Are workpaper reviews preparer-specific?

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ABSTRACT

We investigate the potential for preparer specific performance dimensions to influence workpaper reviewer’s judgments and actions. In a 2 × 2 experimental design, we manipulate two factors: 1) the amount of time, relative to the budgeted hours, expended by the preparer to complete the workpaper, and 2) preparer interpersonal behaviors during the course of the audit. The participants in our sample consist of 138 Mexican audit managers and seniors representing all four Big 4 public accounting firms. Although the participants reviewed an identical workpaper, the results of our experiment reveal that reviewers wrote significantly fewer (more) review comments and judged it to be of higher (lower) quality when the preparer completed the workpaper under (over) the budgeted time or when the preparer demonstrated good (poor) interpersonal behaviors.

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1. Introduction

Workpaper review is fundamental to every financial statement audit, consumes a large proportion of audit supervisors’ time, and is costly (Bamber & Bylinski, 1987; Bamber, Bamber, & Bylinski, 1988; Brazel, Agoglia, & Hatfield, 2004; Rich, Solomon, & Trotman, 1997a). Although the audit workpaper review process achieves multiple objectives, its most important role is to serve as the principal quality control mechanism for audit engagements (Gibbins & Trotman, 2002; Lambert & Agoglia, 2011; Roebuck & Trotman, 1992). Threats to the workpaper review process, therefore, can result in reduced audit quality (Tan & Shankar, 2010; Trotman, Bauer, & Humphreys, 2015). Audit regulators have recently called attention to deficiencies in the workpaper review process and their potential impact on audit quality (Agoglia, Brazel, Hatfield, & Jackson, 2010; Lambert & Agoglia, 2011). The International Forum of Independent Audit Regulators (IFIAR), in its 2012 global survey of audit inspections, characterized adequacy of review and supervision as one of the most common areas of deficiency across geographical jurisdictions and time periods (IFIAR, 2012). Remedial actions to improve engagement quality control reviews were one of the topics of discussion held by the IFIAR in its 2013 meeting (IFIAR, 2012); nevertheless, inadequate review and supervision were again noted in the 2014 inspection reports for a number of jurisdictions (IFIAR, 2014). In the United States, the Public Company Accounting Oversight Board (PCAOB), based upon its audit inspection reports, identified deficiencies in engagement review activities as a significant quality control issue (PCAOB, 2008; 2010a; 2013).

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1 The IFIAR report noted that a failure of the audit reviewer “to critically evaluate the quality of evidence obtained” was one of the most frequently identified audit quality issues (IFIAR 2012, 14).

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The workpaper review process is largely dependent upon the expertise and judgment of the reviewers (Gibbins & Trotman, 2002). Research that sheds light on factors that may bias reviewers’ judgment and actions can therefore contribute to increasing the effectiveness of the review process and lead to higher audit quality (Tan & Jamal, 2001; Tan & Shankar, 2010). In this study, we utilize a between-subjects experimental design to examine the influence of two preparer-specific factors on reviewers’ judgments and actions, namely 1) whether the preparer completed the workpaper under or over the budgeted time or 2) whether the preparer demonstrated good or poor interpersonal performance during the course of audit. The construct of interpersonal performance encompasses the preparer’s relational skills on the job that positively or negatively affect the organizational, social, and psychological environment in which the audit is conducted but do not directly contribute to the quality of the completed workpaper. We focus on these two preparer-specific factors because they are present in tasks that require high levels of efficiency and interpersonal demands, such as auditing. These factors are especially critical for preparers because they are observable by workpaper reviewers (Rich et al., 1997a). Furthermore, these factors are likely salient to workpaper reviewers as they often prepare subordinates’ job performance evaluations, typically including dimensions related to meeting the time budget (Asare, Trompeter, & Wright, 2000; McNair, 1991) and interpersonal effectiveness (Emby & Etherington, 1996; Kaplan & Reckers, 1985; Kida, 1984; Tan & Libby, 1997).

