Time pressure, fee pressure and audit quality

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Abstract.
Today is one of the major challenges and main concern in any society is limited resources and unlimited needs. Auditing standards require auditors to plan and perform audits to obtain reasonable assurance about whether the financial statements are free of material misstatements and to express an opinion about the fair presentation of the financial statements. On the other hand, Auditors are facing time pressure and fee pressure by the client. Some research suggests that fee pressure from clients could reduce audit effort and thus affect audit quality. In addition, some evidence suggests that there is a relationship between time pressure and audit quality. These concerns suggest that impediments to auditor skepticism, such as imposed time pressure, can result in lower quality audits. With regard to the conflict of these two issues, the aim of this paper is identifies the perspectives about time and fee pressure and audit quality. This paper introduces comments and evidence on this issue and offers valuable solutions for solve this problem.

Key words: time pressure, fee pressure, audit quality.

1. Introduction.

Jay Hanson, PCAOB Board Member, highlighted similar concerns in a speech on March 28, 2014 stating that: “One of the biggest impediments to auditor skepticism, however, in my view, is the calendar. Public companies have filing deadlines to meet, and they are rarely missed. When they are missed, the consequences can be serious, including declining share prices and harm to investors. If potential issues are discovered late in the audit process, or an issue is not resolved in a timely manner, auditors may feel pressure to cut corners. We have seen it in inspections and enforcement matters: Auditors recognize that there may be a problem with management's estimates or conclusions but allow themselves to be talked out of doing anything about it. Staying organized and proactively dealing with problems far ahead of filing deadlines will help the auditor avoid running out of time as well as the pressure to accept insufficient audit evidence” (Hanson 2014).

Furthermore, we investigate the existence of downward audit fee pressure, and the consequences of that fee pressure on audit quality, during the economic downturn that is often referred to as the ‘‘Great Recession’’. The Recession began in the U.S. in December of 2007 and officially ended in June of 2009 (NBER, 2010). It was longer than any other since World War II, and had more severe negative effects on gross domestic product, private sector jobs, and retail sales than preceding recessions. With regard to auditors, the severity of the Recession likely increased misstatement risk due to reduced client profitability and potential asset impairments. During and after the Recession, regulators repeatedly expressed concerns that audit fee pressure from clients could reduce audit effort and thus affect audit quality.

Therefore, audit quality can be conceptualized as a theoretical continuum ranging from very low to very high audit quality. Audit failures obviously occur on the lower end of the quality continuum, and so a good starting point in thinking about audit quality is to ask what the rate of outright audit failure is? An audit failure occurs in two circumstances: when generally accepted accounting principles are not enforced by the auditor (GAAP failure); and when an auditor fails to issue a modified or qualified audit report in the appropriate circumstances (audit report failure). In both cases, the audited financial statements are potentially misleading. (Francis, 2004). Since 1989 there are effectively two types of audit reports issued in the United States: the standard clean unmodified report and a modified report for going concern uncertainty. Butler et al. (2004) calculate that 6.6% of US listed companies received a going concern reports during the period 1994-1999. Another study documents yearly going concern reporting rates ranging from 9 to 5%, with a monotonic decline over the period 1990-1997 (Francis and Krishnan, 2002). It seems that the time and cost impact on audit quality.

2. Audit quality.

Audit services are demanded as monitoring devices because of the potential conflicts of interest between owners and managers as well as those among different classes of security holders [see Watts (1977), Watts and Zimmerman (1981), and Benston (1980) for elaboration]. In at least some cases, the provision of audited financial statements is the least-cost contractual response to owner-manager and intra-owner conflicts of interest, i.e., agency costs. Agency costs vary across potential client firms and perhaps over time for a given client. For example, it is well known that client firms going public often switch to Big Eight auditors [Carpenter and Strawser (1971)]. Differential agency costs across firms and over time for a given firm imply a heterogeneous demand for audit services, i.e., differing 'levels' of auditing are demanded. (De Angelo, 1981).

Significant commitment to institutionalise more independent standard setting and oversight processes in the name of strengthening audit quality is evident in the post-Enron period. The regulatory pursuit of audit quality marks a shift in the discourse associated with external auditing which had previously focused on notions of adding value (see Eilifsen, Knechel, & Wallage, 2001; Knechel, 2007; Manson & Zaman, 2001; Peecher, Schwartz & Solomon, 2007; Power, 2007). The loss of public confidence in audit practice means that new representations of auditing are likely to become pivotal in creating and managing new and 'improved' impressions of the profession. In the promotion of audit quality and attempt to restore public confidence in the audit process, the concerns of, and initiatives taken by, regulatory agencies are likely to reflect efforts intended to maintain, defend or manage their individual domains (Holm and Zaman, 2012).

3. Time pressure.

The presumed impact of organizational culture on dysfunctional auditor behavior justifies further research into the potential impact of ethical culture on functional auditor behavior. The ethical culture of an organization has been regarded as one important determinant of unethical behaviors in organizations (Deal and Kennedy, 1982; Fritzsche, 1991; Ford and Richardson, 1994; Key, 1999; Casey et al., 2001). Previous studies from the auditing field indicate that the ethical decisions made by auditors can be greatly influenced by the ethical culture of their audit firms (Ponemon, 1992; Windsor and Ashkanasy, 1995; Douglas et al., 2001), and Sweeney et al. (2010) find that one ethical culture dimension can influence unethical behavior under time pressure Auditors often face pressure from tight time budgets, a situation that at least partly originates from the bidding for audit contracts. The potential conflict between controlling costs and achieving high-quality audits (McNair, 1991) is heightened by the immense weight that audit firms place on attaining time budgets as a measure of efficiency (Anderson-Gough et al., 2001) and their difficulties in measuring audit quality (Power, 2003). As a result, unpaid overtime to cover for unattained time budgets is an informal cultural norm in audit firms (Alderman and Deitrick, 1982; Sweeney and Pierce, 2006).

