

## **Resolving Auditor-Client Conflicts Concerning Financial Statement Issues**

**By**

**Jenny Goodwin**

**Department of Commerce  
University of Queensland  
Australia**

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**Address for correspondence:**

Dr Jenny Goodwin  
Department of Commerce  
University of Queensland  
Brisbane Qld 4072  
Australia

**Email:** [goodwin@commerce.uq.edu.au](mailto:goodwin@commerce.uq.edu.au)

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**ABSTRACT:** This study explores the conflict management styles used by auditors when resolving disputes with clients concerning financial statement issues. Rahim's (1983b) ROCI-II conflict management instrument was used to establish both the styles generally used and also those used in a scenario concerning possible inventory obsolescence. Size of the client and the strength of its corporate governance mechanisms were manipulated in the scenario. It was found that auditors invariably use the integrating style to resolve disputes. The compromising and dominating styles are used to a lesser extent while the obliging and avoiding styles are rarely used. Partners are more likely than managers to use more assertive styles of conflict management. The size of the client and the strength of corporate governance mechanisms in place have a significant but relatively minor impact on the choice of styles. The study also identifies the parties whom the auditor would expect to help resolve the dispute. It was found that the audit committee is perceived to give the most assistance, followed by the chief executive officer.

**Key Words:** Audit, Auditor-Client Conflict, Conflict Management Styles

**Data Availability:** The data is available from the author on request.

## **Resolving Auditor-Client Conflicts Concerning Financial Statement Issues**

### **INTRODUCTION**

Audited financial statements are the outcome of a resolution process between the auditor and the client (Wright & Wright, 1997; Antle & Nalebuff, 1991). This process invariably involves negotiation between the two parties to resolve issues under dispute (Gibbins, Salterio & Webb, 2000). Knapp (1985, p. 202) suggests that conflicts which threaten the successful completion of an audit “are commonly centered around such issues as the need to make adjustments to the financial statements, the propriety of the client’s accounting principles, and the adequacy of financial statement disclosure”. The way that auditors deal with these conflicts can have a significant effect on audit independence and on the content and credibility of financial statements.

A number of studies have identified factors that might influence the auditor’s decision to accept the client position in a dispute. These include the nature of the item under dispute (Wright & Wright, 1997; Knapp, 1985); the relative power of the client and the auditor (Knapp, 1985; Windsor & Ashkanasy, 1995); the auditor’s level of moral reasoning (Tsui & Gul, 1995; Windsor & Ashkanasy, 1995) and the likelihood of litigation (Farmer, Rittenberg & Trompeter, 1987; Goodwin & Trotman, 1995). However, few studies have focused on the negotiation process that takes place between the auditor and client management in order to reach an outcome.

Antle and Nalebuff (1991) use game theory to examine the role of auditor-client negotiation in the production of the client’s financial statements while Gibbins et al.

(2000) develop a negotiation model in an auditing context, based on the results of structured interviews and a field questionnaire. The purpose of the present study is to explore negotiation and conflict resolution from a behavioural perspective. In particular, I focus on the conflict management styles used by auditors to resolve disputes with clients concerning financial statement issues.

The negotiation model developed by Gibbins et al. (2000) contains some features that are basic to all negotiation situations and some that are distinctive to the auditor-client situation. Their model is comprised of three elements – the issue, the auditor-client process and the outcome. An important part of the process element in any negotiation to resolve a dispute is the bargaining strategy adopted by the parties involved (Gibbins et al. 2000). In turn, bargaining strategy is closely linked to the conflict management style used by the parties (Rojot, 1991).

There is an extensive body of literature on conflict management in areas other than auditing. Follett (1940) was the first to conceptually classify the different ways of handling conflicts into five distinct styles. This conceptualization was further refined by Blake and Mouton (1964) who developed an organizational model of conflict handling styles, based on the two dimensions of concern for production and concern for people. Their model described the five styles as forcing, withdrawing, smoothing, compromising and problem solving. Blake and Mouton's (1964) model has been adapted for wider use by a number of researchers, using slightly different terminology (Hall, 1969; Thomas and Kilmann, 1974; Rahim, 1983a).

One of the most commonly used models is that of Rahim (1983a) who developed an instrument known as the Rahim Organizational Conflict Inventory-II or ROCI-II (Rahim, 1983b). This instrument measures the five conflict management styles of dominating, avoiding, obliging, compromising and integrating. Notwithstanding the different terminology, these styles are broadly parallel to those of Blake and Mouton (1964). The instrument has been tested in numerous studies<sup>1</sup> and has been found to have a high degree of validity and internal consistency (Rahim, 1992; King and Miles, 1990; Weider-Hatfield, 1988).<sup>2</sup>

In the present study, a modified version of Rahim's (1983b) ROCI-II is used to establish the conflict management styles of auditors in general and also relating to a specific contextual situation. In this situation, two variables are manipulated, these being the size and influence of the client and the strength of the client's corporate governance mechanisms relating to the audit committee and the board of directors. In addition to establishing the conflict management styles used, the individuals or groups whom the auditor would expect to help solve the dispute are also identified.

Brody, Golen & Reckers (1998) is the only other study to measure conflict management styles in an auditing context. In that study, conflict management style was

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<sup>1</sup> The [roci@LISTS.WKU.EDU](mailto:roci@LISTS.WKU.EDU) internet list reveals that more than 180 journal articles, dissertations and working papers have used the instrument.

<sup>2</sup> Two other widely used instruments are the Management of Differences Exercise or MODE (Kilmann and Thomas, 1977) and the Organizational Communication Conflict Instrument or OCCI (Putnam and Wilson, 1982). The MODE has been criticized for its weak convergent validity and its ipsative nature (Womack, 1988a and 1988b; Kabanoff, 1987). The OCCI is more concerned with the role of communication in conflict management and has been criticized for its reliance on student subjects during its development (Knapp, Putnam & Davis, 1988).

measured as one of the independent variables influencing the external auditor's relationship with the internal auditor. The present study is the first to focus on conflict management style as a dependent variable. As such, the paper increases our understanding of conflict management in auditing. This contribution is important because the adoption of a particular conflict management style can influence not only the outcome of the issue under dispute (Ting-Toomey, 1986; Wilson & Waltman, 1988; Brody, Golen & Reckers, 1998) but also the resolution of future issues that may arise (Gibbins et al., 2000). Thus, the truth and fairness of both the current financial statements and future years' financial statements could be affected, with on-flowing consequences for sound economic decision making.

