

**Auditor-Client Management Negotiation Concerning Client's Financial Reporting:  
Evidence from the Client's Side**

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## **Auditor-Client Management Negotiation Concerning Client's Financial Reporting: Evidence from the Client's Side**

### **ABSTRACT**

Research is showing that auditor-client negotiation is an important part of the process of producing the client's accounting information for the use of third parties. So far, the emphasis has been on the auditor's side of the negotiation. In this paper, we focus on the client's side, in particular the role of the client's Chief Financial Officer (CFO), who plays a central role in a company's financial reporting process. We define and investigate this role by specifying an accounting negotiation process model based on earlier work with auditors, the management literature and in-depth interviews with CFOs. We use the model as a guide for comprehensive questionnaire completed by a sample of CFOs, which provides evidence about the descriptive validity of the model and a foundation for understanding the client's side of the negotiation. Among the key findings are that the CFO focuses on a single issue at a time, views the negotiation process as being distributive (win-lose) in nature from start to conclusion, views the outcomes as predominantly driven by form over substance, and views the process as being heavily impacted by accounting and disclosure standards, the CFO's relationship with and his/her perception of competence of the audit partner, and both the organization's and the auditor's accounting expertise. We report relatively low involvement and low importance associated with Boards and Audit Committees (or their chairs) in overseeing these negotiations about matters that have a material effect on the organizations' financial reporting.

# **Auditor-Client Management Negotiation Concerning Client's Financial Reporting: Evidence from the Client's Side**

## **1. Introduction**

Audited financial statements and related disclosures influence capital market prices, agency relationships and regulatory actions, by providing information about financial performance for a variety of uses including corporate governance and investment decisions (Chaney and Philipich [2002], Penman [2002], Frankel, Johnson, and Nelson [2002], Healy and Palepu [2002]). These statements, the publicly observable outputs of the financial reporting process, have been extensively studied by accounting researchers (e.g., Beaver [1989]). The quality of this information has come under intense scrutiny in recent times (Penman [2002], DeFond, Raghunandan and Subramanyam [2002]) due to such events as Enron and Worldcom (e.g. Jenkins [2003]). Management's responsibility for the organization's financial reporting and disclosure is becoming more explicit due to the certification requirements of the Sarbanes-Oxley Act, the increased importance of Management Discussion and Analysis in public reports, and the generally heightened scrutiny of financial reporting.

There is a growing recognition that such accounting information tends to be the outcome of negotiation between client management and the external auditor (Gibbins, Salterio and Webb [2001] (henceforth GSW [2001])). Given the importance of the accounting information provided to third parties, any negotiation that shapes this information is potentially significant to third parties as well as to the auditor and the client. Related research (e.g. Nelson, Elliott and Tarpley [2002, 2003], Wright and Wright [1997]; Trotman, Wright and Wright [2002]) and the popular press (e.g. Norris [2003], Buckley and Parker [2003], Babington [2003]) focus on the auditor's behavior when faced with client accounting problems, including whether auditors insist on the correction of accounting problems and errors uncovered during the audit, or instead waive them or otherwise fail to negotiate.

The auditor side of accounting negotiation is beginning to receive much-needed attention (e.g. GSW [2001]; Beattie, Fearnley and Brandt [2001]); Christensen, [2002]), no prior research has examined the client's perspective other than incidentally when focusing on the auditor (e.g. Beattie, Fearnley and Brandt [2001], McCracken [2003], Christensen, Demski and Frimor [2002]) or by relying on highly stylized depictions of client management incentives (e.g. Antle and Nalebuff [1991]).

This paper builds from the investigation of the auditor's role in auditor-client negotiation reported by GSW [2001], to model and provide evidence about the client's side of such negotiation. GSW [2001] examined the auditor side through the eyes of audit partners. In this paper, we view this negotiation through the eyes of the client's key manager in these negotiations, the Chief Financial Officer (CFO). Our research has four main objectives: to describe from the client CFO's perspective the nature of the issues negotiated, to provide a more in-depth understanding of the accounting negotiation process and its outcomes, to demonstrate associations among issues, accounting-specific contextual factors and process elements, and to elaborate the GSW [2001] auditor focused negotiation model to take into account the client CFO perspective.

A representative sample of 101 Canadian CFOs (or equivalents, e.g. VP Finance), most having over 20 years' experience, responded to a comprehensive questionnaire, which was based on our CFO-elaborated negotiation model. The questionnaire asked respondents to select a negotiation experience with their auditor arising from an initial difference in opinion on proper financial accounting treatment or disclosure, and to describe the experience in depth. This paralleled the GSW [2001] approach of having audit partners report on their negotiation experience.

We found that revenue recognition, capitalization of expenditures, extent of disclosure, business combinations, and asset write-downs were the main negotiation issues for this representative sample of Canadian CFOs. The negotiated issues typically had multiple accounting and disclosure

implications, were always material, surprised either management and/or the auditor about half the time, and frequently arose because of either accounting standards or new/complex business transactions.

CFOs reported that the typical negotiation considered three potential solutions and that the negotiation process tended to center on learning more about generally accepted accounting principles and on clarifying the facts about the accounting issue from both a business intention and an accounting perspective. The CFOs were single-issue focused, rarely situating the issue they described into the broader context of financial reporting and/or the ongoing relationship with the auditor, including other potential accounting issues. During the negotiation process the CFOs reported extensive internal consultations with fellow managers, especially with the CEO, use of management accounting analyses and external consultations with national office technical partners of the audit firm.

The CFO viewed the process as being impacted by fifteen accounting contextual features, the top five being: accounting and disclosure standards, the CFO's relationship with the audit partner, his/her perception of competence of the audit partner, the organization's accounting expertise, and the auditor's accounting expertise. These top five features were significantly associated with various elements of issue identification (e.g. who was informed immediately), process (e.g. involvement of board members), and outcomes (e.g. whose position was finally adopted) in the CFOs' negotiation examples. The CFOs reported that the negotiated outcome tended to represent form (following the rules) rather than substance (economic reality).

Furthermore, our CFO results confirm the auditor reports in GSW [2001] that negotiation over financial reporting is common: 81% of the responding CFOs experienced negotiation. Similar to GSW [2001]'s auditors, the CFOs chose negotiation examples that generally took place within the last year, involved a long-term audit firm relationship, and took weeks to complete. Nearly all negotiations resulted in agreement and an unqualified ("clean") audit opinion, led to internal and external reporting

of the accounting results (but not necessarily revelation that they were negotiated), and were followed by the reappointment of the auditor.

Overall, our results elaborate markedly on the role of the CFO and management more generally in accounting negotiation, on the nature of the issue being negotiated, and on the extensive negotiation process as seen by the client CFO. The remainder of the paper proceeds as follows. We elaborate on the accounting contextual features that may play a role in the client's negotiation perspective by modifying the GSW [2001] model to provide a simple yet powerful client-focused negotiation model (Section 2). We then report the results, both quantitatively and qualitatively, from our client model-based questionnaire (Sections 3 and 4). We conclude with a discussion of results, limitations and research implications (Section 5).

## **2. The Accounting Contextual Model: A Client Financial Management Perspective**

We extend the GSW [2001] model of auditor-client negotiation over financial reporting. It was developed from the basic negotiation literature (Kennedy [1992]; Pruitt and Carnevale [1993]) but adapted to the specifics of the accounting negotiation setting, from an auditor perspective. This model has been employed to motivate experimental auditor research (e.g. Ng and Tan [2003], Trotman, Wright and Wright [2002]) and in public policy analysis (e.g. Bazerman, *et al.* [2002]). We introduce several client-related modifications to the model, as will be explained further below. Figure 1 (analogous to Figure 1 in GSW [2001]) shows that the accounting negotiation process begins with the negotiation *issue*, which exists in the context of past negotiations and relationships between the parties. Various choices and actions constitute the negotiation *process*. The result is the negotiation *outcome*. Each negotiation becomes an antecedent for the next one. These elements, the antecedent history, and the potential for future interaction are at the top of Figure 1.

Box B of Figure 1 outlines the accounting contextual features, providing practical meaning to the process model. Those features potentially influence or are influenced by any of the three negotiation process elements. The potential for multiple associations between the Box A elements and Box B context features is indicated in Figure 1 by the two-headed Arrow C.

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Insert Figure 1 about here  
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### 2.1 Development of the client-specific accounting negotiation process model

The GSW [2001] model is adapted by relying on the management literature (e.g. Thompson and Strickland [1998]) and interviews we conducted with nine CFOs of companies in a variety of industries and ranging in revenue from \$100 million to several billions. The literature review and the interviews led to significant elaboration of the client interpersonal context part of the model (the middle item in Section B of Figure 1) and less extensive modifications to the external conditions and parties' capabilities contextual features.

### 2.2 Client interpersonal context

The negotiation literature extensively examines the effects of interpersonal features on negotiations (e.g. Moore, *et al.* [1999], Northcraft, *et al.* [1998], Ben-Yoav and Pruitt [1984]). Extending these to the organization's management, accountability relationships arise due to the managerial hierarchy within the organization (e.g., Thompson and Strickland [1998], 268-309, and see Mintzberg, *et al.* [1998] Chapter 8 for discussion) and the corporate governance requirements imposed by law and regulation (e.g., Leighton and Thain [1997], Institute of Corporate Directors [1992]). Our CFO interviewees consistently referred to these accountability relationships when discussing negotiations they had experienced with their audit partners. While the CFOs stated they almost always had primary responsibility for negotiating a resolution to an accounting issue with the auditor, other

members of management were informed of or involved in the negotiation process in potentially meaningful ways. In particular, the CFO interviewees mentioned the CEO's desire for certain financial results and/or reporting provided a key accountability relationship. Eventual accountability to the board or the audit committee was acknowledged in the interviews but was not seen as important in the conduct of the negotiation process (Cohen, *et al.*[2002] report similar evidence from auditors).

