

Foundation for Auditing Research: Call for Research Project Proposals 2017

*December 2016*

*What is FAR?*

The Dutch *Foundation for Auditing Research (FAR)* was launched in Amsterdam on October 20, 2015. While the audit profession is undergoing significant change in terms of expectations and demands, FAR is focusing on enhancing knowledge in the area of what constitutes a good audit today and on achieving sustainable improvement in audit practices. The objective of FAR is to advance the profession's learning curve in terms of continuous improvement of the audit practice, feeding audit education, and extending the accountancy research community in the Netherlands and abroad. Central to FAR is practical relevance through scientific knowledge and research focused on audit quality drivers (and root causes of audit quality failures) within audit firms. FAR pursues these objectives by conducting relevant and rigorous academic research into the drivers of audit quality, by collaborating with other research institutes internationally and by sharing its findings through research conferences. FAR disseminates this knowledge to practitioners and standard setters, regulators, and other stakeholders for practical development and improvement.

Please see the website for further information: [www.foundationforauditingresearch.org](http://www.foundationforauditingresearch.org).

*Research objectives and focus*

FAR is seeking to identify the **drivers and root causes** of audit quality as a means to improve audit practices. This objective can be broken down in at least three main parts:

- the underlying **drivers** of auditors' behavior and decision making, which may include the organizational conditions which stimulate or hamper auditors to work in the way that is expected);
- **root causes** of poor audit quality (rather than the symptoms of the underlying root causes); and
- effectiveness of possible **interventions** (organizational changes and levers of control) implemented to enhance audit quality, including **monitoring** thereof.

In its 2014 report, the IAASB defines the objective of an audit of financial statements as being “for the auditor to form an opinion on the financial statements based on having obtained sufficient appropriate audit evidence about whether the financial statements are free from material misstatement and to report in accordance with the auditor’s findings.”

The IAASB also states in its report that “A quality audit is likely to have been achieved by an engagement team that:

- Exhibited appropriate values, ethics, and attitudes;
- Was sufficiently knowledgeable, skilled, and experienced and had sufficient time allocated to perform the audit work;
- Applied a rigorous audit process and quality control procedures that complied with law, regulation, and applicable standards;
- Provided useful and timely reports; and
- Interacted appropriately with relevant stakeholders.”

While these factors have been identified by experts as determinants of audit quality, we have yet to learn how these factors inter-connect to each other. Following the definition of audit quality by DeFond and Zhang (2014)<sup>1</sup>, FAR believes that audit quality can be studied from three perspectives:

1. Clients’ control environments, reporting systems and innate characteristics: Firms are becoming increasingly complex, in terms of business models, systems of control, and how the audited firms’ underlying economics are reflected in their financial statements;
2. Audit firms’ organizational settings and conditions for creating an organizational culture and architecture that increases the likelihood of audit staff achieving greater assurance and that strengthens incremental learning; and
3. Stakeholders and environmental forces, which may include auditors’ communication (effectiveness of auditors’ reporting), audit quality from multiple stakeholder perspectives, the environmental context of the audit (e.g. in terms of audit industry and markets), and the external supervision and regulatory environment.

FAR believes that research has the potential to identify those factors that influence audit quality in daily practice. The Dutch audit profession has decided to commission research projects to enhance our knowledge of how these factors affect audit quality.

In this context, the Dutch profession is offering opportunities for the scientific community to conduct research into these determinants of audit quality. The range of potential projects encompasses the audit process and its results, both in the broadest terms.

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<sup>1</sup> “We define high audit quality as greater assurance of high financial reporting quality. (...) [i.e.,] greater assurance that the financial statements faithfully reflect the [audited] firm’s underlying economics, conditioned on its financial reporting system and innate characteristics” (DeFond and Zhang 2014: 275-6). This definition “reflects audit quality’s continuous nature, encompasses the auditor’s broad responsibilities, and recognizes audit quality as a component of financial reporting quality that is bounded by the [audited] firm’s reporting system and innate characteristics” (p.313).

