

HOW HIGHER PERFORMANCE ON CLIENT SERVICE AFFECTS AUDITORS'
WILLINGNESS TO CHALLENGE MANAGEMENT'S PREFERRED ACCOUNTING

by

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(Under the Direction of Jacqueline S. Hammersley)

ABSTRACT

Satisfying the client and performing a high quality audit are important goals for auditors. However, these goals often conflict (e.g., when management has aggressive reporting preferences). This conflict is an ongoing concern of regulators and academics because auditors motivated to satisfy the client may be more likely to inappropriately accept management's preferred accounting, impairing audit quality. However, accepting management's preferred accounting is not the only way for auditors to pursue their client satisfaction goals. Auditors can also satisfy the client by performing client service activities, such as communicating effectively and being accessible to clients (Hoang et al. 2017, Koch and Salterio 2017). I address auditors' competing client satisfaction and audit quality goals by experimentally examining how higher performance on client service affects auditors' willingness to challenge management's preferred accounting. I draw on theory from psychology (Fishbach et al. 2009) explaining that people can focus on monitoring their *goal progress* (i.e., moving forward on a goal) or their *goal commitment* (i.e., the importance of a goal). I expect and find that when auditors monitor their progress toward (commitment to) their client satisfaction goals, auditors who perform higher on client service make judgments that are more (less) challenging of management's preferred accounting than auditors who perform

lower on client service. This challenges the conventional wisdom that the pursuit of client satisfaction goals necessarily undermines audit quality.

INDEX WORDS: Client service, Client satisfaction, Audit quality, Goals

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CHAPTER 1

INTRODUCTION

Satisfying the client is an important goal for auditors because auditors need to retain clients (DeZoort and Lord 1997). It is also a problematic goal for auditors because it often conflicts with the goal of performing a high quality audit (e.g., when management has aggressive reporting preferences [Hackenbrack and Nelson 1996]). That is, consciously or unconsciously, auditors who are motivated to satisfy the client may be more likely to inappropriately accept management's preferred accounting, impairing audit quality (Salterio and Koonce 1997; Kadous, Kennedy, and Peecher 2003; Koch and Salterio 2017).¹ Regulators continue to express concern about the potential for auditors to prioritize client satisfaction over audit quality (Canadian Public Accountability Board (CPAB) 2011; Public Company Accounting Oversight Board (PCAOB) 2011; Financial Reporting Council (FRC) 2012) and have cited cases in which auditors failed to adequately challenge management's preferred accounting (e.g., CPAB 2012; PCAOB 2013). Importantly, accepting management's preferred accounting is not the only way for auditors to pursue their client satisfaction goals. Auditors can also satisfy the client by performing client service activities, such as communicating effectively and being accessible to clients (Hoang, Jamal, and Tan 2017, Koch and Salterio 2017). Audit firms dedicate substantial resources to performing client service activities (Hoang 2013) and encourage auditors to perform these activities through the performance evaluation process (Tysiac 2016). However, it is not

¹ Management has significant influence over the hiring and retention of external auditors, despite the Sarbanes-Oxley Act's attempt to shift responsibility for these decisions to the audit committee (Cohen, Krishnamoorthy, and Wright 2010; Fiolleau, Hoang, Jamal, and Sunder 2013; Dhaliwal, Lamoreaux, Lennox, and Mauler 2014). Thus, auditors concerned with *client* satisfaction are concerned with satisfying *management*.

clear whether and how higher performance on client service affects auditors' willingness to challenge management's preferred accounting.

In this paper, I examine how higher performance on client service affects auditors' willingness to challenge management's preferred accounting. When considering their willingness to challenge management's preferred accounting, auditors likely have a sense of the extent to which they have been providing good client service. Thus, I define higher performance on client service in terms of auditors' perception of their performance; higher performing auditors are auditors who perceive their client service as better. I draw on psychology theory about people's pursuit of competing goals (Fishbach, Zhang, and Koo 2009) and expect that, compared to lower performance on client service, higher performance on client service will change auditors' willingness to challenge management's preferred accounting and, critically, that the *direction* of this effect will depend on how auditors monitor their client satisfaction goals.

Psychology research shows that humans have developed two systems for monitoring their competing goals and the subsequent effects of higher performance on a goal depend on which system is more active at the time. First, people use the *goal progress* system to monitor whether they are moving forward on a goal (Fishbach et al. 2009). When people monitor their goal progress, higher performance on a goal provides them with a sense of accomplishment and motivates them to turn their attention to their competing goals (Fishbach and Dhar 2008). Second, people use the *goal commitment* system to monitor whether a goal is important to them, relative to their competing goals (Fishbach et al. 2009). When people monitor their goal commitment, higher performance on a goal represents an expression of their dedication to the goal and motivates them to continue working on the goal. Together, this suggests that the

direction of the effect of higher client service performance on auditors' willingness to challenge management will depend on whether auditors focus on monitoring goal progress or commitment.

Specifically, when auditors monitor their progress toward their client satisfaction goals, I expect auditors who perform higher on client service to feel they are accomplishing their client satisfaction goals, alleviating the pressure to accept management's preferred accounting.

However, when auditors monitor their commitment to their client satisfaction goals, I expect auditors who perform higher on client service to feel they are dedicated to their client satisfaction goals, amplifying their desire to accept management's preferred accounting. Thus, I expect auditors' performance on client service to interact with how they monitor their goals. Compared to auditors who perform lower on client service, I expect auditors who perform higher on client service to focus more on challenging management when they monitor their goal progress, but less on challenging management when they monitor their goal commitment.

I experimentally test my hypotheses using a 2 x 2 design. I manipulate auditors' performance on client service (lower vs. higher) by manipulating an implicit standard against which auditors compare the number of client service activities they list to perform for a client. Thus, I vary auditors' perception of their client service performance, holding constant across conditions the average number of client service activities auditors list to perform and all other determinants of auditors' perception of their client service performance. I also manipulate how auditors monitor their client satisfaction goals (progress focus vs. commitment focus) by asking auditors a series of framing questions about their client service activities. Following the manipulations, auditors evaluate the obsolescence of client inventory that is becoming technologically outdated. Despite various indicators of obsolescence, management takes the aggressive position that inventory does not need to be written down; this sets up a conflict

between auditors' client satisfaction and audit quality goals. To support its aggressive position, management provides inquiry evidence and makes several subjective, unsubstantiated assertions about its ability to sell the inventory. Inquiry evidence is not sufficient audit evidence (AS 1105) and auditors are required to critically assess management's assertions (AS 1015). Thus, higher quality auditor judgments and decisions reflect concern about the reasonableness of management's assertions and a desire to critically assess them. I measure auditors' judgments of the market value of the potentially obsolete inventory and the likelihood that inventory is materially overstated. Auditors also listed audit procedures they would perform and I measure the proportion of the procedures that challenge management's assertions and the net procedures that challenge management's assertions (i.e., challenging minus non-challenging procedures).

Consistent with my theory, I find that auditors' performance on client service interacts with how they monitor their goals such that higher performance on client service increases auditors' willingness to challenge management when they monitor their goal progress, but decreases their willingness to challenge management when they monitor their goal commitment. Specifically, when auditors monitor their progress toward their client satisfaction goals, auditors who perform higher on client service judge the market value of the potentially obsolete inventory to be *lower* than auditors who perform lower on client service. However, when auditors monitor their commitment to their client satisfaction goals, auditors who perform higher on client service judge the market value of the potentially obsolete inventory to be *higher* than auditors who perform lower on client service. This disordinal interaction is also reflected in the focus of auditors' proposed audit procedures.

This study contributes to the auditing literature by challenging the conventional wisdom that the pursuit of client satisfaction goals necessarily poses a threat to audit quality. Auditors'

focus on client satisfaction has been cited as an impediment to professional skepticism (PCAOB 2012, Glover and Prawitt 2014), an independence threat (Levine 2016), and an antecedent of auditors' preferences to accept management's preferred accounting (Koch and Salterio 2017). Consistent with these perspectives, I find that higher performance on client service decreases auditors' willingness to challenge management when auditors focus on their commitment to their client satisfaction goals. However, I also find that higher performance on client service *increases* auditors' willingness to challenge management when auditors focus on their progress toward their client satisfaction goals. This suggests that the pursuit of client satisfaction goals can facilitate audit quality, provided auditors monitor their goal progress.

From a practical standpoint, audit-firm leaders may be able influence whether auditors focus on their progress toward or their commitment to their client satisfaction goals. Psychology research (e.g., Fishbach, Dhar, and Zhang 2006) suggests that audit firms may be able to encourage progress monitoring by designing performance evaluation systems that focus on specific, manageable client service goals and commitment monitoring by designing systems that focus on broad client service goals. Thus, I provide a foundation for future research to examine applied methods that will encourage auditors to interpret increases in client service performance as evidence of their progress toward rather than their commitment to their client satisfaction goals. Further, while my theory focuses on the audit quality benefits of monitoring goal progress, it also suggests some conditions under which commitment monitoring can be beneficial. Supplemental analyses suggest that when auditors perceive their client service as poor in an absolute sense, auditors who focus on monitoring commitment experience a lack of dedication of their client satisfaction goals and, thus, are more challenging than auditors who focus on monitoring progress. Thus, encouraging commitment monitoring can be beneficial when audit-

firm leaders expect auditors to view their client service performance as poor (e.g., when the audit firm or client sets an high benchmark for client service).

My study extends prior research on auditors' willingness to challenge management and responds to Griffith, Kadous, and Young's (2015) call for research examining how competing goals affect auditors' judgments and decisions. Prior studies show that auditors are more likely to accept management's preferred accounting when their incentives favor doing so (Hackenbrack and Nelson 1996; Chang and Hwang 2003; Hatfield, Jackson, and Vandervelde 2011) and when audit firm leaders emphasize client satisfaction goals (Asare, Cianci, and Tsakumis 2009; Aghazadeh and Hoang 2015). These studies focus on how differences in client satisfaction pressures outside the control of individual auditors affect audit quality. In contrast, my study suggests that auditors' willingness to challenge management depends, in part, on conditions auditors themselves can create. I find that auditors' recent client service performance and how they monitor their goals jointly influence their prioritization of their client satisfaction and audit quality goals and, thus, their willingness to challenge management.

Finally, I contribute to the psychology literature by testing a theory about people's competing goals in a domain involving significant professional judgment. Psychology studies show that people's recent performance on their goals affects their subsequent decisions, but these studies focus on simple decisions that are a matter of personal preference (e.g., whether to drink a healthy or unhealthy beverage [Zhang, Fishbach, and Dhar 2007]). In contrast, auditing decisions are based on auditors' evaluations of complex sets of evidence and often involve multiple underlying judgments about this evidence (e.g., judgments about the riskiness of the accounting issue, the degree to which the evidence supports management's position, the applicability of professional guidance, etc.). Although psychology research has not shown that

people's recent performance on their goals affects evidence-driven decisions, I predict and find that auditors' recent goal performance affects these decisions by influencing their underlying judgments about audit evidence.

CHAPTER 2

THEORY AND HYPOTHESIS DEVELOPMENT

Institutional Background

For decades, academics have questioned whether auditors are truly independent of the firms they audit (Mautz and Sharaf 1961). At the heart of the potential for impaired independence is the auditor appointment process (Fiolleau et al. 2013). If management controls the hiring and firing of external auditors, auditors will likely experience pressure to inappropriately accept management's preferred accounting (Watts and Zimmerman 1986; DeZoort and Lord 1997). While Section 301 of the Sarbanes-Oxley Act (SOX) attempts to reduce management's control over external auditor appointment by assigning responsibility for auditor appointment to the audit committee (U.S. House of Representatives 2002), post-SOX research shows that management has substantial influence over the auditor appointment process. For example, 97 percent of audit partner and manager interviewees indicated that management has significant influence over auditor appointment and dismissal (Cohen et al. 2010). In a field study of a publicly traded Canadian firm, Fiolleau et al. (2013, 866) observe that the "audit committee abdicates its information gathering and decision making responsibilities to management, serves as a witness to management's procedures, and approves management's selection decision." Finally, Dhaliwal et al. (2014) find that a given Big 4 firm is more likely to be hired for audit services when management has an alumni affiliation with the Big 4 firm, suggesting that management influences the appointment of external auditors.

Auditor independence is enhanced by countervailing incentives that work against auditors' incentive to inappropriately accept management's preferred accounting (Watts and Zimmerman 1986; Nelson 2006). These countervailing incentives include the risk of reputational harm, litigation loss, and regulatory penalties (Nelson 2006). Basic economic theory predicts that auditors will weigh the cost of challenging management's preferred accounting (i.e., the potential for management to punish the audit firm by switching auditors) against the cost of inappropriately accepting management's preferred accounting (i.e., the potential for reputational harm, litigation loss, and/or regulatory penalties; Watts and Zimmerman 1986). However, it is not obvious whether and how higher performance on client service affects this basic trade-off.