Prior negotiation research indicates that negotiators who are highly accountable to parties with clear preferences may take actions in the negotiation process that are considerably different from those not having such specific accountabilities (e.g., Mosterd and Rutte [2000], Bazerman *et al.* [1992], Ben-Yoav and Pruitt [1984], Neale [1984]). Hence, given the nature of the CFO's accountability relationships to parties that may well have clear preferences for specific accounting outcomes, one might expect a different perspective on or approach to negotiation than that of the audit partner, whose accountabilities and preferences are less focused on particular accounting outcomes in many cases.<sup>1</sup> For the client CFO, therefore, we believe that both the internal to the company management accountability relationships and, potentially, relationships with the organization's corporate governance bodies are key elaborations to the GSW [2001] auditor-focused negotiation model.

### 2.3 Adaptation of other contextual features

The other two categories of accounting contextual features required less extensive elaboration to incorporate the results of the literature review and our CFO interviews.

*External conditions and constraints:* As many organizations (e.g. public companies, not for profit agencies, crown corporations) have external reporting requirements due to regulations, prior research has shown that these organizations consider the degree of publicity and/or sensitivity of an issue that

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<sup>1</sup> Certainly the audit partner has a broad accountability to ensure financial statements are in accordance with GAAP (Hackenbrack and Nelson [1996]) and to his or her partners for an ongoing client relationship (e.g. Gibbins and Newton [1994]) but these accountabilities do not necessarily lead to specific preferences on individual accounting issues (e.g. Kadous, Kennedy and Peecher [2003]) especially where written authoritative GAAP is silent or ambiguous.

may affect external viewers' perceptions (Gibbins, Richardson and Waterhouse [1990], Waterhouse, Gibbins and Richardson [1993]). The larger and/or more public their organization, the more likely were our interviewees to mention publicity/sensitivity concerns. Furthermore, our interviewees pointed out that publicly traded firms carefully consider their communication with financial analysts, who play a key role in the capital markets perceptions of the company (Hirst, Hopkins and Whalen [2002], Tan, Libby and Hunton [2002]). Hence, these are potentially important client-based elaborations to the external conditions contextual features of the negotiation model.

*Parties' capabilities:* According to our interviewees, the CFO's perception of the audit partner's competence can be critical to the CFO's assessment of the quality of the accounting ideas put forward by the audit firm (see also Beattie *et al.* [2001, p. 40]). Our CFO interviewees were also quite sensitive to relative differences in degree of accounting expertise between their organization and the audit firm (see also Anderson, Koonce and Marchant [1994], Koonce and Phillips [1996]).

The process elements and contextual features we expect to observe in the auditor-client accounting negotiation setting from the CFO's perspective are summarized in Figure 2 (analogous to Figure 2 of GSW [2001]), which was consequently used in designing our survey questionnaire. Panel A lists the elements corresponding to Box A of Figure 1, and Panel B lists the contextual features corresponding to Box B of Figure 1. Panel C lists demographic and governance data collected.

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Insert Figure 2 about here  
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### **3. The Client CFO Research Questionnaire**

#### ***3.1 Questionnaire design***

The initial draft questionnaire was a client CFO-modified version of the GSW [2001] audit partner questionnaire. The advantage of using GSW [2001]'s questionnaire as a starting point was the

extensive pre-testing that GSW [2001] employed (see GSW [2001, p. 543]). Audit partners, however, are constrained by professional and legal responsibilities to protect confidential client information (see Messier and Emby [2002], 679-680). Hence, other researchers have had to deal with key limitations regarding what their audit partner respondents would tell them about the negotiation process. While CFOs certainly have concerns about revealing proprietary and sensitive information to researchers, our model development interviews with CFOs clearly revealed that CFOs were more willing to provide information about the accounting issue and the negotiation process than were previous audit partner participants. Hence, we added a number of open-ended questions to probe deeper on various aspects of the negotiation example. We pre-tested our questionnaire draft by having five CFOs (three from large public companies, one from a significant subsidiary of a large public company and one from a large government agency that reports independently) complete the questionnaire while verbalizing factors they considered when answering the questions. Further discussion clarified their comments about the meaning and completeness of questions. These CFOs were not at all reticent about providing considerable detail about their negotiation examples.

The revised questionnaire draft was then sent to the members of the Committee on Corporate Reporting of the Financial Executives Institute Canada (FEI Canada). Seven members completed the questionnaire and another eleven read the questionnaire to provide comments on it. These eighteen CFOs and equivalents discussed clarity and understandability issues with one of the authors during a scheduled committee meeting. Only minor revisions resulted from this second round of pretesting. This two-stage pre-test led to the final questionnaire.

The questionnaire requested respondent CFOs to choose a “difficult accounting measurement, valuation and/or disclosure issue” they had experienced and to describe it in depth (Flanagan [1954],

Huber and Power [1985], Klein, Calderwood, and MacGregor [1989], Golden [1992], Miller, Cardinal and Glick [1997]). We asked the CFOs about

“... cases where difficult accounting measurement, valuation and/or disclosure issues arise. ‘Difficult’ here means that there was an initial difference of opinion between you or your staff and your organization’s external auditors about the appropriate accounting and/or disclosure.”

This request was mentioned in three different ways on the first page of the questionnaire as well as in two covering letters, from both FEI Canada and us. Thus, by the time the respondents chose issues to describe, they would have seen the “difficult issues” characterization up to five times.<sup>2</sup>

The main part of the questionnaire asked CFOs to answer a series of structured and open-ended questions. The questionnaire led them through the issue from its beginning through the negotiation process to the outcome, following the model in Figure 1 and using the features outlined in Figure 2. To allow for the possibility that such negotiation does not occur, the CFOs were given an early by-pass to the demographic section of the questionnaire if they had never experienced such an issue.

### 3.2 Administration

Contacts at FEI Canada were approached to determine if FEI Canada would be willing to sponsor our research and to give us access to the subsection of their members who list themselves as CFOs and equivalents. We explained the purpose of the research study and the details of the questionnaire to the top executives of FEI Canada. After approval by the FEI’s Committee on Corporate Reporting, the following process was employed to elicit participation.

An introductory e-mail was sent under the name of the President of FEI Canada prior to mailing the questionnaire, to alert CFOs that the questionnaire was being sent. The FEI President also provided a cover letter sent with the questionnaire, which included a reference to the FEI approval

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<sup>2</sup> We did not directly describe this situation as a “negotiation” because pre-tests indicated that respondents might view the term pejoratively, but we did meet the definition of a negotiation starting point in GSW [2001] by stating that “there is an *initial difference of opinion* between your organization and the external auditors as to the appropriate treatment.”

process, including an explicit reference to the unanimous approval of the Committee on Corporate Reporting and a personal endorsement from the President. FEI Canada mailed the questionnaire, using its stationery for the covering letter and the envelope. All FEI correspondence to potential participants discussed the importance of our research and encouraged members to participate. A personally hand-signed request from the three authors on the stationery of one of Canada's leading business schools was also included in the material as was a postage-paid response envelope on similar stationery. FEI Canada sent two subsequent follow-up/reminder e-mails (one two weeks after and one four weeks after initial mailing). The second e-mail also allowed potential respondents to reply to the questionnaire electronically. Completed questionnaires were mailed/emailed/faxed at the respondents' discretion directly to us. All participation was anonymous and confidential. This combined e-mail/mail/fax approach with endorsement by a high-prestige sponsoring organization is consistent with the approach recommended in Dillman [2000] to enhance response rates.<sup>3</sup>

#### **4. CFO Results**

667 questionnaires were mailed in mid-2002 to the subset of the FEI Canada members who indicated they held the role of CFO (or equivalent) in their annually updated membership file. 101 questionnaires were returned to us, a 15.1% response rate.<sup>4</sup> FEI Canada described this response rate as "the highest to date" from their membership.<sup>5</sup>

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<sup>3</sup> We could not telephone potential respondents (see Dillman [2000]) due to FEI concerns about member reaction.

<sup>4</sup> Other published academic papers in accounting and finance employing CFOs from among the FEI membership as respondents report response rates in the order of 10% (9% in Graham and Harvey [2001;2003] and 12% in Trahan and Gitman [1995]), for relatively short surveys (two to four pages, estimated times to complete of less than ten minutes): ours had eight pages and took about thirty minutes. We expected challenges in obtaining a reasonable response rate and thus employed the elicitation process recommended in the research literature as described above (see Dillman [2000]). Our tests for early versus later respondents, often used to check for non-response bias due to the contention that later respondents are more likely to be similar to those who do not respond (Dillman [2000]), revealed no statistically significant differences.

<sup>5</sup> This is a lower response rate than the rates often obtained from auditors, such as GSW [2001]'s 70% rate. More recently, however, Nelson et al [2002] were able to elicit responses from only 16% of their partner/senior manager sample despite the research being carried out within only one then Big Five firm with the full support of the firm's national office.

We analyze the responses in four subsections below. First, we describe the nature of the sample and provide evidence that our sample is representative of the population of Canadian organizations and accounting issues encountered. We also describe the negotiations reported by the CFOs (Panel C of Figure 2). Second, we report details of the process model (Box A of Figure 1, Panel A of Figure 2), third, the relative importance of the accounting contextual features (Box B of Figure 1, Panel B of Figure 2) and fourth, an analysis of the associations between the process elements and contextual features (Arrow C of Figure 1).

#### *4.1 Demographics and sample characteristics*

Of the 101 questionnaires returned, 70 reported an accounting negotiation the respondent had experienced. Table 1 Panel A presents demographic information regarding the full sample as well as for the 70 CFOs who described a negotiation they had experienced. Of the 11% of the CFOs who stated they had encountered negotiation but did not report an example, reasons varied from not experiencing negotiation with the current employer to no outstanding issues in the current year.<sup>6</sup> Of the roughly 18% of respondents who never experienced negotiation, the main reasons given were extensive and early consultation with the external auditor (33% of the 18%) and the simple nature of their organizations' business transactions or structure (33%) or both (17%).

The most common accounting issues cited in the CFO examples are revenue recognition (24%), business combinations (16%, almost all goodwill related), extent of necessary disclosure (14%), reserves and write-downs (11%), and capitalization of expenditures as long term assets (11%).<sup>7</sup> These top five issues comprised 76% of all issues reported by our CFOs, comparing well with late 1990s

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<sup>6</sup> One respondent who reported low frequency of auditor-client negotiation explained that he/she did not provide an example as "In general I have found auditors to be malleable to the disclosure and accounting practices that management wanted."

