

# PhD Workshop Auditing EAA 2016

## Empirical Archival Auditing Research

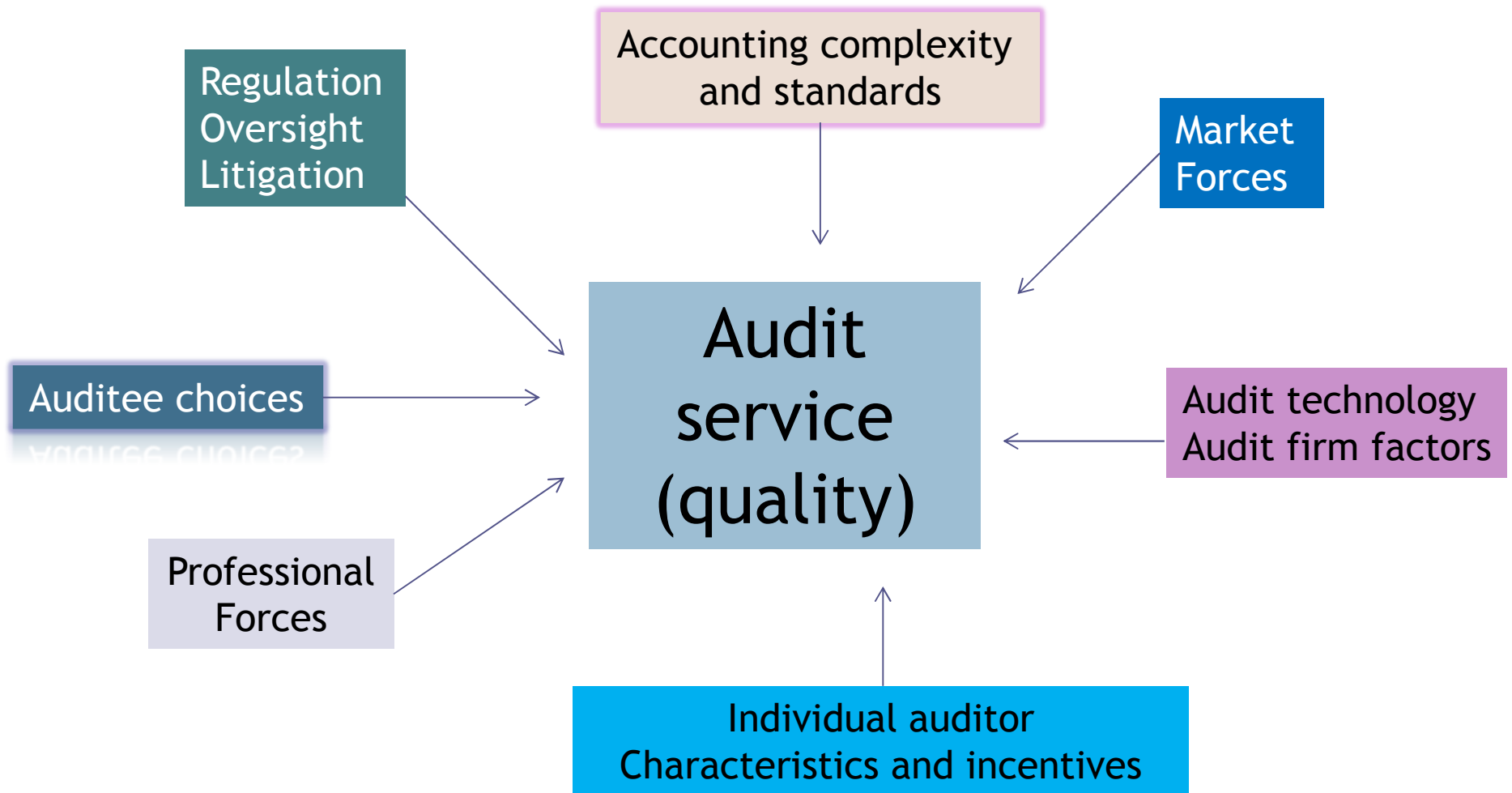
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# Overview

- Discuss the context and major topics addressed in past archival auditing research;
- Zoom in on the notion of “Audit Quality” and how it has been researched in the past and brainstorm on how it could be studied alternatively;
- Discuss avenues for future auditing research in general;
- Assess and critically evaluate the methodology employed in the archival auditing literature.