Client Service Activities

Prior literature shows that clients value good customer service and that audit firms dedicate significant resources to performing client service activities. Specifically, Behn, Carcello, Hermanson, and Hermanson (1999, 587) conclude that an "audit is a service that is differentiable in the eyes of management" and surmise that management satisfaction may be related to service quality attributes that are not documented in the literature, such as the interpersonal relationship between the auditor and management. Hoang et al. (2017) extend this line of work by identifying various intangible client service activities such as the audit team's communication, responsiveness, and ability to tailor their services to the client's preferences. They find that clients value these dimensions of client service and that they contribute significantly to engagement profitability. While many client service activities are tailored to specific client preferences, general examples of these activities include communicating effectively with clients (e.g., using a professional tone [Saiewitz and Kida 2016], avoiding

excessive use of email [Westermann, Bedard, and Earley 2015], proactively informing clients of audit issues and staffing changes), staffing engagements with personnel who possess client-preferred attributes (e.g., expertise in the client's industry, past experience with the client), and being accessible to clients (Behn, Carcello, Hermanson, and Hermanson 1997; Barr and McNeilly 2003; Hoang et al. 2017).

Auditors recognize that clients value service and strategically perform client service activities in order to enhance client satisfaction and promote client retention. Audit firms use customer relationship management practices to develop client relationships (Koch and Salterio 2017) and promise their "high priority clients" more access to senior personnel, more frequent communications, industry networking opportunities, and faster response times (Hoang 2013). Further, firms seek feedback on their client service via client satisfaction surveys; clients rate the audit firm on various client service dimensions as well as their overall satisfaction with the firm (Hoang et al. 2017; Koch and Salterio 2017).² Audit firms also encourage their employees to deliver high quality service through the performance evaluation process. For example, one firm evaluates auditors at all levels on their ability to cultivate client relationships (Tysiac 2016). Further, interview evidence shows that audit firms accommodate management's preferences regarding the audit partner's relationship-management style (i.e., more proactive or reactive) by assigning a partner that matches management's preferences (McCracken, Salterio, and Gibbins 2008). While these studies show that audit firms dedicate resources to client service, there is variability in the level of service clients receive. Some clients complain that service providers

² Koch and Salterio (2017) examine the joint effects of auditors' affinity for the client and client pressure to waive an adjustment on auditors' adjustment decisions. They manipulate whether the audit firm implements a client satisfaction survey, primarily to induce variability in their measure of auditors' affinity for the client. However, they also report that the implementation of a client satisfaction survey has no effect on auditors' perceptions of client service quality. Auditors' perceptions of service quality, while similar to my independent variable, is a supplemental dependent variable in their study.

miss scheduled meetings, are inaccessible, communicate poorly, and staff engagements inadequately (Barr and McNeilly 2003). Poor service can have significant consequences for audit firms because dissatisfied clients are more likely to consider replacing their auditor than satisfied clients (Carcello, Hermanson, and Hermanson 1998).

How Higher Performance on Client Service Affects Auditors' Willingness to Challenge Management

I expect that auditors have competing client satisfaction and audit quality goals due to the conflicting incentives that arise when management has aggressive reporting preferences. This characterization of auditors' goals is consistent with prior studies that refer to auditors' competing "client relations" and "compliance" goals (Asare et al. 2009) and describe a conflict between auditors' "commercial" and "professional" objectives (e.g., Gendron 2001). Although auditors have numerous competing goals, I focus on the conflict between client satisfaction and audit quality because this conflict poses a threat to audit quality. I turn to the psychology literature on competing goals to develop theory about how higher performance on client service affects auditors' willingness to challenge management's preferred accounting.

The psychology literature defines goals as mental representations of desired future states (Gollwitzer, Kappes, and Oettingen 2012) and shows that people allocate and reallocate cognitive resources among their competing goals (Fishbach and Dhar 2005; Louro, Pieters, and Zeelenberg 2007; Fishbach and Dhar 2008). Research on competing goals has identified conditions under which higher performance on a goal motivates people to either disengage from the goal in order to focus on competing goals or to work even harder on the goal (see Fishbach and Dhar 2008 and Fishbach et al. 2009 for reviews). This stream of research shows that the motivational consequences of people's performance on a goal depend on whether people focus on monitoring their progress toward the goal or their commitment to the goal. Goal progress is

“a sense of moving forward on a goal” and reducing the discrepancy between the current state and the desired future state (Fishbach et al. 2009, 317). People who monitor their goal progress ask themselves “Do my actions indicate that I am making sufficient progress toward this goal?” (Fishbach et al. 2009). Goal commitment is “a sense that the goal is valuable and expectancy of attainment is high” (Fishbach et al. 2009, 318) or, more generally, is the importance of a goal relative to competing goals (Fishbach and Dhar 2008). People who monitor their goal commitment ask themselves “Do my actions indicate that I am committed to this goal?” (Fishbach et al. 2009).

Higher performance on a goal motivates people to turn their attention to their competing goals when they focus on monitoring their goal progress, but motivates people to keep working hard on the goal when they focus on monitoring their goal commitment. Specifically, when people monitor goal progress, higher performance on a goal provides them with a sense of accomplishment; they infer that they are achieving their goal (Fishbach et al. 2009). This sense of accomplishment decreases their motivation to continue pursuing the goal and increases their motivation to pursue competing goals (Fishbach and Dhar 2008; Fishbach et al. 2009).

However, when people monitor goal commitment, higher performance on a goal represents an expression of their dedication to the goal; they infer that they care more about the goal than their competing goals (Fishbach et al. 2009). This expression of dedication increases their motivation to continue pursuing the goal and decreases their motivation to pursue competing goals (Fishbach and Dhar 2008; Fishbach et al. 2009). Thus, higher performance on a goal decreases

the subsequent strength of the goal when people monitor goal progress, but increases the subsequent strength of the goal when people monitor goal commitment.³

I expect that auditors can monitor their progress toward or commitment to their client satisfaction goals and that situational factors influence whether auditors focus on monitoring progress or commitment. Psychology research shows that since people can assign a variety of meanings to their actions, they can interpret their performance on a goal as evidence of their goal progress or their goal commitment (Fishbach et al. 2009). Further, situational factors influence whether people focus on monitoring goal progress or goal commitment. For example, people tend to focus on their goal progress when they have specific, well-defined goals (Fishbach et al. 2006), when it is relatively difficult to infer commitment (i.e., when their behavior is compulsory [Finkelstein and Fishbach 2010]), when they are unlikely to question their own goal commitment (i.e., when the relative importance of the goal is unambiguous [Koo and Fishbach 2008]), and when they are asked about their progress (e.g., Zhang et al. 2007). Alternatively, people tend to focus on their goal commitment when they have broad, ill-defined goals (Fishbach et al. 2006), when it is relatively easy to infer commitment (i.e., when their behavior is voluntary [Finkelstein and Fishbach 2010]), when they are likely to question their own goal commitment (i.e., when the relative importance of the goal is ambiguous [Koo and Fishbach 2008]), and when they are asked about their commitment (Zhang et al. 2007).

³ Consider, for example, a person with a health goal who performs a higher intensity workout. If they monitor their goal progress, they will infer: “I’ve made substantial progress toward my health goals.” This will decrease their motivation to pursue their health goals and increase their motivation to pursue their other goals. Higher performance in the gym, therefore, will increase the likelihood that they choose an unhealthy, but tasty and efficient meal. Alternatively, if the person monitors their goal commitment, they will infer: “I am committed to my health.” This will increase their motivation to pursue their health goals and decrease their motivation to pursue their other goals. Higher performance in the gym, therefore, will increase the likelihood that they choose a healthy meal, even if it is bland and takes a long time to prepare.

Compared to auditors who perform lower on client service, I expect auditors who perform higher on client service to subsequently have *weaker* client satisfaction goals when they monitor goal progress, but *stronger* client satisfaction goals when they monitor goal commitment. Specifically, when auditors monitor goal progress, I expect them to focus on the degree to which they are accomplishing their client satisfaction goals. Under a progress focus, I expect auditors who perform higher on client service to subsequently feel more accomplished on client satisfaction than auditors to perform lower on client service. Thus, when auditors monitor goal progress, I expect that auditors who perform higher on client service will be more likely to disengage from their client satisfaction goals in order to focus on their competing goals than auditors who perform lower on client service. However, when auditors monitor goal commitment, I expect auditors to consider the degree to which they are dedicated to their client satisfaction goals. Under a commitment focus, I expect auditors who perform higher on client service to subsequently feel more dedicated to client satisfaction than auditors who perform lower on client service. Thus, when auditors monitor goal commitment, I expect that auditors who perform higher on client service will be more likely to continue working hard on their client satisfaction goals than auditors who perform lower on client service. Together, this suggests that higher performance on client service will lead to weaker client satisfaction goals when auditors monitor goal progress, but stronger client satisfaction goals when auditors monitor goal commitment.

Further, I expect that the strength of auditors' client satisfaction goals will influence their judgments about audit evidence. When auditors have stronger client satisfaction goals, I expect them to approach the audit with a stronger preference to accept management's preferred accounting. Prior research shows that auditors who approach a task with a stronger preference to

accept management's preferred accounting will process information according to this preference (Kadous et al. 2003). Accounting professionals who are motivated to accept management's preferred accounting are more likely to engage in a biased search for evidence that supports management's preferred accounting (Kadous, Magro, and Spilker 2008) and are more likely to interpret subjective evidence in a way that supports management's reporting preferences (Blay 2005; Austin, Hammersley and Ricci 2017). Thus, I expect auditors with weaker client satisfaction goals to make judgments that are more challenging of management's preferred accounting and auditors with stronger client satisfaction goals to make judgments that are less challenging of management's preferred accounting.

Recall that when auditors monitor their goal progress (commitment), I expect auditors who perform higher on client service to subsequently have weaker (stronger) client satisfaction goals than auditors who perform lower on client service. Thus, when auditors monitor goal progress, I expect that auditors who perform higher on client service will make judgments that are more challenging of management's preferred accounting than auditors who perform lower on client service. Alternatively, when auditors monitor goal commitment, I expect that auditors who perform higher on client service will make judgments that are less on challenging of management's preferred accounting than auditors who perform lower on client service.

Formally, I expect

H1: Auditors' performance on client service will interact with how they monitor their goals such that when auditors monitor goal progress (commitment) auditors who perform higher on client service will subsequently make judgments that are more (less) challenging of management's preferred accounting than auditors who perform lower on client service.

If auditors' client service performance and goal monitoring jointly influence auditors' judgments about management's preferred accounting, I also expect these variables to go on to

influence the focus of auditors' subsequent actions. When management takes an aggressive accounting position, actions aimed at accepting and challenging management's position both require effort. Auditors motivated to accept management's preferred accounting must work to justify management's position (Kadous et al. 2003), search for evidence that confirms management's position, and document evidence in a way that does not draw the scrutiny of reviewers and regulators (Rich, Solomon, and Trotman 1997). Similarly, auditors motivated to challenge management's preferred accounting must reflect on factors management may have failed to consider, search for evidence that has the potential to disconfirm management's position, and consider the implications of this evidence. Thus, I do not necessarily expect to observe effects on the amount of effort or audit resources that auditors expend on a task. Rather, I expect auditors' client service performance and goal monitoring to jointly influence the extent to which auditors' actions are focused on challenging versus not challenging management's preferred accounting.

Specifically, when auditors monitor goal progress, I expect that auditors who perform higher on client service will subsequently have weaker client satisfaction goals than auditors who perform lower on client service and, thus, will focus more on actions that challenge management's preferred accounting than auditors who perform lower on client service. Alternatively, when auditors monitor goal commitment, I expect that auditors who perform higher on client service will subsequently have stronger client satisfaction goals than auditors who perform lower on client service and, thus, will focus less on actions that challenge

management's preferred accounting than auditors who perform lower on client service.⁴

Formally, I expect:

H2: Auditors' performance on client service will interact with how they monitor their goals such that when auditors monitor goal progress (commitment) auditors who perform higher on client service will subsequently focus more (less) on actions that challenge management's preferred accounting than auditors who perform lower on client service.

⁴ I do not make predictions about the simple effects of monitoring goal progress versus goal commitment at either level of client service performance because these effects are conditional on how auditors evaluate their *absolute* level of performance on client service. I do, however, perform a supplemental, *ex-post* analysis of the potential simple effects of monitoring goal progress versus goal commitment at each level of client service performance.

CHAPTER 3

RESEARCH METHOD

To test my hypotheses, I perform a 2 x 2 experiment and manipulate auditors' performance on client service (lower vs. higher) and how auditors monitor their client satisfaction goals (progress focus vs. commitment focus). I obtained 126 complete responses from auditors at two Big 4 firms. I obtained data from the first firm in person, while auditors were attending national training sessions ($n = 111$) and from the second firm online, using a Qualtrics survey ($n = 15$).⁵ My final dataset contains 85 responses.⁶ The auditors in my final dataset are all senior auditors with at least 29 months experience; average experience is 43 months and maximum experience is 91 months. These participants are appropriate for at least two reasons. First, prior studies show that auditors at the senior level view client service and audit quality as important components of their performance evaluations (Moreno and Bhattacharjee 2003) and are sensitive to incentives to perform a high quality audit (e.g,

⁵ I obtained institutional review board approval for this study. One hundred and fifty-five auditors started my study, but 13 dropped out before providing any data and 16 did not finish or skipped significant portions the instrument (i.e., skipped the client service manipulation or left multiple dependent variables blank). Collection method is not significantly correlated with any of the independent or dependent variables and model results are qualitatively similar if collection method is included as a covariate.