The paper is organized as follows. The next section contains the background to the study and the research questions addressed. The third section outlines the research methods while in the fourth section the results are reported and discussed. In the final section, some conclusions are drawn, the limitations of the study noted and future research opportunities are discussed.

## **BACKGROUND AND RESEARCH QUESTIONS**

### **Conflict and negotiation between the auditor and the client**

The process of expressing an opinion on the client's financial statements inevitably leads to a certain amount of conflict between the auditor and the client (Wright & Wright, 1997; Gibbins et al., 2000). Before the auditor is willing to provide an unqualified audit report, any issues that have arisen throughout the audit must be resolved. During the

resolution process, the client is likely to attempt to persuade the auditor to accept the client position. The early independence literature (Goldman & Barlev, 1974; Nichols & Price, 1976) modeled the auditor's ability to withstand pressure from a client when resolving issues as a function of the client's source of power relative to the auditor's source of power. Thus, when negotiating with the client, the auditor is faced with "incentives to cooperate and incentives to compete" (Murnighan & Bazerman, 1990, p. 643).

It has been argued that client management has an inherent advantage in negotiating disputes because of the auditor's dependence on client fees (Windsor & Ashkanasy, 1995, Mautz & Sharaf, 1961). A number of researchers have provided evidence that, under certain conditions, auditors may collude with the client, thereby agreeing to waive a financial statement adjustment they perceive to be necessary (Wright & Wright, 1997; Krishnan & Krishnan, 1996). Evidence suggests that factors such as the risk of losing the client (Farmer et al., 1987; Goodwin & Trotman, 1995; Craswell, 1988), and the provision of management advisory services (Knapp, 1985; Lindsay, 1989 and 1990; Gul, 1991) may influence auditors to accept the client position in a dispute.

In contrast, the threat of litigation (Goodwin & Trotman, 1995; Farmer et al., 1987; Wright and Wright, 1997), the size of the audit firm relative to the client (Knapp, 1985; Lindsay, 1989 and 1990; Gul, 1991) and the auditor's level of moral reasoning (Windsor & Ashkanasy, 1995; Tsui & Gul, 1995) have been found to influence the auditor's ability to resist pressure from management in a conflict situation. The nature and materiality of

the issue under dispute is also seen as influencing the outcome of the conflict (Wright and Wright, 1997), with auditors being less willing to compromise when the issue is a serious one such as a going concern qualification (Craswell, 1988).

Drawing heavily from the negotiation literature, Gibbins et al. (2000) develop a model pertaining to negotiation in the auditor-client setting. Their model consists of a three-element process comprising the accounting issue, the auditor-client process and the accounting outcome. The three-element process is influenced by the auditor-client history and it, in turn, influences the next interaction between the auditor and the client. Gibbins et al. (2000) identify a number of features which they suggest distinguish accounting negotiations from other negotiation contexts. These include external conditions and constraints such as accounting and ethical standards, the interpersonal context including the auditor-client relationship and the parties' capabilities resulting from their differing knowledge bases.

To assist in the development of their model, Gibbins et al. (2000) undertook a survey of senior practitioners in Canada, who were asked to reflect on a specific negotiation with a client. Almost 50% of respondents believed that there was a range of mutually acceptable outcomes to a dispute while a further 37% saw their initial role as persuading the client to accept the auditor's position. The most common outcome of the negotiations was an agreement in between the original positions taken by the auditor and the client (41%), followed by an acceptance of the auditor's original position (32%). The least common outcome was a new solution generated during negotiation (16%).

An important factor that can influence the outcome of negotiation is the bargaining strategy of the parties involved. Gibbins et al. (2000), however, do not consider this issue although they do acknowledge its potential importance. They also suggest that the strategy is likely to be context specific. Bargaining strategy is closely related to the choice of conflict management style, which is the focus of the present study. I identify the styles generally used by auditors in the process of achieving an outcome relating to a dispute concerning a financial statement adjustment. I also examine a specific contextual situation relating to a dispute concerning inventory obsolescence. In the latter situation, two variables are manipulated to identify whether they have any influence on the conflict management style of auditors: (1) the size and influence of the client and (2) the strength of corporate governance mechanisms in place. The likely impact of these variables on the conflict management styles of auditors is considered following a discussion of the styles developed in the conflict management and organizational behaviour literatures.

### **Conflict management styles**

As noted, Blake and Mouton (1964) extended the work of Follett (1940) to develop a conceptual model of conflict management styles in organizational behavior. Subsequent models have relied heavily on Blake and Mouton's (1964) theoretical framework of two dimensions and five conflict styles (King & Miles, 1990). These models include those developed by Hall (1969), Thomas (1976) and Rahim (1983a). The models vary mainly in the terminology used. In this study, I focus on the Rahim (1983a) model which describes the two dimensions as concern for self and concern for others. The five conflict styles are integrating, dominating, obliging, avoiding and compromising.

*Integrating Style (high concern for self and others).* The integrating style involves collaboration between parties and is characterized by an open exchange of information to find a solution agreeable to both parties (Rahim, 1997). The style is therefore regarded as being both assertive and cooperative (Rahim & Magner, 1995). Conflicts are resolved by constructively exploring differences and searching for new solutions that go beyond what each party first envisioned (Rahim, 1992). The end result is a win-win situation for the two parties involved (Frederickson, 1997).

*Dominating Style (high concern for self and low concern for others).* The dominating style is considered to be assertive and uncooperative (Rahim & Magner, 1995). A person adopting this style seeks to impose his/her views upon the other party, using forcing behaviour if necessary. Conflict is thus regarded as a win-lose competition (Frederickson, 1997).

*Obliging Style (low concern for self and high concern for others).* This style involves playing down differences and emphasizing issues in common in order to satisfy the concerns of the other party. An obliging person is unassertive and cooperative (Rahim & Magner, 1995), having little regard for their own position (Rahim 1992). Effort is made to smooth over the conflict out of fear of harming the relationship (Frederickson, 1997). Conflict is therefore seen as a lose-win situation.

*Avoiding Style (low concern for self and others).* The avoiding style is considered to be both unassertive and uncooperative (Rahim & Magner, 1995). A person adopting this style exhibits an unconcerned attitude towards the issue, failing to satisfy their own

concerns as well as the concerns of the other party. Conflict is thus recognized as a lose-lose situation.

