

Online FAR Masterclass on internal control quality, audit quality and the predictive value of earnings calls

On Tuesday May 18th, a FAR Masterclass was presented by Christian Hofmann, Sebastian Kuhn, Jeroen van Raak and Nina Schwaiger. Except for Jeroen (who works at the University of Amsterdam), all presenters are affiliated with LMU Munich in Germany.

The masterclass is based on a related FAR-study by Christian Hofmann and his team. The study is aimed at investigating two related themes: (1) understanding the relevance of internal control quality for audit quality; and (2) identifying an information channel that (may) allow auditors to more accurately and efficiently assess internal control quality.

These two ‘work packages’, as they call them, are already covered in a recent FARView-podcast, of which the link is provided at the end of this brief report. The general notion is that financial analysts are highly interested in internal control quality, because that directly affects firm operations, which in turn influence future performance. This is an incentive for the analysts to gain as much information on internal control quality during the analyst meetings. Previous research shows that analysts possess superior information concerning the influence of external determinants (like macro-economic factors) on firm performance, and their internal control quality. In their FAR research project, the research team studies how the analyst knowledge concerning ‘asking the right questions’ can help auditors in assessing fraud risks.

During the masterclass, the participants gained a more detailed background on the ideas underlying their project. So, if you want to know more about the structure of earnings conference calls in general, about the role of financial analysts in those calls, and about the predictive power of individual characteristics (like complexity of language, vocal emotion and even face shape) on internal control material weaknesses, you’re wholeheartedly recommended to look at the video registration of this masterclass. The research team works on building an algorithm to predict internal control problems, based on information which is derived from earnings calls. This may be helpful for auditors during the important, but complex, process of making internal control risk assessments. During the masterclass also substantial explanation was provided on how the algorithm has been developed.

The podcast with Sebastian Kuhn can be found here:
https://www.youtube.com/watch?v=k7_NWRhnUOI

More information on the project is available here:
<https://foundationforauditingresearch.org/en/research-publications/projects/2019b01-internal-control-quality-and-audit-quality-prof-dr-hofmann/>

The video registration of the masterclass will be online soon.