⁶ Since my task centers on an inventory obsolescence issue, I requested access to auditors with prior experience auditing inventory. Since the classrooms at the national training were not organized by industry, I received 39 complete responses from auditors who had never audited inventory. This includes auditors who specialize in the financial services, software, and healthcare industries. I exclude data from these auditors because they do not have the knowledge to generate procedures that would challenge management's position on an inventory obsolescence issue and would not be assigned my task in practice. A binary logistic model shows that the likelihood of exclusion does not differ across conditions (main effect and interaction p-values all > 0.429). Further, for all of my dependent measures, the means for auditors without prior inventory experience are directionally inconsistent with the means for auditors with this experience. Thus, the performance of auditors without inventory experience is inconsistent with that of auditors who have this experience, supporting my conclusion that these auditors do not have the knowledge to perform the task. I also exclude data from 2 participants who provided an extreme response to the client service manipulation (see note 12).

Hackenbrack and Nelson 1996) as well as incentives to satisfy the client (e.g., Aghazadeh and Hoang 2015). Thus, client satisfaction and audit quality are important to senior auditors and they have the potential to trade-off these goals. Second, audit seniors are responsible for directing the search for audit evidence (Hammersley, Johnstone, and Kadous 2011) and are often the first to decide whether to challenge management's accounting. Thus, their decisions are important to overall audit effectiveness.

Task

Participating auditors completed a case about an electronics manufacturer client that began with background information, summary financial information, and the audit materiality threshold.⁷ The background indicated that management is of high integrity, that the audit firm has not had any major disagreements about the client's financial reporting in the past, and that the audit firm has not modified the audit opinion in the past.

Following the manipulations (described below), auditors learned about a potential inventory obsolescence issue. Management determined that a major competitor is in the process of producing and marketing a product that is technologically superior to one of its existing electronics products. Although the inventory in question is material and the competitor is planning to sell its superior product for a lower price, management took the aggressive position that the inventory does not need to be written down. The CFO made five assertions to support the company's position, many of which focused on subjective assumptions, and two of which

⁷ The case was originally developed by Anderson, Jennings, Lowe, and Reckers (1997) and has been modified for use in numerous studies (e.g., Bhattacharjee and Moreno 2002, Robertson 2010, Bhattacharjee, Moreno and Riley 2012, Brown and Popova 2016). With permission, I adapted the original Anderson et al. (1997) case for my study.

were potentially misleading.⁸ Inquiry evidence is not sufficient audit evidence (AS 1105) and auditors are required to critically assess management's assertions (AS 1015). Thus, higher quality auditor judgments and decisions reflect concern about the reasonableness of management's assertions and a desire to critically assess them. Finally, in order to increase the salience of the conflict between auditors' client satisfaction and audit quality goals that arises in this setting, the CFO explicitly stated that he is very busy, he provided all of the available information about the obsolescence issue, and that he hoped the issue will be resolved (cf. Bennett and Hatfield 2013).

Independent Variables

I manipulate auditors' performance on client service (lower vs. higher) by manipulating an implicit standard against which auditors compare the number of client service activities they list to perform for the client. I told all participants that the client expects to receive excellent client service and asked them to list all the client service activities that they would perform for the client.⁹ On the next page, immediately after auditors finished listing the client service activities that they would perform, I asked participants to indicate how many client service activities they listed. I manipulated the response options available to participants as they answered this question, following a procedure developed by Etkin and Ratner (2012). Auditors in the *lower* performance condition received the following options:

3 or fewer	4-6	7-9	10 or more
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

⁸ For example, when explaining why no write down is necessary, the CFO asserted that the product in question sold for an average price of \$400 over the last three years. This is potentially misleading because, instead of focusing on the market value as of the balance sheet date (i.e., the relevant standard for assessing whether the market value is below cost and, thus, whether a write down is necessary [FASB Codification 330-10-35]), he focuses on the historical average selling price over a long window. More relevant assertions contained information about the competitor's timeline for producing the competing product, the competitor's expected selling price of the competing product, and the possibility of selling the potentially obsolete inventory in developing markets.

⁹ As part of this instruction, I provided two example client service activities: (1) Provide detailed status updates to the CFO and (2) Minimize the frequency of meetings with the CFO by consolidating your questions.

Auditors in the *higher* performance condition received the following options:

0	1	2	3 or more
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

I anticipated that participants would list about three client service activities. Thus, due to the manipulated response options, I expect auditors in the higher performance condition to perceive that their client service performance is better than auditors in the lower performance condition, and vice versa. An advantage of this manipulation is that it abstracts away from the determinants of higher performance on client service since participants were randomly assigned to condition without regard to the client service activities they wrote and all other potential determinants of auditors' perception of their performance on client service are held constant.¹⁰

I also manipulate how auditors monitor their client satisfaction goals (progress focus vs. commitment focus). Auditors responded to a series of framing questions that I expect to induce auditors to focus on monitoring their goal progress or commitment. Immediately after auditors indicated how many client service activities they listed, they rated on 7-point Likert scales their level of agreement with four statements about the activities they listed (1 = Strongly Disagree and 7 = Strongly Agree). The nature of the statements differed across progress focus and commitment focus conditions. Participants in the progress focus condition rated their level of agreement with four statements that prompted them to focus on their progress toward their client satisfaction goals:

- (1) Considering how many client service activities I planned to perform, I am making a lot of progress toward my client satisfaction goals on the engagement.

¹⁰ In natural settings, auditors may perceive their client service performance as better because of the quantity or quality of client service activities they endogenously choose to perform, feedback they receive from a client or supervisor, or other factors. I chose a manipulation that abstracts away from these determinants in order to avoid confounding auditors' perception of their client service performance with the endogenous choice of what client service activities to perform, client and supervisor preferences that may be revealed by their feedback on client service performance, and other determinants of higher client service performance that may exist in natural settings.

- (2) Based on how many client service activities I planned to perform, I am meeting or exceeding the CFO's expectations.
- (3) Based on how many client service activities I planned to perform, I am providing the CFO with the highest level of service.
- (4) Considering how many client service activities I planned to perform, I am closer to achieving my client satisfaction goals on the engagement.

Participants in the commitment focus condition rated their level of agreement with four statements that prompted them to focus on their commitment to their client satisfaction goals:

- (1) Considering how many client service activities I planned to perform, I am highly committed to my client satisfaction goals on the engagement.
- (2) Based on how many client service activities I planned to perform, I must really care about meeting or exceeding the CFO's expectations.
- (3) Based on how many client service activities I planned to perform, providing the CFO with the highest level of service is important to me.
- (4) Considering how many client service activities I planned to perform, I am committed to my client satisfaction objectives on the engagement.

This method of inducing a progress versus a commitment focus has been used successfully in the psychology literature (Fishbach and Dhar 2005; Zhang et al. 2007; Sussewind and Hoelzl 2014).

Dependent Variables

I capture two auditor judgments about the potentially obsolete inventory. First, I asked auditors to judge the per unit market value of the potentially obsolete product. Based on its three-year historical selling price, management implied that the market value of the product was \$400 per unit. While auditors did not have enough information to reach a final conclusion on the market value of the product, I asked them to judge the market value in order to capture the degree to which auditors' initial judgments diverged from management's. Since management prefers not to write down the inventory and current conditions (e.g., a competitor accepting orders for a superior product at a lower price) are strongly suggestive of a decline in market

value, lower values are more challenging of management's position and indicative of higher quality judgments. Second, I asked auditors to evaluate the likelihood that the client's inventory is materially overstated on an 11-point Likert scale (0 = Not at all likely, 10 = Extremely likely). Higher values are more challenging of management's position and indicative of higher quality judgments. I use these measures to test H1.

I also asked auditors to describe what additional audit procedures, if any, they would perform regarding the valuation of the potentially obsolete inventory. I code the procedures auditors listed into two categories: (1) Procedures that challenge management's position (2) Procedures that do not challenge management's position. Procedures that challenge management's position include those that question the CFO's position, question the relevance his potentially misleading assertions, indicate concern about bias or subjectivity in the CFO's assertions, and focus on identifying relevant factors missing from the CFO's discussion. Procedures that do not challenge management's position include those that aim to corroborate the CFO's assertions (e.g., by agreeing them to documents mentioned by the CFO or asking for any available "support"), fail to question the CFO's position, fail to question the relevance of his

potentially misleading assertions, and those that are not responsive to the CFO's assertions (e.g., routine procedures that would be performed on any audit of inventory).¹¹

A research assistant and I performed the coding; we were both blind to experimental condition. We discussed all of the items on which we disagreed and came to a decision on the final coding for these items. Our initial agreement rate is 82.26 percent and Cohen's Kappa, which measures whether our rate of agreement is significantly better than chance, is 0.578 ($p < 0.001$). Using the final coding, I calculate the proportion of the total procedures auditors write that challenge management's preferred accounting. I also calculate the net number of challenging procedures by subtracting procedures that do not challenge from procedures that do. Both measures capture auditors' relative focus on challenging versus not challenging management's preferred accounting; higher scores represent a greater focus on challenging management. I use these measures to test H2.

¹¹ Examples of challenging procedures are: (a) "Market sales in the first month of the new year to assess the dollar amount the product is currently selling for" – since the CFO only considers the historical selling price, which is potentially misleading, this procedure considers a relevant factor (i.e., the current selling price) that is missing from the CFO's discussion and implicitly questions the relevance of the CFO's potentially misleading assertion and (b) "Review of credit memos/rebates/discounts to assess if there is an existing issue" – this procedure considers a relevant factor that was missing from the CFO's discussion and (c) "Does this deviate from how management has historically assessed reserves? Indication of bias?" – this procedure questions the CFO's position and expresses concern about bias. Examples of non-challenging procedures are: (a) "Verify that the average price of the product over the past three years has been \$400" – this procedure fails to question the relevance of the historical selling price, which is potentially misleading, and seeks to corroborate it and (b) "Follow-up with the CFO for any supporting documentation or corroborating evidence" – this procedure simply aims to corroborate the CFO's position against any available support, and (c) "Count inventory" – this is a routine procedure that would be performed on any inventory audit and is not responsive to the CFO's assertions about the potentially obsolete inventory. While procedures that do not challenge management's position are not necessarily inappropriate and could eventually lead to challenging behavior (e.g., if the auditor ultimately discovers that the support does not agree to the CFO's assertions), these procedures are considerably less critical of management's position, indicate less concern about a potential audit issue, and reflect less of a focus on performing a quality audit.

CHAPTER 4

RESULTS

Manipulation Checks

In order to assess the effectiveness of the client service performance manipulation, I first examine the client service activities that participants list. On average, participants list 3.87 client service activities. The median number of activities is four and the majority of participants (61.2 percent) wrote three or four activities; the range is one to seven.¹² Consistent with my expectations, auditors do not list a different number of client service activities in the lower performance condition (mean = 3.98) than in the higher performance condition (mean = 3.79, $t_{81} = 0.67$, $p = 0.508$ two-tailed). Further, a research assistant and I coded the items participants list into two categories: (1) Client service activities in the spirit of the instruction (2) Other activities that do not represent client service. Our initial agreement rate is 96.91 percent and Cohen's Kappa is 0.778 ($p < 0.001$ two-tailed). We reconciled the items on which we disagreed and, based on the final coding, 91.49 percent of the items participants list are client service activities in the spirit of the instruction.¹³ Next, I examine participants' responses to the manipulation

¹² I exclude data from two participants who wrote 9 and 11 client service activities and are 3.1 and 4.4 standard deviations above the mean, respectively. This is greater than the rule of thumb for identifying outliers in small samples (i.e., 2.5 standard deviations from the mean; Hair, Black, Babin, and Anderson [2010]). My theory requires participants to have competing goals and does not apply when a goal is so strong that it dominates other goals (Fishbach and Dhar 2008). Since these participants appear to have extremely strong client satisfaction goals, they weaken my ability to perform a strong test of my theory. If I retain the data from these participants, the patterns of means are the same as those reported in Figures 1 to 4, but the statistical significance of some tests is reduced. While the ANOVA interactions remain significant at $p = 0.022$ and $p = 0.0840$ for the market value measure and proportion challenging procedure measure, respectively, the simple effect of client service within the goal progress condition changes from $p = 0.095$ to $p = 0.120$ for the proportion challenging procedures measure and from $p = 0.096$ to $p = 0.135$ for the market value measure. All other tests remain significant at $p < 0.10$.

