

# Can Audit Committee Support Improve Auditors' Application of Professional Skepticism?

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# Motivation and Research Approach

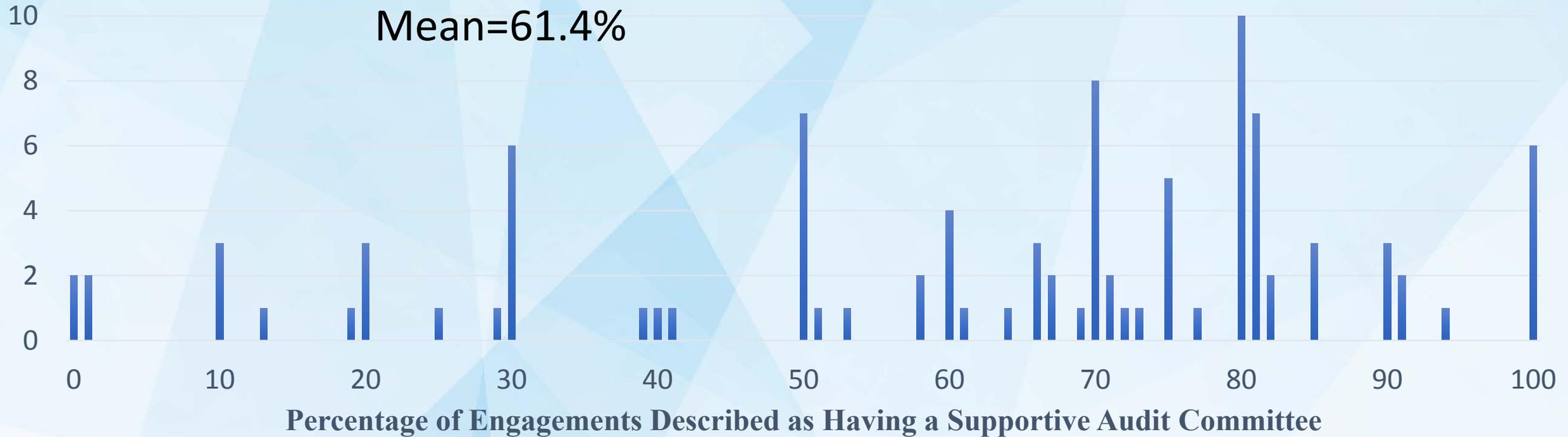
- Professional skepticism is important for audit quality.
- However, exercising PS may come at a cost.
- If costs inhibit auditor skepticism, it is possible that audit committee support could motivate the application of skepticism on audit engagements.
- Survey among auditors of varying ranks at the eight largest US firms (n=46) one Dutch Big4 firm (n=58); total n=104.
- Experiment among audit seniors at multiple firms.

# Key Survey Results

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## Survey Results

# Current State of AC Support (1)



Survey Results

## Current State of AC Support (2)

- Which audit team members have direct interaction with the audit committee?

	n	%
Partner	102	98.1
Director	70	67.3
Senior Manager	70	67.3
Manager	26	25.0
Senior	2	1.9
Staff	0	0.0

Survey Results

# Current State of AC Support (3)

- How was AC support communicated to the audit team?

	n	Mean
Partner or Manager	95	43.81
Member of the Audit Committee		
No mention of AC Support		

*“During an audit committee meeting, we reported various findings and deficiencies that had been discovered during the audit. These findings had been discussed with management prior to the meeting, and **management had disagreed with several of them**, leading to some **tense moments**. However, during the audit committee meeting, certain committee members were very **receptive** to the findings and reiterated just how **important it was for management to address** these items in a timely manner. They also **complimented the thoroughness of the audit** to find these items and voiced their **pleasure with the team**. Due to the significant level of stress and hours put into the engagement, the manager and **partner informed the rest of the engagement team** of the positive comments. The **team was very happy** that their efforts were appreciated by the audit committee, as it seemed they had not been by management. In subsequent engagements, it seemed that the team was even more thorough and were not as affected when management disagreed with a finding/deficiency” (Manager, US).*

Survey Results

## Current State of AC Support (3)

- How was AC support communicated to the audit team?

