulatory-related, audit partner terminations and impose costs on KPMG audit clients who experienced audit partner turnover. The results are consistent with our prediction as KPMG’s overall reputation was not damaged, whereas audit engagements involving audit partners that were potentially involved in the scandal were. In sum, our results suggest that the market finds audit partner identification useful and informative.

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Abstracts

SESSION 5.02: FINANCIAL MISCONDUCT AND AUDITOR BUSYNESS

DATE: SATURDAY, JANUARY 18, 2020

TIME: 1:45 PM–3:15 PM

Monitoring Off-the-Clock Behavior

Brant E. Christensen

The University of Oklahoma

Brandon Cline

Mississippi State University

Nathan Lundstrom

The University of Kansas

Adam Yore

University of Missouri

ABSTRACT: We examine whether two key external monitors—financial statement auditors and financial analysts—respond to public allegations of personal indiscretions against companies' CEOs, other executives, and directors. Specifically, we hand collect and examine personal indiscretions of four types: violence, sexual misadventure, substance abuse, and dishonesty. We find that auditors of indiscretion firms charge significantly higher fees and take longer to issue the audit report in the year of the allegation and are also significantly more likely to resign from the client. We also find that analysts' EPS and consensus forecasts immediately following the first public mention of the allegation are significantly lower and forecast dispersion is higher. Results among both monitors are strongest for allegations related to the CEO, and auditor responses are strongest when the allegation relates to personal dishonesty. Importantly, supplemental tests show that the documented results are not merely due to subsequent declines in actual operating performance or subsequent turnover of the CEO. We interpret our results as suggesting that auditors and analysts view management's personal indiscretions as representing poor tone at the top, thus increasing risk for the company as a whole.

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Abstracts

SESSION 5.02: FINANCIAL MISCONDUCT AND AUDITOR BUSYNESS

DATE: SATURDAY, JANUARY 18, 2020

TIME: 1:45 PM–3:15 PM

Engagement Partner Busyness and Audit Quality: Evidence from the U.S.

Brian Todd Carver

Clemson University

Carl W. Hollingsworth

Clemson University

Terry L. Neal

The University of Tennessee

ABSTRACT: Busy engagement partners face significant time allocation issues that can encourage the partner to take shortcuts during the performance of an audit. Engagement partners, however, have strong reputational incentives to provide high-quality audits. As a result, they may rely on the resources of the accounting firm in order to ensure that each client receives a high-quality audit. Individual firms, however, do not provide access to the same level of resources. This could significantly affect the ability of the engagement partner to mitigate any potential negative effects of maintaining a relatively heavy workload. We investigate this possibility using a sample of engagement partners from U.S. accounting firms registered with the PCAOB. Our results are inconclusive when we consider all clients together. When firm size is considered, our results suggest that busy Big 4 engagement partners are able to maintain a level of audit quality that is consistent with other Big 4 engagement partners, while busy non-Big 4 engagement partners are associated with lower audit fees, longer audit delay, a greater propensity to manage earnings, and a greater likelihood of just meeting earnings benchmark targets.

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Abstracts

SESSION 5.02: FINANCIAL MISCONDUCT AND AUDITOR BUSYNESS

DATE: SATURDAY, JANUARY 18, 2020

TIME: 1:45 PM–3:15 PM

Enterprise Risk Management and Financial Misconduct

Evan Eastman

Florida State University

Chan Li

The University of Kansas

Lili Sun

University of North Texas

Jianren Xu

University of North Texas

ABSTRACT: This study examines the impact of enterprise risk management (ERM) programs on corporate financial misconduct. ERM represents a structured, holistic approach to managing the entire portfolio of risks faced by an enterprise (COSO 2004, 2009). Theoretically, we expect that ERM is associated with less financial misconduct because ERM can effectively reduce opportunities for managers' engagement of financial misconduct by enhancing audit and internal control effectiveness. It can also reduce incentives for managerial financial misconduct by 1) emphasizing reputation risk management, 2) mitigating managerial short-termism, 3) reducing need and cost of external financing, and 4) alleviating financial distress. Since the adoption of ERM is voluntary, to alleviate endogeneity concerns, we use two-stage least squares (2SLS) and a differences-in-differences design. Our analyses are conducted based upon hand-collected data of ERM adoptions among S&P 500 firms from 1990 to 2017. Consistent with our expectation, we find that ERM adoption is associated with less financial misconduct measured by levels of discretionary accruals, AAER violations, class action lawsuits, and financial restatements. The deterrent effect of an ERM on financial misconduct becomes stronger as the ERM becomes more mature over time. These results are robust after controlling for internal control over financial reporting (ICFR) and alternative model specifications controlling for firm fixed effects. Our findings suggest that ERM is beneficial to financial reporting quality and have implications for the debate on ERM's benefits to enterprises.

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Abstracts

SESSION 5.03: AUDIT PLANNING ISSUES

DATE: SATURDAY, JANUARY 18, 2020

TIME: 1:45 PM–3:15 PM

Material Judgments in Materiality Determination

Wilbert Snoei

Nyenrode Business University

Joost Van Buuren

Nyenrode Business University

Barbara Majoor

Nyenrode Business University

ABSTRACT: There is limited archival research on the determination of materiality in the audit of financial statements. In this study, we examine the drivers of setting planning materiality and tolerable error. Our findings are based on proprietary data derived from audit files over the years 2005-2015. We use the accountability theory as explaining theory for the materiality determination, in which the accountable person, the accountability source and the communication between those are operationalized. We find significant differences in materiality setting between audit firms, where the Big4 audit firms apply the highest levels of materiality. Furthermore, the clients' and users' interests as accountability sources seem to be contradictory in influencing the materiality setting. It turns out that the client relationship and economic bonding affects the level of materiality. Overall, our findings highlight the different factors in materiality assessment between firms and urges a better understanding in this important topic.

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Abstracts

SESSION 5.03: AUDIT PLANNING ISSUES

DATE: SATURDAY, JANUARY 18, 2020

TIME: 1:45 PM–3:15 PM

Reliance on Third Party Verification in Bank Supervision

Yadav Krishna Gopalan

Indiana University Bloomington

Andrew John Imdieke

University of Notre Dame

Joseph H. Schroeder

Indiana University Bloomington

Sarah B. Stuber

Texas A&M University

ABSTRACT: We examine how third party verification of internal controls over financial reporting (ICFR) affects bank supervision by exploiting a change in size thresholds for required FDICIA-related internal control audits. We document that affected banks have higher reported levels of nonperforming loans after the removal of internal control audit requirements compared to unaffected banks. This increase in non-performing loans is not accompanied by increases in past due loans, indicating more forthcoming reporting by management rather than operational deterioration. Furthermore, we find that the effects are concentrated in periods of heightened regulatory scrutiny and in banks with less stringent oversight in the pre-period. Examiners increase the length of targeted examinations and downgrade regulatory ratings, indicating an increase in stringency after the elimination of third-party verification of internal controls over financial reporting. Our findings suggest that third-party verification of internal controls is an imperfect substitute for bank supervision and efforts to rely upon externally generated assurance may heighten bank risk.

