

National Chengchi University
Department of Accounting
Ph.D. Qualifying Examination – Auditing
March 25, 2009

PART I

NOTE: In answering this exam, you should use only one language. That is, if you choose Chinese (or English), all your answers should be in Chinese (or English), except for citing prior studies. This requirement stems from my past observation that, due to the open-book system, many of the doctoral students answered the qualifying exams by simply copying and pasting paragraphs from various sources (in Chinese or English) to the answer sheets without knowing what those paragraphs really mean. Being a potential Ph.D. candidate, it is your responsibility to demonstrate your ability of integrating different information, forming your own thinking, and expressing your opinion in an academic way. I strongly believe that, if you really understand a paper, you should be able to discuss it using your own words. This is a fundamental training in the Ph.D. program and I expect that all of you have already had this skill.

(1) The world is experiencing great economic instability and governments of major countries are taking unprecedented actions in efforts to curtail the economic crisis. The economic crisis undoubtedly is affecting both financial statement preparers and the auditors engaged to audit their financial statements. For example, the U.S. has taken actions to prevent worsening economic conditions, including facilitating sales of ailing financial institutions, passing the Emergency Economic Stabilization Act of 2008, rescuing the U.S. automakers, and dramatically increasing the monetary programs available from the Federal Reserve. These tough economic times have made accounting for transactions and auditing entities more challenging than ever. Few, if any, industries are immune to the affects of the crisis so it is more critical than ever for auditors to understand the rapidly changing business, economic, and regulatory environments in which audit clients operate.

Required: Under the global economic crisis,

- ① Identify critical audit risks facing the auditing profession (5 points).
- ② What are the auditors' legal liabilities to the shareholders and the regulators? (5 points)

Justify your answers by either citing prior studies or referring to the most recent standards / articles. Please do not copy anything from the auditing textbook, or you will get zero score on this problem.

(2) In recent years, prominent accounting scholars speaking at the AAA Annual Meetings have bemoaned the state of accounting inquiry. The main thrust of the criticisms is that accounting researchers increasingly pursue very small and narrow questions that do not advance professional knowledge. At the 2006 AAA Annual Meeting, for example, Demski (2007) and Fellingham (2007) even questioned whether accounting was an academic discipline. In addition, Hopewood (2007) argued that accounting researchers were shrinking their research boundaries and that the "top three" U.S. accounting journals are increasingly unlikely to publish truly innovative research. These commentators thus agreed that "innovation is close to nonexistent" and that "our research is largely derivative, bifurcated, and far from foundational" (Demski 2007). In light of this, Fellingham (2007) poses the challenge, "What big intellectual ideas have accounting researchers contributed to the university?"

One major reason, as pointed out by Basu (2008), that senior researchers might feel that the accounting academics is making little progress is that accounting researchers do not share a common research goal. If we are to make big intellectual contributions to the academy, it would probably help to identify the big unanswered questions that we could collectively attack, and then work on finding the tools to answer these questions rather than choosing only the questions that our current research methods can address. This is consistent with an "Imagined World of Accounting," the major theme of the 2007 AAA Annual Meeting.

Required: From an auditing's perspective,

- ① Do you agree with Demski (2007), Fellingham (2007), and Hopewood (2007) that current auditing studies do not contribute to the advance of our understanding of auditing practice and theory? Why or why not? (4 points)
- ② What are the major constituents of an "innovative" auditing study? Why? (3 points)
- ③ In your opinion, what is the most innovative auditing study you have ever seen? Why? (Note: You do not have to restrict your answers to those you have seen in class.) (3 points)
- ④ In your opinion, what are the biggest unanswered questions in modern auditing research? Why do these questions remain unanswered? (10 points)

(3) Susan Haka, President of the AAA, points out that we are now facing some critical accounting tipping points. At first blush, these issues may seem to be unconnected tipping points. However, the global community has, over the last several years, experienced unprecedented financial excesses. These excesses are the context for the accounting changes that now face us. Make no mistake, the outcomes of these tipping points are uncertain and remain controversial. Thus, our collective accounting thought leadership is critical. The following are some tipping points discussed by Haka (2009):

(a) The IFRS Global Epidemic:

In November 2008 the SEC released its roadmap outlining a proposal for domestic issuers to adopt IFRS by 2014. Despite the positive IFRS support by large public accounting firms, some academics, and multinational corporations, others are not convinced that a single set of global accounting standards is appropriate. For example, Charles Niemeier, an influential member of the PCAOB, said "... the switch to IFRS by 2014 could squander comparability among US financial statements and impede the ability of the regulators and auditors to do their jobs..."

Required:

- ① What are the underlying reasons of Charles Niemeier's argument? (5 points)
- ② Do you agree with Charles Niemeier's argument? Why or why not? (5 points)

(b) XBRL:

On November 28, 2008, a new draft of the XBRL U.S. GAAP Taxonomies became available for public review and comment. Public comment by company preparers, investors, financial analysts, auditors, and accounting academics are needed on both the taxonomy and the impacts of this tipping point. A SEC May 30, 2008 proposed rule requires the use of XBRL for the largest public companies as early as the first quarter of 2009.

While much attention has been paid to the creation (and comparability) of the taxonomies around the world and the technical issues of implementing the XBRL, little has been heard from the academic accounting community about the long-run advantages and/or disadvantages of XBRL. Being an accounting researcher, we should not regard XBRL as simply a technical platform of converting traditional financial statements into their web-based presentations. Rather, we need to know more about how this new standard, through its information modeling and expression of semantic meaning commonly required in business reporting, affects the behavior of investors, managers, and auditors in an interactive market environment.

Required:

What are the possible implications of the XBRL to auditing research? (5 points)

(c) Management Compensation Backlash

Last year Wall Street firms awarded a near-record \$33.2 billion in bonuses, just weeks before Bear Stearns went under and many firms took tens of billions of dollars in write-downs. Some people on Wall Street defend big bonuses, saying that bonuses traditionally make up nearly half of employees' total compensation. However, many companies have announced the elimination of bonuses this year. Current talks among government officials about capping bonuses and compensation could have significant impacts for how compensation packages are structured in the future. Since accounting numbers anchor most management bonus schemes and are used to motivate managers, compensation theory thought leadership will be in demand.

Required:

- ① What role(s) do auditors play to the determination of effective bonus compensations that could better align the interests between the managers and the shareholders? (5 points)
- ② What factors influence the success of auditors' playing the role(s) you identify in ① above? (5 points)
- ③ How should the audit committees be compensated so that they can effectively oversight the companies' financial reporting and internal controls? (5 points)

(d) Assets/Liabilities Model Focus

A 2003 SEC report supported the adoption of a principle-based accounting system and simultaneously rejected the revenue/expense accounting model in favor of a model focused on assets/liability accounting. This shift to the balance sheet as the primary accounting statement is supported by IASB and FASB, but has generated controversy. Abandoning principles such as matching and conservatism unsettles accountants. Some assert that the asset/liability model combined with increasing reliance on fair values will result in increased reliance on rules rather than principle-based approach called for by the SEC and the IASB.

Required:

- ① What are the impacts of the assets/liabilities model on the auditing profession? (5 points)
- ② Identify one prior auditing study and discuss how its research design should be revised to accommodate the new assets/liabilities model (8 points). Will the empirical results change based on your proposed research design? (2 points)