*Compromising Style (intermediate in concern for self and others).* A person using this style takes a “middle-ground position” (Rahim, 1997, p. 62) involving give and take. Both parties give up something in order to achieve a mutually acceptable decision (Rahim, 1992). The style involves both assertiveness and cooperativeness but to a lesser extent than the integrating style (Rahim & Magner, 1995). Neither party’s preferred outcome is achieved so that conflict is regarded as a no-win/no-lose situation.

*Integrative and Distributive Dimensions of the Conflict Management Styles.* Thomas (1976) suggested that further insight into the five conflict management styles can be obtained by organizing them into the integrative and distributive dimensions put forward by Walton and McKersie (1965) in the context of labour negotiation (Rahim, 1992 and 1997). The integrative dimension measures the amount of satisfaction of concerns received by both parties to the conflict while the distributive dimension measures the amount of satisfaction of concerns received by one of the parties at the expense of the other party. The integrative and distributive dimensions are constructed as follows:

Integrative Dimension = Integrating Style – Avoiding Style

Distributive Dimension = Dominating Style – Obliging Style

Figure 1 models the five conflict management styles together with these dimensions.

*Insert Figure 1 about here*

Some writers regard the integrating style as the superior conflict management style and thus the most appropriate style to use in all circumstances (Blake & Mouton, 1964; Burke, 1969; Likert & Likert, 1976; Van Slyke, 1999). Integrating is the only conflict management style that considers the interests of both parties and focuses on mutual gains. It is therefore argued that this style produces superior outcomes with more open exchange of information and a higher level of satisfaction through exploring the conflict issues more comprehensively (Van Slyke, 1999).

Others (Hart, 1981; Thomas, 1977; Rahim, 1992 and 1997) have adopted a contingency approach which recognizes that “one style may be more appropriate than another depending on the situation” (Rahim, 1997, p. 72). Rahim (1992 and 1997) suggests that the integrating style is more appropriate when issues are complex and when synthesis of ideas and commitment from both parties are needed to resolve the problem. The obliging style may be more appropriate when the person is in a weaker position than the other party, the issue is more important to the other party, and preserving the relationship is important. A person may be better using a dominating style when the issue is less important to the other party, a speedy solution is needed and he/she is more powerful than the other party. An avoiding style may be suitable when the issue is relatively unimportant and there are potentially dysfunctional outcomes from confronting the other party. Finally, a compromising style may be appropriate when the goals of the parties are mutually exclusive, when both parties are equally powerful and when consensus cannot be reached.

Prior research has also found that the styles themselves are not mutually exclusive (Ting-Toomey, Gao, Trubisky, Yang, Kim, Lin et al. 1991; Trubisky, Ting-Toomey & Lin, 1991; Psenicka & Rahim, 1989; Lee, 1990). While people may adopt one style as the dominant one in a given situation, they may also use aspects of the other styles according to the circumstances and nature of the conflict.

No prior research has identified which conflict management styles are favored by auditors when dealing with disputes concerning material misstatements or disclosure issues in financial statements. The following research question is therefore addressed:

**RQ1:** What conflict management styles are normally used by auditors to resolve a dispute with the client concerning the truth and fairness of the financial statements?

### **The contextual variables**

#### *The size and influence of the client*

As previously noted, the relative power between the auditor and the client can affect the auditor's ability to resist pressure from management (Knapp, 1985; Windsor & Ashkanasy, 1995). This in turn is likely to influence the way that auditors manage conflicts with their clients. The results of prior research suggest that some auditors may be willing to waive an adjustment in order to retain the client and this is likely to be especially so when the client is a large and influential company (Wright & Wright, 1997; Krishnan & Krishnan, 1996). This is because the loss of audit and other advisory services fees are likely to be much greater for a larger client. In addition, the audit firm could suffer a loss of reputation as a result of the publicity surrounding the audit switch.

As a result, the auditor may adopt a compromising or even an obliging style and lean towards accepting the client's position. On the other hand, auditors may consider the consequences of audit failure to be greater when the client is larger and hence they may adopt a more dominating style to persuade the client to accept their position. The results of the survey undertaken by Gibbins et al. (2000) suggest, however, that auditors do not allow themselves to be influenced by the size of the client when negotiating to resolve a dispute. In view of these conflicting arguments concerning client size and influence, the research question explored is as follows:

**RQ2:** Do the size and influence of the client affect the conflict management style used by the auditor to resolve a dispute concerning the financial statements?

#### *Corporate Governance Mechanisms*

One of the benefits of strong corporate governance is the enhancement of auditor independence (Knapp, 1987; Cadbury, 1992; McMullen, 1996). A strong and active audit committee comprising independent directors can act as an intermediary between the auditor and client management. Knapp (1987) found that audit committee members appear to support auditors rather than management in the event of a dispute. Beasley (1996) found that a greater proportion of outside directors on the board significantly reduces the likelihood of financial statement fraud. It has also been argued that an independent chairman can enhance the monitoring role of the board and avoid a concentration of power (Cadbury, 1997). An interesting question, therefore, is whether corporate governance mechanisms such as a strong and independent audit committee, an independent chairman and a majority of independent directors influence the way that

auditors attempt to resolve disputes with client management. This gives rise to the following research question:

**RQ3:** Is the conflict management style used by the auditor to resolve a dispute concerning the financial statements affected by the type of corporate governance structures in place?

### **Identifying the members of the client who would assist to resolve the dispute**

In addition to examining the conflict management styles of auditors when resolving a dispute with the client, the study also sought to identify the various members of the client company who might assist the auditor to resolve a dispute. If a dispute with the finance director cannot be resolved, to what extent does the auditor involve other members of the client company such as the chief executive officer (CEO), the chairman of the board, the audit committee and the board of directors as a whole? The survey undertaken by Gibbins et al. (2000) revealed that 96% of negotiations involved the chief financial officer, 59% the CEO and only 40% the audit committee. The present study explores this issue further by addressing the following research questions:

**RQ4:** When a dispute with the chief financial officer cannot be resolved, to what extent would the CEO, the board chairman, the audit committee and the board of directors assist in reaching an agreement?

**RQ5:** Is the extent of assistance given by the CEO, the board chairman, the audit committee and the board of directors to resolve the conflict affected by the size and influence of the client?

**RQ6:** Is the extent of assistance given by the CEO, the board chairman, the audit committee and the board of directors to resolve the conflict affected by the corporate governance structures in place?