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Abstracts

SESSION 5.03: AUDIT PLANNING ISSUES

DATE: SATURDAY, JANUARY 18, 2020

TIME: 1:45 PM–3:15 PM

*Economic Consequences of Auditing Standards: Evidence from Auditing Standard No. 18
Related Parties*

Haihao Lu

University of Waterloo

Ole-Kristian Hope

University of Toronto

Songlan Peng

York University

ABSTRACT: In 2014, the PCAOB adopted a new auditing standard - AS 18 Related Parties - to improve auditors' performance in related-party transaction (RPT) auditing. In this study, we investigate the impact of AS 18 on firms' real RPT activities and audit fees by examining six years' data surrounding the effective date of AS 18. Using a matched-pair difference-in-differences approach, we find significantly reduced RPT activities and increased audit fees following the adoption of AS 18. Our findings reveal that AS 18 has a greater impact on small client firms, particularly firms audited by non-Big-4 firms. In contrast, the Big-4 firms had already taken measures to improve their RPT audit procedures. We also find a more pronounced effect for firms with high ex-ante fraud risk.

Abstracts

SESSION 5.04: AUDITOR THINKING: APPROACH, INTUITION, AND MINDSET

DATE: SATURDAY, JANUARY 18, 2020

TIME: 1:45 PM–3:15 PM

The Impact of Thinking Approach on Offshore Auditors' Judgment Quality in Performing Analytical Procedures

Skye Zhu

The Australian National University

Neil L. Fargher

The Australian National University

Soon-Yeow Phang

Monash University Caulfield

ABSTRACT: There is concern regarding the quality of audit work conducted in offshore service centers (e.g., PCAOB 2015; CAQ 2015). One criticism raised is that offshore auditors tend to adopt a more reductionist, “tick-box” approach to auditing. We conducted a 2×2 quasi-experiment in which we manipulated thinking approach (system thinking versus reductionist thinking) between-subjects and compared the judgment quality of 44 offshore auditors located in India and 50 onshore auditors located in U.S. and Australian Big 4 firms (onshore versus offshore auditors). Our results indicate that onshore auditors achieve higher judgment quality than offshore auditors for the analytical procedure task. Use of a systems-thinking approach helps offshore auditors to achieve better judgment quality as measured by the likelihood allocated to a CFO explanation. The evidence is however mixed with respect to the effect of the interaction between offshore location and type of thinking approach, suggesting that the concerns regarding offshoring cannot be simply explained by offshore auditors adopting a reductionist auditing approach. Our research provides some support for continued concerns surrounding offshoring and is relevant to calls for maintenance of adequate quality control across both onshore auditors and offshore service centers (e.g. IAASB 2019).

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Abstracts

SESSION 5.04: AUDITOR THINKING: APPROACH, INTUITION, AND MINDSET

DATE: SATURDAY, JANUARY 18, 2020

TIME: 1:45 PM–3:15 PM

When Documentation Inhibits Helpful Auditor Intuition: An Examination of Experience and Accountability

Erin Michelle Hawkins

Clemson University

Scott David Vandervelde

University of South Carolina

Aaron F. Zimbelman

University of South Carolina

ABSTRACT: We examine whether more experienced auditors develop helpful intuition through pattern recognition. We expect documentation requirements to inhibit the use of intuition by activating different knowledge structures, reducing judgment quality in areas where auditors have helpful intuition. In an experiment with practicing auditors, we find evidence suggesting that more experienced auditors develop helpful intuition related to misstatements caused by error (detected with relative frequency in practice, conducive to the development of knowledge structures) but not fraud (detected with relative infrequency in practice, not conducive to the development of knowledge structures). Further, when auditors are asked to document justification for their error-related risk assessments, their judgment quality decreases relative to the judgments of an expert panel. This suggests that documentation requirements include a hidden cost that may decrease audit quality by activating different knowledge structures and thereby crowding out helpful intuitive knowledge structures.

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Abstracts

SESSION 5.04: AUDITOR THINKING: APPROACH, INTUITION, AND MINDSET

DATE: SATURDAY, JANUARY 18, 2020

TIME: 1:45 PM–3:15 PM

How Does “Fit” Versus “Non-Fit” Affect Audits of Estimates? The Compatibility Between Focus and Mindset

Bright Hong

The University of Iowa

ABSTRACT: Auditors frequently fail to critically evaluate management’s accounting estimates, jeopardizing financial reporting quality (PCAOB 2017). I propose that one way to potentially improve audits of estimates is to align an auditor’s focus (prevention/promotion) and mindset (concrete/abstract) in a compatible way. I predict that judgment quality will be higher when the focus and mindset fit versus do not fit each other. Results partially support my prediction. I find that judgment quality is higher under fit versus non-fit for auditors who are initially less engaged in the judgment task. However, for auditors who are initially more engaged in the task, judgment quality is higher under non-fit versus fit. My study suggests that how fit versus non-fit affects performance is more complex than previously thought. My study implies that firms should consider auditors’ initial task engagement when using fit and non-fit to improve audits of estimates.

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Abstracts

SESSION: BREAK WITH RESEARCH AND EDUCATION POSTER FORUM
DATE: SATURDAY, JANUARY 18, 2020
TIME: 3:15 PM–4:00 PM

A Note on the Potential Usefulness of Separate Consideration of Different Types of Auditor Changes in Market Reaction Studies

Richard Holwczak
Baruch College–CUNY

David Louton
Bryant University

Hakan Saraoglu
Bryant University

Charles P. Cullinan
Bryant University

ABSTRACT: Research examining market reactions to auditor changes has generally yielded models with low explanatory power (typically single digits). Part of the reason for this low explanatory power may relate to treating all auditor changes as one type of event; implicitly assuming that market reaction to different types of auditor changes would all be affected by the same factors. We consider whether certain types of auditor changes may be more predictable than other by splitting our observations based on the Big 4 status of the old and new auditors. We find that the most explainable market reactions are those in which a client moves from a non-Big 4 to a Big 4 auditor, with this model explaining nearly 25% of the variation in market reaction.

Abstracts

SESSION: BREAK WITH RESEARCH AND EDUCATION POSTER FORUM
DATE: SATURDAY, JANUARY 18, 2020
TIME: 3:15 PM–4:00 PM

Are Accounting Professors Effective Monitors? An Empirical Investigation of Accounting Professors on Audit Committees

Wei Yu
Hunter College–CUNY

Jian Zhou
University of Hawaii at Manoa

ABSTRACT: In this paper, we investigate the phenomenon of accounting professors (AP) on audit committees. On one hand, AP have the training and expertise to be effective monitors. AP have been exposed to the monitoring role of audit committees through the literature on the impact of audit committees on financial reporting quality. AP also have incentives to be effective monitors to preserve their reputation in the labor market and in academia. The training, expertise, exposure and reputation incentives may help them become effective monitors. On the other hand, AP may be less likely to be effective monitors for a couple of reasons: (1) compensation dependency; (2) lack of recent real business experience. The compensation from board membership may constitute a large percentage of the compensation of an AP audit committee member compared to other board members. The compensation dependency may weaken AP independence. AP may also lack recent real business experience. Given the lack of the recent real business experience, they may defer to other audit committee members for significant monitoring decisions. The compensation dependency and lack of recent real business experiences may weaken the monitoring effectiveness of AP audit committee members. Our findings suggest that AP audit committee members are effective monitors. More specifically, firms with AP audit committee members are related to less earnings management as measured by discretionary current accruals. These firms are also related to lower fraud score and fewer internal control weaknesses. Our findings are robust to either AP audit committee members or AP audit committee chair. These findings show that the training, expertise, exposure and reputation incentives of AP dominate the compensation dependency and lack of recent real business experience. Our findings have implications for management, boards of directors, regulators and academia.