# Audit service (quality)...





**The Past...**

# Some Key Facts

1995 – PSLRA in US

2001 – Mandatory disclosure audit fees in US  
(with ‘Audit Analytics’ as a result)

2001 – Enron

2002 – SOX Act in the US;  
subsequently similar regulations elsewhere

2005 – Mandatory IFRS in Europe and other countries

2006 – EC audit directive  
and subsequent implementation in EU

2007/2008 – GFC

2008 – GAO report in US

2010 – Dodd-Frank Act

2010 – EC green paper on audit issues

2014 – EP votes audit regulations (extended audit reports, ...)

2016 – June, regulation EU in effect



# What have we learned from archival studies?

(Source: Hay, Knechel & Willekens, 2014. Routledge Companion to Auditing)

# Audit environment

- Audit quality
- Effects of joint supply of audit and non-audit services
- Effects of auditor tenure and rotation
- Earnings management and auditing
- Market for audit services
- Globalization of auditing
- Institutional differences between audit environments
- Auditing in private companies

# Impact of regulation

- Impact of standards
- Effects of litigation
- Oversight and inspection



# Audit Process related

- Industry specialization
- Judgment and decision making
- Analytical procedures
- Audit approaches and business risk auditing
- Audit committee and corporate governance
- Auditing ethics



# Audit reporting

- Going concern
- Reporting on internal control

# Alternative audit services

- Assurance of environmental, social and sustainability information


# Most popular keywords in AJPT since 1995 (archival studies)

- Audit committee
- Audit fees
- Audit quality
- Auditor independence
- Corporate governance
- Earnings management
- Going-concern
- Industry specialization
- Material weaknesses
- Non-audit fees/services
- Restatements
- Sarbanes-Oxley Act



**Many things  
we did we NOT learn  
so much about...**

**and Why?**

- 
- What is the incremental effect of auditing, really?  
Most audit quality studies are jointly testing financial statement quality and audit quality.
    - Data limitations
  - Most studies have an implicit constant audit-firm quality assumption. What is the effect on quality of individual auditor characteristics.
    - Make full use of partner level data!
  - What do we know about auditing in the financial sector, as it is typically deleted from our samples, though it is a crucial sector!
    - 'Easy' fix




**The future?**



is a mystery...

But audit quality will always matter!



“Our contribution to knowledge and practice can be enhanced by a concentration on some central themes and incrementally building on previous research. I believe the discipline may benefit more from theory refinement than individual papers all looking to be the first in some way”

K. T. Trotman in: *The Routledge Companion to Auditing*, 2014.



# Theory...

- Rational expectations... and economic theory is great
- Do we believe that economics is the true driver of history (or auditing), just like Lucas?
- Move beyond agency theory and borrow theories from other disciplines to describe auditing phenomena

# Audit Quality...

- New metrics of audit quality
- How do the primary attributes of an audit affect the various indicators of AQ?
- One size does not fit all!  
For different stakeholders, different audit attributes will be valuable