Our sample consists of 138 Mexican managers and seniors, representing all four of the Big 4 firms, with an average of over seven years of audit experience. The results of our hypotheses tests indicate that reviewers write significantly fewer (more) review comments for a workpaper when 1) the preparer’s input time is under (over) the budgeted time or 2) the preparer has good (poor) interpersonal performance during the audit. Specifically, reviewers wrote, on average, 12.5 comments for a workpaper that was described as having been prepared under the budgeted time by an auditor with interpersonal behaviors consistent with good interpersonal performance. When the same workpaper was described as having been prepared over the budgeted time by an auditor with poor interpersonal performance, participants wrote an average of 17.8 review comments. These results have important implications because preparer-specific feedback can potentially introduce noise and high variance into the review process, and could have an adverse impact on workpaper review quality and audit quality (Tan & Shankar, 2010). As reviewer comments typically require the preparer to address mechanical errors or conceptual issues identified in the workpaper (Rich et al., 1997a,b; Tan & Trotman, 2003), a preparer tasked with clearing thirteen review comments, for example, may produce a different quality workpaper than when he/she is tasked with eighteen review comments.

The results of our hypotheses tests further reveal that reviewers judge the overall quality of a workpaper as higher (lower) when completed under (over) the budgeted time or by a preparer with good (poor) interpersonal performance. The quality judgment of reviewers is important because the final set of reviewed and archived audit workpapers must provide sufficient support for the audit opinion and may be subject to inspection by audit regulators. The workpaper quality judgments of our participants were significantly influenced by preparer-specific differences, conceptual review comments, and reviewers’ perceptions of preparer competence.

In contrast to audit reviewers, audit regulators in their post-audit inspections do not witness the preparation of workpapers and are therefore not influenced by preparer-specific behaviors. Instead, regulators are expected to focus their evaluation solely on the contents of archived workpapers. As a result, the workpaper quality judgments of audit reviewers may lack calibration with the quality assessments of regulators. By identifying the impact of preparer-specific association-based biases on reviewer judgments and actions of workpaper quality (Arkes, 1991), this study provides information useful to management of audit firms for designing a more effective review process, potentially resulting in higher audit quality, improved inspection results (IFIAR 2012; Tan & Jamal, 2001), and maintenance of audit market share (Nagy, 2014).

In the following section, we examine the research literature relevant to workpaper review and reviewer judgment. Following the literature review, we propose directional hypotheses related to the impact of workpaper preparation time relative to budgeted time and preparer interpersonal performance on reviewer judgments and actions. We then explain the methodology of this study, including descriptions of the design and participants, experimental procedures, and measurement of the independent and dependent variables. Finally, we report the results and discuss the implications of our findings.

2. Hypotheses development

During the last three decades and especially after Enron’s bankruptcy and the related collapse of Arthur Anderson, researchers and standard setters have criticized the quality of audits performed by accounting firms (e.g., Francis, 2004; IAASB, 2014; PCAOB, 2015; Sutton, 1993), noting the lack of a general understanding of audit quality and its related measurement and analyses. Sutton (1993) attributes the absence of a single definition of audit quality to conflicting interests amongst various stakeholders (e.g., external users, management, the audit committee, and the auditors). In alignment with this view, the International Auditing and Assurance Standards Board (IAASB, 2014) recognizes the diversity of perceptions regarding what constitutes audit quality as one of the factors that make it difficult to assess. The judgmental nature of the audit process, its potential effect on auditor judgements as well as the limited transparency with respect to the work performed, and audit findings are also listed by the IAASB (2014, p. 36) as major factors increasing the complexity of describing and evaluating audit quality.

Audit workpapers, as a process measure, contain preparer assertions intended to persuade the reviewer that the procedures performed, evidence gathered, and conclusions documented are sufficient and defensible (Rich, Solomon, & Trotman, 2003). As reviewer comments typically require the preparer to address mechanical errors or conceptual issues identified in the workpaper (Rich et al., 1997a,b; Tan & Trotman, 2003), a preparer tasked with clearing thirteen review comments, for example, may produce a different quality workpaper than when he/she is tasked with eighteen review comments.

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