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Abstracts

SESSION: BREAK WITH RESEARCH AND EDUCATION POSTER FORUM
DATE: SATURDAY, JANUARY 18, 2020
TIME: 3:15 PM–4:00 PM

Attestation, Upcharges, and Nonassurance Services: An Empirical Review of Assurance Pricing Around Local Government Organization Form in a Municipal Market

Alfred Yebba
Binghamton University, SUNY

Randal J. Elder
The University of North Carolina at Greensboro

ABSTRACT: This study provides an empirical analysis of bundled auditor services in a governmental market. We first explore differences in demand for audit services depending on governmental organizational form and find increased use of a market leading auditor and use of some of the largest audit firms in the country. Then, using a unique data set, we examine the pricing for auditor services including bookkeeping fees, financial statement preparation fees, and the likelihood of the municipality being upcharged on their audit contract. The results suggest that nonassurance services are indirectly associated with attestation pricing. Additionally, the evidence suggests governments that are upcharged on their base contract tend to have greater initial audit pricing, suggesting that upcharges are not used in response to a low-balled bid but rather assessed in response to client deficiencies discovered in the audit process. Auditor changes indicate that governments are sensitive to billing for attestation and nonassurance services and that through changing auditors, governments do not necessarily select market leaders. Evidence is found of greater demand for fee premium specialist auditors with other auditors discounting, regardless of their expertise. Demand for types of nonassurance services and upcharges also varies with auditor specialization and a government's auditor retention

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Abstracts

SESSION: BREAK WITH RESEARCH AND EDUCATION POSTER FORUM
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TIME: 3:15 PM–4:00 PM

Audit Fee Premium: Does Audit Partner Expertise in Digitalization Pay Off?

Arpine Maghakyan
Aalto University

Lasse Niemi
Aalto University

Henry Jarva
Aalto University

Jukka Sihvonon
Aalto University

ABSTRACT: This study examines whether clients are willing to pay an audit fee premium for audit partner with expertise in client's digitalization. Using panel data on large Finnish public and private companies for the five-year period (2012-2016), we construct client portfolios for all audit partners in the market for large audit clients. After controlling for the audit partner's generic expertise, industry specialization, various audit partner and client characteristics, we document four interesting findings regarding the audit partner's expertise in client's digitalization. First, audit partners that have more experience in highly digitalized clients earn audit fee premium not only for highly digitalized clients but for all of their clients, suggesting that expertise gained from auditing highly digitalized clients is a generic skill rather than industry-specific one. Second, when industries are clustered together based on similarities in the forms of digitalization between industries, leading audit partners in these clusters earn a fee premium. Third, the magnitude of fee premium earned from the expertise in highly digitalized clients, however, increases with the level of digitalization of a given industry. Combined, our results suggest that the audit partner's expertise in digitalization brings value to all clients, but particularly for highly digitalized clients. Keywords: audit partner expertise, audit fees, digitalization, business automation.

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Abstracts

SESSION: BREAK WITH RESEARCH AND EDUCATION POSTER FORUM
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TIME: 3:15 PM–4:00 PM

Audit Fees and Earnings Downside Risk

Laura Rickett
Cleveland State University

Pervaiz Alam
Kent State University

Paris Liu
Kent State University

ABSTRACT: We examine whether accounting-based earnings downside risk is captured in audit fees. Do auditors price accounting-based earnings downside risk or the expectation of future downward operating performance? Audit fees are determined partially based on risk because riskier audit clients are charged higher audit fees as a compensation for higher risk (Simunic and Stein 1996). Prior studies primarily examine the effect of litigation risk (Simunic and Stein 1996) and control risk (Jiang and Son 2014) on audit fees. However, no study that we are aware of considers accounting-based downside risk in the pricing of audit services. Accounting-based or earnings downside risk (EDR) is the expectation of future downward operating performance and is an important consideration when evaluating risk as it contains distinct information about the overall risk of the client firm. Konchitchki et al. (2016) demonstrate that earnings downside risk has a key role in risk assessment by documenting that earnings downside risk explains the variation in the cost of capital and this link is incremental to earnings attributes, accounting and risk factor betas, return downside risk, default risk, earnings volatility, and firm fundamentals. We find that earnings downside risk is significantly and positively associated with audit fees indicating that audit firms are more likely to consider earnings downside risk in their audit risk assessment for purposes of setting audit fees. Earnings downside risk is expected to reduce the acceptable level of audit risk due to the increased risk that client firm will experience financial difficulties as a result of downward operating performance in the future. The auditor will charge higher fees to compensate for this increased risk. We split the sample into Big4 and non-Big4 firms and find positive and significant relationship for both groups, between earnings downside risk and audit fees. This relationship is slightly less significant for non-Big 4 audit firms, but overall it appears that audit firms consider EDR when evaluating audit risk and audit firms may charge higher fees for firms with higher earnings downside risk.

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Board Level Co-Determination and Aggressive Reporting: Do Employees on the Board influence Tax Aggressiveness and Earnings Management?

Marc Eulerich
University Duisburg-Essen

Benjamin Fligge
University Duisburg-Essen

ABSTRACT: We examine whether board level co-determination reduces aggressive reporting. Therefore, we define aggressive reporting as high degrees of tax aggressiveness on the one hand and as the intensive use of earnings management on the other hand. From an agency-perspective, we expect that co-determination can reduce tax aggressiveness and earnings management, but we also consider that low expertise of employee representatives can build up information asymmetries between management and audit committee / supervisory board and thus leads to more earnings management. Our results suggest that co-determination can reduce reporting aggressiveness. Especially, the proportion of full-time unionists on the supervisory board is an important co-determination mechanism that reduces reporting aggressiveness. Surprisingly, we found more tax aggressiveness in firms where the vice chairman is an employee representative.

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CEO Accounting Background and SEC Comment Letters

Yu-Chun Lin

National Changhua University of Education

ABSTRACT: To improve the disclosure quality of companies, the SEC periodically reviews the filings of all public companies and issues comment letters to companies whose filings are determined to be deficient in some way. This study investigates the association between CEO accounting background and the likelihood of receiving comment letters. We collected comment letters data from the EDGAR database. By controlling for firms characteristics, audit quality, and other common corporate governance variables, this study finds that (i) CEO accounting background is negatively associated with the likelihood of receiving SEC comment letters, and (ii) when firm executives are accounting experts, firms' response time for the resolution of comment letter is shorter. Furthermore, CEO accounting background mitigates the receipts of accounting rule violation comment. The evidence about CEO characteristics and comment letters might provide political implications for the SEC publicly releasing comment letters and the correspondence from 2005.

