Internet Appendix A114: Auditing

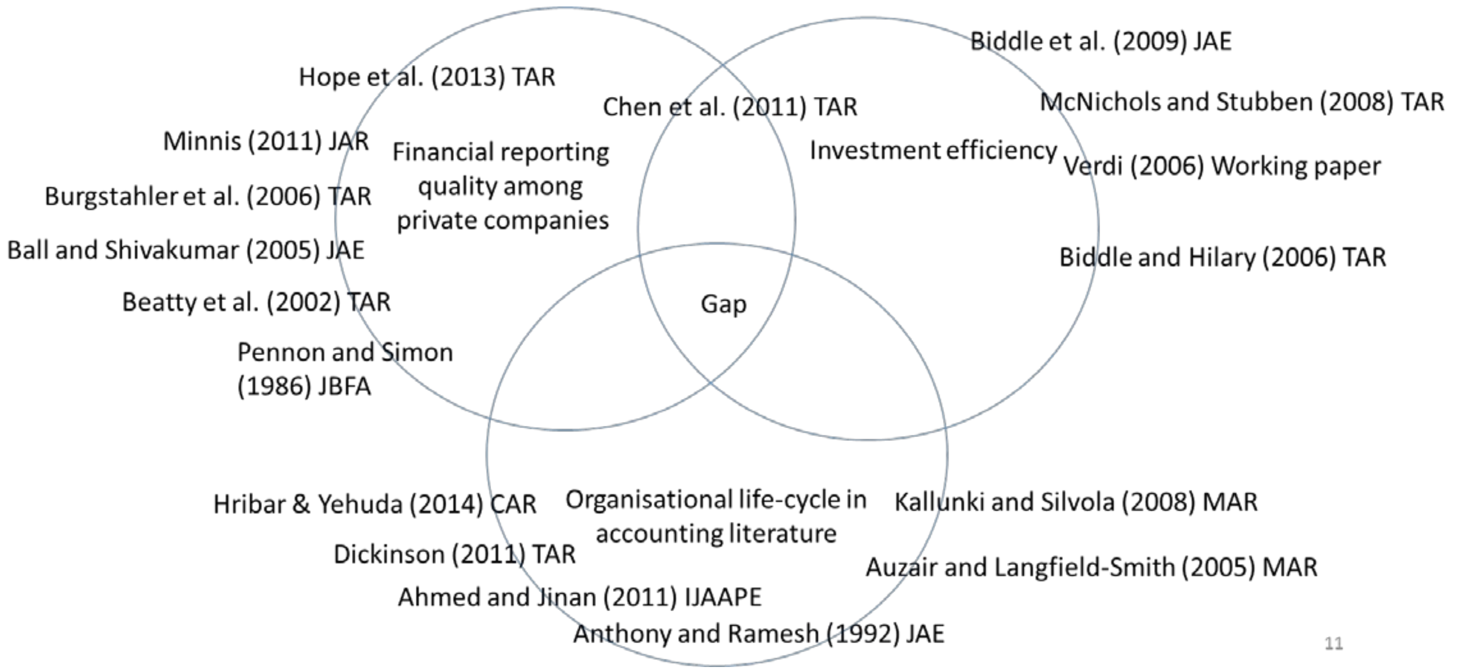
A114.1 Illustrative Pitch Template Example (NBthis pitch won the best pitch award at the AFAANZ 2015 Doctoral Symposium).