	n	Mean
Partner or Manager	95	43.81
Member of the Audit Committee	95	13.26
No mention of AC Support		

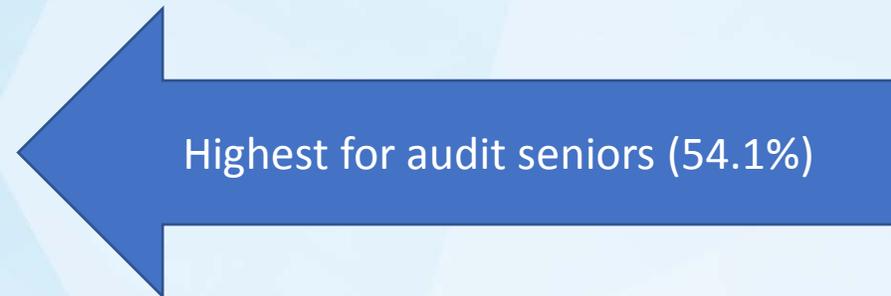
*"The audit committee member stopped by the team's conference room to wave and yell "you guys are doing great!". Although this was a very brief moment, it was nice to get some positive encouragement from other parties. At another client, we sometimes received a basket of goods from the AC as a means of gratitude for the audit." (Senior, US).*

Survey Results

## Current State of AC Support (3)

- How was AC support communicated to the audit team?

	n	Mean
Partner or Manager	95	43.81
Member of the Audit Committee	95	13.26
No mention of AC Support	95	41.49



Highest for audit seniors (54.1%)

## Survey Results

# How ACs Can Show Support

- Top 3 responses:
  - AC **openness** to the auditor
  - Ability to stress to **management** their need to **cooperate** with the auditor
  - AC expressing **appreciation** for the role of the audit

*“[...] support from the audit committee can be expressed in the following ways: / 1. Be open and thankful if we discover red flags, misstatements, and control deficiencies. They should see this as a way to improve the organization. / 2. Make sure that management and staff share also the same views. Most of the time we see that top management is happy with our work but the actual employees that we talk to see us as a burden because we cause them more work. [...]” (Senior, NL).*

- Common theme: role of AC in insulating and supporting the auditor when tensions with management are present.
- Relatively few respondents mentioned AC role regarding audit fees/budget overruns

## Survey Results

# How ACs Have Affected PS By Teams

- 45.3% indicate ACs have *no impact* on PS of engagement teams.
  - Why??? May be due to lack of conveyance of support?
- No clear consensus, but when ACs affect PS this concerns the **scope** of the audit/substantive testing phase of the audit and, to a lesser extent, the risk assessment phase, e.g.:

*“Obtaining positive feedback from the AC in our audit procedures has provided assurance that we are doing the right procedures. Also, where the audit committee has requested we increase our audit scope - e.g. requesting we bring more component locations into scope” (Manager, NL: Scope of Testing).*

## Survey Results

# AC Support Best Practices

- Top responses
  - Openness
  - Mediating management conflicts and insulating auditor from management pressure
  - AC shares insights

*“In a perfect world, audit committees would stress to management the importance of the audit process and ensuring proper responses to any audit findings/deficiencies. They would further provide a more intricate analysis of the company and where there may be risks that the auditor wouldn't specifically identify. [...]” (Manager, US)*

# Survey Study: Conclusions

- Experiences with AC support vary substantially and ways in which ACs support teams is multifaceted.
- AC support may not actually be trickling down to the lower levels of the engagement team.
  - Might explain why some respondents don't see effect on skepticism?
- Openness and availability are key form of support.
- Also: importance of ACs insulating the team in case of conflicts with client management.
- AC support is most likely during the substantive testing phase of the audit.
- Unexpectedly, additional fees was not seen as an important form of support.
- These insights helped us develop our experiment where we examine:
  - Does AC support affect auditors's PS?
  - Does it matter who conveys the support (partner or AC chair)?
  - Is the effect of support contingent on client management's attitudes (good vs. poor)?

# Preliminary Experiment Results

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# Predictions & Research Questions

- ***Hypothesis 1:*** Auditors are less likely to exercise skepticism when management has a poor attitude versus a good attitude.
- ***Hypothesis 2:*** The effects of poor management attitude on PS are reduced when audit committee support is communicated to auditors.
- ***Research Questions:***
  - If communicating AC support “works,” does it matter who communicates the support?
  - More specifically, is support communicated by the AC chair more effective than support conveyed by the audit partner?