## RESEARCH METHODS

### Research instrument

The research instrument was divided into three parts.<sup>3</sup> The first part concerned the normal approach that auditors take when resolving conflicts with the client that may affect the audit opinion. The second part described a specific scenario where a conflict had arisen between the audit partner and the client's finance director. The final part of the instrument contained demographic questions about the participant. During its development, the instrument was reviewed by five accounting academics with experience in auditing and by a senior audit practitioner. Pilot testing by final year auditing students verified the strength of the manipulations and the clarity of the instrument.

### *Part One*

Using a modified version of the ROCI-II (Rahim, 1983b), participants were asked how they would normally resolve conflicts with the client concerning financial statement issues. The ROCI-II (Rahim, 1983b) comprises 28 statements, seven of which relate to the integrating style, six each to the obliging and avoiding styles, five to the dominating style and four to the compromising style. The wording of these statements was modified to refer to the client as the other party in the conflict.<sup>4</sup> Participants were asked to indicate

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<sup>3</sup> A copy of the instrument is available from the author.

<sup>4</sup> These statements are reproduced in Appendix 1.

the extent of their agreement with the statement by circling a number on a seven-point numerical scale ranging from Strongly Disagree (1) to Strongly Agree (7).<sup>5</sup>

### ***Part Two***

This section of the instrument concerned a dispute between the audit partner of a listed company and the finance director concerning the valuation of inventory. Participants were asked to assume that they had been the partner in charge of the audit for the last five years and that they had had a good working relationship with the finance director up to this point of time. The company, an electrical and electronic products manufacturer, was experiencing difficulty maintaining market share and had decided to drop a major product line. Both the finance director and the senior design engineer had advised that the components associated with this product had alternative uses and no writedown of value was necessary. The audit partner, however, believed that inventory could be materially overstated to the extent of 20% of net profit. He/she was particularly concerned because both the finance director and the engineer received performance bonuses based on profit. The partner therefore suggested that an independent expert be appointed to give an opinion on the future probable use and sale of the inventory. The finance director did not believe that this action was justified.

Two variables in the scenario were manipulated in a between-subjects design. The first variable was the size and influence of the client. In the small client condition,

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<sup>5</sup> The use of a seven-point scale is a further modification of the ROCI-II which uses a five-point Likert scale. The main reason for this modification is that an extension of the study is planned to examine cultural effects on auditors' conflict management styles. Because some cultures avoid using the end-point of scales (Triandis, 1992), there is a danger that responses on a five-point scale may cluster around the mid-point. A wider spread of results is possible if a larger scale is used. As research has indicated that internal-consistency reliability increases steadily up to a seven-point scale (Rosenthal & Rosnow, 1991), this size scale was used for this part of the study.

participants were advised that the client was a small company which, while being listed, was one of the firm's smaller clients. In the large client condition, participants were informed that the company was the firm's largest client with considerable influence in the industry. The second variable was the strength of corporate governance. In the strong governance situation, the company was chaired by an independent chairman, four of the seven directors were independent and the audit committee comprised all independent directors. The auditor was entitled to attend all audit committee meetings while the finance director could be invited to attend. Two audit committee members had accounting expertise and the auditor perceived the committee to be effective. In the weak condition, the CEO was also board chairman and four of the seven directors were executives. While the audit committee comprised the three independent directors, the finance director was entitled to attend all meetings. The auditor, who was also entitled to attend, had perceived that the members had very little accounting expertise and tended to endorse the views of the finance director.

Participants were asked to respond to the same set of statements from the ROCI-II (Rahim, 1983b) as in the first part of the instrument, with minor modifications to refer to the finance director as the other party in the conflict. Following these statements, participants were then told to assume that they had been unable to resolve the dispute with the finance director. They were asked to indicate the extent to which they believed the CEO, the chairman,<sup>6</sup> the audit committee and the board of directors would each help

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<sup>6</sup> It should be noted that, in the weak governance condition, these two roles were held by the same person and the instrument therefore described them as the CEO/Chairman. In the strong condition, the positions were separate.

to reach an agreement. For this part of the instrument, an eleven-point scale was used ranging from 0 to 10.<sup>7</sup>

Finally, participants were asked to indicate the likelihood that they would qualify their audit opinion if they were unable to persuade the board of directors to obtain an independent opinion or to write down the value of inventory. Again, an eleven-point scale was used, ranging from “highly unlikely” to “highly likely”. The objective of this question was to give an indication of the seriousness with which participants viewed the dispute.

### ***Part Three***

This part of the instrument comprised demographic questions about the participants’ background and experience, including the type of audit firm, their rank within the firm and their years of experience.

### **Participants and Procedures**

Participants were audit partners and managers from Australia and New Zealand.<sup>8</sup> The Australian participants were located in Brisbane and Adelaide, while the New Zealand participants were located in Auckland and Wellington. A partner in the various branches of each firm was contacted and asked if he/she would assist with the study. Those who agreed were given between two and six instruments to distribute to partners and

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<sup>7</sup> The endpoints of the scale were annotated as “to a very little extent” and “to a very great extent”.

<sup>8</sup> The Australian participants were informed that the company in Part Two of the instrument was listed on the Australian Stock Exchange while the New Zealand participants were advised that the company was listed on the New Zealand Stock Exchange. In all other respects, the instrument was the same.

managers. In all, 110 instruments were delivered and 72 responses were received, giving a response rate of 65%.<sup>9</sup>

There were 36 responses each from Australia and New Zealand. The great majority of respondents (68) were from the Big Five accounting firms while the remainder were from other international audit firms. There were 39 partners (22 from Australia and 17 from New Zealand) and 33 managers (14 from Australia and 19 from New Zealand). Forty-seven (65%) were aged 40 or under and 58 (81%) were males. The mean years of auditing experience were 16.15, with a minimum of four years and a maximum of 42 years. Table 1 presents a summary of the demographic variables.

*Insert Table 1 about here*

Statistical tests<sup>10</sup> revealed that there were no differences in responses based on country, firm and sex of participants. Significant differences did occur based on rank, years of experience and age group. These variables are therefore included in the analysis of results.

## **RESULTS**

### **Reliability scores**

The internal consistency reliability of the styles for both Part One and Part Two of the instrument was measured by Cronbach alpha (Cronbach, 1951). Alpha scores exceeded

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<sup>9</sup> As it is possible that some of the instruments may not have been distributed, the actual response rate of those receiving an instrument is likely to be higher than this figure.

<sup>10</sup> Analyses of variance and t-tests were used where appropriate.