<sup>7</sup> All transcriptions and codings of the qualitative responses provided by the CFOs were prepared by two undergraduate accounting majors and one accounting Ph.D. student working independently. The final transcription and codings were checked 100% by one of the authors and the minor differences were reconciled by discussion.

survey data from audit partners and managers in Nelson, Elliott and Tarpley [2002] where these issues represented 84% of audit adjustments considered by the auditors, and with financial statement restatement data compiled by the GAO [2002] in 1997 through 2002 where these issues represented 85% of the items restated after initial filings for publicly traded US companies. The negotiated issues reported by our Canadian CFOs map well onto other reports of contentious accounting issues.

Table 1, Panel B contains demographic information about the 70 CFOs and their organizations. The CFOs were typically from larger organizations. Median (average) total revenue was \$288 million (\$1.2 billion) and median (average) total assets were \$300 million (\$2.9 billion).<sup>8, 9</sup> The descriptive statistics about governance in Table 1 Panel B item 2 are similar to those in prior Canadian archival research (Beasley and Salterio [2001], TSE [1999], Daniels and Morck [1995]).<sup>10</sup> The reported descriptive statistics in Table 1, Panel B item 3 about the audit committee are also consistent with prior reported data (Beasley and Salterio [2001], Bujaki and McConomy [2002], TSE [1999]).<sup>11</sup> Thus, based on the reported description of the nature of the negotiated issues, reported firm size data, and reported corporate governance data we believe our sample is representative of the broader population.

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Insert Table 1 about here  
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<sup>8</sup> We tested all negotiation characteristics in Tables 2 to 6 for differences due to organization size. We tested for both revenue (greater or less than \$288 million median ) and for total assets (greater or less than \$300 million median). After adjusting for multiple comparisons within each item we found only two size related effects: who was thought to understand GAAP better (auditor or organization, see Table3 item 8a) for smaller companies based on total revenue and whether a consulting partner of the audit firm was involved in issue resolution (Table 3 item 2(3)) was more likely for larger companies based on total assets. To test the sensitivity to median cutoff, we reformed the analysis at \$500 million for each. Again only two items in all our comparisons were significantly associated with the size variables.

<sup>9</sup> For our public company sub-sample the CFOs reported a median of \$600 million revenue and a median of \$400 million total assets. The median revenue and total assets reported for Toronto Stock Exchange 300 companies in 2001 was \$700 million and \$800 million respectively. Hence our sample public companies are comparable in terms of total revenue and about half the size of the TSE 300 in terms of total assets. Classifying companies as public versus all others has no impact on our reported results in Tables 6-8.

<sup>10</sup> In particular, reported average board size, percentage of outside directors, public companies with blockholders on the Board, and frequency of joint CEO/Board Chair positions were all comparable to cited archival and survey Canadian data.

<sup>11</sup> In particular, reported average size and composition of audit committee membership, and CFO perception of percentage of members with accounting expertise compares well with cited Canadian survey and archival data.

Table 1, Panel C shows that our CFOs' examples mainly come from for-profit companies audited for more than three years by a Big Five auditor. Most were recent, within the previous year.

#### 4.2 Process model

##### *4.2.1 Issue.*

The CFOs described their chosen examples in response to the open-ended question, "Please state briefly why you chose this as an example of a difficult accounting measurement, valuation and/or disclosure issue." 30% of the examples were selected because there was a difference in auditor and client preferences and 23% because the issue was significant. Respondents also selected examples that involved judgment (16%); complex or unique issues (18%) and/or external rules and regulations (13%). As reported in Table 2's tabulations from the categorical choice questions, the reason for selecting the negotiation example confirmed the above open-ended question responses about the nature of the issue. Table 2's tabulations also describe that on average the issue was discovered by the CFO's organization, the CEO was immediately informed, and it was rare for the board (or chair if not the CEO, or the audit committee chair, or any member) to be informed at this early stage. The issues selected typically had implications for income measurement as well as balance sheet valuation, were material in the current year alone or in both the current and future years, and at least one party was surprised by the issue being raised. In explaining why they had chosen their examples, the CFOs frequently made reference to issue "materiality" and its close synonyms (at least 51 references to "material", "significant" or "large" in the 70 examples) (see Price and Wallace [2001]).

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Insert Table 2 about here  
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##### *4.2.2 Negotiation process*

In response to an open ended question "Please describe briefly the process by which the issue was resolved, including your own role" as well as in responses to other open ended questions where

the CFOs commented on the negotiation process, the CFOs described the process along several dimensions. First, consistent with our specification that such issues involved an initial difference between the organization and the auditor, 75% of these unprompted comments mentioned an initial difference of opinion between the CFO and the audit partner. For example, one CFO described it as “A difference of opinion arose around recording revenue net or gross for a particular line of business.” Second, there was discussion to ensure that both sides understood the business transaction (mentioned in over 70% of the examples). As another CFO reported “Through much discussion, (we) ensured that the auditors understood the issues and the transaction that had occurred.”

Third, there was discussion about how these facts fit either an authoritative GAAP standard (over 47% of the CFOs’ comments referred to GAAP and another 21% to accounting standards) or how other companies accounted for similar situations (17% mentioned this). As one CFO explained, he/she “reviewed current literature on revenue recognition .... in order to determine alternatives.” This often involved extensive research of written GAAP and practices of other companies concluding with the preparation by one or both sides of a written memorandum documenting their position and rationale. As another CFO described it “The company then completed a financial analysis .... and arrived at two likely outcomes. The analysis was reviewed by the auditors, who conducted their own review of the accounting standard.” Finally, over 25% of the CFO’s reported that management accounting analyses (e.g. overhead application and costing systems) and management accounting related issues (e.g. management incentive plans) were important to the negotiation process.

Table 3 tabulates information about the negotiation process. The process normally involved both the CFO and the CFO’s accounting staff, with the CEO involved about half of the time and the audit committee chair about a third of the time. As to the auditors, CFOs reported that normally the engagement partner and engagement manager were involved and about half of the time a consulting or

concurring partner was involved (see also Salterio and Denham [1997]). In most instances there was no active involvement of third parties such as other audit firms. Almost half of the CFOs entered negotiations believing that there was a range of mutually acceptable outcomes whereas a quarter believed their initial role was to persuade the auditor that their position was the only one. This indicates that nearly three quarters of the time, a distributive (win-lose) solution was anticipated. The CFOs reported that on average three potential solutions were discussed in the process.

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Insert Table 3 about here  
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#### 4.2.3 Outcomes

Most of the CFOs who commented on the final resolution described it in distributive terms (i.e. they said either the organization had “given in” or the auditor “gave in” or there was a “compromise” often with a characterization as to “bad” or “good”). Table 4’s tabulations show that roughly one third of the negotiations ended with the adoption of the organization’s original position and a further 20% on the auditor’s original position. A quarter of the time, the negotiation process resulted in an agreement somewhere between the two original positions. Almost half of the final solutions represented form rather than substance, in the CFO’s view (Table 4, item 2). The CFOs frequently viewed the negotiations as dealing with only one specific issue. The CEO was informed of the outcome in the vast majority of the cases, reinforcing the importance of the issues under negotiation. Almost half of the negotiations resulted in changes to the financial statements and 30% were important enough to impact MD&A disclosure. Note this does not mean annual report readers could determine there was a negotiation, only that the negotiation affected the contents of the annual report disclosures. Subsequent to the issue’s resolution, the audit committee was informed the result 89% of the time, but not necessarily that it had been negotiated. Indeed some respondents explicitly reported they deliberately did not inform the audit committee of the fact negotiations preceded the reporting adopted.

One respondent stated “It is not the Audit Committee’s job to resolve disputes but probably they should be informed of major disputes and how they are resolved.” Nonetheless, that respondent did not report his/her firm’s very material and high-profile issue and the fact that there was a negotiated accounting outcome to his/her firm’s audit committee.

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#### 4.2.4 Auditor-client history and next interaction

In Figure 1, there are two boxes outside the three process elements: history and next interaction. Results show that the CFOs went into the negotiation with expectations about it (Table 3 item 6), that prior negotiations had moderate to high importance to resolving the current issue (Table 5 item 1), and that 41% of all issues were expected to come up again in the future (Table 4 item 4 (a)). Hence, the CFOs perceived their reported negotiation to be situated in the broad context of the overall negotiation history and future relationship with the auditor but not related to other specific issues.

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Insert Table 5 about here  
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#### 4.3 Accounting contextual features

Turning to our model, all the accounting contextual features proposed in Panel B of Figure 2 were measured in one question that required respondents to rate the importance of each of 30 contextual features (scale details provided in Table 6), except two marked with “ # ” in Figure 2.<sup>12</sup> These features are reported separately in Table 5, item 2 and indicate that on average CFOs did not perceive the auditor as having an overall better understanding of GAAP about this issue than they did and that the organization initially understood the issue better than the auditor.

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<sup>12</sup> To test for a random response pattern in this question, Kendall’s non-parametric coefficient of concordance ( $W$ ) was calculated. For the 30 items,  $W = .358$  ( $p < .001$ ) indicating the response patterns are non-random. In addition, in Section 6.4 we examine response patterns in more detail, providing further evidence that the patterns are not random.

Given the large number of features suggested in Figure 2, we chose to have CFOs rate the importance of each rather than attempt to rank them (see Haskins [1987] for a similar scale and rating approach). For the 30 features, we first tested whether the reported means were significantly different from no importance (designated as a score of 1 in Table 6). Employing both parametric and non-parametric statistics adjusted for multiple comparisons, each mean in Table 6 is significantly different from 1 ( $p < 0.05$ ). Thus, all the accounting contextual features suggested in the discussion leading to Figure 2 had at least some degree of importance in the CFOs' negotiation examples.

