Auditors' consideration of corporate governance and management control philosophy in preplanning and planning judgments

The professional literature (e.g., COSO 1992, POB 1993), recent auditing standards (e.g., SAS Nos. 78 and 82), and prior research (e.g., Beasley 1996; Beasley et al. 1999; Dechow et al. 1996) highlight the importance of corporate governance and management control philosophy in ensuring the integrity of the financial-reporting process. We examine the link between these two macro-level factors and both preplanning (e.g., client acceptance, business risk judgments) and planning judgments (e.g., extent and timing of testing).

Ninety-six auditors evaluated a hypothetical client with corporate governance and management control philosophy characteristics that were either strong or weak. More experienced auditors performed preplanning (client acceptance) judgments, while the remaining auditors performed planning judgments related to the extent and timing of substantive testing. As predicted, management control philosophy and the governance structure did affect the preplanning and planning judgments, with a stronger effect observed for management control philosophy. While the results for judgments related to the extent of testing were consistent with professional guidance, auditors lacked consensus in judging the effect on the timing of tests. The results provide insight into the effect of two important elements of the control environment on preplanning and planning judgments and could prove useful in the development of work papers and risk assessment models.

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Corporate Governance is also intimately concerned with honesty and transparency, which are increasingly expected of the public both in corporate dealings and disclosure (Page, 2005). Investor confidence and market efficiency depend on the disclosure of accurate information about corporate performance. To be of value in global capital markets, disclosed information should be clear, consistent, and comparable (OECD, 1999). Entails the skillful consideration and balancing of the interests of all stakeholders, including employees, customers, partners, and the local community. Entails the accurate and timely disclosure of clear, consistent, and comparable information in good times and bad times. As predicted, management control philosophy and the governance structure did affect the preplanning and planning judgments, with a stronger effect observed for management control philosophy. While the results for judgments related to the extent of testing were consistent with professional guidance, auditors lacked consensus in judging the effect on the timing of tests. This study investigates the impact of the quality of corporate governance and management control philosophy on preplanning (judgments related to the client-acceptance process) and audit-planning judgments. Both corporate governance and management control philosophy relate to the sharing of power among stakeholders and the protection of shareholders' interests. Corporate governance and internal control: An empirical analysis. American Accounting Association (AAA) Annual Meeting, Atlanta, GA: AAA. In turn, auditors report relying to a greater extent on corporate governance information in planning and performing the engagement. However, results also suggest that at least some changes in governance may have been more form than substance. Two competing models of corporate boards are presented. Management control proposes that the board is a rubber stamp for management, and plays a minor role in strategic management, while resource dependence asserts that the board is a tool used to manage environmental uncertainty.