

Table of Contents

Foreword.....	V
Acknowledgements.....	VII
List of Figures.....	XV
List of Tables	XIX
Abbreviations.....	XXI
List of Symbols.....	XXIII

1 Introduction 1

1.1 Problem Statement.....	1
1.2 Research Objective	3
1.3 Research Data and Methodology	4
1.4 Basic Assumptions and Hypothesis	5
1.5 Outline of this Study	6

2 Literature Review and Current Issues 7

2.1 Agency Theory and Audit Services	7
2.2 Definitions of Audit Quality	10
2.2.1 Two Main Schools of Thoughts.....	10
2.2.1.1 DeAngelo's Definition of Audit Quality.....	10
2.2.1.2 Level of Compliance with Standards	10
2.2.1.3 Financial Reporting Quality and Compliance with Auditing Standards.....	11
2.2.1.4 Francis Framework on Audit Quality Research	13
2.2.2 Regulatory Definitions and Frameworks on Audit Quality	14
2.2.2.1 Directive of the European Union	14
2.2.2.2 PCAOB's Definition of Audit Quality.....	14
2.2.2.3 International Standard on Quality Control (ISQC 1).....	15
2.2.2.4 IAASB Framework on Audit Quality	18
2.2.2.5 UK Financial Reporting Council's Framework on Audit Quality	24

2.2.2.6	Overview of Important Institutions Concerned with Audit Quality	24
2.3	Determinants of Audit Quality	25
2.3.1	Overview	25
2.3.2	Independence	27
2.3.2.1	Prerequisite for Professional Judgment	27
2.3.2.2	Threats to Independence	30
2.3.3	Audit Firm Size	40
2.3.4	Audit Fees	41
2.3.5	Provision of Non-Audit Services	48
2.3.6	Audit Tenure	50
2.3.7	Legal Liability	53
2.3.8	Accounting and Audit Knowledge	54
2.3.9	Client, Industry and Audit Experience	58
2.3.10	Audit Effort and Resource Mix	59
2.3.11	Audit Methodology and Tools	60
2.4	Criticism on Selected on Audit Quality Measures	61
2.4.1	Earnings Management	61
2.4.2	Restatements	65
2.4.3	Going-Concern Reporting	66
2.5	Conclusion and Knowledge Gap	67

3 Audit Quality Measure Based on Reporting Errors69

3.1	Overall Audit Objectives and Audit Failures	69
3.1.1	Overall Objectives of the Auditor	69
3.1.2	Material Misstatements	70
3.1.2.1	Misstatements in Financial Statements	70
3.1.2.2	Materiality	71
3.1.2.2.1	Concepts of Materiality	71
3.1.2.2.2	Quantitative Considerations of Materiality	76
3.1.2.2.3	Qualitative Considerations of Materiality	77
3.1.2.3	Audit Risk and Materiality	79
3.1.2.4	Consequences	80
3.1.3	Audit Failures	80
3.1.3.1	Definitions	80
3.1.3.2	Indicators of Audit Failures	83
3.1.3.2.1	Significant Audit Engagement Deficiencies	83