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Insert Table 6 about here  
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As shown in Table 6, every feature, except financial analysts and client size relative to audit firm size, was reported as “essential” in at least one negotiation example. Every feature was also reported to have no importance to at least one negotiation. The two features in Table 5 (item 2) had the same pattern. The response frequencies in Table 6 also suggest that some features are consistently rated as important or unimportant across many of the respondents' examples, while other features' importance varies. We classified such features by a two-part procedure: (1) is the feature identified by more (or less) than 50% of the CFOs as being above (or below) the middle moderate rating of 3?; and (2) is the feature's rating significantly higher (or lower) than 3? (We used both parametric t tests and non-parametric sign and sign rank tests adjusted for multiple comparisons,  $p < .05$ .)<sup>13</sup> With these criteria, five features (**bolded** in Table 6) were important across many negotiations and fifteen features (*italicized*) were unimportant to many. Consistent with our qualitative responses reported above, accounting and disclosure standards were rated as the most important accounting contextual feature.

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<sup>13</sup> We checked the sensitivity of our two-part test by using a 60% cut-off. The only change to the results shown in Table 6 is that “Relationship with audit partner” is no longer consistently important using a 60% criterion. Using a 40% cutoff, the only change to the results is that “Organization's CEO” becomes consistently unimportant. Hence, our two part test presents stable results about the consistency of feature importance/unimportance across all CFO examples.

#### 4.4 Associations between process elements and contextual features

We now turn to Arrow C of Figure 1, the associations between the process model elements and the contextual features, central to the contextualized model proposed in Figure 1. We investigate the associations in two steps: first, the overall association of the pattern of contextual features with the process elements, and second, the individual associations. We examine the 15 accounting contextual factors that were determined to be relatively more important to the negotiations by the CFOs.<sup>14</sup>

##### *4.4.1 Overall association between contextual features and negotiation process elements*

We begin with an investigation of overall association. Overall association is examined using multivariate MANOVAs or multivariate multiple regression analyses. We test whether the process model element measures are associated with the overall patterns of accounting contextual feature importance. Each measure in the process model is treated as an independent variable and the set of 15 contextual features CFOs rated as more important (see Table 6) as the dependent variable. This provides a measure of association between the former and the latter *as a set* and incorporates the correlations among the 15 items into the test statistic (Stevens [1996]). We do not imply any direction to the association by use of this analysis.

The process model measures were taken from Tables 2, 3, and 4.<sup>15</sup> Not all the measures in those tables were used in the multivariate analysis, usually because there was not enough variation in the measures to make the analysis feasible. Table 7 shows eleven at least marginally significant ( $p < 0.10$  two sided) associations out of the 28 tested.<sup>16, 17</sup> Of particular note are the associations with who

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<sup>14</sup> We performed analogous tests for all 30 accounting contextual variables. Due to the loss of an additional 15 degrees of freedom, statistical results, while qualitatively similar, are generally weaker.

<sup>15</sup> Table 5 (item 1) reports on the effects of the resolution of past issues on this negotiation outcome. Our analysis shows that the 15 contextual features CFOs rated as more important are significantly (Wilk's  $\lambda < 0.05$ ) related with past issues. In univariate analysis, past relationship with auditors is highly significantly related ( $p < 0.001$ ) as would be expected. Other significant associations are with the audit firm's accounting expertise and organization's business reputation as well as a marginally significant association with the auditor's power to qualify and audit partner relationship.

<sup>16</sup> To test whether this result is due to chance association, we test whether this finding is significantly different from a chance expectation of 10% of the items being associated and it is ( $\chi^2 = 26.7, p < 0.001$ ).

in the organization was informed and when, who was involved directly in the process, and whose position was taken in the final outcome (client's original versus any other outcome).

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Insert Table 7 about here  
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#### 4.4.2 Individual associations between contextual features and negotiation process elements

The significant overall associations indicate that individual item associations are likely to be systematic. Table 8 shows the significances of individual feature ANOVAs and regressions between those process elements determined to be significant overall in Table 7 and the 15 CFO rated more important features. The features are shown in order of their importance ratings (from Table 6) within each of the categories used in Figures 1 and 2. Only those univariate associations that are at least marginally significant ( $p < 0.10$  two sided after adjustment for multiple comparisons) are indicated in Table 8. There are 33 significant associations in Table 8 – a fifth of the 165 potential relationships (15 features X 11 process elements).<sup>18</sup> Balance sheet effects of the issue negotiation were associated with the most accounting contextual features followed by understanding of GAAP, who identified and was initially informed about the issue, and corporate governance involvement.

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Insert Table 8 about here  
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## 5. Discussion and Conclusions

Overall the reported results in Tables 6 to 8 provide support for the contention that auditor-client management negotiation is highly contextual with different features mattering differentially to

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<sup>17</sup> Table 5 (item 2) reports two other contextual features that were worded as agree/disagree hence cannot be pooled with the other 30 items in our multivariate tests. We conducted analogous tests for these two items relationship with the various negotiation process elements reported in Table 7. Highly significant relationships were found with who identified the issue, who wanted agreement, better issue analysis, better understood GAAP, saw resolving the issue as more important, and whose position was taken in the final agreement (client's original versus all others). A significant relationship was found with duration of negotiation and a marginally significant relationship was found with who was/was not surprised and whose position was taken in the final agreement.

different negotiations and being associated with different elements of the negotiation process. This final section discusses these results and outlines some implications for further research on auditor-client management accounting negotiation. We also point out some limitations in our conceptualization of the topic and in the portrayal obtained from the data.

### *5.1 Results discussion*

The CFOs reported that the negotiation process began with both parties gaining an understanding of the business transaction and how accounting standards and/or other companies treated similar transactions. This process, marked by an initial difference of opinion between the CFO and the audit partner, took weeks to finish on average, involved research by both the CFO and his/her staff as well as the auditor and his/her national office. There appears to be limited involvement by those charged with corporate governance responsibilities in these material contentious financial reporting issues. While it is common for the outcomes of these negotiations to be reported to governance boards and committees there is little evidence that these governance actors are involved in the negotiation process or have knowledge that the outcome reported to them is a result of negotiation with the auditor.

The reported negotiations had a material effect on income and balance sheet figures, and often on disclosure, indicating negotiation matters to the financial accounting information that is provided to various stakeholders. The major types of issues that were negotiated are revenue recognition, business combinations, extent of necessary disclosure, reserves and write-downs and capitalization of expenditures as long term assets. The CFOs saw form as generally more important than substance in determining a resolution to the issue under negotiation, which may have implications for the quality of accounting information.

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<sup>18</sup> To test whether this result is due to chance association, we test whether this finding is significantly different from a chance expectation of 10% of the items being associated and it is ( $\chi^2 = 7.84, p < 0.01$ ).

The generic negotiation literature (e.g. Pruitt and Carnevale [1993]) proposes that the “gold” standard for negotiators is to develop integrative (win-win) solutions, but accounting negotiation is seen by the CFOs as distributive (win-lose). The CFO enters the negotiation intending to persuade the auditors that their accounting is the acceptable solution or believing there is compromise position between the initial two positions. Auditor acquiescence to client management’s wishes or compromise is the norm in the CFO reported negotiation examples and rarely are new solutions developed. GSW [2001] found a similar distributive presumption in audit partners’ views of negotiation.

The CFOs’ view these negotiations as highly context-specific, dependent on the particular issue, the relative competencies of the various people involved, the relevant accounting standards, and other features dependent on issue context. This context variation exists against a background of consistent processes: negotiation usually takes considerable time; accounting standards and auditor-client interpersonal relationships are important to it; and the parties desire to reach a mutually satisfactory resolution.

## 5.2 Research implications

A number of research implications are suggested by this study. First, the negotiation process is significant to the resulting accounting information, but there is as yet no measure of *how* significant it is, in terms of specific effects on earnings, continuous disclosure, valuation or other phenomena studied by accounting researchers. We do know, however, that the CFOs in this study and the auditors in GSW [2001] consider the issues negotiated as material. Second, it would be useful to have a “before and after” analysis of negotiation situations in which particular changes in accounting information, auditor-client relationships, and people’s career paths and other incentives were revealed. This implies a potentially difficult longitudinal research design with uncertain payoffs.

Third, the negotiation process itself needs study. It would be useful for future research to examine bargaining and other negotiation behavior as it occurs, because our retrospective questionnaire cannot reveal the roles of bargaining strategy, communication during the negotiation, and other negotiation behaviors. In particular, our research found no hints of CFO strategic behavior but communication among the parties was continually emphasized. Fourth, accounting and disclosure standards get top billing as to importance to the negotiation process. The role of judgment and behavior in the presence of standards, and the role of such standards in shaping the negotiation process and outcomes need study (see Ng and Tan [2003] for an initial examination of this issue). Part of such a study might examine why CFOs believe negotiation outcomes favor form rather than substance.

Fifth, this study used the negotiation issue as its starting point but further research is needed to reveal how parties' evaluate the potential issues. How strongly felt are various preferences, how much overlap is there between the auditors' and CFOs' positions, or how far apart are they? Sixth, there is an intriguing absence of impact by corporate governance oversight groups on reported negotiations, so the implications of such negotiations for quality of corporate governance could be explored.

### *5.3 Limitations*

Our research considers the CFOs' perceptions about their negotiations. However, it still represents only half of the story because the auditor may recall the same negotiation differently. We acknowledge this study's CFO responses were based on memory for events, some of which happened as long as three years ago. While our pre-tests showed that CFOs had no difficulty in recalling these events, biased recalls may affect the reported results. Furthermore, while we were able to elicit more detailed issue and process information than auditor-centered research has, we are only able to present limited evidence on such likely context-sensitive factors as bargaining strategy, first mover advantage, or information development and/or transmittal during negotiation. Also, as with all survey studies, we

are limited by the self-selection bias, both by who selected to respond and by the negotiation they chose to discuss. The range of issues raised in the CFOs' examples, the size of their organizations, and their governance structures indicate that our sample is a reasonably representative one. A final limitation is that this study is primarily descriptive. While the study was guided by theory about negotiation and the accounting context, these results are informed by theory, but do not test it. Hypotheses testing research is necessary to evaluate the predictive validity of the model.