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Clients' "Soft" Political Contributions and Auditor Pricing—Evidence from a Natural Experiment on Campaign Finance Regulation

Shunlan Fang
Kent State University

Benjamin Hoffman
Cleveland State University

R. Drew Sellers
Kent State University

ABSTRACT: We utilize a natural experiment on campaign finance regulation to examine the causal relation between corporate “soft” political contributions and audit fees. Corporate soft money donation was used to circumvent the restrictions on the fundraising of federal candidates. The loophole in the campaign finance law coupled with corporate frauds in the early 2000s eventually led to the passage of Bipartisan Campaign Reform Act (BCRA) in 2002, aka the McCain-Feingold Act, which banned corporate soft money contributions. Our results indicate that auditors priced client’s risks associated with political contributions and that the price premium attenuated once firms’ ability to make “soft” political contributions was restricted. Based on additional analysis, these results cannot be explained by changes in corporate lobbying activities, accrual quality or the differential impact of SOX on firms.

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Abstracts

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TIME: 3:15 PM–4:00 PM

Contagion of Financial Misconduct: Unethical Institutional Ownership and Aggressive Financial Reporting

Babak Mammadov
Clemson University

Avishek Bhandari
University of Wisconsin–Whitewater

Blerina Bela Zykaj
Clemson University

ABSTRACT: This paper contributes to the new stream of literature on contagious unethical corporate behavior. We examine how financial misconduct of institutional investors (i.e. their disciplinary history) affects managerial incentives to engage in aggressive financial reporting practices. Specifically, we conjecture that institutional investors who faced disciplinary actions themselves (i.e. unethical institutional investors) are less likely to provide monitoring and more likely to overlook or even nudge firms towards aggressive financial reporting to boost short-term performance. We find evidence that firms held by unethical institutional investors are more likely to engage in aggressive financial reporting practices, such as earnings management, which results in restatement or receiving accounting and auditing enforcement release (AAER) from the SEC. Next, we show that higher unethical institutional ownership positively affects the stock price crash risk, suggesting that unethical institutional ownership increases a firm's bad news hoarding behavior. Interestingly, we find evidence of ethical institutional investors impeding firm's aggressive financial reporting. The results continue to hold after implementing various statistical tests to address potential endogeneity issues (i.e., regression discontinuity analysis, two-stage least squares regression and propensity-score matched methodology). Our study is the first to investigate the implications of institutional investors' ethics on corporate governance.

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TIME: 3:15 PM–4:00 PM

Corporate Innovation and Audit Fees

Daqun Zhang

Texas A&M University–Corpus Christi

Donald R. Deis

Texas A&M University–Corpus Christi

Hsiao-Tang Hsu

Texas A&M University–Corpus Christi

ABSTRACT: Economic literature documents that the investment rate of intangibles has exceeded that of tangible assets in the U.S. private sector since the mid-1990s. However, whether or how the increasing intangibles created by innovative activities affect audit process and pricing have not been empirically examined yet. This study investigates whether the features of corporate innovation (e.g., complexity, efficiency, or obsolescence) are associated with audit fees. Using patent-based metrics to measure the features of innovation within firms, we find that the complexity of corporate innovation is positively associated with audit fees, while auditors do not charge higher fees for clients with greater research and development (R&D) intensity. Firms that can more efficiently convert R&D inputs into innovation outputs, which are measured by the number, citation frequency, and economic value of patents, are associated with lower audit fees. Furthermore, firms holding more aged patent portfolio are associated with higher audit fees.

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Determinants and Consequences of Audit Committee Voluntary Disclosures

Zhongxia Ye

The University of Texas at San Antonio

ABSTRACT: In recent years a variety of stakeholders request more disclosures of audit committees' activities. In response, audit committees in many large companies have voluntarily enhanced the depth and scope of the disclosures of their activities in the proxy statements. However, controversy arises surrounding whether more disclosures of audit committees' activities are beneficial to investors. In 2015, the SEC started to seek comments from the public on this issue. I find that companies with more diligent, more active, longer-tenured audit committee members and audit committees with a higher proportion of female members provide more voluntary disclosures of audit committees' activities. However, audit committees that face higher litigation risk are less transparent about their activities. Also, larger companies that pay higher total auditor fees and expect more future equity financing, and companies that have adopted the majority voting policy for director elections provide more voluntary disclosures of audit committees' activities. Moreover, I find that audit committee voluntary disclosures are associated with shareholders' voting on the elections of audit committee director nominees and auditor ratification. However, the significance and directions of the associations vary with the content of the disclosures. Audit committees get more supportive votes in director elections if they discuss their considerations in appointing the external auditor, but there is weak evidence that audit committees get more negative votes in director elections if they discuss how nonaudit services may impact auditor independence or indicate that the evaluation of the external auditor is at least an annual event. Further analysis suggests that the discussion of how nonaudit services may impact auditor independence can lower shareholder dissatisfaction toward audit committees for high nonaudit fee ratios. Also, only when the nonaudit fee ratio is high shareholders are dissatisfied with the disclosure that the evaluation of the external auditor is at least an annual event. Moreover, shareholders are more likely to vote against the auditor ratification if the audit committee indicates that it has shared responsibility for risk oversight, or if the audit committee discusses how nonaudit services may impact auditor independence. Overall, this study can benefit policy makers such as the SEC and PCAOB as well as audit committees.

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Determinants of the Existence and Extent of Delays in Naming a Successor Auditor

John Conrad Naegle
Missouri State University

ABSTRACT: The Securities and Exchange Commission (SEC) mandates timely public disclosure of an external auditor change by a publicly traded client company. Typically, the disclosure names the successor auditor. At times, however, the successor is initially unnamed, but is typically named in a later announcement. This study identifies instances of these auditor change events, and hypothesizes they (1) include the disclosure of more undesirable information about the client company; and (2) as the amount of this undesirable information increases, the number of days that pass before appointing a successor increase. The results, including both primary and supplemental tests, show significant evidence consistent with both hypotheses; however, exceptions with primarily the second hypothesis are noted with diminishing sample sizes in supplemental tests. This study contributes to the auditor changes literature by identifying and empirically investigating the determinants of this sparsely identified and researched type of auditor change, opening opportunities for future research. The study also expands our understanding of the auditor-client relationship surrounding the occurrence of certain auditor change events likely associated with a measure of auditor-client friction.

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Does Exposure to Crime Distort Social Norms: Evidence from Local Crime Rate and Financial Misreporting

Babak Mammadov
Clemson University

ABSTRACT: Akers and Jensen's (2006) social learning theory of deviance proposes that exposure to crime increases the probability of individuals' engaging in deviant or unethical behavior. Medical research concludes that exposure to violence makes people less empathetic to others' pain because such exposure causes the parts of the brain responsible for empathy to experience reduced activation. This study investigates whether exposure to crime affects managers' tendency to misreport financial statements. The results show that managers who are exposed to a higher local crime rate are more likely to engage in financial misreporting, resulting in a higher likelihood of restatements. Further analysis demonstrates that the effect is stronger in areas where managers have greater exposure to crime through media coverage. The results are robust and continue to hold after addressing the endogeneity issues. Additional analysis shows that management is more likely to hoard bad news in higher crime areas, resulting in increased stock price crash risk. Overall, the results suggest that the managers who are exposed to a higher crime rate in a local area are less likely to empathize with investors who suffer from the negative consequences of financial misreporting. This study has public policy implications and contributes to the debate about the effect of social norms on financial reporting.