However, the focus of the industry is to enhance knowledge in the following areas:

1. Audit inputs, such as audit team composition and interaction, the personal characteristics of audit partners and staff, their workload, and the knowledge, skills, and experience of auditors in relation to the complexity and context of the audits they are currently performing;
2. The audit process of planning, collection, and interpretation of audit evidence, which may include risk assessment, audit methodologies and tools, the intrinsic quality of audit evidence, the nature, timing, and extent of audit procedures, and time and budget (pressures);
3. Auditors' intentions and behaviors, such as judgment and decision making, professional skepticism, partner involvement throughout the audit, dysfunctional auditor behavior, and auditor-client negotiations regarding audit findings;
4. Audit outcomes, which may include communication, such as the usefulness of audit reporting and the economic consequences of audit outcomes;
5. Audit firm organization, governance, and culture, which may include governance structures, benefit schemes, quality control systems and indicators, firm and team culture, and the roles of firm networks.

FAR supports projects using multiple research approaches and methods. Although all research projects are to start with a research synthesis, a strong focus of the program is to expand the understanding of the theoretical substance of auditing by making available archival empirical data collected from audit firms, while the participating audit firms have also agreed to cooperate with survey research, interviews, and experiments.

#### *Call for Research Projects*

In this call, FAR invites scholars to submit research proposals with regard to 5 topics in the following 2 research programs:

- **Research Program A: Research syntheses**, to unlock what we already know from science (in accounting and in other fields) about a specific question and potential interventions that can be suggested to strengthen audit quality. Such research projects would have an expected project timeline of 6 to 12 months and may develop into a Program B project.
- **Research Program B: Empirical research projects**, including a research synthesis (program A), with a project timeline of 1 to 4 years (depending on scope of the research project).

FAR invites scholars to submit research proposals that aim to examine the determinants (drivers and root causes) of audit quality on the following 5 topics:

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**Research topics in this call for research project proposals**

<i>Project Name</i>	<i>Main topic</i>	<i>Illustrative questions to further inform (but not limit) the research proposal (based on the questions from practice)<sup>2</sup></i>
<b>Research program A – Research Syntheses</b>		
1. Going concern opinions	What are the main determinants, considerations and hurdles for auditors to move on to a going concern opinion?	<ul style="list-style-type: none"> <li>• What are the primary stakeholders’ expectation in relation to auditors’ detection and reporting of an auditees going concern risks?</li> <li>• What are the determinants of auditors’ effective going concern judgments (e.g., fear of self-fulfilling prophecy)?</li> </ul>
<b>Research program B – Empirical research projects</b>		
2. Auditing standards’ function, setting, interpretation and application:	Do different stakeholders (e.g., audit firms and audit regulators) interpret and apply the audit standards differently in terms of nature, timing and extent of audit procedures (to be) performed?	<ul style="list-style-type: none"> <li>• What is the appropriate function of auditing standards in driving a high quality audit?</li> <li>• What are the (appropriate and actual) roles of different stakeholders in the auditing standard setting process in the Netherlands? For example, while standards provide guidance to the auditor (such as those helping the auditor to determine the audit evidence to be obtained to determine the effective operation of system based controls), these standards also leave room for audit regulators to introduce “shadow standards” (i.e., an alternative, more strict interpretation of the auditing standards) based on their different interpretation of the standards. Can additional standards overcome such interpretation differences?</li> <li>• Do auditing standards (or does the auditing standard setting process) hinder audit innovation and how does this affect audit quality? And, if so, how should auditing standards (setting process) be changed to leave room for (or facilitate) audit innovation while at the same time provide the standard for a quality audit?</li> <li>• What is the effect of rules- versus principle-based standards on auditors’ judgment and decision making quality?</li> <li>• To what extent does strict compliance to the auditing standards (versus professional judgment) result in better error-identification in the financial statements, fraud detection, and going concern judgments?</li> </ul>
3. Different audits for different purposes: auditing in the Owner-Managed-Business (OMB) environment	Does the OMB environment call for different audits and auditing standards?	<ul style="list-style-type: none"> <li>• What are the stakeholder expectations of an audit in the OMB environment and how are these different from the PIE environment (e.g., the restricted audience of the audit opinion)?</li> <li>• What institutional factors (e.g., complexity, size, capital market structure, legal environment, audit risks, etc.) in the OMB environment may call for a specific audit approach and auditing standards for OMB audits?</li> </ul>

<sup>2</sup> These are just illustration and are not intended to be leading.