#### *5.4 Conclusion*

Overall, our paper develops three contributions to the research literature on auditor-client management negotiation. Our first contribution stems directly from the focus on the client via the CFO. Building on prior theoretical research and incorporating perspectives drawn from the management literature and in-depth interviews with CFOs, we develop a simple yet powerful model of the client's perspective on the auditor-client management negotiation process. Based on this model we collect and report survey-based evidence about the CFO's participation in the negotiation process and thus provide evidence about the model's descriptive ability, which complements and extends prior auditor centric research.

Second, the CFO-focused survey also provides a distinct advantage over prior auditor-centered accounting negotiation research. Audit partners are constrained by professional and legal responsibilities to protect confidential client information hence are constrained in what they can reveal to researchers. Our CFO respondents provided more detail about both the issues negotiated and the negotiation process than previous auditor research has, thus filling in a significant gap in the small but growing accounting negotiation literature.

A third contribution arises from the focus on the CFO's view of the negotiation process and its consequences to the accounting information. Prior research and the popular press have focused on an

apparent tendency for external auditors to fail to negotiate or insist on the correction of problems uncovered by the auditor without considering the role of client management that allowed the problems to occur in the first instance. Therefore, being informed about the CFO perspective on negotiation provides a more complete understanding of the context in which auditors may fail to negotiate or insist on correction of material adjustments.

In summary then, the CFO is central to organizations' financial reporting, and leads the management side in any negotiation with the external auditors over such financial reporting. For the CFO, negotiation with the auditors involves a complex set of context-sensitive features. The research also shows that several important contextual features are unique to the CFO's perspective on negotiation. In addition, this paper reinforces concerns from previous research regarding the relative unimportance of corporate governance oversight over the financial reporting process even when dealing with highly material and contentious issues.

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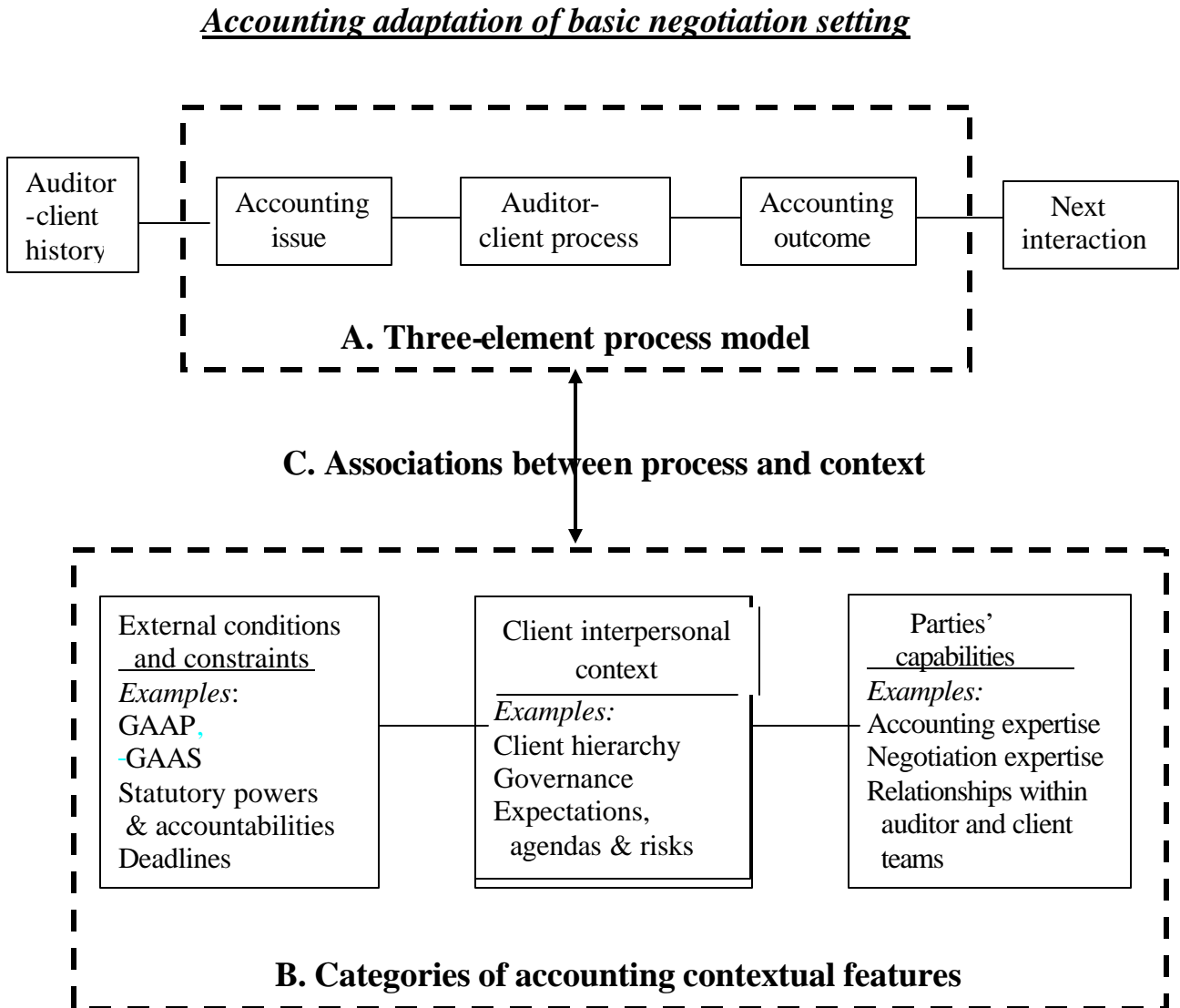
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Figure 1  
 The Accounting Contextual Features Negotiation Model: The Client Perspective



We adapt this model from Gibbins, Salterio and Webb (2001) by surveying the management literature and interviews with Chief Financial Officers (CFOs).

Figure 2

Data Gathered in the Questionnaire: Characteristics of the Negotiation Setting, Importance of Contextual Features, Demographics and Example Characteristics

<i>Panel A: Characteristics of accounting version of basic negotiation setting</i>				
<u>History</u>	<u>Issue</u>	<u>Process</u>	<u>Outcome</u>	<u>Next Interaction</u>
Effects of past issues on negotiation	Identification Accounting and disclosure implications Materiality Surprise to parties How public Who informed	Respondent's and other's roles Duration Participants' initial beliefs Steps taken to resolve issue Participants' preferred positions Issue analysis quality Issue sensitivity Importance of resolving Number of solutions considered	Agreement or disagreement Audit results Other issues settled Whose position adopted Substance versus form (economic vs. legal) How public issue resolution Importance of resolution	Issue(s) arise again
<i>Panel B: Categories of accounting features contextual in the aggregate</i>				
<u>Primarily external conditions</u>	<u>Primarily client interpersonal context</u>	<u>Primarily parties' capabilities</u>		
Accounting and disclosure standards Industry practices Auditing standards Securities or exchange regulations Auditor's power to qualify Time pressure Reporting or filing deadline Legal considerations Ethical considerations Financial analysts Tax considerations Creditor/lender considerations Owner/investor considerations	CEO Board chair Audit committee chair Audit committee Internal auditors Organization's business reputation Financial reporting reputation of organization Relationship with audit partner Past relationship with auditors	Relative understanding of GAAP# Audit firm's accounting expertise Audit partner's competence Your organization's accounting expertise Your organization's negotiation Size/resources of your organization Relative size-your organization to audit firm Audit firm's other services, e.g. tax Cost of problem-solving and data gathering Initial understanding of issue#		
<i>Panel C: Demographics and example characteristics</i>				
<u>Respondent Demographics</u>	<u>Example Characteristics</u>	<u>Corporate Governance</u>		
Job responsibilities Years of experience Frequency of experiencing auditor-client negotiations Professional designations/ academic business degrees	Reason example chosen Type of auditor Recency of example Length of auditor relationship	Board size and composition Audit committee size and composition Audit committee accounting expertise Board chair and CEO same		

We adapt this model from Gibbins, Salterio and Webb (2001) by searching the management literature and interviews with CFOS. The features in Panel B are organized by their primary likely nature but they are interrelated. All features are measured as perceived by respondents. Pre-tests indicated that most features in Panel B were better asked about using importance to the issue measures except for two, indicated by “#” above, which were better phrased using agree/disagree measures.

**Table 1**

CFO Respondents' Job Responsibilities, Professional Qualifications, Experience and Characteristics of Their Chosen Examples

*Panel A: Demographic information about respondents*

	Total Responses	Percent of 101	Responses with example	Percent of 70
1. Respondent's present job responsibilities:				
CFO only	58	57%	40	57%
Controller only	12	12	11	16
Treasurer only	2	2	2	3
CFO and other	18	18	11	15
Other titles (e.g. VP finance)	10	10	6	9
Question not answered	<u>1</u>	<u>1</u>	<u>0</u>	<u>0</u>
	<u>101</u>	<u>100%</u>	<u>70</u>	<u>100%</u>
2. Respondent's professional qualifications:				
Professional Accountant	77	76%	51	73%
MBA only	5	5	4	6
Professional Accountant & MBA (EMBA)	16	16	13	19
Professional Accountant & other (CFE)	1	1	1	1
Question not answered	<u>2</u>	<u>2</u>	<u>1</u>	<u>1</u>
	<u>101</u>	<u>100%</u>	<u>70</u>	<u>100%</u>
3. Respondent's years of business experience:				
Less than 10 years	2	2%	2	3%
10-15 years	12	12	10	14
15-20 years	21	21	16	23
Over 20 years	65	64	42	60
Question not answered	<u>1</u>	<u>1</u>	<u>0</u>	<u>0</u>
	<u>101</u>	<u>100%</u>	<u>70</u>	<u>100%</u>
4. Frequency of respondent's experience with difficult accounting/disclosure issues:				
Never experienced	18	18%	0	0%
More than never but less than 50% of years	60	59	49	70
50% of years	10	10	9	13
More than 50% of years but not every year	10	10	10	14
Every year	2	2	2	3
Question not answered	<u>1</u>	<u>1</u>	<u>0</u>	<u>0</u>
	<u>101</u>	<u>100%</u>	<u>70</u>	<u>100%</u>

*Panel B: Demographic information about CFO respondent's organizations (example provided only)*

Responses    Percent of 70

1. Size of Organization:

(a) Annual revenue (\$CDN)

Below 10 million	6	9%
10 million – 99 million	11	16
100 million – 499 million	27	39
500 million – 999 million	8	11
1 billion – 10 billion	13	19
More than 10 billion	3	4
Question not answered	<u>2</u>	<u>3</u>
	<u>70</u>	<u>100%</u>

(b) Total assets (\$CDN)

Below 10 million	2	3%
10 million – 99 million	13	19
100 million – 499 million	23	33
500 million – 999 million	2	3
1 billion – 10 billion	18	26
More than 10 billion	4	6
Question not answered	<u>8</u>	<u>11</u>
	<u>70</u>	<u>100%</u>

2. Corporate Governance – Board of Directors

(a) Number of directors:

Less than 5	14	20%
5 – 9	31	44
10 – 14	19	27
15 or more	5	7
Question not answered	<u>1</u>	<u>1</u>
	<u>70</u>	<u>100%</u>

(b) Descriptive statistics about board (one subsidiary of a public company did not have a board despite being separately incorporated):

<u>Mean (Std. Deviation)</u>	<u>Median</u>	<u>Low</u>	<u>Range</u>	<u>High</u>
8.36 (4.14)	8	0		20

(c) % of outside (non-management) directors:

<u>Mean (Std. Deviation)</u>	<u>Median</u>	<u>Low</u>	<u>Range</u>	<u>High</u>
62% (36%)	75%	0%		100%

(d) Large block holder (for profit organizations only)?