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JASP for Audit: Bayesian Tools for the Auditing Practice

Koen Derks

Nyenrode Business University

Jacques de Swart

Nyenrode Business University

Eric-Jan Wagenmakers

University of Amsterdam

Jan Wille

PwC

Ruud Wetzels

Nyenrode Business University

ABSTRACT: Statistical theory is fundamental to many auditing guidelines and procedures. In order to assist auditors with the required statistical analyses, and to advocate state-of-the-art Bayesian methods, we introduce JASP for Audit (JfA). JfA is easy-to-use, free-of-charge software that automatically follows the standard audit workflow, selects the appropriate statistical analysis, interprets the results, and produces a readable report. This approach reduces the potential for statistical errors and therefore increases audit quality. Next to the frequentist methods that currently dominate audit practice, JfA incorporates Bayesian counterparts of these methods that come with several advantages. For example, Bayesian statistics allows incorporation of expert knowledge directly into the statistical analyses, allowing for a decrease in sample size, and an increase in efficiency. In sum, JfA is designed with the auditor in mind, it guides the auditor through the statistical aspects of an audit, and therefore has the potential to increase audit efficiency and quality.

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TIME: 3:15 PM–4:00 PM

Key Audit Matters: Does ISA 701 Provide Self-Explanatory Matters for Audit Report Decisions?

Mohamed Abdel Aziz Hegazy
The American University in Cairo

Noha Kamar Eldawla
Cairo University

ABSTRACT: Purpose: This study aims to investigate how external auditors properly classify the requirement of ISA 701 for Key Audit Matters (KAM) compared with Emphasis of a Matter or other matter (EOM) in ISA 706, Going Concern (GC) in ISA 540 and qualified opinion (QO). Design/methodology/approach: This research uses survey-based questionnaires sent to a sample of external auditors in five audit firms with international affiliation including two of the big 4. Descriptive and statistical analyses mainly paired sample t-test were undertaken to assess whether external auditors faced confusion when interpreting the explanatory matters included in ISAs. Findings: The research suggests that the current ISA 701 may not adequately help auditors in their proper identification of all KAM from among the different matters they reach during their audit. When EOM and GC were introduced most of the auditors were not able to differentiate them from KAM, either through misclassifying them as KAM or through having little agreement toward the correct classification. Originality/value: This study is considered among the first that surveyed the appropriateness of the explanations included in ISAs for KAM, EOM, GC and how auditors perceive them when forming their opinion about their clients' financial statements. Practical Implications: The study is timely, and the results have implications for standard setters and regulators through revising the different audit reporting standards including ISA 701, and consider the interactions among them.

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Knowledge and Skill Requirements for Audits of Fair Values

Jefim Boritz
University of Waterloo

Lev Timoshenko
University of Calgary

ABSTRACT: This study contributes to the auditing educational literature by identifying competencies critical for correct performance of fair value auditing tasks and heuristics and behavioral shortcuts that may need corrective action and that may be addressed in the classroom. Using the audit of goodwill impairment as the exemplar task for identifying fair value auditing competencies, we create a normative process map for this task through an analysis of accounting and auditing standards and verbal protocols of experienced auditors. Next, we use an analysis of verbal protocols of students' performance of the task and a comparison of those protocols against the normative process map to develop an understanding of weaknesses in how students approach the audit of goodwill/cash generating unit (CGU) impairment under IFRS. These findings lead to recommended curriculum development to address the identified weaknesses that should be of interest to auditing educators and audit firm personnel involved in development of staff training programs.

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TIME: 3:15 PM–4:00 PM

Long Term Trends in Auditor Choice

Hua Xin
University of Louisville

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

Jerry W. Lin
University of South Florida St. Petersburg

Baolei Qi
Xi'an Jiaotong University

ABSTRACT: The division of the market for audit services across the Big-4 (KPMG, PWC, D&T, and E&Y) and non-Big-4 (NB-4) auditors reflects both demand-side effects (perceptions of higher Big-4 quality) and supply-side effects (the difference in fees across these two auditor types). Using empirical evidence from long-term changes in Big-4 market shares over the period 2001-2015, we demonstrate a counter-intuitive result that a larger increase of audit fees by Big-4 auditors relative to NB-4 auditors results in a lower likelihood of switching to an NB-4 auditor. By analyzing switching behavior across different industries and client firm's asset quintiles, and by separating switches into resignations (auditor initiated or supply-side effects) as opposed to dismissal (client-initiated or demand-side effects) we provide insights into the effects of different economic causes on the choice of a Big-4 auditor by client firms.

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SESSION: BREAK WITH RESEARCH AND EDUCATION POSTER FORUM
DATE: SATURDAY, JANUARY 18, 2020
TIME: 3:15 PM–4:00 PM

Non-Big 6 Audit Firms' Access to External Resources through Inter-Organizational Relationships (IORs)

Jeff Boone

The University of Texas at San Antonio

Lele Chen

The University of Texas at San Antonio

Juan Mao

The University of Texas at San Antonio

ABSTRACT: Small audit firms try to reduce their resource constraints in serving clients by engaging in inter-organizational relationships (IORs) through accounting networks or contractual agreements with individual firms. They have access to audit manuals and personnel and perform joint audits and marketing of their audit services through IORs. We utilize a novel dataset created from the PCAOB Form 2 from 2010 to 2018 where audit firms are required to report such relationships and specific resources they have utilized through such IORs. We document that while audit fees are significantly higher for audit firms participating in IORs, audit quality is not significantly improved, consistent with the legitimacy theory. Audit quality is improved when audit firms have access to audit manuals and technologies through IORs and it is not affected by access to employees of other audit firms, suggesting that audit quality differs depending on what types of resources firms utilize through IORs. The findings have practical implications for both regulators who look for ways to help small audit firms compete in the audit market and small audit firms who search for ways to reduce their resource constraints.

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Abstracts

SESSION: BREAK WITH RESEARCH AND EDUCATION POSTER FORUM
DATE: SATURDAY, JANUARY 18, 2020
TIME: 3:15 PM–4:00 PM

Pending Litigation and the Audit Report Lag: Evidence from China

Liu Hui

Xi'an Jiaotong University

Charles P. Cullinan

Bryant University

Junrui Zhang

Xi'an Jiaotong University

ABSTRACT: Audit clients may be defendants in lawsuits that are unresolved at year-end (pending litigation). Clients with pending litigation may be more time-consuming to audit as a result of the complexity and subjectivity of estimated related to the outcome of pending litigation, which is a type of contingent liability. Among Chinese listed companies, we find that 7.4% face pending litigation at year-end and that these companies take longer to audit (i.e., have longer audit report lags). These results are strongest among companies not governmentally-controlled, and for those based in regions of China with more developed legal systems.