.73<sup>11</sup> for all styles except for the compromising style in Part One, which attained an alpha score of .62. Omitting one question from this measure resulted in an alpha score of .76. However, further tests revealed that the omission of this question did not have a significant impact on the results. Furthermore, the comparable score for the same style in Part Two was .78. It was therefore decided to retain the question in the subsequent analysis so that comparisons could more easily be made between the styles normally used and those used in the scenario.

### **Conflict management styles normally used (RQ1)**

The mean scores together with the rankings for each style are reported in Table 2. It can be seen that participants overwhelmingly indicated that they invariably choose the integrating style when attempting to resolve conflicts with clients. The compromising and dominating styles are used to a lesser extent while the obliging and avoiding styles are used infrequently.

*Insert Table 2 about here*

The positive mean score of 2.97 for the integrative dimension indicates that participants attempt to some extent to satisfy the concerns of both parties to the conflict. With a seven-point scale, this score can vary from +6 to -6, with +6 representing maximum satisfaction of both parties' concerns and -6 representing no satisfaction of their concerns. The low positive score (0.395) for the distributive dimension indicates only slightly more satisfaction of participants' own concerns at the expense of the concerns of the client. A score of zero on this scale indicates that both parties' concerns

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<sup>11</sup> These reliability scores are comparable with those obtained by Rahim (1983) when the instrument was developed.

are equally satisfied, while a positive score leans towards the participant's satisfaction and a negative score favors the other party's satisfaction (Rahim, 1992).

As noted, the integrating style is regarded by some commentators as the superior style which produces a better solution to the conflict. Those who favour a contingency approach recognize that the integrating style is more appropriate when issues are complex and commitment is needed from both parties to resolve the conflict. In either case, when resolving issues concerning errors or misstatements in financial statements, it would seem that the integrating style is the most suitable style and this is indeed the style that most auditors use.

Some differences in responses did occur based on rank, age group and years of auditing experience. These three variables are highly correlated with each other, with partners tending to be in the older age group and having more years of auditing experience. While similar differences were found across all three variables, rank provided slightly stronger results. This variable appeared to be the best proxy for expertise and is therefore the one used in subsequent analysis.

*Insert Table 3 about here*

From Table 3 it can be seen that, while there are no significant differences in the use of the integrating and dominating styles based on rank, partners are less likely than managers to use the compromising, obliging and avoiding styles. Partners also score significantly higher on the integrative dimension, indicating that they attempt to satisfy both parties' concerns to a greater extent than do managers.

### **Conflict management styles used in the scenario (RQ2 and RQ3)**

Table 4 shows the overall mean scores and rankings for each of the five conflict management styles and the two dimensions used to resolve the specific conflict in the scenario described in Part Two of the instrument.

*Insert Table 4 about here*

It can be seen that, overall, the integrating style is again the dominant style used by participants. The mean score for the dominating style is significantly higher than for Part One (see Table 2), with this style ranked second by 32 participants for the scenario compared to 26 for the style normally used. The score for the obliging style is significantly lower than for Part One, being ranked fifth by 23 participants for the scenario compared to only ten for the style normally used. The score for the avoiding style is also significantly lower than that normally used, with more participants ranking this style in third and fourth place for the scenario. The mean score for the distributive dimension is significantly higher for the scenario compared to that normally used, suggesting a greater satisfaction of participants' own concerns than those of the client. Overall, these differences suggest that participants favoured the auditor's position in the conflict described in the scenario and were therefore prepared to take a stronger stance against the client position. This shows that, while auditors do adopt the integrating style as their dominant style, they change the way that they handle conflicts according to the nature of the conflict and the materiality of the issue under dispute.

Table 5 reports the results of analyses of variance (ANOVAs) together with the relevant descriptive statistics for the manipulated variables. Because none of the interaction effects were significant, only main effects are reported.

*Insert Table 5 about here*

The size of client factor is significant for the integrating style, with auditors being more likely to use this style when the client is small. A marginally significant difference for the dominating style suggests that auditors may also be more likely to use aspects of this style when the client is small. Both of these styles indicate assertiveness and thus, taken together, this suggests that auditors are more willing to use assertive behaviour to manage conflicts when the client is small than when the client is large and influential.

The corporate governance factor is marginally significant for the obliging style, with auditors being slightly more likely to use this style when governance is strong. This suggests that auditors may be more willing to accept the views of the finance director when they know that sound corporate governance structures are in place to monitor his decisions.

The rank of the auditor is significant for the compromising, obliging and avoiding styles, with managers being more likely than partners to use each of these three styles. All of these styles show a low concern for self, thus suggesting that managers are more willing to accommodate the views of the client than are partners. This result may reflect a perceived power imbalance between client management and audit managers (Windsor

and Ashkanasy, 1995). Alternatively, it may reflect a lack of experience on the part of audit managers when negotiating with client management.

Further insight can be gained by examining the impact of the manipulated variables on the two conflict management dimensions. Table 6 shows that both size of client and auditor's rank are significant for the integrative dimension while corporate governance is significant and size of client marginally significant for the distributive dimension. Participants appear to be more likely to try and satisfy the concerns of both parties when the client is small compared to when it is large and influential. However, they are also slightly more likely to lean towards satisfying their own concerns at the expense of the concerns of the client. Again, this suggests the use of more assertive conflict management styles when the client is small. When corporate governance is weaker, auditors are also more likely to satisfy their own concerns at the expense of those of the client. Finally, partners are more likely than managers to try and satisfy the concerns of both parties.

*Insert Table 6 about here*

#### **The members of the client who would assist to resolve the dispute (RQ4, RQ5 and RQ6)**

Table 7 reports the results of ANOVAs, together with the descriptive statistics relating to the parties who the auditor considered would assist to resolve the conflict. As seen in Panel B of the table, overall, the audit committee was regarded as the most likely party to be of assistance, followed by the CEO. This contrasts with the findings of

Gibbins et al. (2000) where the CEO was more involved in negotiations than the audit committee.

*Insert Table 7 about here*

Panel A of Table 7 indicates that the size of the client has little impact on the auditor's perceptions of who would help resolve the conflict. None of the differences were significant at the .05 level, with only a marginally significant difference with respect to the board chairman ( $p = .099$ ).

As far as corporate governance is concerned, it should be recalled that in the weak condition, the CEO was also chairman of the board and thus the means are the same. The means for the CEO in the strong condition and the CEO/Chairman in the weak condition did not differ significantly. However, auditors expect that the CEO/Chairman would be more likely to assist in resolving the conflict than would an independent chairman in the strong governance condition. A marginally significant difference ( $p = .052$ ) for the audit committee suggests that a stronger, more independent audit committee would be more likely to help resolve the conflict than would a weaker committee.