¹³ One participant in my dataset did not follow instructions; all of the items s/he wrote are audit procedures that cannot be linked to client service. Inferences are not sensitive to the inclusion or exclusion of this participant.

itself, which asked them to indicate how many client service activities they listed. Ninety-six percent of participants selected the response that was consistent with the number of activities they listed. Further, 97 percent of participants in the lower performance condition selected options that were on the lower half of the scale (i.e., the “3 or fewer” or “4-6” options) and 96 percent of participants in the higher performance condition selected options that were on the upper half of the scale (i.e. the “2” or “3 or more” options). Together, this suggests that participants followed instructions.

In order to evaluate whether participants in the higher performance condition perceive that their client service performance is better than participants in the lower performance condition, I included a question in the post-experimental questionnaire that asked auditors to indicate the degree to which they felt they planned to provide the client with excellent client service. Auditors responded on an 11-point Likert scale (0 = poor client service, 5 = average client service, and 10 = excellent client service). On average, auditors rated themselves highly (overall mean = 8.04, standard deviation = 1.48), consistent with prior studies that have asked auditors to self-assess service quality (Koch and Salterio 2017). Inconsistent with my expectations, the mean response of auditors in the higher performance condition (mean = 8.06) is not significantly higher than that of auditors in the lower performance condition (mean = 8.02, $t_{81} = 0.12$, $p = 0.451$ one-tailed). The lack of significant differences on this measure may be due to social desirability bias (Fisher 1993). In order to maintain a positive image of themselves, auditors may report that they performed well, regardless of how they actually feel about their performance. Alternatively, auditors’ feelings about their performance on client service may be unconscious or contaminated by their responses to the dependent variables. Since the results that

follow are consistent with my theory and I am unaware of plausible alternative explanations for the observed disordinal interactions, the lack of results on this manipulation check does not undermine the conclusion that my hypotheses are supported (Sigall and Mills 1998).¹⁴

Hypothesis 1: Auditors' Judgments

Hypothesis 1 predicts that when auditors monitor goal progress (commitment) auditors who perform higher on client service will make judgments that are more (less) challenging of management's preferred accounting than auditors who perform lower on client service. In order to test H1, I examine auditors' judgments about the market value of the potentially obsolete product and their judgments of the likelihood that inventory is materially overstated.

Market Value per Unit of Product

Management implied that the market value of the potentially obsolete product was \$400 and auditors' market value judgments range from \$0 to \$400, with a mean of \$304.¹⁵ Lower values are more challenging of management's position and indicative of higher quality judgments. Table 1 provides descriptive statistics (Panel A) and Figure 1 plots the means by condition. Figure 1 shows that the pattern of means is qualitatively consistent with my theory. I

¹⁴ Similarly, auditors' average responses to the progress and commitment framing questions do not differ across conditions. For auditors who receive the progress questions, those in the higher client service performance condition do not report significantly higher goal progress (mean = 5.98) than those in the lower performance condition (mean = 5.68, $t_{41} = 1.18$, $p = 0.246$ two-tailed). For auditors who receive the commitment questions, those in the higher client service performance condition do not report significantly higher goal commitment (mean = 6.08) than those in the lower performance condition (mean = 6.04, $t_{40} = 0.12$, $p = 0.906$ two-tailed). The purpose of these questions is to manipulate whether auditors focus on monitoring goal progress or commitment and, thus, the questions were not designed to detect differences in auditors' perception of their client service performance. Similar to my manipulation check question, these questions likely suffer from social desirability bias (Fisher 1993) and, in light of the main results, the lack of differences on these measures does not undermine my theory (Sigall and Mills 1998).

¹⁵ Given the wide range of market value judgments, I examine the market value data for outliers and identify three extremely low values (\$0, \$26, and \$85). These numbers are 4.3, 3.9, and 3.1 standard deviations below the mean, respectively, which is greater than the rule of thumb for identifying outliers in small samples (i.e., 2.5 standard deviations from the mean; Hair et al. [2010]). The inferences reported in this section are unchanged if I replace the extremely low values with the next lowest value (\$131) and if I perform square or cube transformations of the data to reduce the left skewness caused by the extremely low values.

test for the hypothesized disordinal interaction using an ANOVA model (Table 1, Panel B).¹⁶

Consistent with my expectations, Panel B shows a significant client service by monitoring interaction ($F_{1, 74} = 7.03$, $p = 0.010$). Follow-up pairwise comparisons (Table 1, Panel C) further support my expectations. As expected, when auditors monitor goal progress, auditors who perform higher on client service judge the market value to be marginally lower (mean = \$302.0) than auditors who perform lower on client service (mean = \$330.7, $t_{74} = 1.32$, $p = 0.096$ one-tailed).¹⁷ However, also as expected, when auditors monitor goal commitment, auditors who perform higher on client service judge the market value to be higher (mean = \$314.3) than auditors who perform lower on client service (mean = \$260.2, $t_{74} = 2.42$, $p = 0.009$ one-tailed). These results support H1. When auditors monitor their goal progress (commitment), auditors who perform higher on client service make market value judgments that are more (less) challenging of management's position than auditors who perform lower on client service.

Likelihood of Material Misstatement

I also examine auditors' judgments of the likelihood that inventory is materially overstated. Higher values are more challenging of management's position and indicative of higher quality judgments. Table 2 provides descriptive statistics (Panel A) and Figure 2 plots the means by condition. Figure 2 shows that the effect of client service within the goal commitment condition is qualitatively consistent with my expectations, but the effect of client service within the goal progress condition is not. I test for the hypothesized disordinal interaction using an ANOVA model (Table 2, Panel B).¹⁸ Panel B does not show a significant client service by monitoring interaction ($F_{1, 79} = 1.82$, $p = 0.182$), but does show a marginally significant main

¹⁶ This analysis omits data from seven participants who did not provide a market value judgment.

¹⁷ For all results, I report one-tailed p-values to test directional predictions and, otherwise, report two-tailed p-values.

¹⁸ This analysis omits data from two participants who did not provide a likelihood judgment.

effect of client service ($F_{1, 79} = 3.68$, $p = 0.059$). Follow-up pairwise comparisons (Table 2, Panel C) show that, inconsistent with my expectations, when auditors monitor goal progress, auditors who perform higher on client service do not judge the likelihood of obsolescence to be higher (mean = 5.09) than auditors who perform lower on client service (mean = 5.38, $t_{74} = 0.41$, $p = 0.660$ one-tailed). However, as expected, when auditors monitor goal commitment, auditors who perform higher on client service judge the likelihood of obsolescence to be lower (mean = 4.87) than auditors who perform lower on client service (mean = 6.53, $t_{79} = 2.26$, $p = 0.014$ one-tailed).

Follow up investigation reveals that the lack of significant difference under a progress focus is consistent with the size of the misstatements implied by auditors' average market value judgments. Under a progress focus, the average market values for participants in the lower and higher performance conditions imply misstatements of \$0 and \$780k, respectively, the latter of which is only 36 percent of the materiality threshold in the case. Thus, under a progress focus, a material misstatement is on average rather unlikely in both client service conditions, likely explaining the lack of effect on this measure.¹⁹

Taken together, these results support H1. Auditors' market value judgments are a powerful measure of the degree to which their judgments diverge from management's. Using this measure, I find that when auditors monitor goal progress (commitment), auditors who perform higher on client service make judgments that are more (less) challenging of management's position than auditors who perform lower on client service. Although this

¹⁹ In contrast, under a commitment focus, the average market value for participants in the lower performance condition implies a misstatement of \$3.3M, which is over the materiality threshold, and the average market value for participants in the higher performance condition implies a misstatement of \$60k, which is only 3 percent of the materiality threshold. Thus, under a commitment focus, a material misstatement is on average more likely in the lower performance condition than the higher performance condition.

disordinal interaction is not reflected in auditors' likelihood judgments, results using the likelihood measure are consistent with the size of the misstatements implied by auditors' market value judgments.

Hypothesis 2: Auditors' Focus on Challenging Management

Hypothesis 2 predicts that when auditors monitor goal progress (commitment), auditors who perform higher on client service will focus more (less) on actions that challenge management's preferred accounting than auditors who perform lower on client service. To test H2, I examine the proportion of procedures auditors write that challenge management's preferred accounting and the net number of procedures auditors write that challenge management's preferred accounting.

Proportion Challenging Procedures

Table 3 provides descriptive statistics for proportion challenging procedures (Panel A) and Figure 3 plots the means by condition. Higher values on this measure reflect a greater focus on challenging management's preferred accounting. Figure 3 shows that the pattern of means is qualitatively consistent with my theory. I test for the hypothesized disordinal interaction using an ANOVA model (Table 3, Panel B).²⁰ Consistent with my expectations, Panel B shows a significant client service by monitoring interaction ($F_{1, 80} = 3.94, p = 0.051$). Follow-up pairwise comparisons (Table 3, Panel C) further support my expectations. As expected, when auditors monitor goal progress, auditors who perform higher on client service write a marginally higher proportion of items challenging management (mean = 35.9 percent) than auditors who perform

²⁰ This analysis omits data from one participant that did not write any procedures because the proportion is undefined for this participant. Since proportion challenging procedures represents the number of challenging procedures written (range = 0 to 5; overall mean = 0.98; standard deviation = 1.14) scaled by the total number of procedures written (range = 1 to 8; overall mean = 3.31; standard deviation = 1.42), the variable can be treated as continuous and analyzed using an ANOVA model.

lower on client service (mean = 21.9 percent, $t_{80} = 1.32$, $p = 0.095$ one-tailed). However, also as expected, when auditors monitor goal commitment, auditors who perform higher on client service write a marginally lower proportion of items challenging management (mean = 26.9 percent) than auditors who perform lower on client service (mean = 43.1 percent, $t_{80} = 1.48$, $p = 0.072$ one-tailed). These results support H2. When auditors monitor their goal progress (commitment), auditors who perform higher on client service dedicate a larger (smaller) proportion of their audit procedures to challenging management than auditors who perform lower on client service.

Net Challenging Procedures

Table 4 provides descriptive statistics for net challenging procedures (Panel A) and Figure 4 plots the means by condition. Higher values on this measure reflect a greater net focus on challenging management's preferred accounting. Figure 4 shows that the pattern of means is qualitatively consistent with my theory and similar to the pattern for proportion challenging procedures. I test for the hypothesized disordinal interaction using an ANOVA model (Table 4, Panel B). Panel B does not show a significant client service by monitoring interaction ($F_{1, 81} = 2.60$, $p = 0.111$). Follow-up pairwise comparisons (Table 4, Panel C) show that, inconsistent with my expectations, when auditors monitor goal progress, auditors who perform higher on client service do not write significantly more net challenging items (mean = -1.23) than auditors who perform lower on client service (mean = -1.81, $t_{81} = 0.85$, $p = 0.198$ one-tailed). However, consistent with my expectations, when auditors monitor goal commitment, auditors who perform higher on client service write marginally fewer net challenging items (mean = -1.54) than auditors who perform lower on client service (mean = -0.56, $t_{81} = 1.42$, $p = 0.080$ one-tailed). Thus, for the net challenging procedures measure, the pattern of results is qualitatively consistent

with the proportion challenging measure. However, the overall ANOVA interaction and the simple effect of client service within the goal progress condition are not statistically significant.²¹

Taken together, these results provide some support for H2. The results using the proportion challenging measure show that when auditors monitor goal progress (commitment), auditors who perform higher on client service focus more (less) on challenging management than auditors who perform lower on client service. The net challenging measure yields qualitatively similar, although statistically weaker, results.

²¹An ANOVA model on raw challenging procedures does not show a significant client service by frame interaction ($F_{1, 81} = 1.65$, $p = 0.203$); the simple effect of client service within the goal progress condition is not significant ($t_{81} = 0.03$, $p = 0.980$ two-tailed), but the simple effect of client service within the goal commitment condition is marginally significant ($t_{81} = 1.77$ $p = 0.080$ two-tailed). The proportion and net challenging measures are sharper measures of the extent to which auditors *focus* on challenging management and, thus, I use these measures to test my hypotheses. Total procedures written also do not differ significantly across conditions (main effect and interaction p -values all > 0.197).