Yes	32	53%
No	<u>28</u>	<u>47</u>
	<u>60</u>	<u>100%</u>

(e) Board Chair and CEO the same person:

Yes	12	17%
No	<u>58</u>	<u>83</u>
	<u>70</u>	<u>100%</u>

3. Corporate Governance -- Audit Committee

(a) Number of directors:

Board is audit committee	14	20%
1 – 4	33	47
5 – 9	22	31
Question not answered	<u>1</u>	<u>1</u>
	<u>70</u>	<u>100%</u>

(b) Descriptive statistics about audit committee (excluding board acting as audit committee, N = 55):

<u>Mean (Std. Deviation)</u>	<u>Median</u>	<u>Low</u>	<u>Range</u>	<u>High</u>
3.57 (2.34)	3	0		9

(c) % of non-management members (as in (b)):

<u>Mean (Std. Deviation)</u>	<u>Median</u>	<u>Low</u>	<u>Range</u>	<u>High</u>
71% (39%)	100%	0%		100%

(d) % of members with extensive accounting experience (as in (b)):

<u>Mean (Std. Deviation)</u>	<u>Median</u>	<u>Low</u>	<u>Range</u>	<u>High</u>
31% (30%)	25%	0%		100%

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*Panel C: Characteristics of CFO respondents' examples*

	Responses	Percent of 70
1. Type of organization:		
Public company	30	43%
Non-traded subsidiary of a public company	8	11
Large private company	13	19
Public sector	5	7
Crown corporation	5	7
Other (e.g. small private company)	<u>9</u>	<u>13</u>
	<u>70</u>	<u>100%</u>
2. Type of audit firm:		
Big 5 firm	61	87%
Other international/national firm	2	3
Regional firm	2	3
Federal auditor general	2	3
Other (e.g. one office firm)	<u>3</u>	<u>4</u>
	<u>70</u>	<u>100%</u>
3. Recency of negotiation example:		
0 to 3 months	11	16%
3 to 6 months	16	23
6 months to 1 year	17	24
1 to 2 years	16	23
More than 2 years	<u>10</u>	<u>14</u>
	<u>70</u>	<u>100</u>
4. Length of relationship with auditor:		
One year	6	9%
Two years	3	4
Three years	2	3
More than three years	<u>59</u>	<u>84</u>
	<u>70</u>	<u>100%</u>

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**Table 2**

Issue Identification, Implications, Materiality and Prior Knowledge (Sample: 70 CFO Respondents)

## 1. Why did the issue arise (multiple responses possible from the list below)?

	<u>Responses</u>	<u>Percent of 70</u>
A new transaction or business deal	40	57%
A complex transaction or business deal	21	30
A new accounting standard	21	30
Lack of accounting standards	9	13
A change of personnel in organization	4	6
A change of personnel by external auditors	3	4
Other (e.g. change of auditor, acquisition, etc.)	<u>17</u>	24
	<u>115</u>	

## 2. Who identified the issue in the first place?

Organization's management	15	21%
Organization's financial people	27	39
External auditors, during the audit	21	30
External auditors, separately from the audit	<u>7</u>	<u>10</u>
	<u>70</u>	<u>100%</u>

## 3. People who were immediately informed after respondent became aware of the issue: (Responses, % of 70, except for audit committee, % of 55)

	Total	(1)	(2)	(3)	(4)	(5)	(6)	(7)	Other combinations
(1) CEO	<u>44</u> (63%)	<u>14</u> (20%)	-	-	-	-	-	-	-
(2) Chair of Board (excluding CEO's)	5(7%)	-	2(3%)	-	-	-	-	-	-
(3) Chair of audit committee	6(11%)	<u>2</u> (3%)	-	-	-	-	-	-	-
(4) Audit committee	5(9%)	<u>3</u> (4%)	-	-	-	-	-	-	-
(5) Other senior management members	33(47%)	<u>14</u> (20%)	-	1(1%)	1(1%)	<u>10</u> (14%)	-	-	-
(6) No one	4(6%)	-	-	-	-	-	4(6%)	-	-
(7) Other (e.g. external auditors)	15(21%)	<u>3</u> (4%)	-	<u>15</u> (21%)	-	2(3%)	-	6(9%)	<u>8</u> (11%)

Multiple responses possible for this question. Thus, numbers in the "Total" column represent how many times each of the seven choices provided in the questionnaire (CEO, Chair of Board, Chair of Audit Committee, Audit Committee, other senior management members, no one, and other people) appeared in the 70 responses. For example, **44** of the 70 respondents informed CEO immediately after they became aware of the issue. Among the 44 cases, **14** of them (the cell where row (1) crosses to column (1)) only informed CEO, **2** of them (the cell where row (3) crosses to column (1)) informed both CEO and Chair of audit committee, **3** of them (the cell where row (4) crosses to column (1)) informed both CEO and Audit committee, **14** of them (the cell where row (5) crosses to column (1)) informed both CEO and other senior management members, **3** of them (the cell where row (7) crosses to column (1)) informed both CEO and one other person (e.g. external auditor), and **8** of them informed at least three people including CEO (e.g. CEO, other senior management member, and external auditor). The last 8 cases are not able to be separately reported but are included in the bottom-right cell.

Similar methods are used to read the other matrix tables.

4. Accounting/disclosure implications of the issue: (Responses, % of 70)

	Total	(1)	(2)	(3)	(1)&(2)	(2)&(3)	(1)&(2)&(3)	(1)&(2)&(4)	(1)&(2)&(3)&(4)	Other combinations
(1) Income measurement	54(77%)	11(16%)	-	-	-	-	-	-	-	-
(2) Balance sheet valuation	48(69%)	7(10%)	5(7%)	-	-	-	-	-	-	-
(3) Footnote disclosure	28(40%)	1(1%)	-	1(1%)	5(7%)	-	-	-	-	-
(4) Other disclosure (e.g. MD&A)	21(30%)	-	1(1%)	1(1%)	1(1%)	2(3%)	3(4%)	-	-	-
(5) Tax implications	18(26%)	1(1%)	-	-	2(3%)	-	3(4%)	4(6%)	2(3%)	-
(6) Legal or contract implications	12(17%)	-	-	-	1(1%)	-	-	-	1(1%)	-
(7) Business event/transaction implications	11(16%)	-	-	-	2(3%)	-	-	-	-	-
(8) Other (e.g. consolidation)	5(7%)	1(1%)	-	5(7%)	-	-	-	-	-	15(21%)

5. Materiality of the issue: (Responses, % of 70)

	Total	(1)	(2)	(3)	(4)	(8)	(9)	combinations
(1) Material by itself in current year	18(26%)	12(17%)	-	-	-	-	-	-
(2) Material by itself in future years	6(9%)	-	4(6%)	-	-	-	-	-
(3) Material by itself in current and future years	31(44%)	-	-	17(24%)	-	-	-	-
(4) Material considering other issue(s) in current year	6(9%)	1(1%)	-	-	3(4%)	-	-	-
(5) Material considering other issue(s) in current and future years	6(9%)	-	-	2(3%)	-	-	-	-
(6) Material to the organization but not to the parent in current year	4(6%)	1(1%)	-	-	1(1%)	-	-	-
(7) Material to the organization but not to the parent in current and future year	7(10%)	-	-	6(9%)	-	-	-	-
(8) Material in another way	15(21%)	2(3%)	2(3%)	3(4%)	1(1%)	6(9%)	-	-
(9) Not material by itself – but could be in future	4(6%)	-	-	-	-	-	4(6%)	-
Other Combinations	-	-	-	-	-	-	-	5(7%)

6. Was the issue a surprise?

	<u>Responses</u>	<u>Percent of 70</u>
Neither organization nor auditors were surprised	35	50%
Auditor were surprised, not client	11	16
Organization was surprised, not auditor	15	21
Both organization and auditors were surprised	<u>9</u>	<u>13</u>
	<u>70</u>	<u>100%</u>

7. How publicly was the issue when it arose?

	<u>Responses</u>	<u>Percent of 70</u>
The issue was already known outside the organization, and there was external pressure to deal with it	3	4%
there was no external pressure to deal with it	8	11
The issue was not known outside the organization, and it would likely become known in time	17	24
it was unlikely to become known	41	59
Question not answered	<u>1</u>	<u>1</u>
	<u>70</u>	<u>100%</u>

**Table 3**

Parties Involved in Resolving the Issue, Duration of the Chosen Examples, and Beliefs About Possible Outcomes (Sample: 70 CFO Respondents)