		<ul style="list-style-type: none"> <li>• Can there be different applications of materiality (“precision”) and nature, timing, and extent of the auditing procedures (“reliability”) to address market-expected levels of assurance (and thus quality) in the OMB environment (as compared to the PIE environment) – if at all?</li> <li>• What are the most effective / appropriate independence requirements in the OMB segment (e.g., given the extended role and closer relationship with clients)?</li> </ul>
4. The auditees internal controls and financial reporting quality	What is the mutual impact of the audit and the auditee’s internal controls and financial reporting quality?	<ul style="list-style-type: none"> <li>• What is the impact of the quality of the auditee (e.g., internal controls, governance, management accounting, etc.) on audit quality and value?           <ul style="list-style-type: none"> <li>• What is the impact of the quality of the auditee on the pre-audited financial statements? What are the primary determinants?</li> <li>• What is the impact of the quality of the auditee on the “absolute” level of audit quality and on the “relative” level of audit quality (improvement progress)?</li> <li>• What is the impact of auditors’ knowledge of the auditee on the audit process and audit quality?</li> </ul> </li> <li>• What is the (preventive) impact of the audit on the design and operating effectiveness of the auditees’ internal governance and controls?           <ul style="list-style-type: none"> <li>• What are the (auditor of auditee centric) determinants that drive auditees to follow-up on audit recommendations in, for example, the management letter?</li> <li>• Does internal control improve as a result of (clients’ follow-up of the recommendations coming from) the audit? Does this improvement result in an improvement of pre-audited financial reporting quality?</li> </ul> </li> <li>• What is the (preventive) impact of the audit on non- or pre-audited interim financial reporting and pre-audited year-end financial reporting?</li> </ul>
5. Fraud detection by the auditor	What are the determinants of a fraud (not) being detected and reported by the auditor? What can be improved?	<ul style="list-style-type: none"> <li>• What are the primary stakeholders’ expectations of frauds being detected by the financial statements audit?</li> <li>• What are the root causes of frauds not being detected and/or reported (by the auditor or otherwise)?</li> <li>• To what extent do the legal instruments at hand to the auditor suffice for the auditor to effectively address identified fraud signals and frauds?</li> </ul>

Given these topics, an interdisciplinary approach is most likely called for, also in relation to the research syntheses. This will be a major criterion for selection of research teams.

The support that FAR will provide for successful applications may include, but is not limited to, access to appropriate experimental, archival, survey, and other relevant data from participating audit firms (for Program B only) and coverage of travel costs, support for research assistants and students, and/or release time for project participants. While FAR does not intend to impose undue constraints on meaningful research, some of the criteria that will be used to determine successful applications for support include:

1. Proposals that aspire to inform practitioners as well as the research community: While it is of course vital that each project will be scientifically rigorous, it is important that the research proposal also speaks to the practical relevance of the study.
2. Projects led by a researcher who has a strong track record of publication in world class journals (including, but not limited to, *JAE*, *JAR*, *TAR*, *CAR*, *AOS*, *RAST*, and *AJPT*): The researcher is encouraged to seek collaboration with one or more talented junior researchers at his/her discretion (e.g. PhD students, assistant professors, etc.).
3. Deliverables include a research syntheses between 6 to 12 months (for both programs) and (intermediate, annually throughout the project) FAR Practice Notes, research / working papers and one or more presentations at FAR Masterclasses and the (annual) FAR conference and/or to the participating audit firms and their stakeholders: It is also important that the research teams are willing to communicate their findings both with their peers and with auditors working in practice (e.g. by writing or including a survey directed to auditors in practice).
4. For international scholars, collaboration with at least one person employed at a Dutch university is highly recommended, but not strictly required. In case FAR needs to liaise in establishing an Dutch research connection, we are willing to do so during the application process.