Pitcher's Name	Amirul Nasir				
		FoR category	Auditing	**Date Completed**	9 June 2015
(A) Working Title	Does Auditing Affect Owner-managers' Decision-making? - Evidence from Different Company Life-cycles.				
(B) Basic Research Question	Does auditing reduce information asymmetry and improve investment decisions of owner-managers of small private companies and what are the effects of auditing at different stages of company life-cycle?				
(C) Key paper(s)	1. Hribar, P. & Yehuda, N. (2014). The Mispricing of Cash Flows and Accruals at Different Life-Cycle Stages. Contemporary Accounting Research. 2. Chen, F., Hope, O. K., Li, Q. & Wang, X. (2011). Financial reporting quality and investment efficiency of private firms in emerging markets. The Accounting Review, 86, 1255-1288. 3. Minnis, M. (2011). The value of financial statement verification in debt financing: Evidence from private U.S. firms. Journal of Accounting Research, 49(2), 457-506.				
(D) Motivation/Puzzle	Despite lower agency conflict, private companies still engage external auditors to audit their financial statements for various reasons (e.g. lowering cost of debt and improving credit rating). This puzzle motivates me to extend the current application of agency theory for owner-managed private companies. This study suggests that auditing reduces information asymmetry within owner-managed companies. In light of the importance of accounting information in internal decision-making and limited studies in accounting related to company life-cycles, this study posits that auditing affects owner-managers' decision-making differently at every company life-cycle stages due to different levels of information asymmetry that exist. **Puzzle:** Should owner-managers engage auditors and does auditing affect owner-managers' decision-making differently at different life-cycle stages?				
THREE	**Three** core aspects of any empirical research project i.e. the "**ID**io**T**s" guide				
(E) Idea?	**"Core" idea:** Agency theory posits that an independent audit reduces adverse selection and moral hazard issues (agency conflicts) between preparers and users of financial statements. Agency conflicts in private companies differ as owners are also the managers of the companies. Little attention has been given to understanding the benefits of auditing to owner-managers, particularly in reducing information asymmetry and investment decision among small private companies. Companies are evolving entities that are determined by their company life-cycles which are distinct and identifiable stages. While evidence shows investment behaviour is different for distressed and healthy companies, this study presumes investment behaviour is also different at every company's life-cycles stages. There is very little research on investment behaviour at different company's life-cycles stages and no prior studies have explicitly examined the effect of financial reporting quality on owner-managers decision-making particularly investment across company's life-cycle. **Central hypothesis(es):** To test the positive effects of auditing in reducing information asymmetry and improving owner-managers' investment decision particularly at maturity stage of company life-cycles. **Key dependent variables:** (i) Financial reporting quality and (ii) investment efficiency. **Explanatory variable**: Auditing. **Interaction variable:** Company life-cycle stages. **Endogeneity threat:** Yes, especially the influence of auditing on both dependent variables. **Strategy to deal with endogeneity:** Using Generalised Method of Moment (GMM) modelling. Is there any **theoretical "tension"** that can be exploited? Yes. (i) In agency theory, either monitoring or information hypotheses or both could explain this phenomena. (ii) There is a possibility of positive effect of auditing at growth and decline stages and not at the maturity stage (If the "spill-over effect" theory is more predominant).				
(F) Data?	(1) **Country/setting:** UK small private companies UK **Why?** Because it is the most comprehensive data available. **Unit of analysis:** Individual companies **Sampling interval:** Annual. **Sample period:** 2004-2013 **Type of data:** Firm specific (2) **Expected sample size:** > 50,000 company-year observations. **Sample period:** 2004-2013. (3) **Is it a panel dataset**? Yes. Unbalanced panel data. (4) **Data Sources:** UK Fame database. Are the data commercially **available?** Yes. Any **hand-collecting required?** No. Are the data to be created based on your own **survey instrument?** No. Or by **interviews?** No. **Timeframe?** 2 weeks. Research **assistance** needed? No. **Funding/grants?** No. Are they novel **new data?** No. (5) Will there be any problem with **missing data/observations?** Yes. Especially if additional data is required in the later stage of research. Database **merge issues?** No. **Data manipulation/"cleansing" issues?** Yes. FRQ and life-cycle variables will reduce the amount of available data. (6) Will your "**test" variables** exhibit adequate ("meaningful") variation to give good power? Yes, variables used by key papers. Quality/**reliability of data?** Yes, data have been used by prior research.				

Cued Template taken from Faff, Robert W., Pitching Research (January 11, 2015). Available at SSRN: http://ssrn.com/abstract=2462059 or http://dx.doi.org/10.2139/ssrn.2462059