There were also significant differences based on rank of respondent. Partners believed that both the audit committee and the board of directors were more likely to assist in resolving the conflict than did managers.

The final question in Part Two of the instrument related to the likelihood that the auditor would issue a qualified audit report if the conflict was unresolved and the client company maintained its position. Results are reported in Table 8.

*Insert Table 8 about here*

The overall mean of almost seven out of ten indicates that participants believed that the inventory valuations in the financial statements would be misstated if no writedown occurred. This suggests that they viewed the conflict as a serious one. Significant differences occurred on the basis of size of client, with participants indicating that they would be more likely to qualify the accounts of a larger client. This implies that auditors consider the consequences of audit failure to be greater for a large client than for a smaller client. Partners would also be more likely to qualify the accounts than would managers. This result is consistent with the earlier finding that managers appear to be more willing to accommodate the views of the client.

## **CONCLUSION**

This study is the first to examine the conflict management styles used by audit partners and managers when resolving financial statement issues with clients. Participants indicated that, in general, they invariably use the integrating style to resolve disputes. The compromising and dominating styles are used to a lesser extent while the obliging and avoiding styles are rarely used. Managers are more likely to use the compromising, obliging and avoiding styles than are partners. The results for the scenario concerning possible inventory obsolescence also indicated that the integrating style would be primarily used. However, the dominating style was used to a greater

extent and the obliging and avoiding styles were used to a lesser extent than in general. This suggests that auditors do make some adjustments to the way that they resolve conflicts depending on the nature and seriousness of the dispute. The size of the client and the strength of corporate governance mechanisms in place had a significant but relatively minor impact on the choice of styles. However, significant differences occurred between partners and managers, with partners indicating that they would use more assertive styles of conflict management than would managers.

The results of this study can be contrasted with the survey results of Gibbins et al. (2000) in their Canadian study. In the latter, respondents indicated that the most common outcome of negotiations was an agreement between the original positions of the client and the auditor. This suggests a compromising conflict management style. Acceptance of the auditor's original position was the next most common outcome from the Gibbins et al. (2000) survey and this suggests a dominating style. Interestingly, the least common outcome of a new solution being generated during negotiation is the one that suggests the use of an integrating style.

With regard to the other parties who would assist the auditor to resolve the conflict, it was found that the audit committee was perceived to give the most assistance, followed by the CEO. However, Gibbins et al. (2000) found the CEO to be more involved in negotiations than the audit committee. Taken together, these findings suggest that audit committees could play a greater role in the conflict resolution process than they currently do.

The study has a number of limitations. The sample size was relatively small and this may have led to insignificant interaction effects between the variables. While the ROCI-II (Rahim, 1983b) is a well-established instrument for measuring conflict management styles, it was originally developed for an organizational context. As such it may not adequately capture the differences between styles used in an auditor-client situation. A further weakness of this and other conflict management instruments is that they fail to capture the dynamic process of negotiation during the course of resolving a conflict. Rather, they focus on the initial style adopted by one of the parties to the conflict. An additional limitation is that the study relies on the self-reports of participants and the findings may not therefore be indicative of what auditors actually do in practice when resolving disputes with a client.

In spite of its limitations, the study makes an important contribution to our understanding of the auditor-client negotiation process. As the first in-depth study to focus on conflict management styles in an auditing context, it provides insights into the bargaining strategy used by auditors when resolving conflicts with clients. Such strategy can have an impact not only on the outcome of the particular issue under dispute but also on the way that future conflicts with the client are resolved (Gibbins et al., 2000). The study also provides further evidence concerning the members of the client who are most likely to assist the auditor to resolve a conflict.

The results of this study suggest a number of opportunities for future research. Other research methods such as interviews and surveys, together with alternative measures of

conflict management styles, could be used to further explore how auditors resolve conflicts with clients. Studies that capture the dynamic nature of the conflict management process could provide more insight into the bargaining strategies used by auditors. Other contextual variables that may affect bargaining strategy could also be explored. For example, does the auditor use a more dominating style when the accounting issue under dispute is more clearly governed by an accounting standard? The findings of the present study regarding differences between partners and managers suggest that the issue of experience is worthy of further exploration. Finally, reconciling the results of the present study with those of the survey undertaken by Gibbins et al. (2000) provides additional research opportunities.

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**TABLE 1**  
**Demographic variables**

	<b>Rank</b>		<b>Total</b>
	Partner	Manager	
<b>Country:</b>			
Australia	22	14	36
New Zealand	<u>17</u>	<u>19</u>	<u>36</u>
Total	39	33	72
<b>Sex:</b>			
Male	37	21	58
Female	<u>2</u>	<u>12</u>	<u>14</u>
Total	39	33	72
<b>Age Group:</b>			
40 and under	15	32	47
Over 40	<u>24</u>	<u>1</u>	<u>25</u>
Total	39	33	72
<b>Years of Experience:</b>			
Less than 10	2	16	18
10 - 19	12	16	28
20 or more	<u>25</u>	<u>1</u>	<u>26</u>
Total	39	33	72

**TABLE 2**  
**The conflict management styles normally used to resolve conflicts with clients -**  
**all participants**

<b>Panel A - Conflict Management Styles</b>						
<b>Style</b>	<b>Mean (s.d.)</b>	<b>Number of times style ranked as</b>				
		<b>1<sup>st</sup></b>	<b>2<sup>nd</sup></b>	<b>3<sup>rd</sup></b>	<b>4<sup>th</sup></b>	<b>5<sup>th</sup></b>
Integrating	6.088 (0.577)	68	3	1	0	0
Compromising	4.365 (0.856)	1	36	24	9	2
Dominating	4.106 (0.995)	3	26	14	17	12
Obliging	3.711 (0.793)	0	5	25	32	10
Avoiding	3.116 (0.995)	1	3	10	16	42
<b>Panel B - Conflict Management Dimensions</b>						
<b>Dimension</b>	<b>Mean (s.d.)</b>					
Integrative	2.972 (1.256)					
Distributive	0.395 (1.239)					

**TABLE 3**  
**A comparison of conflict management styles and dimensions normally used by partners and managers**

	<b>Rank</b>		
	<b>Partner</b>	<b>Manager</b>	
<b>Style</b>	<b>Mean (s.d.)</b>	<b>Mean (s.d.)</b>	<b>Sig. of t-test</b>
Integrating	6.139 (0.564)	6.026 (0.595)	.411
Compromising	4.051 (0.803)	4.735 (0.773)	.000
Dominating	4.046 (1.050)	3.824 (0.938)	.586
Obliging	3.513 (0.806)	3.944 (0.721)	.020
Avoiding	2.684 (0.915)	3.626 (0.840)	.000
<b>Dimension</b>			
Integrative	3.455 (1.100)	2.400 (1.200)	.000
Distributive	0.533 (1.398)	0.231 (1.016)	.306