# Experimental Design

- 3 x 2 between-subjects experiment
  - *Management attitude:* Good, Poor
  - *AC support:* AC Chair convey, Partner convey, No support conveyed

## MANIPULATION OF MANAGEMENT ATTITUDE

### Good - Pleasant/friendly

Also, you and your team have experienced Ruiters' management and accounting personnel as **overall friendly and respectful** in responding to your team's inquiries. For example, in your experience client personnel often **wave or say "hello"** when they see you. When you have requested information, they have **responded promptly** and have been **polite**.

### Poor - Disrespectful/unfriendly

However, you and your team have experienced Ruiters' management and accounting personnel as rather **unfriendly or even rude** in responding to your team's inquiries. For example, in your experience client personnel often **roll their eyes and look annoyed** when they see you. When you have requested information, they have **responded promptly** but have been **impolite**.

# AC Support Manipulation

## AC Chair & Partner conditions

- Come in the room
- Using either I/We (AC Chair) or the audit committee (Partner)
  - Acknowledge responsibility of the AC to protect investors via the audit
  - Have stressed importance to management & encouraged timely responses
  - Mention importance of supporting audit team if disagreements with management arise
  - Would consider additional fee for justified budget overruns
  - Will check in with the audit team – committed to open lines of communications
  - Thanks the team for their time

These were items survey respondents offered as best practices/ways AC could support the audit team.



## No Support condition

- Partner is meeting with the audit committee & then holds an engagement team meeting
- Announces the AC meeting went well & the AC thanks everyone for their hard work & commitment
- Partner thanks the team for their time