1. Who in the organization was involved in resolving the issue: (Responses, % of 70; except audit committee, % of 55)

	Total	(1)	(2)	(3)	(1)&(2)	(2)&(3)	(1)&(3)	(1)&(2)&(3)	Other combinations
(1) CFO	57(81%)	3(4%)	-	-	-	-	-	-	-
(2) Accounting staff	55(79%)	12(17%)	3(4%)	-	-	-	5(7%)	-	-
(3) CEO	35(50%)	-	-	1(1%)	-	-	-	-	-
(4) Board Chair (excluding CEOs)	9(13%)	-	-	-	-	-	3(4%)	-	-
(5) Audit committee chair	18(33%)	1(1%)	-	-	-	1(1%)	1(1%)	5(7%)	-
(6) Legal counsel	13(19%)	1(1%)	2(3%)	-	1(1%)	-	-	3(4%)	-
(7) Parent company personnel	13(19%)	-	-	-	2(3%)	-	-	2(3%)	-
(8) Non-manager owners	1(1%)	-	-	-	-	-	-	-	-
(9) Others (e.g. function managers)	15(21%)	15(21%)	3(4%)	-	2(3%)	1(1%)	-	1(1%)	17(24%)

2. Audit firm's personnel involved in resolving the issue:

	Total	(1)	(2)	(6)	(1)&(2)	(1)&(2)&(3)	Other combinations
(1) Engagement partner	66(94%)	2(3%)	-	-	-	-	-
(2) Manager	58(83%)	17(24%)	1(1%)	-	-	-	-
(3) Consulting or technical partner	35(50%)	1(1%)	-	-	15(21%)	-	-
(4) Managing partner	15(21%)	1(1%)	1(1%)	-	2(3%)	1(1%)	-
(5) Review or concurring partner	13(19%)	-	-	-	-	5(7%)	-
(6) Staff	11(16%)	3(4%)	-	1(1%)	3(4%)	1(1%)	-
(7) Auditor's legal counsel	3(4%)	-	-	-	-	-	-
(8) Others (e.g. national office)	8(11%)	8(11%)	-	-	1(1%)	1(1%)	14(20%)

3. Other people involved in resolving the issue:

	<u>Responses</u>	<u>Percent of 70</u>
Regulator(s)	3	4%
Creditor(s)	1	1
Other audit firm(s)	5	7
Others (e.g. underwriters)	8	11
Total involved	<u>17</u>	<u>24%</u>

4. Length of time to resolve the issue:

	<u>Responses</u>	<u>Percent of 70</u>
Days	24	34%
Weeks	28	40
Months	16	23
Years	2	3
	<u>70</u>	<u>100%</u>

5. When did the issue arise and when was it resolved? (Responses, % of 70)

<u>When did the issue resolved</u>	<u>When did the issue first arise?</u>				
	<u>Quarter 1</u>	<u>Quarter 2</u>	<u>Quarter 3</u>	<u>Quarter 4</u>	<u>Year end</u>
Quarter 1	4(6%)	-	-	-	1(1%)
Quarter 1	-	3(4%)	-	-	-
Quarter 1	-	2(3%)	3(4%)	-	-
Quarter 1	-	-	1(1%)	2(3%)	-
Year end	1(1%)	2(3%)	-	-	45(64%)
Question not answered	6(9%)	-	-	-	-

6. Beliefs about possible outcomes when the issue arose:

	<u>Responses</u>	<u>Percent of 70</u>
There was a range of mutually acceptable outcomes within which agreement likely could be found	33	47%
No mutually acceptable outcomes were apparent, therefore:		
The organization was prepared to work to develop a new solution that would be mutually acceptable	12	17
The organization needed to persuade other parties that its position was the only acceptable one	19	27
Other belief about outcome(s)	<u>6</u>	<u>9</u>
	<u>70</u>	<u>100%</u>

7. How important was each of the following accounting effects to the process of resolving the issue?

	Degree of Importance					No Response	Effects Were Mainly				No Response
	None	Low	Moderate	High	Essential		Current	Future	Both		
Income effects	10	5	11	29	15	0	30	13	14	13	
Balance sheet effects	8	16	18	19	9	0	31	9	12	18	
Footnote effects	17	14	16	16	6	1	27	3	9	31	
MD&A effects	29	10	18	9	2	2	25	2	7	36	
Cash flow effects	40	14	6	8	2	0	16	10	4	40	
Other accounting effects	23	1	1	2	0	NA	2	1	0	NA	

8. (a) Respondent's views about process characteristics: (Responses, % of 70)

	Who?			To what extent?			
	<u>Org.</u>	<u>Auditors</u>	<u>Same</u>	<u>Slightly</u>	<u>Moderately</u>	<u>Strongly</u>	<u>Dominated</u>
Did the better analysis of the issue?	45(64)	21(30)	0	15(21)	18(26)	24(34)	7(10)
Most wanted to reach an agreement?	48(69)	11(16)	9(13)	9(13)	14(20)	34(49)	4(6)
Better understood GAAP?	16(23)	48(69)	3(4)	22(31)	23(33)	17(24)	1(1)
In the more sensitive/exposed position?	45(64)	18(26)	1(1)	6(9)	29(41)	22(31)	4(6)
Saw solving the issue as more important?	41(59)	15(21)	10(14)	12(17)	21(30)	22(31)	1(1)

(b) Descriptive statistics about respondent's views ("Slightly" = 1 and "Dominated" = 4 for purposes of calculations):

	Organization Chosen		Auditor Chosen	
	<u>Mean (SD)</u>	<u>Median</u>	<u>Mean (SD)</u>	<u>Median</u>
Did the better analysis of the issue?	2.56(0.91)	3	1.95(0.97)	2
Most wanted to reach an agreement?	2.53(0.79)	3	2.45(0.93)	3
Better understood GAAP?	1.87(0.74)	2	2.00(0.86)	2
In the more sensitive/exposed position?	2.48(0.73)	2	2.18(0.81)	2
Saw solving the issue as more important?	2.28(0.78)	2	1.93(0.83)	2

9. Descriptive statistics about the number of solutions reported as being considered during the process?

<u>Mean (Std. Deviation)</u>	<u>Median</u>	<u>Mode</u>	<u>Range</u>	
<u>Low</u>	<u>High</u>			
2.98 (1.05)	3	2	2	7

**Table 4**

Resolution of the Issue, Disposition of Other Issues and Overall Audit Results for the Respondents' Chosen Examples (Sample: 70 CFO Respondents)

	Responses	Percent of 70
1. The resolution of the issue:		
Agreement:		
On organization's original position	24	34%
On auditor's original position	13	19
Somewhere between the original positions	18	26
On a new solution generated in the negotiation	12	17
No agreement (issue remained and disagreement continued)	1	1
Question not answered	<u>2</u>	<u>3</u>
	<u>70</u>	<u>100%</u>
2. How much did the resolution represent substance (economic reality) versus form (satisfying rules)?		
Entirely substance	6	9%
Mostly substance	14	20
Equal	13	19
Mostly form	20	29
Entirely form	16	23
Question not answered	<u>1</u>	<u>1</u>
	<u>70</u>	<u>100%</u>
3. Disposition of other issues:		
Other prior issue(s) were settled when dealing with this issue	6	9%
Other prior issue(s) were not settled as this one was dealt with	7	10
Dealing with this issue raised and settled other issue(s)	7	10
Dealing with this issue raised but did not settle other issue(s)	3	4
No other issue(s) involved	45	64
Question not answered	<u>2</u>	<u>3</u>
	<u>70</u>	<u>100%</u>
4. After issue was resolved:		
(a) The following occurred:		
CEO was informed about the issue	62	89%
The issue/resolution was disclosed in next financial statement	33	47
The issue was considered again in subsequent years	29	41
The issue was disclosed in the next MD&A	21	30
There were items in print or other media inquiries about the issue	6	9
Organization issued an announcement or press release about the issue	1	1
Other important post-resolution events	8	11
(b) The audit outcome was:		
Financial statements for that year received a clean opinion	61	87%
Audit firm was reappointed for the next year	63	90
Audit committee was informed about the issue (N = 55)	51	89

**Table 5**

Antecedents and Respondents' Relative Capabilities about Respondents Chosen Examples (Sample: 70 CFO Respondents)

1. Impact of previous negotiations ("None" = 1 and "Essential" = 5 for purposes of calculations):

	<u>"Importance" Frequencies</u>					<u>Overall</u>		
	<u>None</u>	<u>Low</u>	<u>Moderate</u>	<u>High</u>	<u>Essential</u>	<u>Mode</u>	<u>Mean</u>	<u>SD</u>
The way prior issues were solved	10	12	18	24	5	4	3.03	1.19

2. Parties' capabilities ("Entirely/Strongly Disagree" = 1 and "Entirely/Strongly Agree" = 5 for purposes of calculations):

	<u>"Agreement" Frequencies</u>					<u>Overall</u>		
	<u>Disagree</u>			<u>Agree</u>		<u>Mode</u>	<u>Mean</u>	<u>SD</u>
	<u>Entirely/Strongly</u>	<u>Mildly</u>	<u>Neutral</u>	<u>Mildly</u>	<u>Entirely/Strongly</u>			
The auditor had a better understanding of GAAP than the organization did	16	3	20	16	15	3	3.16	1.43
The organization initially understood the situation better than the auditor did	7	5	15	11	32	5	3.8	1.36

**Table 6**  
 Respondents' Rating of the Importance of 30 Accounting Contextual Features to Their Examples (Sample: 70 CFO Respondents<sup>a</sup>)