**TABLE 4**  
**The conflict management styles used to resolve the conflict in the scenario -**  
**all participants**

<b>Panel A - Conflict Management Styles</b>						
<b>Style</b>	<b>Mean (s.d.)</b>	<b>Number of times style ranked as</b>				
		<b>1<sup>st</sup></b>	<b>2<sup>nd</sup></b>	<b>3<sup>rd</sup></b>	<b>4<sup>th</sup></b>	<b>5<sup>th</sup></b>
Integrating	6.028 (0.592)	68	4	0	0	0
Compromising	4.434 (1.032)	2	34	25	8	3
Dominating	4.472 <sup>a</sup> (0.925)	4	32	20	13	3
Obliging	3.181 <sup>a</sup> (0.760)	0	0	19	30	23
Avoiding	2.975 <sup>b</sup> (0.996)	0	1	12	20	39
<b>Panel B - Conflict Management Dimensions</b>						
<b>Dimension</b>	<b>Mean (s.d.)</b>					
Integrative	3.053 (1.271)					
Distributive	1.292 <sup>a</sup> (1.186)					

<sup>a</sup> Significantly different from style normally used at  $p = .000$  (see Table 2).

<sup>b</sup> Significantly different from style normally used at  $p = .05$  (see Table 2).

**TABLE 5**  
**The conflict management styles used: impact of client size, strength of corporate governance and participant's rank**

<b>Panel A: ANOVAs</b>						
		<b>Integrating</b>	<b>Compromis- ing</b>	<b>Dominating</b>	<b>Obliging</b>	<b>Avoiding</b>
<b>Factor</b>		<b>F-value (sig.)</b>	<b>F-value (sig.)</b>	<b>F-value (sig.)</b>	<b>F-value (sig.)</b>	<b>F-value (sig.)</b>
Size of Client		12.174 (.001)	0.403 (.528)	3.389 (.070)	0.325 (.571)	0.586 (.447)
Corporate Governance		0.344 (.560)	0.553 (.460)	1.845 (.179)	3.833 (.055)	0.586 (.447)
Auditor's Rank		0.059 (.808)	6.747 (.012)	0.411 (.524)	10.574 (.002)	9.200 (.003)
<b>Panel B: Treatment Statistics</b>						
<b>Factor</b>	<b>n</b>	<b>Mean (s.d.)</b>	<b>Mean (s.d.)</b>	<b>Mean (s.d.)</b>	<b>Mean (s.d.)</b>	<b>Mean (s.d.)</b>
Size of Client:						
Large	40	5.832 (0.555)	4.556 (0.967)	4.295 (0.748)	3.283 (0.764)	3.092 (0.902)
Small	32	6.272 (0.551)	4.281 (1.105)	4.694 (1.079)	3.052 (0.746)	2.828 (1.099)
Corporate Governance:						
Stronger	34	5.971 (0.528)	4.500 (1.048)	4.306 (0.802)	3.304 (0.747)	3.064 (1.118)
Weaker	38	6.079 (0.646)	4.375 (1.028)	4.621 (1.010)	3.070 (0.764)	2.895 (0.879)
Auditor's Rank:						
Partner	39	6.044 (0.606)	4.141 (1.005)	4.426 (0.985)	2.944 (0.718)	2.637 (1.025)
Manager	33	6.009 (0.582)	4.780 (0.968)	4.527 (0.860)	3.460 (0.722)	3.374 (0.805)

\* Because none of the interaction effects were significant, only main effects are reported

**TABLE 6**  
**The conflict management dimensions: impact of client size, strength of corporate governance and participant's rank**

<b>Panel A: ANOVAs</b>			
		<b>Integrative</b>	<b>Distributive</b>
<b>Factor</b>		<b>F-value (sig.)</b>	<b>F-value (sig.)</b>
Size of Client		5.577 (.021)	3.501 (.066)
Corporate Governance		0.793 (.376)	5.562 (.021)
Auditor's Rank		5.378 (.024)	2.381 (.128)
<b>Panel B: Treatment Statistics</b>			
<b>Factor</b>	<b>n</b>	<b>Mean (s.d.)</b>	<b>Mean (s.d.)</b>
Size of Client:			
Large	40	2.741 (1.163)	1.012 (1.042)
Small	32	3.444 (1.309)	1.642 (1.277)
Corporate Governance:			
Stronger	34	2.907 (1.301)	1.002 (1.043)
Weaker	38	3.184 (1.246)	1.551 (1.259)
Auditor's Rank:			
Partner	39	3.407 (1.278)	1.481 (1.176)
Manager	33	2.635 (1.145)	1.068 (1.177)

\* Because none of the interaction effects were significant, only main effects are reported