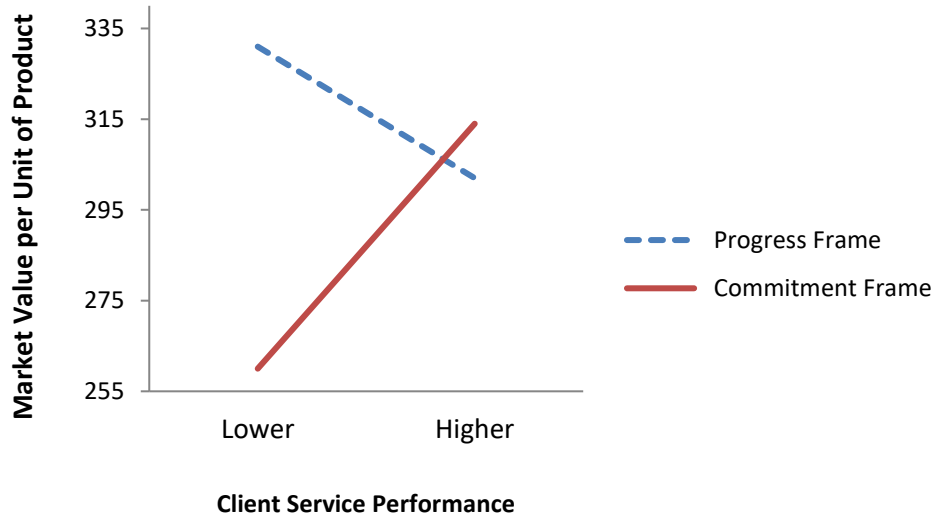


FIGURE 1: H1 Results – Market Value per Unit of Product

Figure 1 plots the means, by condition, for auditors' judgments of the market value of the potentially obsolete product. Client service is manipulated at two levels, *Lower* and *Higher Performance*. All participants listed the client service activities they would perform and I manipulated an implicit standard against which auditors compared the number of client service activities they listed. Monitoring is manipulated at two levels, *Progress* and *Commitment Focus*. Auditors answered framing questions that prompted them to think about either their progress toward or commitment to their client satisfaction goals. *Market Value per Unit of Product* represents auditors' judgments of the per unit market value of the potentially obsolete product (in dollars); lower values are more challenging of management and indicate higher quality judgments.

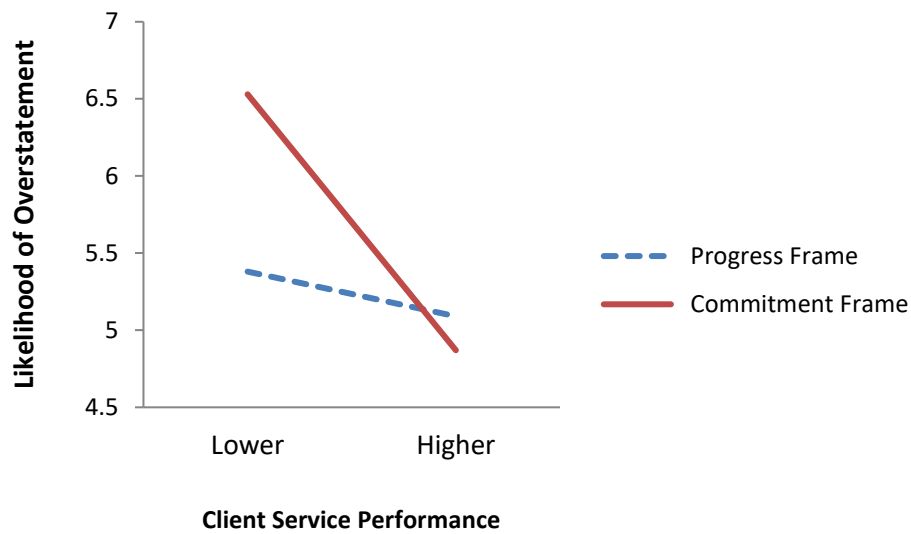


FIGURE 2: H1 Results – Likelihood of Overstatement

Figure 2 plots the means, by condition, for auditors' judgments the likelihood that inventory is materially overstated. See Figure 1 for definitions of the independent variables. *Likelihood of Overstatement* represents auditors' judgments of the risk that inventory is materially overstated; higher values are more challenging of management and indicate higher quality judgments.

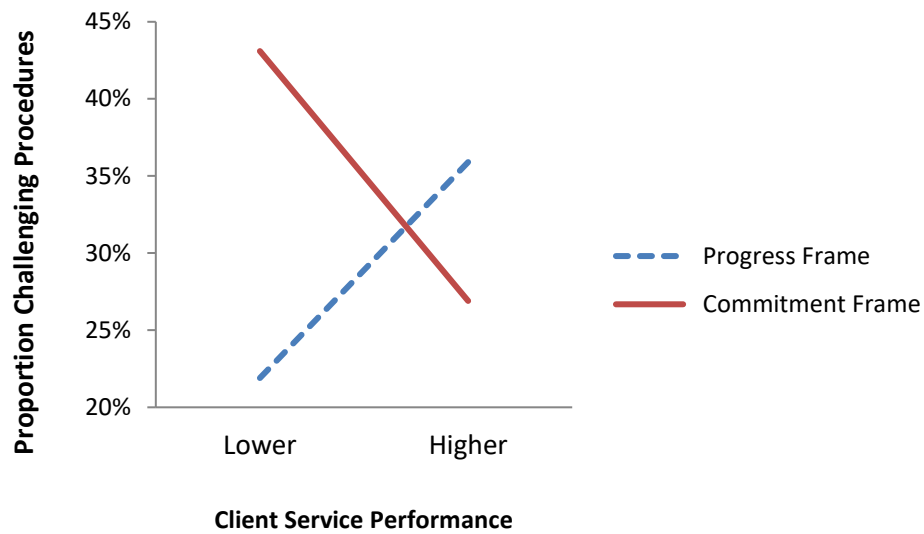


FIGURE 3: H2 Results – Proportion Challenging Procedures

Figure 3 plots the means, by condition, for proportion challenging procedures. See Figure 1 for definitions of the independent variables. *Proportion Challenging Procedures* is the proportion of the total audit procedures auditors list that challenge management's assertions about a potentially obsolete product.

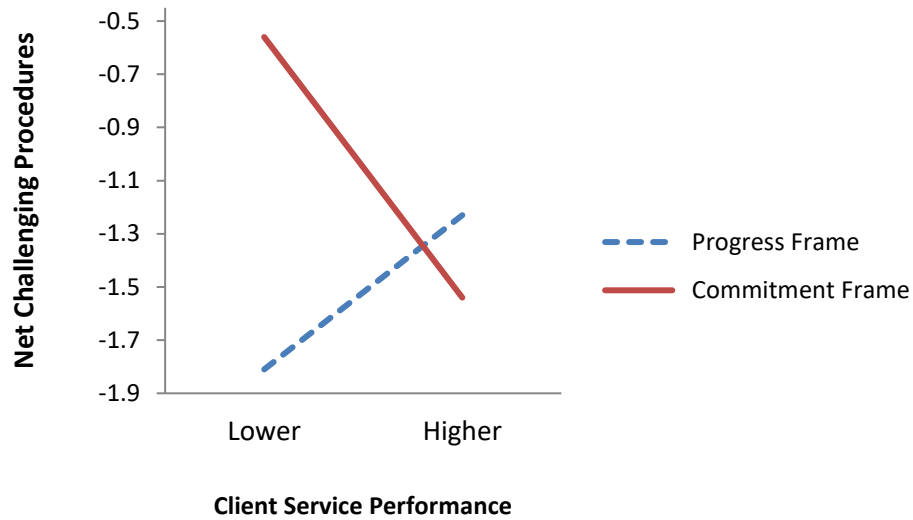


FIGURE 4: H2 Results – Net Challenging Procedures

Figure 4 plots the means, by condition, for net challenging procedures. See Figure 1 for definitions of the independent variables. *Net Challenging Procedures* is constructed by subtracting procedures that do not challenge management from procedures that do.

TABLE 1: H1 Results - Market Value per Unit of Product**Panel A: Market Value per Unit of Product – LS Mean (SE) [n]**

	Client Service Performance:		Overall
	Lower	Higher	
Progress Focus	330.7	302.0	316.3
	(16.0)	(14.8)	(10.9)
	[18]	[21]	[39]
	A	B	
Commitment Focus	260.2	314.3	287.2
	(17.5)	(13.9)	(11.2)
	[15]	[24]	[39]
	C	D	
Overall	295.4	308.1	
	(11.9)	(10.1)	
	[33]	[45]	

Panel B: Market Value per Unit of Product – ANOVA Table

Source of Variation	df	MS	F	p-value
Client service performance	1	3,038	0.66	0.419
Monitoring focus	1	15,982	3.47	0.066
Client service performance x Monitoring focus	1	32,378	7.03	0.010
Error	74	4,605		

Panel C: Market Value per Unit of Product – Pairwise Comparisons

	t ₇₄	one-tailed p-value		t ₇₄	two-tailed p-value
B < A	1.32	0.096	A > C	2.97	0.004
D > C	2.42	0.009	B < D	0.61	0.546

Table 1 reports the results for the auditors' judgments of the market value of the potentially obsolete product. Client service is manipulated at two levels, *Lower* and *Higher Performance*. All participants listed the client service activities they would perform and I manipulated an implicit standard against which auditors compared the number of client service activities they listed. Monitoring is manipulated at two levels, *Progress* and *Commitment Focus*. Auditors answered framing questions that prompted them to think about either their progress toward or commitment to their client satisfaction goals. *Market Value per Unit of Product* represents auditors' judgments of the per unit market value of the potentially obsolete product (in dollars); lower values are more challenging of management and indicate higher quality judgments

TABLE 2: H1 Results – Likelihood of Overstatement**Panel A: *Likelihood of Overstatement* – LS Mean (SE) [n]**

	Client Service Performance:		Overall
	Lower	Higher	
Progress Focus	5.38	5.09	5.24
	(0.50)	(0.49)	(0.35)
	[21]	[22]	[43]
	A	B	
Commitment Focus	6.53	4.87	5.70
	(0.56)	(0.48)	(0.37)
	[17]	[23]	[40]
	C	D	
Overall	5.96	4.98	
	(0.38)	(0.34)	
	[38]	[45]	

Panel B: *Likelihood of Overstatement* –ANOVA Table

Source of Variation	df	MS	F	p-value
Client service performance	1	19.46	3.68	0.059
Monitoring focus	1	4.40	0.83	0.364
Client service performance x Monitoring focus	1	9.60	1.82	0.182
Error	79	5.29		

Panel C: *Likelihood of Overstatement* – Pairwise Comparisons

	t₇₉	one-tailed p-value		t₇₉	two-tailed p-value
B > A	0.41	0.660	A < C	1.53	0.130
D < C	2.26	0.014	B > D	0.32	0.748

Table 2 reports the results for auditors' judgments of the likelihood that inventory is materially overstated. See Table 1 for definitions of the independent variables. *Likelihood of Overstatement* represents auditors' judgments of the risk that inventory is materially overstated; higher values are more challenging of management and indicate higher quality judgments.

TABLE 3: H2 Results – Proportion Challenging Procedures

Panel A: *Proportion Challenging Procedures* – LS Mean (SE) [n]

	Client Service Performance:		Overall
	Lower	Higher	
Progress Focus	21.9%	35.9%	28.9%
	(7.6)	(7.4)	(5.3)
	[21]	[22]	[43]
	A	B	
Commitment Focus	43.1%	26.9%	35.0%
	(8.2)	(7.2)	(5.5)
	[18]	[23]	[41]
	C	D	
Overall	32.5%	31.4%	
	(5.6)	(5.2)	
	[39]	[45]	

Panel B: *Proportion Challenging Procedures* – ANOVA Table

Source of Variation	df	MS	F	p-value
Client service performance	1	<0.01	0.02	0.887
Monitoring focus	1	0.08	0.64	0.428
Client service performance x Monitoring focus	1	0.47	3.94	0.051
Error	80	0.12		

Panel C: *Proportion Challenging Procedures* – Pairwise Comparisons

	t₈₀	one-tailed p-value		t₈₀	two-tailed p-value
B > A	1.32	0.095	A < C	1.90	0.061
D < C	1.48	0.072	B > D	0.87	0.386

Table 3 reports the results for proportion challenging procedures. See Table 1 for definitions of the independent variables. *Proportion Challenging Procedures* is the proportion of the total audit procedures auditors list that challenge management's assertions about a potentially obsolete product.

TABLE 4: H2 Results – Net Challenging Procedures

Panel A: *Net Challenging Procedures* – LS Mean (SE) [n]

		Client Service Performance:		
		Lower	Higher	Overall
Progress Focus	Challenging	0.81	0.82	0.81
	Not Challenging	<u>2.62</u>	<u>2.05</u>	<u>2.33</u>
	Net Challenging	-1.81	-1.23	-1.52
		(0.49) [21] A	(0.48) [22] B	(0.34) [43]
Commitment Focus	Challenging	1.50	0.88	1.19
	Not Challenging	<u>2.06</u>	<u>2.42</u>	<u>2.23</u>
	Net Challenging	-0.56	-1.54	-1.05
		(0.53) [18] C	(0.46) [24] D	(0.35) [42]
Overall	Challenging	1.16	0.85	
	Not Challenging	<u>2.34</u>	<u>2.23</u>	
	Net Challenging	-1.18	-1.38	
		(0.36) [39]	(0.33) [46]	

Panel B: *Net Challenging Procedures* – ANOVA Table

Source of Variation	df	MS	F	p-value
Client service performance	1	0.86	0.17	0.679
Monitoring focus	1	4.64	0.93	0.337
Client service performance x Monitoring focus	1	12.93	2.60	0.111
Error	81	4.98		

Panel C: *Net Challenging Procedures* – Pairwise Comparisons

	t₈₁	one-tailed p-value		t₈₁	two-tailed p-value
B > A	0.85	0.198	A < C	1.75	0.084
D < C	1.42	0.080	B > D	0.48	0.634

Table 4 reports the results for net challenging procedures. See Table 1 for definitions of the independent variables. *Net Challenging Procedures* is constructed by subtracting procedures that do not challenge management from procedures that do.