3.1.3.2.2	Restatements	86
3.1.3.2.3	Litigations	89
3.1.3.2.4	Accounting Enforcement Releases	90
3.2	Accounting Enforcement in Germany.....	91
3.2.1	Legal Basis.....	91
3.2.2	Examination Triggers	93
3.2.2.1	Examination with Cause (Concrete Indicators).....	94
3.2.2.2	Examination on Request by BaFin (Certain Indicators)	94
3.2.2.3	Examination by Random Sampling (no Indicators).....	95
3.2.3	Enforcement Process.....	101
3.2.3.1	Examination Commencement	101
3.2.3.2	Examination Process	103
3.2.3.3	Process for Publication.....	104
3.2.3.4	Materiality in the Enforcement Process	106
3.2.4	Summary of Enforcement Results	108
3.2.4.1	Error Rate Trend	108
3.2.4.2	Error Categories	109
3.2.4.3	Causes of High Error Rates.....	111
3.2.5	Evaluation of the Enforcement Methodology	112
3.2.5.1	Evaluation Criteria	112
3.2.5.2	Evaluation by Criteria	116
3.2.5.2.1	Objectivity.....	116
3.2.5.2.2	Reliability.....	119
3.2.5.2.3	Validity	121
3.2.5.2.4	Transparency	122
3.2.5.2.5	Adequacy	122
3.2.5.2.6	Reflexivity.....	123
3.2.5.2.7	Discussion of Limitations	124
3.2.5.2.8	Triangulation.....	125
3.2.5.2.9	Evaluation Summary.....	125
3.3	Published Reporting Errors as Audit Quality Indicator	128
3.3.1	Audit Failure Rates Definitions	128
3.3.1.1	Auditors' Absolute Failure Frequency	128
3.3.1.2	Auditors' Relative Failure Frequency	129
3.3.2	Data Description	130
3.3.2.1	Data Basis	130

3.3.2.2	Distribution of Absolute Failure Frequencies	131
3.3.2.3	PIE Market Concentration	132
3.3.2	Data Analysis.....	134
3.3.2.1	Absolute Failure Frequencies.....	134
3.3.2.2	Relative Failure Frequencies.....	136
3.3.2.3	Big vs. Small Audit Firms	142
3.3.3	Conclusions	144
4	Reporting Errors and Audit Firm Characteristics	147
4.1	Audit Service Production Models	147
4.1.1	Audit Production Function	147
4.1.2	A Modified Audit Production Framework.....	149
4.2	Audit Input Factors	150
4.2.1	Audit Input Factors Overview	150
4.2.2	Auditor's Competence and Audit Effort.....	151
4.2.2.1	Cost-Optimization Model	151
4.2.2.2	Optimization Model for the Input Factors Audit Time and Experience	154
4.2.2.3	Auditor's Competence	156
4.2.2.4	Audit Effort.....	158
4.2.3	Audit Methodology.....	159
4.2.4	Audit Support Systems	161
4.3	Preparing and Auditing Financial Statements.....	164
4.3.1	Process Overview	164
4.3.2	Financial Statement Preparation	165
4.3.3	Audit Process.....	165
4.3.4	Interactions and Iterative Process	166
4.4	Audit Firm Structure and Audit Firm Characteristics.....	167
4.4.1	Multinational Audit Firms and SMP	167
4.4.2	Organizational Levels of Multi-National Audit Firms	168
4.4.3	Structure of Audit Firm's Organization.....	170
4.4.4	Audit Engagement Team Structure.....	171
4.4.5	Employee Specialization	172
4.4.6	Accessible Audit Firm Characteristics.....	173
4.5	Audit Firm Characteristics and Financial Reporting Errors.....	174
4.5.1	Working Hypothesis	174
4.5.2	Research Model	175

4.5.3	Research Data	175
4.5.4	Certified Audit Professionals Ratio	175
4.5.5	Employee Experience	179
4.5.5.1	Average of Experience per Employee.....	179
4.5.5.2	Total Years of Experience of all Employees.....	184
4.5.6	Client-Specific Experience	186
4.5.7	Results Summary	190
5	Summary and Conclusions.....	193
5.1	Conclusions on Literature Review and Current Issues.....	193
5.2	Summary and Conclusions on Empirical Study.....	194
5.3	Limitations and Further Research	196
	Appendix.....	199
	Appendix A: Published Reporting Errors	199
	Appendix B: Involved Audit Firms.....	204
	Appendix C: Data Basis for Certification Rate Calculation.....	206
	Appendix D: Example Calculation of Isoquality Curves.....	210
	Appendix E: Derivation of Formulas	216
	References.....	219

Audit Quality

Association between published reporting errors and
audit firm characteristics

Tritschler, J.

2014, XXIII, 235 p. 61 illus., 5 illus. in color., Softcover

ISBN: 978-3-658-04173-1