

Department of Accounting
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Ph.D. Qualifying Exam- Auditing
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PART 2

(1) Please briefly answer the following two questions and cite papers to support your answers:

- (a) What are the auditors' commonly-used responses (or reactions) to litigation exposure? **(8 points)**
- (b) What are the key differences between auditor dismissals and auditor resignations? **(3 points)**

(2) Independence requires the auditor to act with integrity and objectivity both in mental attitude and in appearance. In operational term, independence ensures that those who perform an audit engagement should be mentally objective when collecting, investigating, and reporting on information. The Public Oversight Board's *Panel on Audit Effectiveness* emphasizes that independence is "fundamental to the reliability of auditor's reports." Because auditor independence not only increases the likelihood that firms' financial statements are in conformity with the generally accepted accounting principles (GAAP), but also encourage investors to rely more on the financial statements, auditor independence has long been regarded as a cornerstone to the public accounting profession. However, since many recent audit failures have been attributed to a lack of independence (e.g., Arthur Andersen vs. Enron), a call to restore public trust through improving auditors' independence has been emphasized by regulators, practitioners, and auditing academic.

- (a) How do auditing researchers measure auditor independence empirically? **(3 points)** What are the potential problems associated with these measurements? **(3 points)** Please cite prior studies to justify your answers.
- (b) What are the possible mechanisms that may be used to enhance auditor independence? Please discuss prior studies that have examined these mechanisms. What are their key conclusions? What are the potential research design problems in these studies? Please organize your answers using your own categorization scheme. A simple duplicate of the lecture notes is not acceptable! **(12 points)**
- (3) There are many issues of audit quality that are not directly addressed in the SOX. The following are some of these important issues:
- ① The existing research on auditor size may be interpreted as either larger auditors supplying higher levels of audit quality, or as smaller auditors supplying sub-optimal levels of audit quality. The SEC is now considering mandating a uniform level of audit quality across auditors of all sizes.
 - ② Regulators and researchers generally seem to assume (at least implicitly) that the auditor's bias towards conservatively-reported financials improves earnings quality. However, some of the policy makers and auditing researchers are now arguing that this may be true for the creditors, but not for equity holders.
 - ③ The FASB seems to move from the "rule-based" accounting towards "fair value-based" and "principles-based" accounting standards after recent several accounting scandal. The FASB explains that "fair value-based" and "principles-based" accounting standards can partially improve audit quality.

Comment on the above three most recent regulatory trends in audit quality. Do you agree or disagree? Why or why not? Cite prior studies to support your answers. **(21 points)**