CHAPTER 5

SUPPLEMENTAL ANALYSES

Challenging Management's Potentially Misleading Assertions

As described previously, the CFO made five assertions to support the company's position that no inventory write down is necessary, two of which were potentially misleading. The two potentially misleading assertions were (1) providing the three-year historical average selling price of the potentially obsolete product, rather than of focusing on the current market value (i.e., the relevant standard for assessing whether the market value is below cost (FASB Codification 330-10-35), and (2) implying the company's work on a replacement product mitigates the obsolescence issue.

In my main tests, I examine the procedures auditors write that challenge the CFO's entire portfolio of assertions because auditors are required to critically assess all of the assertions, individually and taken together. As a supplemental test, I examine the procedures auditors write that challenge only the two potentially misleading assertions and find results that are generally consistent with my main results. First, I examine the proportion of the total procedures auditors write that challenge the two potentially misleading assertions. Consistent with my expectations, I find a significant client service by monitoring interaction ($F_{1, 80} = 4.77, p = 0.032$) that is in the expected disordinal shape. Follow-up pairwise comparisons show that, when auditors monitor goal progress, auditors who perform higher on client service write a higher proportion of items challenging management's potentially misleading assertions (mean = 20.6 percent) than auditors who perform lower on client service (mean = 4.0 percent, $t_{80} = 2.47, p = 0.008$ one-tailed).

However, when auditors monitor goal commitment, auditors who perform higher on client service do not write a significantly lower proportion of items challenging management's potentially misleading assertions (mean = 7.5 percent) than auditors who perform lower on client service (mean = 12.0 percent, $t_{80} = 0.65$, $p = 0.260$ one-tailed).

I also examine the net procedures auditors write that challenge the two potentially misleading assertions. To calculate the net measure, I identify procedures that focus on the two potentially misleading assertions and subtract the non-challenging procedures from the challenging procedures. Consistent with my main results, results are weaker using the net measure. The overall interaction is in the expected disordinal shape, but is not significant ($F_{1, 81} = 1.85$, $p = 0.178$). The expected simple effect within the goal progress condition is significant ($t_{81} = 1.69$, $p = 0.047$ one-tailed), but the expected simple effect within the goal commitment condition is not ($t_{81} = 0.25$, $p = 0.404$ one-tailed).

Monitoring Progress versus Commitment at Each Level of Client Service Performance

I do not make predictions about the effects of monitoring goal progress versus goal commitment at either level of client service performance because these simple effects are conditional on how auditors evaluate their *absolute* level of performance on client service. Psychology theory predicts that *poor* performance motivates continued goal pursuit when people monitor progress and goal disengagement when people monitor commitment (Fishbach and Finkelstein 2012). Thus, if auditors who perform *lower* on client service believe their performance is *poor* in an absolute sense, I would expect auditors who monitor goal progress to be less likely to challenge management than auditors who monitor goal commitment. Similarly, psychology theory predicts that *good* performance motivates goal disengagement when people monitor progress and continued goal pursuit when people monitor commitment (Fishbach and

Finkelstein 2012). Thus, if auditors who perform *higher* on client service believe their performance is *good* in an absolute sense, I would expect auditors who monitor goal progress to be less likely to challenge management than auditors who monitor goal commitment. However, I manipulate auditors' *relative* performance on client service and *ex ante*, it is possible that auditors in either performance condition will believe their performance is moderate (i.e., not poor or good in an absolute sense). Since psychology theory is silent about the effects of monitoring goal progress versus goal commitment at moderate levels of performance, I refrain from making predictions about these potential effects and, instead, perform an *ex-post* analysis of them.

Within the lower client service performance condition, I find that auditors who monitor goal progress are less challenging than auditors who monitor goal commitment. Specifically, within the lower performance condition, auditors who monitor progress judge the market value of the potentially obsolete product to be significantly higher (mean = \$330.7) than auditors who monitor commitment (mean = \$260.2, $t_{74} = 2.97$, $p = 0.004$ two-tailed), judge the likelihood of overstatement to be lower (mean = 5.38), although not significantly lower, than auditors who monitor commitment (mean = 6.53, $t_{79} = 1.53$, $p = 0.130$ two-tailed), write a marginally smaller proportion of procedures that challenge management (mean = 21.9 percent) than auditors who monitor commitment (mean = 43.1 percent, $t_{80} = 1.90$, $p = 0.061$ two-tailed), and write marginally fewer net procedures that challenge management (mean = -1.81) than auditors who monitor commitment (mean = -0.56, $t_{81} = 1.75$, $p = 0.084$ two-tailed); see Panel C of Tables 1 to 4. Together, this suggests that auditors in the lower performance condition likely viewed their client service as poor in an absolute sense. Auditors monitoring commitment likely inferred a lack of commitment to their client satisfaction goals, while auditors' monitoring goal progress likely inferred that they needed to make up for their lack of progress on these goals. This

suggests that, to the extent that audit firms expect auditors to perceive their client service performance as poor (e.g., in situations where the audit firm or client sets a high benchmark for client service), audit firms may benefit from practices that encourage auditors to monitor goal commitment.

Within the higher client service performance condition, I find no evidence of differences between the goal progress and goal commitment conditions (all p-values > 0.386); see Panel C of Tables 1 to 4. This suggests that auditors in the higher performance condition did not view their client service as good in an absolute sense.

Client Service Activities

Descriptive Analysis of Client Service Activities

I examine the client service activities auditors list to perform in order to provide insight into the types of client service activities auditors can choose to perform in practice. Specifically, I group similar client service activities into categories and identify eleven distinct categories. In Table 5, I provide illustrative examples of the client service activities contained in each category and indicate the proportion of items contained in each category.²² Since I told auditors that the CFO had a busy schedule and provided auditors with example client service activities, including “provide detailed status updates to the CFO” and “minimize the frequency of meetings with the CFO by consolidating your questions,” it is not surprising that activities involving timely or proactive communications are listed most frequently (36.8 percent) and activities aimed at accommodating the client’s schedule and minimizing disruptions are listed next most frequently (15.8 percent). Other frequently listed activities involve managing the client’s expectations for the audit and meetings (10.7 percent), being prepared for the audit and client meetings (8.3

²² For this analysis, and all analysis of client service activities, I use my full data set (i.e., all complete responses).

percent), and building a personal relationship with the client (6.1 percent). Less frequently mentioned items include seeking feedback on client expectations and whether they are being met (4.4 percent), providing accounting or industry guidance (2.8 percent), ensuring that the engagement is staffed in a way that allows the team to provide good service (1.6 percent), providing feedback to the client (1.4 percent), exhibiting a professional attitude (0.8 percent), and making the client aware of other audit firm services (0.6 percent).

Since I provided auditors with example client service activities, and thus steered auditors toward thinking about certain types of client service activities, this descriptive analysis is unlikely to be representative of the complete population of client service activities auditors perform in practice or the frequencies at which the listed activities are performed. However, since the prior literature focuses on relatively abstract categories of client service (e.g., communication, accessibility [Hoang et al. 2017]), this analysis provides insight into specific types of service activities auditors describe performing within the categories described, which are likely drawn from the population of activities they perform on their own clients.

Importance of Client Service to Performance Evaluations

I asked all participants to rate the degree to which client service is important to their performance evaluations. Participants responded on an 11-point Likert scale (0 = Not at all important, 10 = Extremely important). The mean response was 7.61 and this is significantly higher than the midpoint of the scale ($t_{124} = 15.08$, $p < 0.001$ two-tailed). This supports my decision to use senior auditors as participants and updates Moreno and Bhattacharjee's (2003) finding that auditors at the senior level are evaluated on client service dimensions.

Importance of Client Service to Big 4 and Non-Big 4 Auditors

I also asked participants to report, in general, how important it is for auditors to provide excellent client service. Participants responded on an 11-point Likert scale (0 = Not at all important, 10 = Extremely important). The mean response was 8.62, which is significantly higher than the midpoint of the scale ($t_{125} = 28.97$, $p < 0.001$ two-tailed). Further, while pilot testing my study, I asked a sample of non-Big 4 auditors ($n = 34$) to respond to the same question. The non-Big 4 auditors (mean = 9.01) report that client service is marginally more important than the Big 4 auditors in my main study (mean = 8.62, $t_{158} = 1.87$, $p = 0.064$ two-tailed). This result is consistent with anecdotal evidence that non-Big 4 firms view client service as a strategic way to differentiate themselves from their larger competitors.

Evidence that New Auditors are Socialized to Perform Client Service Activities

While planning my study, I surveyed students ($n = 13$) and recent graduates ($n = 2$) who had completed audit internships. I asked them to think about a specific engagement they worked on during their internship and to describe the client service activities they performed. I defined client service activities as “all of the actions you took, big and small, to enhance client satisfaction,” but did not provide any examples. I found that 9/15 (60 percent) of the interns described at least one client service activity that is consistent with those described in Table 5. The following quotes illustrate that many of the interns had a meaningful understanding of client service and its importance to their audit firm:

Intern 1: “Arriving timely, working flexibly with client hours, going out to lunch with clients, asking questions in a concise and non-intrusive way...”

Intern 9: “I introduced myself on the first day of fieldwork. I also made sure that that I did not ask [the client] for the files again by asking the audit team first.”

Intern 11: “I brought donuts to the office one day to make the client happy.”

Intern 14: “I always tried to consolidate all requests or questions before meeting with the client or sending an email. I also tried to work through issues quickly so if there was a need to return to the client with questions or concerns, that process could happen while the information was still fresh on their minds. I also was just friendly in general with clients...”

Together, this suggests that, early in their careers, auditors are socialized to recognize the importance of client service and to begin engaging in client service activities.

TABLE 5: Descriptive Analysis of Client Service Activities

Categories and Examples	Percentage
<p><i>Timely or Proactive Communications</i></p> <ul style="list-style-type: none"> • Provide weekly status updates to the CFO. • Prepare an updated request list on a weekly basis. • Timely communication of setbacks that impact the audit's timeline. • Commitment to respond to inquiries within 48 hours. • Raise issues as they come up if time sensitive or material. 	36.8%
<p><i>Accommodating Client's Schedule and Minimizing Disruptions</i></p> <ul style="list-style-type: none"> • Be mindful of time – aggregate questions. Avoid 5:00 questions. • Plan meetings well in advance to accommodate his busy schedule. • See if some questions can be answered by lower-level employees. • Allow an appropriate amount of time for client to provide support for sample selections (2 weeks). • Perform testing at interim to remove stress of numerous questions/requests [at year end]. 	15.8%
<p><i>Managing Client Expectations</i></p> <ul style="list-style-type: none"> • Discuss approach with the CFO and set expectations. • Send out a pre-call agenda a few hours before. • Provide explanation of why we're making certain requests. • Meet with the CFO prior to beginning the work to ensure an understanding on both sides of the expectations, scope, and timing. 	10.7%
<p><i>Being Prepared</i></p> <ul style="list-style-type: none"> • Go through the prior year file for an understanding of the client, its processes, and accounting records prior to meeting with the client. • Prepare before and anticipate his questions to have quick responses. • Make sure the audit team has a solid understanding of industry trends and the business before asking questions. • Ensure the appropriate [people] are at important meetings. 	8.3%

<i>Relationship Building</i> <ul style="list-style-type: none"> • Get to know the CFO outside of work...family what he likes. • Bring in donuts/bagels once a week on Friday. • Take the CFO out to lunch. • Coordinate an event outside of the office... dinner or a sports outing. 	6.1%
<i>Seeking Feedback and Understanding Client Preferences</i> <ul style="list-style-type: none"> • Ask for feedback regarding previous years to help improve. • Debrief meeting at end of audit to discuss what went well and what we could have done better. • Inquire preference of email, call, or in-person meetings. 	4.4%
<i>Accounting or Industry Guidance</i> <ul style="list-style-type: none"> • Keep the CFO updated on current issues relevant to the industry. • Provide learning events (e.g., CPE events, lunch and learns) for technical topics affecting the entity. 	2.8%
<i>Staffing and Access to Engagement Team Personnel</i> <ul style="list-style-type: none"> • Bring back the same audit team for the 2016 audit. • Limit junior team members' interaction with the CFO. 	1.6%
<i>Providing Feedback to the Client</i> <ul style="list-style-type: none"> • Feedback about [the CFO's] accounting team and its competency. • Share our thoughts with management. 	1.4%
<i>Exhibiting a Professional Attitude</i> <ul style="list-style-type: none"> • Interact in a professional/courteous manner with all client contacts. • Thank the CFO for his assistance. 	0.8%
<i>Cross-Selling Services</i> <ul style="list-style-type: none"> • Keep up to speed on [audit firm] offerings to provide as options. • Make the CFO aware of other services we may be able to offer. 	0.6%
<i>Other Service Activities</i>	2.8%
<i>Non-Service Activities</i>	7.9%
<i>Total</i>	100%

Table 5 provides a descriptive analysis of the types of client service activities auditors list to perform. Since I provide auditors with example client service activities, this analysis is unlikely to be representative of the complete population of client service activities auditors perform or the frequencies at which these activities are performed. However, this table identifies some of the client service activities auditors perform for their clients.

