Does Providing Tax Services Impair Auditor Independence? Evidence from Assessing Tax Accrual Quality

By Choudhary, Koester, and Pawlewicz

A Practitioner’s Perspective

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Is knowledge spillover helpful in auditing tax accounts?

• Technical challenges of applying ASC 740
  – Understanding relevant federal, state, and foreign tax laws, including the interaction among them
  – Understanding U.S. GAAP rules, to permit translation of financial results into tax amounts
  – Understanding the complex accounting for income tax rules themselves (a subset of US GAAP)
• Tax-related restatements/material weaknesses are not uncommon
• Timing challenges for provision preparation (tax is typically among the last entries booked)
• Timing challenges for the auditor
Are all tax-related services the same?

- Proxies must disclose spending on tax services provided by the auditor, but typically do not quantify the types of tax services purchased.
- Consider the knowledge spillover of:

  Preparation of worldwide tax returns vs. Computation of the research credit for a multiyear time period
Are fewer restatements and lower tax accrual quality compatible?

• Are tax-related restatements really that rare?
• 1,149 tax-related restatements for the years 2003 and later
• Tax is consistently rated one of the top reasons for restatements
• Why are restatements considered an “indirect” indication of audit quality?
Tax-Related Restatements
2003 to 2012

Source — Audit Analytics
Other questions

• Why should being an “audit expert” help? Compare the smallest Big Four in NYC and the largest audit firm in Abilene, Texas — which one would be the “expert”?
• Why does the TaxACC formula exclude changes in short-term deferred tax balances?
• How accurate is the TaxACC concept (connection between tax expense and cash tax paid)? Do the errors go the “right” way?
• How much more accurate do the accruals go as the years move further from Sarbanes implementation?
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