	(7) Other **data obstacles?** Not at the moment. E.g. **external validity?** Yes, results can be generalise to small private companies. **Construct validity?** No issues as the proxies are compelling and based on the proxies used by prior studies.
(G) Tools?	Basic empirical framework and **research design?** Empirical design. Is it a **regression model approach?** Yes, it is a dynamic panel data regression. This study uses GMM modelling to deal with the endogeneity in panel data settings. GMM modelling provides an advantages of not relying on exogenous external instrumental variables. Econometric **software needed**/appropriate for job? Stata. **Accessible** through normal channels? Yes. Personal licence. **Knowledge of implementation of appropriate or best statistical/econometric tests?** Not yet, but the strategy is to learn from other colleagues. **Compatibility** of data with planned empirical framework? Yes, data have been applied before by previous researchers. Is **statistical validity** an issue? No. This study has appropriate data, sampling and tests.
TWO	**Two** key questions
(H) What's New?	**Novel**ty: The idea of extending the application agency theory with the integration of company life-cycle theory using information hypothesis argument in voluntary auditing environment. **"Driver":** Idea. **"Passengers":** Data/tools. UK data with 10-year data and the application of GMM dynamic panel data modelling for regression analyses. Is this "Mickey Mouse" [i.e. can you draw a simple Venn diagram to depict the novelty in your proposal?] Yes. Attached.
(I) So What?	Why is it **important** to know the answer? It is important to know the answer because not only owner-managers can make an informed decision to engage auditors but more importantly to highlight to public policy debate for the auditing requirement for private companies. How will **major decisions/behaviour/activity etc be influenced** by the outcome of this research? This study provides evidence for policy makers to make more informed decisions on the economic consequences of auditing at different stages of company life-cycle. This study may restore confidence to the auditing profession in providing value to owner-managers of small private companies.
ONE	**One** bottom line
(J) Contribution?	What is the **primary source of the contribution** to the relevant research literature? Simple. There are two incremental contributions of this study. (i) To understand the value of auditing to owner-managers of small private companies by extending the application of agency theory using information hypothesis and (ii) to integrate the understanding of the value of auditing to owner-managers in agency theory with company life-cycle theory; this study also extends the literature on life-cycle which is mostly investigated in organisational studies but not in accounting research.
(K) Other Considerations	Is **Collaboration** needed/desirable? **Idea:** Collaboration with supervisors for publication **Data:** Not at the moment **Tools:** Collaboration with supervisors for publication **Target** Journal(s)? A* accounting journal. **Realistic?** Yes. **Sufficiently ambitious?** Yes, based on Chen et al (2011), Minnis (2011) and Hribar & Yehuda (2014) published in A* journal. "**Risk**" assessment: **"No result" risk:** HIGH However, there are some other alternative models of financial reporting quality that can be tested. Nevertheless, an insignificant results will be as interesting as significant results because it may offer different explanation. "**Competitor" risk:** MEDIUM Number of researchers in this area are increasing, hence, I need to keep up to date with the recent publications. **Risk of "obsolescence":** LOW Auditing requirements of private companies is continuously debated by policy makers. **Other risks?** No Are there any **serious challenge(s)** that you face in executing this plan? What are they? Are they related to the Idea? The Data? The Tools?: Probably data management and understanding the tools. No short cut, the strategy is to learn quickly. Are there e**thical considerations? Ethics clearance?**: Not relevant Is the **scope** appropriate? Not too narrow, not too broad: Yes, at appropriate level.

“Mickey Mouse” Venn diagram



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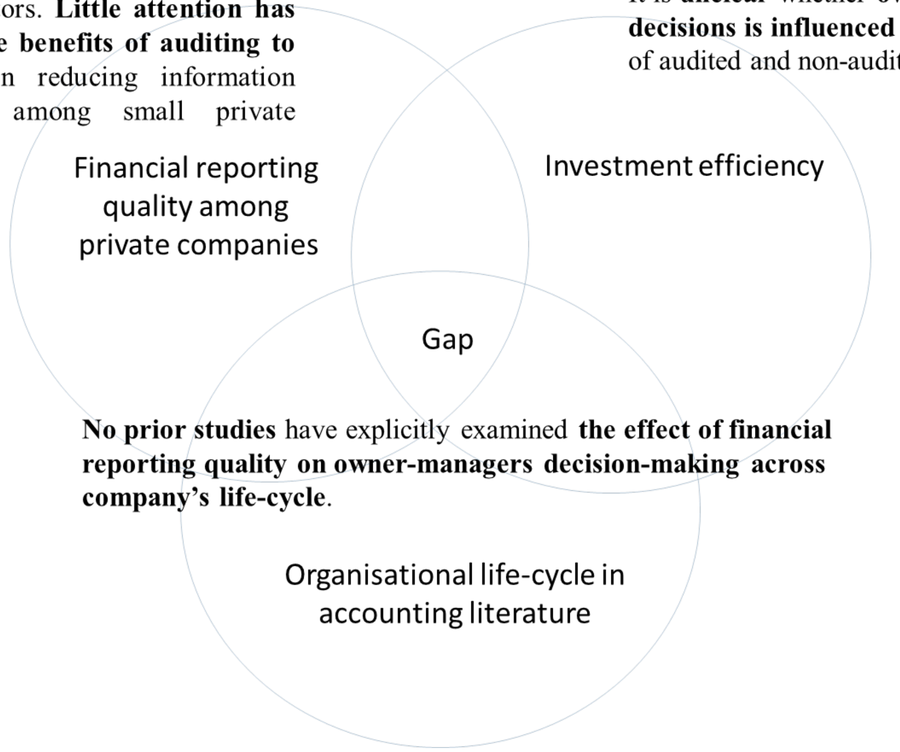
Gaps identified from "Mickey Mouse" Venn diagram

Research has mainly focused on the role of auditing to shareholders, investors and creditors. **Little attention has been given to understanding the benefits of auditing to owner-managers,** particularly in reducing information asymmetry (agency conflict) among small private companies.

It is **unclear** whether **owner-managers' investment decisions is influenced by financial reporting quality** of audited and non-audited companies.



No prior studies have explicitly examined **the effect of financial reporting quality on owner-managers decision-making across company's life-cycle**.

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