# What is Audit Quality?

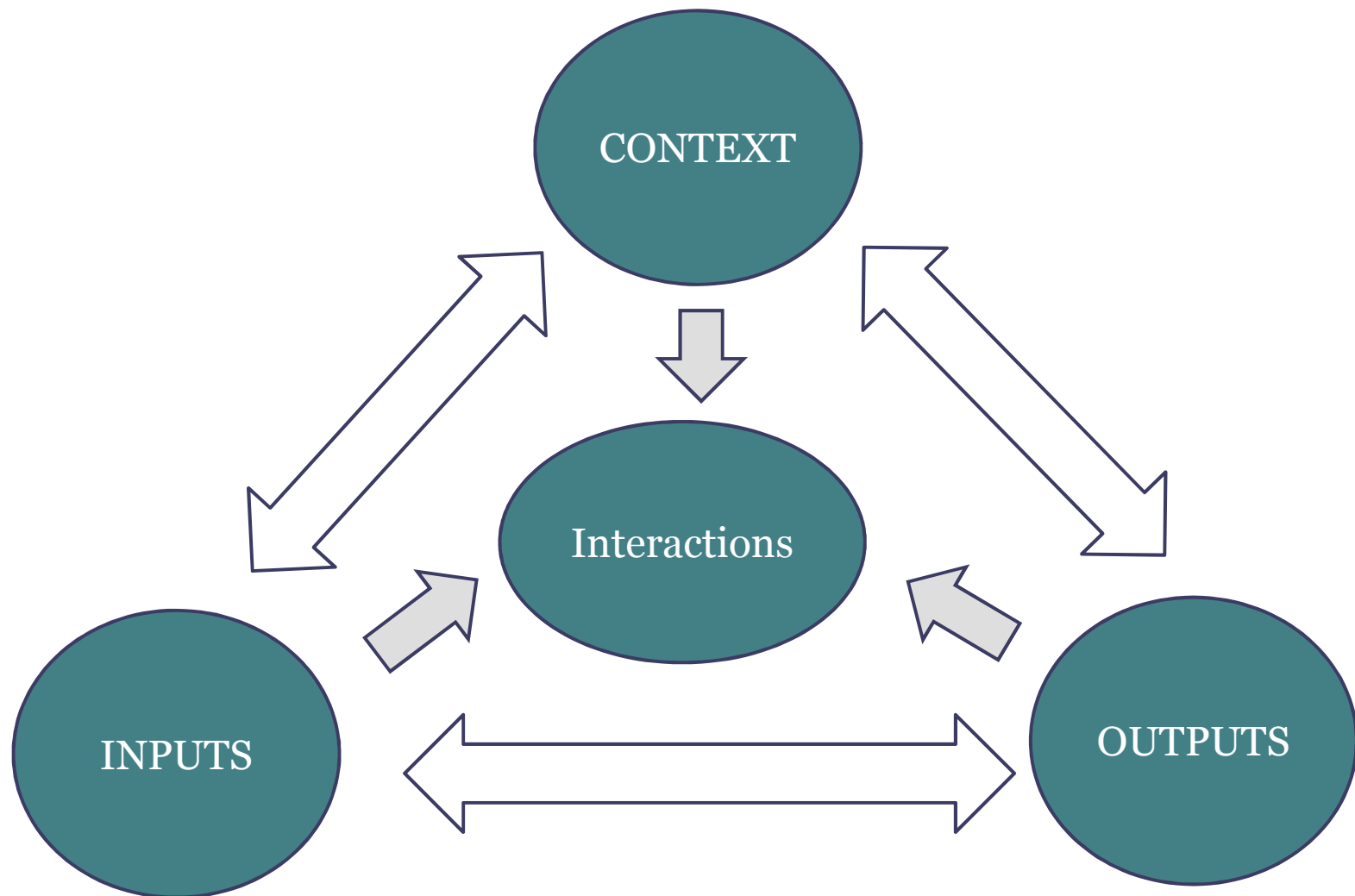
- How to define AQ?  
How to measure AQ?
- There exist a number of audit quality frameworks:

By scholars:

For example Francis (2011); Knechel et al. (2013)

By standard setters; regulators.