	"Importance" Frequencies <sup>c</sup>					Overall <sup>d</sup>		
	None	Low	Moderate	High	Essential	Mode	Mean	SD
<b>External Conditions and Constraints</b>								
<b>1. Accounting and disclosure standards</b>	<b>1</b>	<b>4</b>	<b>10</b>	<b>37</b>	<b>18</b>	<b>4</b>	<b>3.96</b>	<b>0.88</b>
2. Auditor's power to qualify audit report	17	17	10	11	15	1&2	2.86	1.5
3. Ethical considerations	18	14	12	18	8	1&4	2.77	1.38
4. Auditing standards	17	14	17	17	5	1&3&4	2.70	1.28
5. Industry practices	18	12	18	16	5	1&3	2.68	1.29
6. Owner/investor considerations	31	9	6	18	5	1	2.34	1.46
7. <i>Time pressure</i>	29	18	9	9	4	1	2.14	1.26
8. <i>Financial analysts</i>	33	12	15	8	0	1	1.97	1.09
9. <i>Securities or exchange regulations<sup>b</sup></i>	39	8	7	10	3	1	1.96	1.31
10. <i>Legal considerations</i>	35	15	11	7	2	1	1.94	1.15
11. <i>Reporting or filing deadline</i>	38	16	6	7	2	1	1.83	1.14
12. <i>Creditor/lender considerations</i>	42	14	6	7	1	1	1.73	1.08
13. <i>Tax considerations</i>	46	10	5	6	3	1	1.71	1.18
<b>Interpersonal Context</b>								
<b>14. Relationship with audit partner</b>	<b>4</b>	<b>4</b>	<b>23</b>	<b>33</b>	<b>6</b>	<b>4</b>	<b>3.47</b>	<b>0.94</b>
15. Organization's financial reporting reputation	6	9	16	26	13	4	3.44	1.19
16. Organization's business reputation	7	7	15	33	8	4	3.4	1.13
17. Past relationship with auditors	10	11	17	27	5	4	3.09	1.19
18. Organization's CEO	23	17	11	15	4	1	2.43	1.3
19. <i>Organization's audit committee</i>	24	17	13	11	2	1	2.25	1.2
20. <i>Organization's audit committee chair</i>	33	10	10	14	1	1	2.12	2.16
21. <i>Organization's board chair</i>	28	20	9	10	2	1	2.1	1.18
22. <i>Organization's internal auditors</i>	54	9	2	0	1	1	1.26	0.66
<b>Parties' Capabilities</b>								
<b>23. Organization's accounting expertise</b>	<b>2</b>	<b>2</b>	<b>12</b>	<b>40</b>	<b>14</b>	<b>4</b>	<b>3.89</b>	<b>0.86</b>
<b>24. Audit firm's accounting expertise</b>	<b>2</b>	<b>3</b>	<b>21</b>	<b>35</b>	<b>9</b>	<b>4</b>	<b>3.66</b>	<b>0.87</b>
<b>25. Competence of audit partner</b>	<b>4</b>	<b>5</b>	<b>15</b>	<b>33</b>	<b>13</b>	<b>4</b>	<b>3.66</b>	<b>1.05</b>
26. Organization's negotiation expertise	1	16	26	19	8	3	3.24	0.98
27. <i>Size of the organization</i>	16	21	16	16	1	2	2.5	1.13
28. <i>Organization's size relative to the audit firm</i>	39	17	6	8	0	1	1.76	1.03
29. <i>Cost of problem-solving and data gathering</i>	35	25	7	2	1	1	1.7	0.87
30. <i>Audit firm's tax services</i>	54	6	3	2	2	1	1.39	0.94

See Table 1 Panel A for a description of the sample respondents. In each category, responses are in order of mean importance. Respondents rated the importance of each item to their chosen negotiation example on a 5-point scale with points None, Low, Moderate, High and Essential. Those points are designated 1, 2, 3, 4 and 5 for purposes of descriptive statistics reported. Total number of responses is less than 70 for some items because of CFOs not rating those items. Features in bold are significantly ( $p = 0.05$  or lower) above the scale mid-point (3) and reported as "high/essential" by more than 50% of respondents. Both parametric (simple t-tests) and non-parametric (Wilcoxon signed rank test and sign test) statistical tests were employed (adjusted for multiple comparisons) and the results do not differ. Features in italics are significantly ( $p = 0.05$  or lower) below the scale mid-point (3) and reported as "low/none" by more than 50% of respondents. Both parametric (simple t-tests) and non-parametric (Wilcoxon signed rank test and sign test) statistical tests were employed (adjusted for multiple comparisons) and the results do not differ. Multivariate analysis of variance (MANOVA) is used to test the null hypothesis that the responses for the set of 30 items do not differ across public companies/subsidiary of public company/large private versus all others. The only significant difference is the importance of securities and exchange regulations.

**Table 7**

Multivariate Tests of Association Between Selected Issue, Process and Outcome Elements and the Overall Pattern of the 15 CFO Rated More Important Accounting Contextual Features (Sample: 70 CFOs)

Negotiation Process Element	Table/ Item <sup>c</sup> ?	Wilk's ?	F-Stat
<b>Issue</b>			
Who identified issue (client, auditor or other)	2/2	0.34	1.39*
Who was informed upon identification (CEO, Board or audit committee, other management)	2/3	0.68	1.63*
Who (auditor or client) was/was not surprised	2/6	0.66	1.72*
How public was issue when it arose (public/nonpublic)	2/7	0.76	1.09
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Negotiation Process Element	Table/Item <sup>c</sup> ?	Wilk's ?	F-Stat
<b>Process</b>			
Total number of client personnel involved	3/1	0.64	1.97**
CEO involvement	3/1	0.55	2.76***
Board and/or audit committee chair involvement	3/1	0.60	2.26**
Total number of audit personnel involved	3/2	0.82	0.85
National consulting or technical partner involved	3/2	0.74	1.18
Duration of the negotiation	3/4	0.76	0.49
Beliefs about possible outcomes	3/6	0.58	0.92
Number of solutions considered	3/9	0.73	0.97
Importance of accounting effects to resolve issue	3/7		
Income statement		0.67	1.67*
Balance sheet		0.58	2.41***
Footnote		0.85	0.57
Management discussion and analysis		0.73	1.25
Cash flow		0.73	1.27
Wanted agreement (organization/auditor/same)	3/8	0.48	1.48*

Better issue analysis(organization/auditor)	3/8	0.83	0.69
Better understood GAAP (organization/auditor)	3/8	0.65	1.70*
Sensitive position (organization/auditor)	3/8	0.73	1.13
Saw resolving issues as more important (organization/auditor/same)	3/8	0.50	1.30
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Negotiation Process Element	Table/Item <sup>c</sup> ?	Wilk's ?	F-Stat
<b>Outcome and Next Interaction</b>			
Whose position was taken in the final agreement	4/1	0.40	1.12
Whose position was taken in the final agreement (client's original versus other)	4/1	0.60	2.16**
Substance versus form	4/2	0.82	0.73
Issue disclosed in next financial statements	4/4(a)	0.81	0.75
Consider issue again in subsequent years	4/4(a)	0.74	1.14
Audit committee informed about issue (excluding those with no separate committee)	4/4(b)	0.75	0.84
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“Table” refers to Tables 2 - 4 in which each negotiation process element is reported and “Item” refers to the specific item within the table. Not all negotiation process elements reported in the tables are included in these analyses because of the lack of variation in some measures (“issue materiality”, “other people involved in the negotiation”, “CEO was informed about the issue”, and “audit outcome” except for “audit committee informed”) and the descriptive complexity of others (“accounting/disclosure implications of the issue”, “when did issue arise and when was it resolved”, and “disposition of other issues”). “More important” is defined as the non-italicized items in Table 6. Multivariate analysis of variance (MANOVA) or multivariate regression analysis is used to test the null hypothesis that the negotiation process element is not associated with the set of 30 accounting contextual features versus the alternative that the association is significant. Each negotiation process element is treated as the independent variable in the analysis and the set of 30 accounting contextual features is the dependent variable. MANOVA is used to test the significance of the association with the negotiation process element when the independent variable is deemed to be categorical. The categories used in each MANOVA are consistent with those reported in Tables 2 - 4 except where noted in brackets in the element’s description. Multivariate regression is used to test the significance of the association for both “Total number of audit personnel involved” and “Total number of client personnel involved” where the independent variable is the total number of participants for each respondent’s example. For “Resolution represent substance versus form” the independent variable is the respondent’s judgment measured on a 5-point scale (see Table 5 for a description of the scale). Significance of the F-statistics for the multivariate analyses: \*\*\*p < 0.01, \*\*p < 0.05, and \*p < 0.10

**Table 8**

Univariate Tests of Associations Between 15 CFO Rated More Important Accounting Contextual Features and Selected Issue, Process and Outcome Elements

	Negotiation Elements										
	Issue			Process							Outcome
	(1) Who identified issue	(2) Who was informed upon identification (CEO)	(3) Who (auditor or client) was/was not surprised	(4) Total number of client personnel involved	(5) CEO involvement	(6) Board and/or audit committee chair involvement	(7) Importance of Income statement effects to resolve issue	(8) Importance of Balance sheet effects to resolve issue	(9) Wanted agreement (organization/auditor/same)	(10) Better understood GAAP (organization/auditor)	(11) Whose position was taken in the final agreement (client's original versus other)
15 CFO rated more important accounting contextual features in order of importance (see Table 6 for selection details)											
<b>External Conditions and Constraints</b>											
1. Accounting and disclosure standards								***	*		**
2. Auditor's power to qualify audit report					**		***				
3. Ethical considerations	**							***			**
4. Auditing standards		**						***			
5. Industry practices			*								
6. Owner/investor considerations				**						*	
<b>Interpersonal Context</b>											
14. Relationship with audit partner						*				*	
15. Organization's financial reporting reputation								**			
16. Organization's business reputation	**		*					**	**		
17. Past relationship with auditors								**			
18. Organization's CEO		**		***	***	**	*				
<b>Parties' Capabilities</b>											
23. Organization's accounting expertise								*		**	
24. Audit firm's accounting expertise		***				***		***		*	
25. Competence of audit partner											
26. Organization's negotiation expertise	**										
Overall degree of association for 15 features <sup>c</sup>	*	*	*	**	***	**	*	***	*	*	**

Only those negotiation process elements found to be significantly associated with the set of 15 accounting contextual features per Table 7's multivariate tests are analyzed further in this table. Univariate analysis of variance (ANOVA) or regression analysis is used to test the null hypothesis that the negotiation process element is not associated with each of the 15 accounting contextual features versus the alternative that the association is significant. The negotiation process element is the independent variable and the accounting contextual feature is the dependent variable. See Table 7 for a description of the independent variable measures used in the analyses.

Significance of the F-statistics for the univariate analyses: \*\*\*p < 0.01, \*\*p < 0.05, and \*p < 0.10