Corporate Governance in the Post-Sarbanes-Oxley Era: Auditors’ Experiences

This article discusses how accounting events preceding Sarbanes-Oxley Act (SOX), such as World Com and Enron’s mishandling of accounting statements, led to SOX. Cohen, Krishnamoorthy, and Wright (CKW), the authors of this article, primarily wanted to identify how external auditor experiences changed due to SOX implementation. The authors main concern was the change in external auditor’s interactions with the audit committee, the board of directors, and internal auditors and how it affects the auditor’s risk assessment, accounting issue resolutions, and the hiring/firing of auditors.

***Prior Research and CKW Current Study’s Goal***

Prior academic research has indicated that presence of strong corporate governance has led to lower rates of fraud, fewer restatements, and a lower level of earnings management. CKW move past this prior research by taking into account auditor experiences with SOX, audit committee expertise, and audit committee support.

***Research Question***

“How have auditors’ experiences with corporate governance parties changes in the post-SOX era?”

***Research Method***

CKW used a semi-structured interview approach to address their research question. They used this method because it allowed them to gain insight on the audit process and the interaction between the auditors and the major corporate governance parties.

CKW solicited voluntary participation from each of the Big 4 firms in the Northeast of the United States of America. Eleven managers and nineteen partners from three of the Big 4 firms were interviewed in 2006. The participants were well experienced. The managers had an average of nine years’ auditing experience, while the partners had an average of 18.5 years’ auditing experience. Additionally, the manager participants spent 66 percent of their last five years’ experience with public companies, while 76 percent of the partners spent last five years’ experience with public companies. Furthermore, all of the participants had a wide breadth of industry specializations.

The interviewees were presented 19 interview questions from CKW. These questions were reviewed by two audit partners and several academic researchers to ensure internal and external validity. The interview questions were emailed to the interviewees in advance, but the interviewees were asked to refrain from discussing the questions with their colleagues. The interviews lasted approximately 45 minutes to one hour.

***Results***

*Corporate Governance Definition*

The interviewees were asked to define their definition of corporate governance. The definitions provided by the interviewees predominantly focused on management and the boards responsibility at ensuring effective corporate governance. Management and the board were mentioned in 67 percent of respondent’s definition of corporate governance, but also to a lesser extent audit committee and control activates were emphasized in the definitions of corporate governance.

*Auditor Appointment and Termination*

The interviewees were asked to share who they believe actually has the most influence on the appointment and dismissal of auditors in a public company. While CKW posed this question to the participants, they emphasized “actual influence” and not influence in name via regulation. As a result of this questions, the auditors assigned 53 percent of actual influence on management and 41 percent of actual influence to the audit committee. This questions demonstrated the large amount of influence management still has on the decision on whether or not to hire an external auditor. Moreover, the amount of influence management has increases when the CEO is on the board of directors.

*Corporate Governance and the Audit Committee*

The interviewees were also asked about the nature and extent the use of corporate governance had in the various phases of the audit process. The results indicated that 97 percent of the auditors interviewed indicated that corporate governance played a role in the planning phase, while 59 percent said that it played a role in the field testing phases. Furthermore, in the last five years’ 57 percent of respondents indicated that the use of corporate governance in manager and peer review has increased. Thus, the results indicated that the use of corporate governance in the various phases of the audit has increased.

*Interactions with the Audit Committee*

SOX has placed greater responsibility on the audit committee, with regard to financial reporting, the audit process, and internal controls. Not surprisingly, auditor interactions with the audit committee has nearly doubled since the implementation of SOX. The interviewees indicated that the substance of these meeting ranged from accounting and auditing issues, audit planning, results of the audit, SAS No. 61, and the quality of accounting personnel employed by the client. The participants indicated that these meeting mostly influenced the auditors’ audit risk assessment and program planning process, but these meeting also helped the auditor resolve contentious issues with management. Additionally, participants indicated that the interactions with the audit committee with regard to control environment has increased. It seems as if auditors believe that SOX has had a positive influence on the audit committee’s ability to oversee controls and challenge management.