# IAASB audit quality Framework





# Various IAASB levels (of analysis)

- Engagement level
- Audit firm level
- National level

## INPUTS

## OUTPUTS

### Engagement level

*Values, ethics and attitudes*  
at level of engagement team  
*Knowledge, experience and time*  
partners and staff competences  
*Audit process and quality control procedures*  
as applied at level of engagement team

*Auditors*  
appropriate auditor reporting  
*Entity*  
appropriate entity reporting  
*Audit regulators*  
info on individual audits

### Audit firm level

*Values, ethics and attitudes*  
governance arrangements  
and tone at the top  
*Knowledge, experience and time*  
structural issues  
*Audit process and quality control procedures*  
audit methodology

Transparency reports  
Annual Report

### National level

*Values, ethics and attitudes*  
regulators and professional  
accountancy organizations  
*Knowledge, experience and time*  
licensing, education requirements  
labor markets  
*Audit process and quality control procedures*  
inspections  
mechanisms in place to investigate audit failures

Aggregate view on results from  
audit firm inspections

# Framework for Audit Quality

## Antecedents

### Inputs

- Auditor Independence
- Auditor Knowledge and Expertise
- Professional Skepticism

### Process

- Audit Production Process
- Materiality
- Risk Assessments
- Audit Firm Quality Controls
  - Client Portfolio Management
  - Audit Support Systems
  - Audit Review Process
  - Engagement Quality Reviews
  - Internal Quality Reviews

Audit  
Quality

## Consequences

### Outcomes

- Financial Statement Restatements
- Litigation against the Auditor
- Accuracy of Audit Reports
- Financial Reporting Quality
- Regulatory Reviews of Audit Firms
  - AICPA Peer Reviews
  - PCAOB Inspections

# Regulation

- Why and how does audit quality differ across countries and regulatory settings?
- Oversight and inspection effects
- Effects of the recent changes in regulation, e.g. in the EU, w.r.t audit reporting, etc.



# Audit markets

- How do auditors compete?
- Differentiation versus cost leadership strategies
- How do audit firms differentiate beyond size and industry ?
- Audit market segmentation?
- Measurement of industry specialization
- Structure of the global audit market?

# Auditing and governance

- Monitoring nexus: Internal control over financial reporting, Internal auditing, external auditing, audit committees and boards: disentangle (joint) effects on financial reporting
- Audit committee characteristics and its effect on auditing and financial reporting quality
- CEO and CFO incentives

# Auditing in private companies

- Different role/value of auditing in private companies
- Do we really need a mandatory audit requirement for privately held firms in the EU?
- Is competition in the market for private audit clients different as compared to the market for public clients?

# New forms of assurance

- Competition in this segment of the assurance market
- Effect of these new assurance services on competition, pricing and quality in the audit services market
- Effects of new forms of assurance on markets and costs

# Ethics research

- Under –researched area, though ethics themes are fairly constant over time
- Link between individual auditor ethics characteristics and audit quality issues
- Ethics dimension as ‘omitted variable’ in most audit studies: how to adapt research designs?

# ‘Archival’ judgment research

- Link between various judgment-related variables and audit quality metrics
- Auditor judgment studies with archival data – validate tons of valuable experimental evidence by archival data from working papers: what did the auditors really do?

# Institutional

- Relationship between accounting complexity (and variation therein) and value/role of auditing
- Institutional differences beyond the ‘traditional’ country variables; sound and up-to-date audit indices at country level are needed
- Is the role of auditing the same in different countries, and as a result can we compare countries using the same ‘measures’?