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Abstracts

SESSION: BREAK WITH RESEARCH AND EDUCATION POSTER FORUM
DATE: SATURDAY, JANUARY 18, 2020
TIME: 3:15 PM–4:00 PM

Revelations of Undetected Client Non-Compliance and Their Effects on Stock Returns of Other Audit Clients of the Involved Auditor

Christian Friedrich

Technische Universität Darmstadt

ABSTRACT: I analyze capital market reactions to clients of Big Four auditors involved in 64 client fraud and non-compliance scandals in Germany between 2010 and 2017 in order to identify effects of such scandals on other clients' stock returns, which may be interpreted as an indicator of auditor reputation. To calculate expected returns, I construct individual indices which hold out potentially affected clients from the market index. I hypothesize but only find some support that, in line with the level of auditor responsibility implied by ISA 240 and ISA 250, client stock returns are more likely to suffer from fraud and from non-compliance with direct effects on financial statements than from other non-compliance. My results suggest that, while such effects do depend on non-compliance category, the categories for which a reaction is most likely are partly others than a strict interpretation of ISAs would suggest. Moreover, my cross-sectional analysis with different scandal characteristics which could drive negative abnormal stock returns indicates that the individual scandal characteristics may be more important drivers of reputation effects than the non-compliance category alone.

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Abstracts

SESSION: BREAK WITH RESEARCH AND EDUCATION POSTER FORUM
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TIME: 3:15 PM–4:00 PM

Shareholder Litigation Risk and Stakeholders: Evidence from the Auditor Perspective

Alona Bilokha
Fordham University

Joon Ho Kong
Fordham University

Joseph Micale
Fordham University

ABSTRACT: This paper analyzes the impact of state-level adoption of universal demand (UD) laws in the United States, and the resulting reduction in shareholder litigation, on auditor pricing and the quality of financial reporting. UD laws, adopted by 23 states between 1989 and 2005, limit the ability of shareholders to initiate litigation, thereby reducing shareholder oversight and increasing agency conflicts. We corroborate our findings regarding the impact of UD law adoption through analysis of a secondary source of external oversight – the outside auditor. We observe a 10% reduction in audit fees, reduced audit report lag, and improved financial reporting quality for firms operating in states that adopt UD laws. These findings suggest that in the aftermath of UD law adoption, auditors reduce effort and lower fees, while firms improve the quality of their financial reporting to mitigate adverse effects resulting from an increase in agency conflicts attributable to the adoption of UD laws. This paper addresses the important question of how auditor's perceive and react to a limitation on shareholder litigation, presents evidence that firms improve the quality of their financial reporting in response to an increase in agency conflicts, and contributes to the emerging literature on the impact of UD laws.

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Abstracts

SESSION: BREAK WITH RESEARCH AND EDUCATION POSTER FORUM
DATE: SATURDAY, JANUARY 18, 2020
TIME: 3:15 PM–4:00 PM

The Impacts of Audit Office Relocation

Jared A. Eutsler
University of North Texas

Tram Ngoc Nguyen
University of North Texas

ABSTRACT: This study investigates the economic impacts and consequences of audit office relocation within the same geographical area. Specifically, we examine how relocating an audit office affects an audit office's ability to attract clients, audit fees, and audit quality. We document that relocated offices generate increased revenue through an increase in clients and higher audit fees in the following year compared to non-relocated offices. These results suggest that audit firms likely move their office to gain more clients, and they are able to pass their increased costs associated with relocating to their clients through increased audit fees. However, we also find that relocating offices provide lower audit quality—perhaps due to the increased disruption or stress caused by the move. As a result, auditors should be aware of a possible decline in audit quality after an office relocation so they can adapt their audit procedures or allocation of internal resources to limit this negative impact. To our knowledge, this is the first paper to examine the effects of relocating audit offices, which is a fairly common occurrence. The findings in this paper should be useful for auditors to make decisions regarding the possible relocation of an audit office, or the resource allocation afterward. Also, these findings should be helpful to regulators in promoting audit quality with their monitoring functions.

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Abstracts

SESSION: BREAK WITH RESEARCH AND EDUCATION POSTER FORUM
DATE: SATURDAY, JANUARY 18, 2020
TIME: 3:15 PM–4:00 PM

The Internal Audit Function's Role in Risk Management: Does the Saliency of the IAF Stakeholders Matter?

Romina Rakipi
University of Pisa

Giuseppe D'Onza
University of Pisa

Marco Allegrini
University of Pisa

ABSTRACT: The importance of risk management (RM) and the role of the internal audit function (IAF) in RM have grown in recent years. Despite the relevance of these topics, prior literature infers that the IAF has become the 'jack of all trades' of RM, but does not clearly capture its actual roles. This paper investigates through a fuzzy-set qualitative comparative analysis (fsQCA), how different levels of saliency of the several IAF stakeholders can influence the role of the IAF regarding RM (assurance role vis-à-vis consulting role), and the focus of the IAF on different categories of risks. We ground our study on the theory of Stakeholders Identification and Saliency (Mitchell et al., 1997) to identify who really counts for the chief audit executives (CAEs) in shaping the IAF's role in RM. The results of our analysis, based on 16 interviews with CAEs, working for top public non-financial Italian companies, and on the analysis of relevant documents, indicate that a higher saliency of the board and the control bodies, compared to senior management, leads the IAF to assume a more marked role on the assurance of the RM system, and a greater focus on compliance, reporting, fraud and reputational risks. When the board is perceived as the most salient stakeholder, the IAF focus primarily on strategic risks. Finally, when the senior management is perceived as the most salient stakeholder, the IAF's role shifts toward a consulting approach for the improvement of RM, and with a greater attention to operational risks.

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Abstracts

SESSION 6.01: EXOGENEOUS SHOCKS AND AUDITS

DATE: SATURDAY, JANUARY 18, 2020

TIME: 4:00 PM–5:30 PM

How Changing Economic Conditions Over Multiple Periods Affect Earnings Overstatements, Audit Risk, and Market Prices

Evelyn R. Patterson

Indiana University

Reed Smith

Indiana University–Purdue University Indianapolis

Samuel Louis Tiras

Indiana University–Purdue University Indianapolis

ABSTRACT: We analyze a setting in which the auditor designs an audit to detect a possible overstatement in reported earnings over multiple periods. The multi-period analysis allows us to examine how changing economic conditions affect the auditor’s assessment of fraud, the manager’s inclination to overstate earnings, the firm’s market price and audit risk. On the one hand, good economic conditions may promote earnings overstatement due to the market’s expectations for good earnings reports and may provide “cover” for a dishonest manager to execute a fraudulent reporting strategy. On the other hand, bad economic conditions may encourage earnings overstatement in order for the manager to maintain continued earnings growth and firm value. Our two-period strategic auditing model considers how changes in economic conditions and changes in the auditor’s and manager’s payoffs affect market price, audit risk, earnings overstatements and audit effort both within and across periods. The empirical implications of our study include: how bias is reflected in market prices through an intercept effect; the limitations of a contemporaneous research design on assessing the implications of an exogenous shock to existing economic conditions; and, how the changing expectations of future earnings affect the auditor’s allocation of effort across periods and the related implications of this allocation on earnings overstatements, market price, and audit risk.