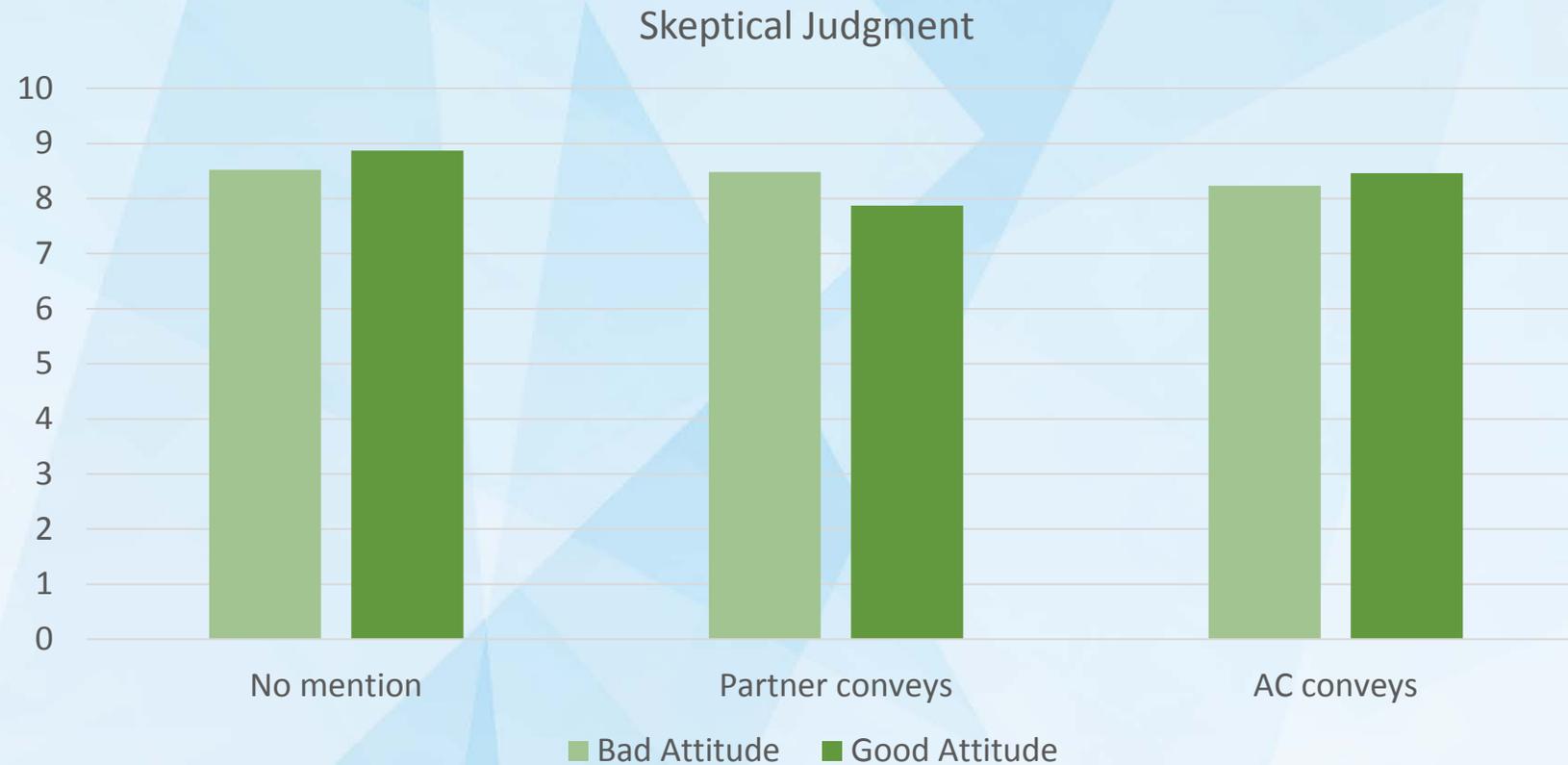
# Participants & Task

- 184 practicing auditors participated
  - Demographics:
    - 58 months experience on average
    - Various industries
    - 71% of engagements no support is expressed on average
- Analytical procedure over sales account task
  - Assumed role as audit senior
  - Calculated expectation and determined whether additional work was necessary

# Measures of Professional Skepticism

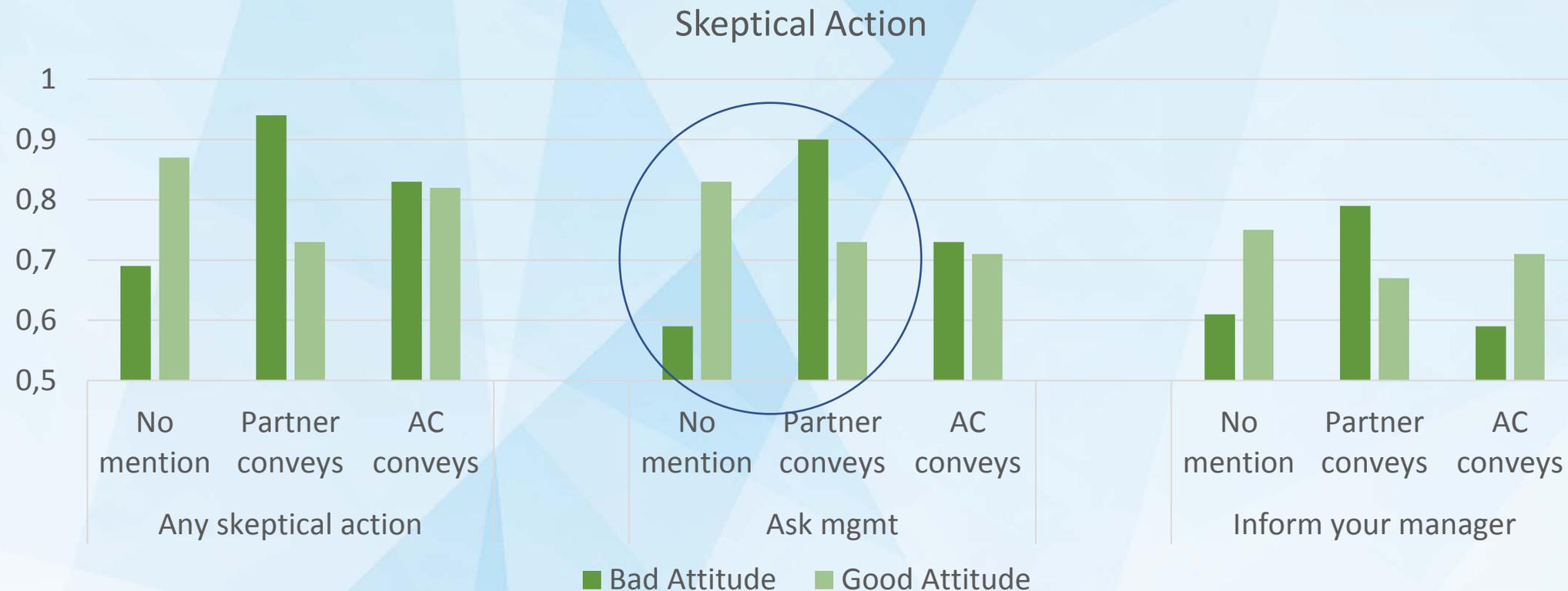
- Skeptical Judgment
  - Perception of difference between NFM and revenue growth (whether they noticed the inconsistency)
- Skeptical Action
  - Ask management
  - Inform your manager
  - Aggregate measure