CHAPTER 6

DISCUSSION AND CONCLUSION

I examine how higher performance on client service affects auditors' willingness to challenge management's preferred accounting. Drawing on psychology theory about people's pursuit of competing goals, I find that auditors' performance on client service affects their willingness to challenge management and, critically, that the *direction* of this effect depends on whether auditors focus on monitoring their goal progress or their goal commitment. I find that when auditors monitor their *progress* toward their client satisfaction goals, auditors who perform higher on client service make judgments that are more challenging of management's preferred accounting than auditors who perform lower on client service. Further, I find that when auditors monitor their *commitment* to their client satisfaction goals, auditors who perform higher on client service make judgments that are less challenging of management's preferred accounting than auditors who perform lower on client service. I observe the same disordinal interaction when examining the focus of auditors' proposed audit procedures

This study contributes to the auditing literature by providing evidence about how auditors trade-off between their competing client satisfaction and audit quality goals. I show that higher performance on client service increases auditors' willingness to challenge management when they monitor their goal progress, but decreases their willingness to challenge management when they monitor their goal commitment. This is important to the ongoing debate about auditor independence (PCAOB 2011, FRC 2012) for two reasons. First, my study suggests that activities directed at client satisfaction do not necessarily undermine audit quality. I show that

higher performance on client service can reduce the pressure to accept management's preferred accounting, provided that auditors focus on their progress toward their client satisfaction goals. Second, my study suggests that the degree to which auditors maintain their independence from management depends in part on conditions auditors themselves can create. I show that auditors' performance on client service affects how they cope with the ongoing pressure to accept management's preferred accounting.

Finally, I suggest several avenues for future research. First, my study provides a foundation for future research to examine applied methods that will encourage auditors to interpret increases in performance on client service as evidence of their progress toward their client satisfaction goals. Psychology research (e.g., Fishbach et al. 2006) suggests that breaking down broad client service goals into specific, manageable sub-goals may encourage progress monitoring. Thus, examining how the structure of auditors' client service goals affects their judgments and decisions may be a fruitful avenue for future research. Second, future research can examine whether the source of higher performance on client service moderates the effects observed in this study. The motivational consequences of higher performance on client service may depend on whether the higher performance is achieved by the individual auditor, the audit team collectively, the supervisors on the team, or the subordinates on the team. Third, future studies can examine how auditors' performance on client service affects the client's behavior, such as management's negotiation positions or willingness to record proposed audit adjustments. My study deliberately holds the client's behavior constant in order to examine how auditors' performance on client service affects auditors' own cognition. However, any effects of client service on the client's behavior would also be of interest to theory and practice. Finally, future research can examine how higher performance on audit quality dimensions (e.g., successfully

negotiating an audit adjustment) affects auditors' subsequent willingness to challenge management. The psychology theory discussed in this paper suggests that performing well on audit quality dimensions may cause auditors to subsequently turn their attention away from audit quality when they monitor goal progress, but may reinforce auditors' commitment to audit quality when they monitor goal commitment.

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APPENDIX A
CONSENT FORM

Informed Consent to Participate in an Experimental Study
Title: Audit Judgments

Investigators

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Jacqueline S. Hammersley
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Purpose

You have been invited to participate in a research study of judgment and decision making. The purpose of the study is to increase understanding of how auditors make subjective judgments. Provision of any information is completely voluntary. All participants must be 18 years of age or older.

Risks and Benefits

There are no known risks or discomforts associated with this research. Taking part in the study is not expected to benefit you personally, but the researcher will learn new things about decision making in accounting.

Procedures

This study involves completing a case study about a hypothetical company. If you choose to participate, you will be asked to read the case and answer questions about it, which should take about 25 minutes.

Confidentiality

Your name will not be associated with any of the responses you give today. Confidentiality will be maintained to the degree permitted by the technology used. If you are participating online, the software will strip your IP address from your response. However, no guarantees can be made regarding the interception of data sent via the internet by any third parties. The results of this study will be aggregated and may be published; however, your name will not be used or your identity associated with the results in any reports or publications.

Right to Refuse Participation or Withdraw

You do not have to take part in this study. If you start the study and decide that you do not want to finish, you may do so at any time. Refusing to participate or withdrawing at any time will not result in penalty or loss of benefits to which you are otherwise entitled, nor will it affect your standing at work. You can ask to have information collected from you returned to you, removed from the research records, or destroyed. Your decision to participate or refuse participation will have no bearing on your employment or your performance evaluations.

Further Questions

You may contact Michael A. Ricci with any further questions about the research. He can be reached via the contact information above. Additional questions or problems regarding your

rights as a research participant should be addressed to The Chairperson, Institutional Review Board, University of Georgia, Telephone (706) 542-3199; E-Mail Address IRB@uga.edu.

Statement of Consent

By completing the case study, you indicate that you understand the above information and are agreeing to participate in the above described research project. Please save this page for your records.

APPENDIX B
RESEARCH INSTRUMENT

RED PLANET CASE

Background Information:

You are part of the engagement team that is performing the fiscal year 2016 audit of Red Planet, Inc. (RP). You are responsible for performing audit procedures related to the inventory cycle. RP is a manufacturer that sells a variety of electronics products. Its customers include third party retailers and various end users including corporations and individual consumers. RP is a medium-sized publicly traded company with an April 30, 2016 year-end. Over the past three years, RP's net income grew at a 3 percent annual rate. Summary financial information for the year-ended April, 30 2016 is presented below.

Summary Financial Information for the Year-Ended April 30, 2016 (in thousands, unaudited)

Net Sales	\$419,976	Accounts Receivable	80,936
Cost of Sales	315,176	Inventory	76,072
Net Income	42,960	Plant & Equipment	257,009

Overall materiality for the fiscal year 2016 audit was established at \$2.15 million using net income as the basis for the materiality calculation.

In your experience, RP hires competent and experienced people of high integrity. RP has strong internal controls and management has been cooperative in the past. RP's executives are compensated with a base salary, bonus, and stock compensation.

RP has been an important client in your office for many years. Your firm has issued a standard unqualified audit opinion in each year that it has audited RP. The engagement team hasn't had any major disputes over RP's financial reporting in the past.

You are currently in the process of **testing the valuation of RP's inventory**. Your main point of contact at RP is the CFO. Like most clients, RP's CFO **expects to receive excellent client service**. He expects you to be considerate of his busy schedule and expects professional service from the audit team.

Client Service Activities on the RP Engagement:

Since client service is important to RP's CFO, please take a moment to plan the client service activities that you will perform for RP during audit fieldwork. For example, you may want to perform the following activities on the RP engagement:

- Provide detailed status updates to RP's CFO.
- Minimize the frequency of meetings with RP's CFO by consolidating your questions.

In the space below, **please list all the client service activities you will perform for RP** in order to maintain or enhance client satisfaction. Please focus on the client service activities that you will perform while you are completing your audit work.

1.

Preliminary Questions:

Before continuing to the next part of the case, please answer the following questions.

1. How many client service activities did you list that you will perform for RP?

{Note: Participants in the lower client service performance condition received the following response options.}

3 or fewer

☐

4-6

☐

7-9

☐

10 or more

☐

{Note: Participants in the higher client service performance condition received the following response options.}

0

☐

1

☐

2

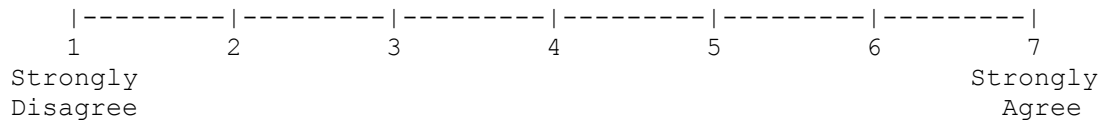
☐

3 or more

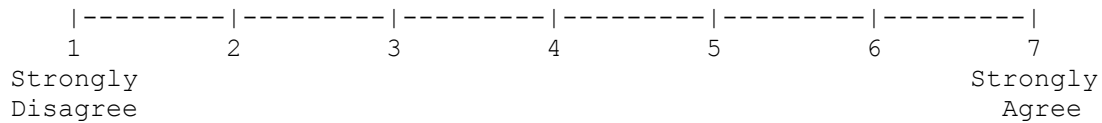
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{Note: Participants in the progress focus condition answered the following questions. Questions 3, 4, 8, and 9 are part of the manipulation. Questions 2, 5, 6, and 7 are filler questions and were held constant across conditions.}

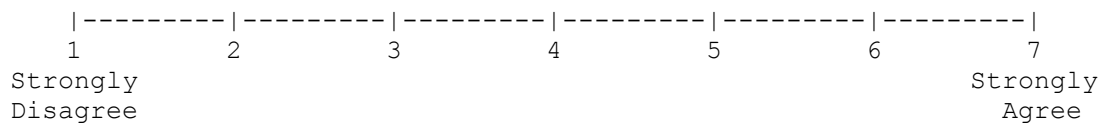
2. I am responsible for performing audit procedures related to RP's inventory cycle.



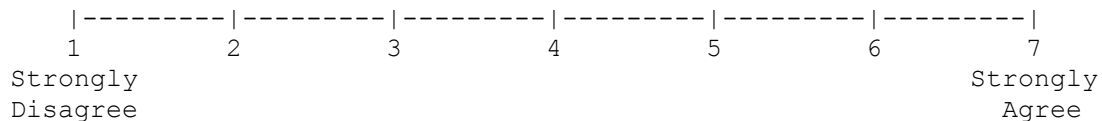
3. Considering how many client service activities I planned to perform, I am making a lot of progress toward my client satisfaction goals on the RP engagement.



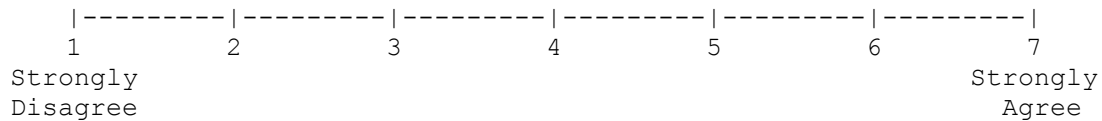
4. Based on how many client service activities I planned to perform, I am meeting or exceeding the CFO's expectations.



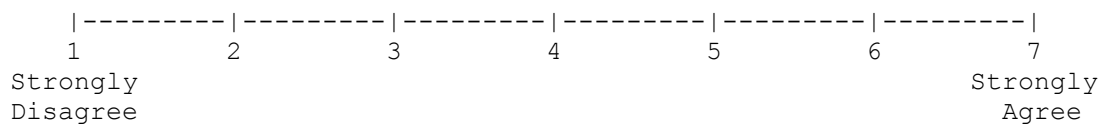
5. RP's net income grew at an annual rate of about 10 percent in recent years.



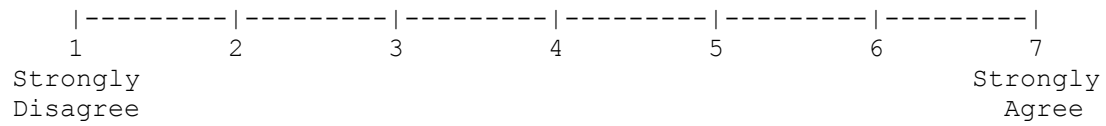
6. RP's executives are compensated with a base salary only.



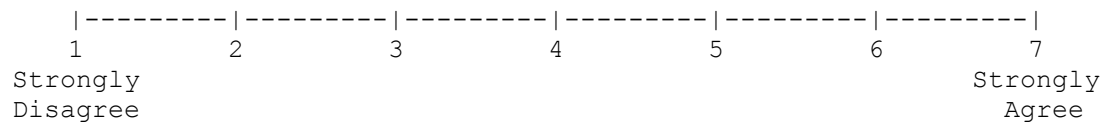
7. Net income was used as the basis for the materiality calculation on the RP engagement.



8. Based on how many client service activities I planned to perform, I am providing RP's CFO with the highest level of service.

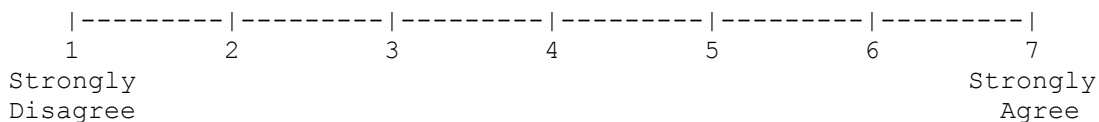


9. Considering how many client service activities I planned to perform, I am closer to achieving my client satisfaction objectives on the RP engagement.