Previous studies have found a causal relationship between time pressure and dysfunctional behaviors. RAQ acts and URT initially tend to increase as time budgets become less attainable (Alderman and Deitrick, 1982; Margheimand Pany, 1986; Kelley and Margheim, 1987, 1990; Ponemon, 1992; Otley and Pierce, 1996a, b; Willett and Page, 1996; Pierce and Sweeney, 2004; Gundry and Liyanarachchi, 2007; Bowrin and King II, 2010), although they may decrease when time budgets appear too unattainable (Kelley and Margheim, 1990). However, if the auditor receives forewarning of the impeding time constraint, the negative effects of time pressure are smaller (Low and Tan, 2011). Several studies claim that relationships exist between perceived TBP and position in the audit firm (Cook and Kelley, 1991; McNair, 1991; Gist and Davidson, 1999; Moreno and Bhattacharjee, 2003). Factors that cause TBP to increase, indicated as an increase in URT, may differ between low- and high-ranking auditors. Partners' URT increases with risk factors relating to clients, while juniors' URT does not depend on client risk factors (Gist and Davidson, 1999). With few exceptions, research into TBP and dysfunctional behaviors has concerned low-ranking auditors, i.e. juniors and seniors (Sweeney et al., 2010), who perceive higher levels of TBP than do high-ranking auditors, i.e. managers and partners (Cook and Kelley, 1991; McNair, 1991; Savanberg and ohman, 2013).

4. Fee pressure.

Fee pressure arises in auditing due to difficulties that audit firm management experiences in anticipating the level of fees needed to recover the cost of the effort required to achieve an acceptable level of audit risk, and an acceptable level of return sufficient to maintain long-run profitability. One line of relevant prior research measures fee pressure directly using the level of audit fees. For example, using audit seniors as experimental participants, Houston (1999) demonstrates that fee pressure caused by a reduced audit fee is associated with audit budgeting that is less responsive to increased client risk. Further, as an example of quality-threatening behavior generated by fee pressure, Gramling (1999) finds that audit managers encountering clients who impose a high level of fee pressure via an explicit preference for lower audit fees are more likely to rely on internal audit work of questionable quality (Bedard et al, 2008).

The concept of fee pressure to which these claims refer is undeveloped. Given the lack of an accepted proxy for fee pressure, we devise our own. We compare each client's actual audit fee in the test year (2008) with a benchmark audit fee for that year. The benchmark audit fees are intended to represent normal levels of audit effort by controlling for changes in audit fees that correspond with changes in fee cost drivers. Specifically, a new shock to fee pressure is reflected in current year actual audit fees, but not in the benchmark fees, a comparison of each client's 2008 benchmark fee with its 2008 actual fee determines. Whether the client has successfully exerted fee pressure. We find approximately 47 percent of clients experienced fee pressure during 2008. The median fee pressure experienced by firms is $163,000, which represents 29 percent of median audit fees of clients that successfully exerted fee pressure (Ettredge et al, 2014). The recession was longer and more severe than any other since World War II. It imposed significant financial pressures on many companies. For instance, the number of U.S. commercial bankruptcies for the first eleven months of 2008 was 35 percent greater than the number filed in the entire year of 2007 (Pugh, 2008). Companies expected auditors to share the economic pain by agreeing to fee reductions (Goelzer et al., 2010). If fee reductions occurred, such decreases would be in sharp contrast to the fee increases in the years following the passage of the Sarbanes Oxley Act of 2002 (Cheffers &Whalen, 2010; Ettredge, Li, & Scholz, 2007). In addition, Global and

U.S. accounting firms had several rounds of layoffs throughout the recession (Accounting Today, 2009; WSJ, 2008). Accounting firms also experienced slower receivables collections (Accounting Today, 2009), potentially leading to cash flow problems. Thus, accounting firms as well as their clients appear to have experienced financial challenges during the Recession. Regulators have stated concerns that increased fee pressure might have threatened audit quality. (Ettredge et al, 2014).

5. Conclusion.

In this study mentioned the time pressure, fee pressure and audit quality. PCAOB Staff Audit Practice Alert No. 10 (PCAOB 2012a) raises concerns that audit scheduling can cause auditors to feel pressured to ‘complete assignments too quickly’ which can lead to dysfunctional audit behavior (e.g. gathering easy to obtain evidence as opposed to relevant and reliable evidence; insufficient amounts of evidence; giving undue weight to confirming evidence without adequately considering contrary evidence). With these concerns in mind, we examine whether audits completed under deadline imposed time pressure, as proxied by the proximity of the audit report date to a company’s 10-K filing deadline, are associated with measures of low audit quality. (Glover et al, 2015). This paper show audit quality is affected by time pressure and fee pressure. It is especially interesting that results show that when budget pressure is reduced, the extra hours are used by engagement teams. This implies that when the engagement members feel that it is “safe” to report more hours, they do so. The opposite implication holds when engagement team members experience high budget pressure.

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