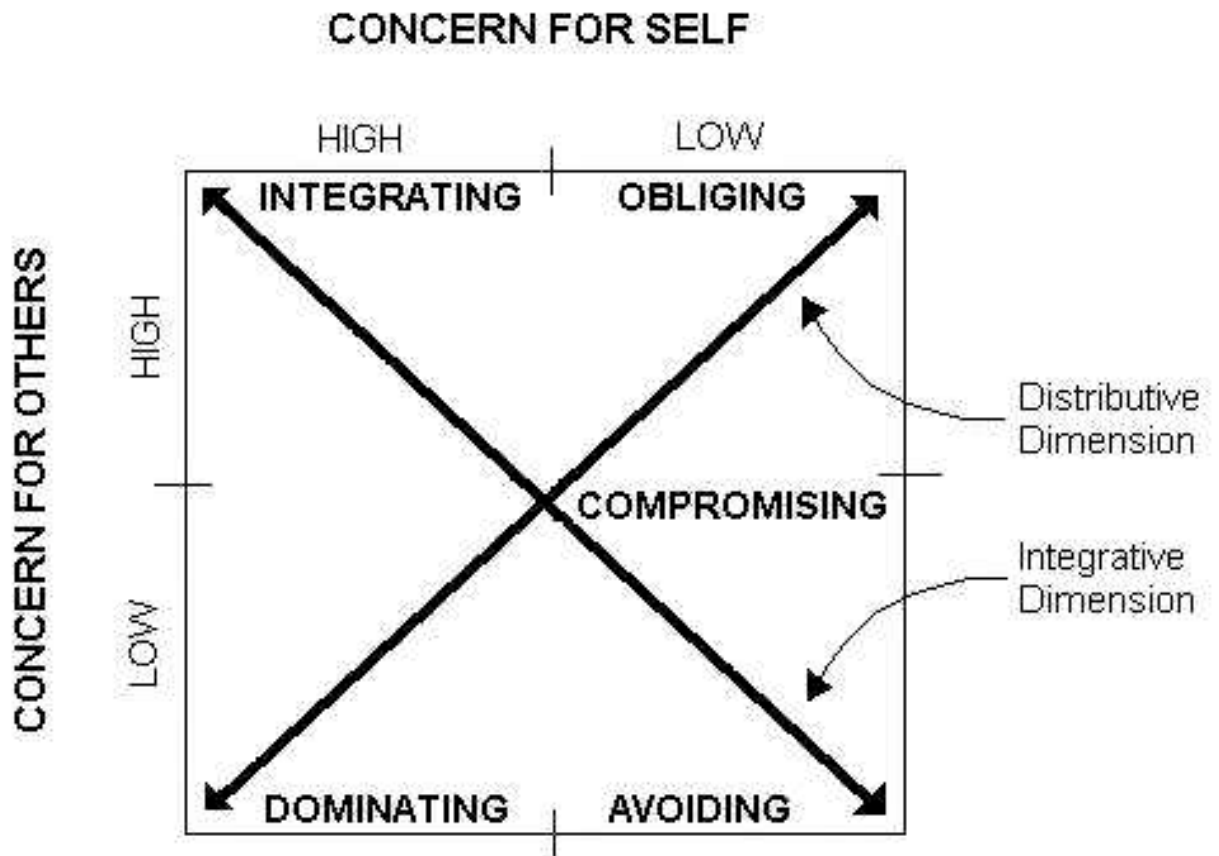
**TABLE 7**  
**The parties who would assist the auditor to resolve the conflict:**  
**impact of client size, strength of corporate governance and participant's rank**

<b>Panel A: ANOVAs</b>					
		<b>CEO</b>	<b>Board Chairman</b>	<b>Audit Committee</b>	<b>Board of Directors</b>
<b>Factor</b>		<b>F-value (sig.)</b>	<b>F-value (sig.)</b>	<b>F-value (sig.)</b>	<b>F-value (sig.)</b>
Size of Client		1.867 (.177)	2.805 (.099)	0.155 (.695)	1.676 (.200)
Corporate Governance		1.570 (.215)	7.314 (.009)	3.932 (.052)	0.338 (.563)
Auditor's Rank		0.005 (.946)	2.054 (.157)	5.131 (.027)	5.518 (.022)
<b>Panel B: Treatment Statistics</b>					
<b>Factor</b>	<b>n</b>	<b>Mean (s.d.)</b>	<b>Mean (s.d.)</b>	<b>Mean (s.d.)</b>	<b>Mean (s.d.)</b>
Size of Client:					
Large	40	6.725 (2.010)	6.300 (1.800)	7.925 (1.655)	6.000 (1.797)
Small	32	7.438 (2.031)	7.313 (2.442)	8.000 (1.778)	6.750 (2.286)
Corporate Governance:					
Stronger	34	6.705 (2.140)	6.088 (2.137)	8.265 (1.399)	6.206 (2.057)
Weaker	38	7.342 (2.017)	7.342 (2.017)	7.684 (1.905)	6.447 (2.063)
Auditor's Rank:					
Partner	39	7.026 (2.412)	7.051 (2.438)	8.487 (1.254)	6.923 (2.070)
Manager	33	7.061 (1.658)	6.394 (1.731)	7.333 (1.948)	5.636 (1.817)
Overall	72	7.042 (2.086)	6.750 (2.154)	7.959 (1.700)	6.333 (2.049)

\* Because none of the interaction effects were significant, only main effects are reported

**TABLE 8**  
**Would the auditor qualify the accounts?**  
**The impact of client size, corporate governance and participant's rank**

Factor	F-value	sig.	Descriptive Statistics	
			n	Mean (s.d.)
Size of Client:	4.070	.048		
Large			40	7.350 (1.748)
Small			32	6.406 (2.434)
Corporate Governance:	0.215	.645		
Stronger			34	7.030 (2.067)
Weaker			38	6.842 (2.188)
Auditor's Rank:	5.477	.022		
Partner			39	7.410 (2.099)
Manager			33	6.364 (2.028)
Overall			72	6.931 (2.119)



**Figure 1.** Integrative and Distributive Dimensions of the Style of Handling Interpersonal Conflict (Source: Rahim 1997)

## Appendix 1

The ROCI-II comprises 28 statements which measure the five conflict management styles. While the order of these statements is randomised in the questionnaire, they are grouped below according to the conflict management styles they measure.

### Integrating Style

I try to investigate an issue with the client to find a solution acceptable to us  
 I try to integrate my ideas with those of the client to come up with a decision jointly  
 I try to work with the client to find solutions to the problem which satisfy both our expectations  
 I exchange accurate information with the client to solve the problem together  
 I try to bring all our concerns out in the open so that the issues can be resolved in the best possible way  
 I collaborate with the client to come up with decisions acceptable to both of us  
 I try to work with the client for a proper understanding of the problem

### Compromising Style

I try to find a middle course to resolve the impasse  
 I usually propose a middle ground to break the deadlock  
 I negotiate with the client so that a compromise can be reached  
 I use “give and take” so that a compromise can be made

### Dominating Style

I use my influence to get my ideas accepted  
 I use my authority to make a decision in my favour  
 I use my expertise to make a decision in my favour  
 I am generally firm in pursuing my side of the issue  
 I sometimes use my power to win a competitive situation

### Obliging Style

I generally try to satisfy the needs of the client  
 I usually accommodate the wishes of the client  
 I give in to the wishes of the client  
 I usually allow concessions to the client  
 I often go along with the suggestions of the client  
 I try to satisfy the expectations of the client

### Avoiding Style

I attempt to avoid being “put on the spot” and try to keep my conflict with the client to myself  
 I usually avoid open discussion of my differences with the client  
 I try to stay away from disagreement with the client  
 I avoid an encounter with the client  
 I try to keep my disagreement with the client to myself in order to avoid hard feelings  
 I try to avoid unpleasant exchanges with the client