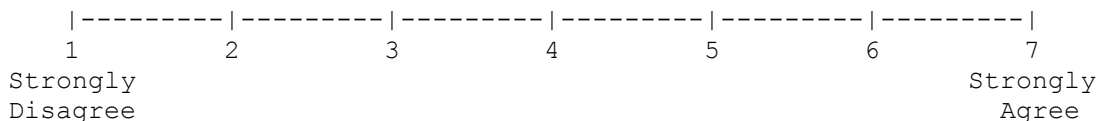


{Note: Participants in the commitment focus condition answered the following questions. Questions 3, 4, 8, and 9 are part of the manipulation. Questions 2, 5, 6, and 7 are filler questions and were held constant across conditions.}

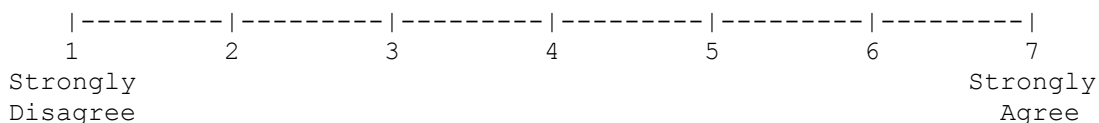
2. I am responsible for performing audit procedures related to RP's inventory cycle.



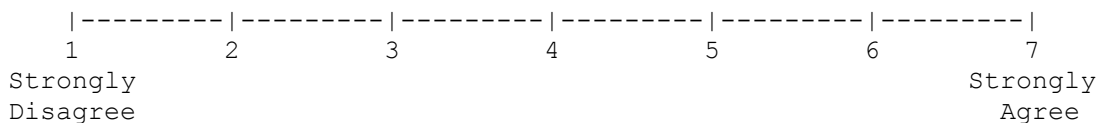
3. Considering how many client service activities I planned to perform, I am highly committed to my client satisfaction goals on the RP engagement.



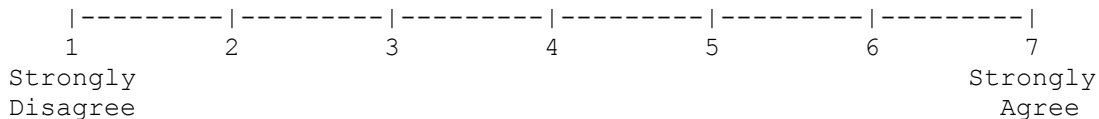
4. Based on how many client service activities I planned to perform, I must really care about meeting or exceeding the CFO's expectations.



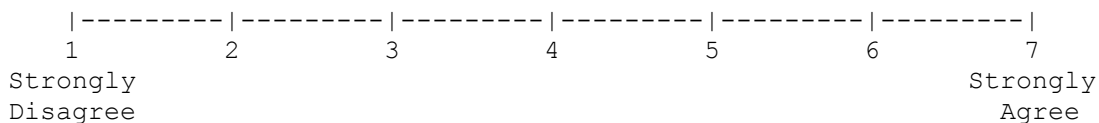
5. RP's net income grew at an annual rate of about 10 percent in recent years.



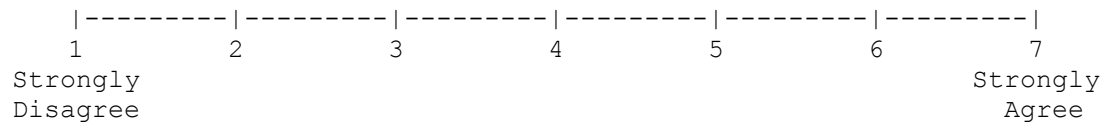
6. RP's executives are compensated with a base salary only.



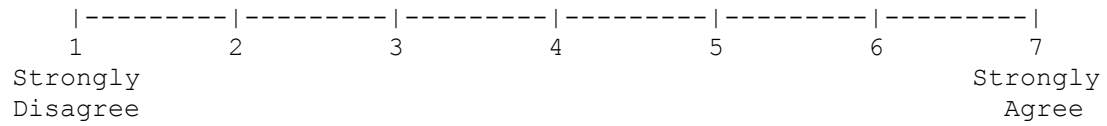
7. Net income was used as the basis for the materiality calculation on the RP engagement.



8. Based on how many client service activities I planned to perform, providing RP's CFO with the highest level of service is important to me.



9. Considering how many client service activities I planned to perform, I am committed to my client satisfaction objectives on the RP engagement.



Please continue to the next page.

Inventory Obsolescence:

While completing your inventory valuation testing, you became aware of a potential inventory obsolescence issue. You met with RP's CFO, who was very forthcoming, and explained:

"A major competitor is in the process of producing and marketing a product that is technologically superior to Product A, one of our existing electronics products. However, we do not believe this causes any obsolescence issues for fiscal year 2016 and we do not believe we need to write down our Product A inventory at this time."

Inventory at year-end included \$18.9 million of Product A (60,000 units carried at full absorption cost of \$315). This represents about six months of sales of Product A.

In order to support his position that Product A inventory does not need to be written down, the CFO made the following assertions:

- Product A sold for an average price of about \$400 over the last three years.
- The competitor is in the process of accepting orders for the technologically superior product, but RP estimates that it will be 8-15 months before the competitor is producing at its full capacity. RP knows that many of its customers cannot or will not wait that long to order new products and expects that they will be cautious about placing large orders of a thus far unproven product, even if it boasts better technology.
- According to the competitor's press release, its product will sell for about \$320. The competitor is also accepting limited orders, for later delivery, at \$290 per unit. RP believes that the pricing on the limited orders reflects a temporary marketing strategy.
- RP has already started work on developing a competitive replacement product and expects to have it ready by the end of the fiscal year 2017.
- Past experience indicates that there is a healthy third-world market for devices with older technology. RP expects that using existing marketing channels and personnel, it could sell 5,000 units of Product A per month in developing markets, with positive margins on these sales.

After providing you with this information, the CFO explained that he will be very busy in the next few days and would appreciate it if you could keep your questions to a minimum. He indicated that this is all the available information about the obsolescence issue. He expressed his hope that the issue would be resolved and that it wouldn't require any more of his time.

Case Questions:

1. What **additional audit procedures**, if any, would you like to perform regarding the valuation of Product A inventory? Please be as specific as possible and explain the **reason** for performing each procedure.

Procedures:	Reasons:
1.	1.

2. How likely is it that Product A inventory is **materially overstated** as of year-end?

-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	
0	1	2	3	4	5	6	7	8	9	10
Not at all							Extremely			
Likely							Likely			

3. What is your best estimate of the **per unit market value** of Product A as of year-end?

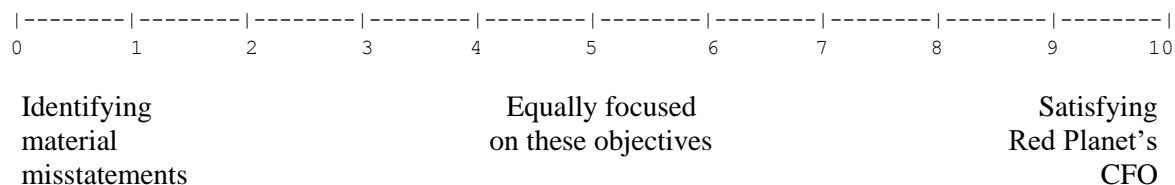
\$ _____ / per unit

4. Please show or provide a brief explanation of how you arrived at your estimate:

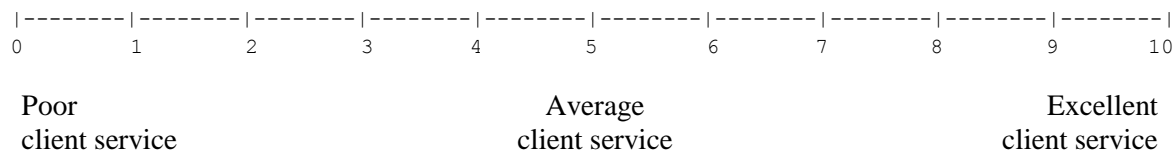
Please place this packet back in the envelope and continue to the next packet called “Final Questions.”

FINAL QUESTIONS

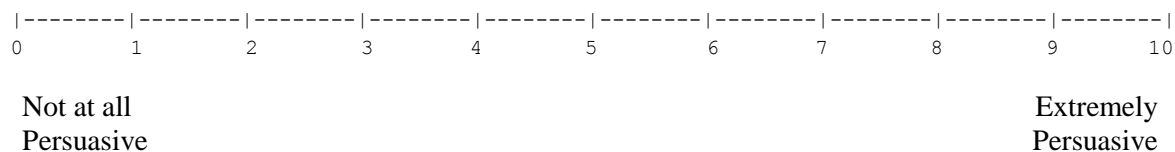
1. While working on the RP case, I was primarily focused on:



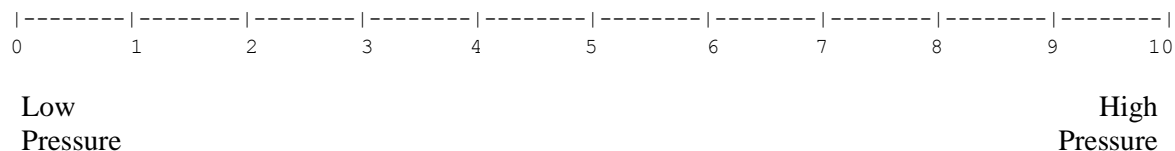
2. I felt like I planned to provide RP with:



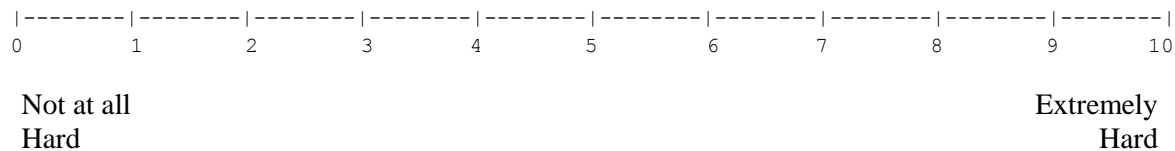
3. How persuasive was the CFO's position that Product A inventory does not need to be written down?



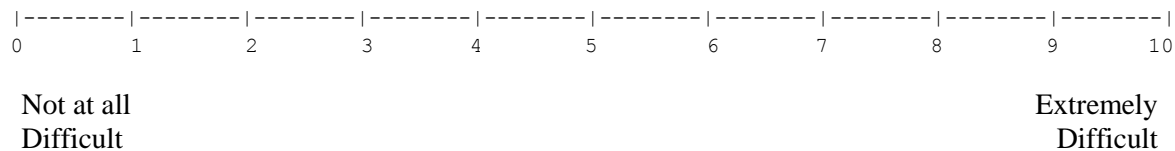
4. How much pressure was there to accept RP's position that Product A inventory does not need to be written down?



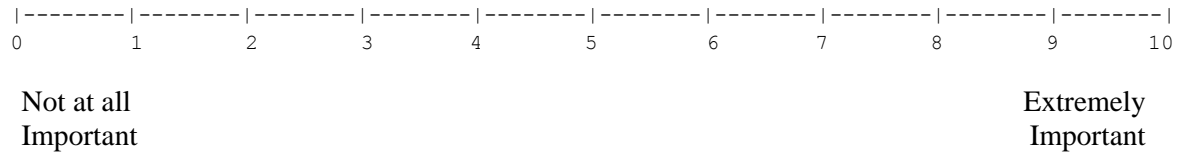
5. How hard did you work on the RP case?



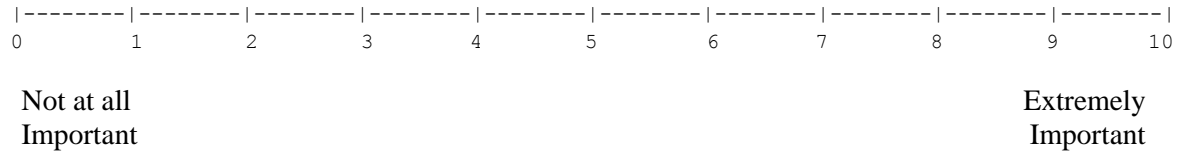
6. How difficult was the RP case?



7. In general, how important is it for auditors to provide excellent client service?



8. How important is client service to your performance evaluations?



Please continue to the next page.

Demographic Questions:

Please answer these demographic questions. These will help me to explain differences between your responses and those of others.

1. What is your current position in the firm (check one)?

___ Staff ___ Senior ___ Manager ___ Partner

2. How much auditing experience do you have (in months)?

Number of months: _____

3. On how many audits have you audited the inventory account?

Number of audits: _____

4. In what industry(ies) are most of your clients?

--

5. How long has it been since your last promotion (in months)?

Number of months: _____

6. Which certifications have you earned (select all that apply)?

___ CPA ___ CMA ___ CFA

___ Other (Please describe: _____)

You are done! Please place this packet back in the envelope and return the envelope to the researcher. Thank you!!