Discussion of: Koch & Salterio, “Pressures on Audit Partners’ Negotiation Strategy and Decision Making”

Illinois Audit Symposium
September 12, 2014
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My first reaction to this paper

- We know auditors engage in motivated reasoning in order to satisfy client preferences for reporting outcomes.

- Pressure to satisfy clients comes from multiple sources, including...
  - External sources (client pressure)
  - Internal sources (CRM practices)

- Why would it be interesting to cross these different sources of pressure in an experiment?
  - Just four different levels of “pressure”…
HELP!

Three paragraphs (or sentences!)

Predictive Validity Framework
What is the problem?

- Auditors have competing motivations
  - Satisfy clients (commercial motivation)
  - Maintain professional integrity by serving the public interest (professional motivation)

- This is different than many other business settings...
Why is it important?

The customer is always right!
Why is it important?

- For retailers (and other strictly commercial ventures), commercial and professional pressures lead in the same direction.
  - Satisfying the customer and maximizing profit are not in conflict with your responsibilities and identity as a retailer.

- For auditors, the “customer” is not always right!
  - We rely, at least in part, on internal pressure from firms to maintain professional identity and resist commercial pressure.
  - CRM practices may be changing this.
Why is it important?

Internal pressure may change the way auditors interpret client pressure.

- Why? In the context of an audit firm, internal pressure is fundamentally different than external pressure.
- If pressure to satisfy clients comes from inside the firm, it is less likely to be viewed as inconsistent with professional identity.

In the language of motivated reasoning, internal pressure loosens the “reasonableness constraints” that normally restrain auditors from acceding to client pressure.
What did they do?

- Experiment with 2x2 between subjects design

- Comments/questions on experiment
  - Appropriate participant group (auditors with experience of client pressure and within-firm pressure)
  - Manipulation of pressure is well-done. Both conditions are realistic.
  - More detail on 25 responses not used? Is this the reason for the large difference in cell sizes?
  - Why no direct manipulation check for the CRM manipulation?
Predictive Validity Framework

**Conceptual**

Independent (X)
1. External pressure
2. Internal pressure

Dependent (Y)
Resistance to client preference for aggressive accounting

**Operational**

1. Client pressure
2. CRM practices

(Manipulated & Measured)

- Accept/reject judgment
- Minimum adjustment
- Negotiation tactics
Concern #1

- Do results really support H1?
  - No results for three of five dependent measures

<table>
<thead>
<tr>
<th>Client pressure</th>
<th>CRM reminding</th>
<th>Reject (0-10)</th>
<th>Adjust (0.0–4.0 m euros)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Implicit</td>
<td>No CRM</td>
<td>5.99 (2.51)</td>
<td>2.55 (0.82)</td>
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<tr>
<td>N = 26</td>
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<td></td>
<td></td>
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<tr>
<td>CRM</td>
<td></td>
<td>6.89 (2.13)</td>
<td>2.65 (1.00)</td>
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<td>N = 37</td>
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<tr>
<td>Explicit</td>
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<td>7.45 (2.21)</td>
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<tr>
<td>CRM</td>
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<td>7.16 (2.28)</td>
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<td>N = 37</td>
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<tr>
<td>Overall</td>
<td>N = 133</td>
<td>6.93 (2.30)</td>
<td>2.49 (0.87)</td>
</tr>
</tbody>
</table>
Concern #1

- Do results really support H1?
  - No results for three of five dependent measures

Panel B. Auditor intended negotiation tactics (scale 0-7)

<table>
<thead>
<tr>
<th>Client pressure</th>
<th>CRM reminding</th>
<th>Concede (2 items)</th>
<th>Compromise (2 items)</th>
<th>Contend (3 items)</th>
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<tbody>
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<td>No CRM</td>
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<td>3.78 (1.82)</td>
<td>5.13 (1.61)</td>
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<tr>
<td>CRM</td>
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<td>Explicit</td>
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<td>3.27 (1.73)</td>
<td>5.61 (1.14)</td>
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<tr>
<td>CRM</td>
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<td>3.30 (1.58)</td>
<td>3.24 (1.72)</td>
<td>5.22 (1.39)</td>
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<tr>
<td>N = 37</td>
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<tr>
<td>Overall</td>
<td>N = 133</td>
<td>3.20 (1.72)</td>
<td>3.41 (1.75)</td>
<td>5.35 (1.36)</td>
</tr>
</tbody>
</table>
Concern #1

- Do results really support H1?
  - Pattern of cell means...

![Graphs showing data trends with p-values]
Concern #1

- Do results really support H1?
  - Pattern of cell means…

![Diagram showing the pattern of cell means with statistical significance values:](image)
Concern #2: Construct Validity

- Does measurement of “affinity for client needs” capture the same construct as the pressure arising from CRM (what I call “internal pressure”)?

Medtech AG is not personally important to me as an auditor at Audit WPG (afc1, reverse coded).

I as an auditor at Audit WPG really feel as if Medtech AG’s problems are my own (afc2).

We at Audit WPG want to remain the auditor of Medtech AG because we genuinely enjoy our relationship with Medtech AG. (afc3).

The above three items are elicited on a -5 to +5 scale anchored with “strongly disagree” and “strongly agree”:

<table>
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<th>-5</th>
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<th>-3</th>
<th>-2</th>
<th>-1</th>
<th>0</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
</table>

Strongly disagree | Neither agree nor disagree | Strongly agree
Concern #3: SEM

“[M]any reviewers and editors do NOT know how to evaluate [SEM] models!!! So stop faking it and if you do not know how to use a method DO NOT bluff your way through a review and hope for the best.”

-Steve Salterio

https://morebysteve.wordpress.com/
Structural Equations Modeling (SEM)

- When is SEM most useful/appropriate?
  - When you have strong theory-based expectations about the form of the relations between constructs (this does not mean modifications cannot be made ex-post, but even modifications must be grounded in theory).
  - When the hypothesized relations between constructs are relatively complex (multiple expected mediation relationships is one example).
  - When you want to test the relation between latent variables or a combination of latent and observed variables (SEM combines factor analysis and regression).
  - When you have a (reasonably) large sample (ideally, a minimum sample size to parameters ratio of 20:1, and no lower than 10:1).
Structural Equations Modeling (SEM)

- When is SEM unnecessary/inappropriate?
  - When analysis is purely exploratory.
  - When you want to test simple relations between observable variables (in this case, SEM is equivalent to regression).
  - When you have a small sample.


Concern #3: SEM

- Affinity for Client
- Concede
- Compromise
- Contend

Solid (dotted) lines represent direct (indirect) effects of perceived pressure and affinity for client needs on strategies and outcomes.

See Table 4 for variable definitions.

Variables of interest

Intended negotiation tactics

Accounting outcomes

Likelihood of rejecting client preferred accounting

Adjustment Required to Bring Accounting into GAAP Conformity
Concluding Remarks

- **Strengths**
  - Tests the possibility that internal and external pressures to satisfy clients are fundamentally different, and may interact, in an audit setting.
  - Experiment: great participant group & clever, clean manipulations
  - Interesting results that should lead to additional studies.

- **Concerns**
  - Excess of institutional and theoretical detail obscures key message.
  - Theory for interaction could be strengthened.
  - Strength & interpretation of results for H1.
  - Construct validity of “affinity for client” measure
  - SEM could be used more effectively by (1) including interaction and (2) either excluding negotiation variables or more precisely explaining relations.

I enjoyed reading it – Thank you!