# The audit firm black box

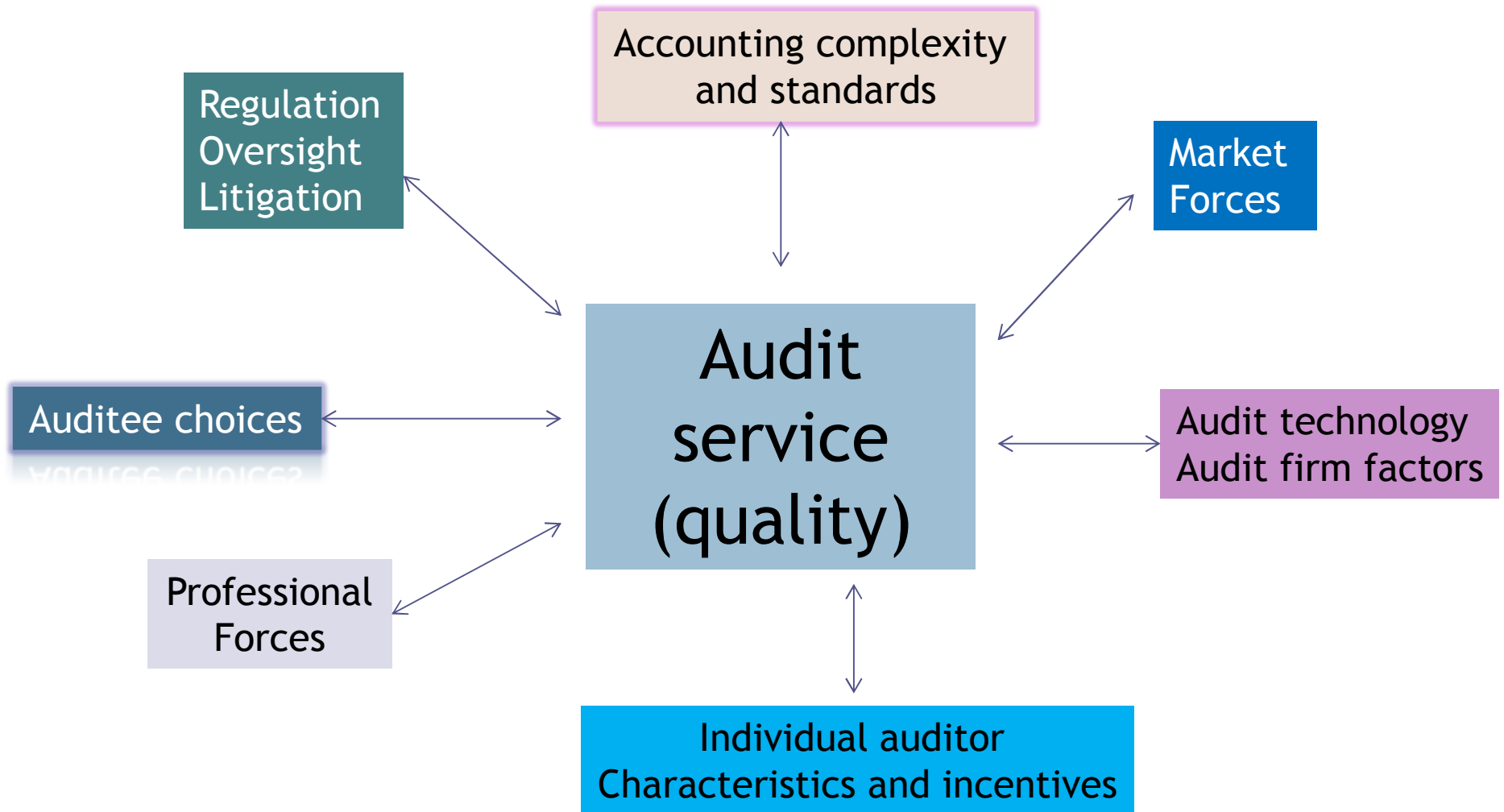
- What is the effect of various quality control mechanisms
- Human research practices and differences between audit firms
- Audit team composition effects



# More effects, please!

- Move beyond ‘earnings/financial statement/disclosure quality’ effects
- How does auditing affect the world?
  - Effects on financial markets and cost of financing
  - But also beyond: ‘macro-effects’ such as taxation income in countries

# Audit service (quality)...



Thank you for your attention