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Abstracts

SESSION 6.01: EXOGENEOUS SHOCKS AND AUDITS

DATE: SATURDAY, JANUARY 18, 2020

TIME: 4:00 PM–5:30 PM

Natural Disasters and the Job Demands—Resources Model: Catastrophic Effects on Professional Service Firms

Jared A. Eutsler

University of North Texas

M. Kathleen Harris

Washington State University

Tyler Williams

Bentley University

ABSTRACT: The frequency of reported natural disasters in the United States has risen substantially over the last two decades, resulting in unprecedented social and economic costs. Research in the Job Demands–Resources literature suggests that the introduction of acute extra-organizational job stressors, such as natural disasters, creates an imbalance in the availability of job resources to meet increased job demands. This imbalance increases psychological distress which negatively affects decision-making and work task completion—resulting in a decline in employee performance. Through a professional service firm setting tethered to professional accounting practice, we find that external audits occurring simultaneously with natural disasters influence the financial reporting process of publicly-traded companies. Specifically, we note delays in the release of financial information to the capital markets and increases in client fees. We also find corresponding decreases in the quality of the audit services provided by the auditor; however, perhaps most interesting, we note the decrease in quality is not mitigated by additional effort—as evidenced by protracted timelines for audit work completion and increases in client fees. These findings infer that the occurrence of a natural disaster during audit fieldwork results in professional service firm performance deficiencies that prove detrimental to publicly-traded clients.

Abstracts

SESSION 6.01: EXOGENEOUS SHOCKS AND AUDITS

DATE: SATURDAY, JANUARY 18, 2020

TIME: 4:00 PM–5:30 PM

Flu Season, Human Capital Resources, and Audit Outcomes

Landi Morris

Bentley University

Rani Hoitash

Bentley University

ABSTRACT: This study examines whether influenza (flu), a threat to human capital resources, is associated with audit outcomes. Because the peak months of flu season overlap with audit busy season, we examine whether audit offices most impacted by the flu will be associated with adverse audit outcomes. We test our hypotheses using flu data collected from the Centers for Disease Control and Prevention (CDC) and find that audit quality suffers, audit report lag is prolonged, and audit production costs increase in audit offices most impacted by the flu. This association extends to Big 4 but not non-Big 4 auditors. Examining Big 4 offices that serve complex clients, we find that the effect of the flu is heightened when the need for auditors' client specific knowledge and judgment is stronger. This study informs regulators and practitioners with a vested interest in threats to auditor judgment and audit quality.

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Abstracts

SESSION 6.02: KNOWLEDGE SHARING AND SPILLOVERS

DATE: SATURDAY, JANUARY 18, 2020

TIME: 4:00 PM–5:30 PM

Neighbor Office Knowledge Sharing and Audit Quality

Lin Wang

Central University of Finance and Economics

ABSTRACT: I examine whether and how focal office's audit quality is influenced by knowledge from neighboring offices. Measuring knowledge complementarity by clients' product similarity, I first document higher audit quality in terms of earnings-restatements incidence for audit offices' clients that exhibit higher product similarity with clients of geographically proximate offices. To substantiate the knowledge sharing argument, I condition the effect of product similarity on the quality of knowledge from neighbor offices. I find that the effect is evident only when the neighbor's clients are more complex than the focal client, have longer tenure, or exhibit higher audit quality, and is stronger when there is a gap in the expertise between offices, i.e., when the focal office is not an industry leader but the neighbor is. Analyzing the practice of sharing partners between offices as a channel of knowledge sharing, I find that the effect of product similarity only exists between neighbor offices that share partners. This paper contributes to the audit research by documenting the existence of inter-office knowledge sharing and its implication for audit quality.

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Abstracts

SESSION 6.02: KNOWLEDGE SHARING AND SPILLOVERS

DATE: SATURDAY, JANUARY 18, 2020

TIME: 4:00 PM–5:30 PM

Knowledge Spillover from Audit Clients Using the Same ERP System: Effects on Audit Efficiency, Quality and Pricing

Uday S. Murthy

University of South Florida

Jong Chool Park

University of South Florida

Thomas Joseph Smith

University of South Florida

James D. Whitworth

University of South Florida

ABSTRACT: We utilize a unique dataset (Global Software Leads) to examine the association between the level of ERP expertise acquired through interactions with various clients at the office level and audit report lag and audit fees of clients with similar ERP systems. Consistent with our prediction we observe shorter audit report lags and better audit quality when clients use an ERP system that is used by more of the clients of the office conducting the audit. We suggest that this finding is consistent with audit offices gaining knowledge of an ERP system and using that knowledge to improve the audit efficiency and audit quality of clients where that ERP-specific knowledge is more relevant. We further document that this ERP familiarity is associated with lower audit fees, suggesting that the audit firm appears to share the efficiency gains with the client through lower fees. The latter finding provides an important contribution to the literature which has generally failed to find evidence of fee discounts when the auditor appears to experience efficiency gains. The findings of this study are therefore important and timely to both practice and academics as the profession continues to move toward a more tech enabled audit and as most large audit clients operate ERP systems.

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Abstracts

SESSION 6.02: KNOWLEDGE SHARING AND SPILLOVERS

DATE: SATURDAY, JANUARY 18, 2020

TIME: 4:00 PM–5:30 PM

Sharing Knowledge or Proprietary Information? An Examination of Audit Clients Who Share the Same Audit Partner

Jung Koo Kang

University of Southern California

Clive Lennox

University of Southern California

Vivek Pandey

University of Southern California

ABSTRACT: We argue that knowledge transfers are more valuable when partners audit clients from the same product market. However, there are potential costs when rival companies share the same partner due to concerns about the leakage of proprietary information. Consistent with beneficial effects of knowledge transfers, we find that audit fees are lower and accounting misstatements are less frequent when rival companies share the same partner. On the other hand, we find that rival companies are less likely to share the same partner when they are more concerned about confidential proprietary information, as measured by redactions of proprietary information from SEC filings, the existence of trade secrets or proprietary information, and high levels of R&D and patents.

Abstracts

SESSION 6.03: CHIEF AUDIT EXECUTIVES AND DECISION MAKING

DATE: SATURDAY, JANUARY 18, 2020

TIME: 4:00 PM–5:30 PM

Auditors' Decision-Making Process Analyzed Through a Decision Tree Method

Eo Jin Lee

Florida International University

ABSTRACT: This study examines the complex relationships between many factors associated with an auditor's decision to issue a going concern audit opinion. This study utilizes a statistical machine learning method, specifically a decision tree model, that can explore this complex decision process. Using U.S. audit going concern opinion data with 9,087 observations and eighty variables, this study finds that stock market factors are more predictive than client factors or auditor factors, and that stock price and prior-year going concern contained the most relevant information about the current going concern decision. This implies that the stock market has priced in the bankruptcy risk that the auditor independently evaluates when deciding to issue a going concern opinion. This study also implies that audit fees are not related to the going concern decision. To the best of my knowledge, this study is the first to use U.S. audit archival data and statistical machine learning methods to show multiple interacting factors related to an auditor's decisions-making process when issuing a going concern opinion. The performance of the decision tree is also found to compare favorably with traditional regression, and the simplicity of decision trees makes them a good approach for practitioners.