# Preliminary Results – Skeptical Judgment



Good news...Auditors recognize the issue across conditions!

# Preliminary Results – Skeptical Action



# Big Picture Takeaway

- There's a disconnect between auditors' skeptical judgments & skeptical actions.
- An easy intervention of supportive audit committee + partner communicating this support seems to increase skeptical action.
- The more costly intervention of having the AC chair communicate the support does not seem superior.
- This is supported by an AC chair quote in the survey saying it seems like a decent idea but would be impractical on larger engagements with teams dispersed geographically.

# Thank You! 😊

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**AC Chair convey condition**

You are sitting in the audit room one afternoon, preparing for a meeting that will involve the entire engagement team. Your partner is currently meeting with Ruiters' audit committee, and the partner has announced an engagement team meeting will take place immediately after the audit committee meeting is finished.

The partner finally arrives, and you are surprised to see that the audit committee chair has walked into the audit room, as well. The audit committee chair asks for the attention of the entire engagement team, and makes an announcement:

"Thank you for your hard work and commitment. I and the rest of the audit committee have a responsibility to protect Ruiters' investors, and this audit is essential to fulfilling that responsibility. We are very involved and aware of how the audit is progressing. I have stressed to management that this audit is very important, and have encouraged timely responses to all audit requests.

I recognize that it is important to support the audit team when disagreements arise between the team and management. The audit committee will also consider additional fees for budget overruns, if the overruns are reasonable and justified. I and the rest of the audit committee are committed to ensuring a successful audit, and I will check in with the audit team periodically. We are committed to maintaining open lines of communication."

The audit committee chair thanks the engagement team for their time, and then leaves the room.

**Partner convey condition**

You are sitting in the audit room one afternoon, preparing for a meeting that will involve the entire engagement team. Your partner is currently meeting with Ruiters' audit committee, and the partner has announced an engagement team meeting will take place immediately after the audit committee meeting is finished.

The partner finally arrives, asks for the attention of the entire engagement team, and makes an announcement:

"The audit committee meeting went well. The audit committee asked me to thank you for your hard work and commitment. They recognize they have a responsibility to protect Ruiters' investors, and that this audit is essential to fulfilling that responsibility. They said they are very involved and aware of how the audit is progressing. The audit committee also told me they have stressed to management that this audit is very important, and they have encouraged timely responses to all audit requests.

The audit committee told me they recognize that it is important to support the audit team when disagreements arise between the team and management. The audit committee will also consider additional fees for budget overruns, if the overruns are reasonable and justified. The audit committee told me they are committed to ensuring a successful audit, and will check in with the audit team periodically. They say they are committed to keeping open lines of communication."

The audit partner thanks the engagement team for their time, and then leaves the room.

**No support condition**

You are sitting in the audit room one afternoon, preparing for a meeting that will involve the entire engagement team. Your partner is currently meeting with Ruiters' audit committee, and the partner has announced an engagement team meeting will take place immediately after the audit committee meeting is finished.

The partner finally arrives and asks for the attention of the entire engagement team. The partner makes an announcement that the audit committee meeting went well and thanks everyone for their hard work and commitment. The audit partner then thanks the engagement team for their time, and then leaves the room.