#### *Application Procedure*

Research groups in accounting and auditing are invited to submit a written proposal to the Scientific Committee of FAR not later than 17 March 2017. The Scientific Committee will evaluate the proposals and make a recommendation for support to the Board of FAR. The final decision regarding support will be made by the Board. During the admission process, FAR may ask the research groups to elaborate on their data needs. Such a request may be necessary to ensure the appropriate support from participating audit firms and *does not in itself signal that the project will be accepted*. Early in

May 2017, the Board will conditionally select the projects it will fund and notify all applicants accordingly. FAR will subsequently work with the selected applicants towards a final research proposal. The timing of project funding approved by the board will depend on when the project actually starts. Application forms may be downloaded from the FAR web site:

<http://www.foundationforauditingresearch.org/>.

Please send application forms, including appendices, to Olof Bik and Jan Bouwens at [info@foundationforauditingresearch.org](mailto:info@foundationforauditingresearch.org) . Applicants will receive a confirmation of their submission.

*What may FAR funds be used for?*

#### Funding for PhDs and faculty members

While FAR will support the research groups in gaining access to appropriate data from the participating audit firms (for Program B), FAR is, under certain conditions, also prepared to fund the research projects should the research group wish to be funded. Research groups may submit research proposals that include expenses for both established academics and PhD candidates. In the case of established scholars, FAR funds are intended to be used to acquire release time at their home university. Such funds can be used at different universities and internationally if appropriate. When PhDs are included, the home university must demonstrate a clear willingness to provide joint support for the student (i.e. FAR support is not intended to cover 100% of the cost of a doctoral student). In cases that include PhDs, FAR funding can be awarded for a period of one to five years, or until the student completes his or her thesis, whichever comes first and depending on the nature of the project.

Project funding may include salary and travelling costs that a student typically has to make. In addition, FAR may cover 5% of the salary costs of the supervisor for each student he/she supervises (for the period concerned). The university may claim a maximum of 25% of the project related salary costs to cover other project-related costs. In addition, team members may claim up to €6,000 a year to visit designated international conferences and the like. Office space and overhead costs will not be funded by FAR.

FAR may fund small and large projects. For example, projects spanning one year of a PhD student or to buy release time for a seasoned researcher up to a four year project of a PhD candidate plus expenses that allow for travelling and some allowance for the (senior) researcher(s) in charge. Project funding could amount to anywhere between €0 and €200,000 as a benchmark for Research Program B and between €0 and €25,000 for Research Program A. Of course, if a project has exceptional features FAR may still consider a project that requires further accommodation.

Funding for research data (for Research Program B)

Audit firms have agreed to provide the research groups with experimental, survey, archival, or other relevant data as is appropriate for the project. FAR will assist research groups to collect this data. One essential element of the process is to ensure that the data is de-personalized, transformed, and that data cannot be identified with the auditor, the audited firm, the audit firm, or its personnel.

FAR will facilitate data collection for projects that require proprietary data from audit firms based on a specific data gathering protocol to be drawn up for each project. To maintain confidentiality, the applicant's data plan should define what data he/she would require in as much detail as possible. In order to gauge whether data requirements can be achieved, the researcher may discuss the research plan with FAR management during the application process.

The data is subsequently collected under the supervision of FAR, and, where the situation so requires, data can be encrypted or transformed. Encryption/transformation is needed to avoid attribution of the source of the data to an individual client or audit firm. In such a case, the audit firm or [CentERdata](#), the entity that helps us maintain data confidentiality, will handle the encryption/transformation process, and FAR will provide the research team with a code that enables them to conduct the necessary analysis. In any case where proprietary data is used and disclosure thereof would be detrimental, all research team members will be required to sign a Non-Disclosure Agreement and the research team and university of research institute a Data Processing Agreement. Data gathered through FAR commissioned projects, either by FAR or the research groups, will remain FAR proprietary data at the disposal and discretion of FAR for future research purposes. FAR will provide for acknowledgements of data originality for review boards, where needed.

Approved projects will be subject to periodic progress reporting and review with the academic board of FAR.

For further information or questions, please contact FAR at [info@foundationforauditingresearch.org](mailto:info@foundationforauditingresearch.org).