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Abstracts

SESSION 6.03: CHIEF AUDIT EXECUTIVES AND DECISION MAKING

DATE: SATURDAY, JANUARY 18, 2020

TIME: 4:00 PM–5:30 PM

Internal Auditor Turnover, Financial Reporting Quality, and Audit Risk Assessment

Kenneth L. Bills

Michigan State University

Hua-Wei Huang

National Cheng Kung University

Yi-Hung Lin

Monash University

David A. Wood

Brigham Young University

ABSTRACT: Internal audit serves a valuable monitoring role inside of companies; yet, we understand relatively little about factors that affect internal audit's ability to monitor financial reporting. We study one factor—how turnover of the chief audit executive (CAE) position—influences financial reporting quality and audit risk assessment. Using a large sample of firm data from Taiwan, where companies are required to disclose when and why CAEs change position, we find that a CAE turnover event increases the odds of a restatement by approximately 30 percent and discretionary accruals increase by 5 percent. Furthermore, we find that the relation only holds for firms with forced CAE changes (i.e., demotions, dismissals, or resignations) and not for unforced changes (i.e., lateral moves in the company, promotions, retirements, etc.). We corroborate these findings by examining external auditors' response to CAE turnover and find that external auditors charge approximately 4 percent higher fees the year there is a CAE change. The results provide evidence of the important monitoring role of internal auditing, and especially of the critical role the CAE plays in the internal audit function.

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Abstracts

SESSION 6.03: CHIEF AUDIT EXECUTIVES AND DECISION MAKING

DATE: SATURDAY, JANUARY 18, 2020

TIME: 4:00 PM–5:30 PM

Does a Chief Audit Executive Matter? Evidence from Corporate Disclosure of the Position

Wei Zhang

University of Massachusetts Amherst

ABSTRACT: A Chief Audit Executive (CAE) is the leader of a company's internal audit function. Because there is no mandated disclosure requirement for the internal audit structure, little is understood about the influence of a CAE on a company. Following the logic that a CAE disclosed in SEC filings is more influential in a company's oversight function, I identify an influential CAE using the disclosure of the role. I then examine the association between an influential CAE and monitoring outcomes. Using data hand collected from SEC filings for S&P 1500 companies from 2004 to 2015, I find companies that have an influential CAE are generally larger, older, and have a larger corporate board. More importantly, I find that an influential CAE in NYSE-listed companies is associated with higher internal control quality. This association is stronger for companies that reference a CAE's direct interaction with the audit committee. This study provides an initial investigation into a common, but little understood position in corporate oversight.

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Abstracts

SESSION 6.04: MANAGING THE AUDITOR-CLIENT RELATIONSHIP

DATE: SATURDAY, JANUARY 18, 2020

TIME: 4:00 PM–5:30 PM

Auditors' Customer Relationship Management and Managers' Cooperation with Auditor Evidence Requests

Kris Hoang

The University of Alabama

Richard Hatfield

The University of Alabama

Edward Thomas

Georgia College & State University

Michael Ricci

University of Florida

ABSTRACT: Auditors use customer relationship management (CRM) strategies, such as minimizing disruptions and communicating clearly, to maintain or increase customer satisfaction of client managers. The conventional perspective is that CRM is either benign or can even threaten audit quality by reducing independence and objectivity. However, using Social Exchange Theory, we predict and find that CRM improves one aspect of audit quality, managers' cooperation with auditor evidence requests. In an experiment, we show that compared to managers experiencing lower quality CRM, managers experiencing higher quality CRM are more cooperative throughout the evidence provision process. They assign higher priority to auditor evidence requests, work harder to gather audit-relevant information, are more forthcoming with this information, and convey an openness to future rounds of negotiation. Importantly, we find that managers experiencing higher quality CRM are even more forthcoming with information that contradicts their preferred accounting position. Our findings have implications for audit quality because managers' provision of evidence in a more timely and forthcoming manner improves auditor-manager interactions and better positions auditors to evaluate evidence.

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Abstracts

SESSION 6.04: MANAGING THE AUDITOR-CLIENT RELATIONSHIP

DATE: SATURDAY, JANUARY 18, 2020

TIME: 4:00 PM–5:30 PM

Auditor Skepticism and Client Ill Will

Jared A. Eutsler

University of North Texas

Darin Kip Holderness

West Virginia University

Jesse C. Robertson

University of North Texas

Mary B. Curtis

University of North Texas

ABSTRACT: Professional skepticism is considered an essential component of audit quality. Consequently, research has focused on ways to increase skepticism by identifying factors that either limit or encourage its practice. However, research has yet to explore potential negative consequences of professional skepticism. We conduct two experiments to investigate if high levels of skepticism create ill will in audit clients, and how ill will affects the auditor-client relationship and audit quality. In the first experiment, we find that high skepticism creates ill will in the client, which increases the likelihood the client recommends switching auditors and decreases the amount of evidence provided to the auditor. We find that auditors can ingratiate themselves with the client as an intervention to decrease the development of ill will and mitigate its adverse effects. In our second experiment, we examine if client pressure to persuade the auditor of their accounting position mitigates the relationship between high skepticism and ill will. We find an interaction such that if the evidence does not support the accounting treatment the client recommends, a high level of auditor skepticism does not cause clients to experience as much ill will toward the auditor. We contribute to the literature by investigating a new empirical construct, client ill will, and developing a more nuanced perspective of the interactions between auditors and their clients.

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Abstracts

SESSION 6.04: MANAGING THE AUDITOR-CLIENT RELATIONSHIP

DATE: SATURDAY, JANUARY 18, 2020

TIME: 4:00 PM–5:30 PM

Projection or Reflection? The Effect of Social Projection, Dark Triad, and Moral Identity on Auditor Risk Assessments and Ethical Action-Taking

Kristen Steury

University of South Carolina

Chad Matthew Stefaniak

University of South Carolina

ABSTRACT: Using two distinct scenarios, we investigate how auditors' personality traits influence their risk assessments and ethical action-taking. First, we draw upon social projection theory (i.e., assigning a state of one's own to someone else) to determine whether auditors' use of their own ethical predispositions (i.e., Dark Triad) as a proxy for their clients' predispositions affects risk assessments. We find a significant interaction between social projection and Dark Triad traits, suggesting that higher Dark Triad auditors assess client risk to be as high, or higher, than lower Dark Triad auditors, depending on whether they exhibit social projection. Second, we extend prior ethical action-taking literature in accounting by finding that while an auditors' level of Dark Triad personality has historically been directly linked to ethical action-taking, it is ultimately auditors' moral identities (i.e., the degree to which morality is important to a person's self-concept) that significantly influences their ethical actions. Our findings support our prediction that auditors' moral identity is the predominate self-regulatory mechanism restricting unethical actions.