Audit Committee Member Investigation of Significant Accounting Policy Decisions[1]

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ABSTRACT

In the post-Enron environment, audit committee (AC) members are under increased pressure to demonstrate their effectiveness in resolving significant accounting policy decisions. However, while prior studies have demonstrated that significant accounting policy decisions are often negotiated between the auditors and client management, recent research suggests that AC members are typically not involved in material auditor-client negotiations and that they are often not informed that accounting policy decisions were negotiated (Gibbins et al. 2001; 2005). Therefore, without knowledge that a negotiation took place AC members may not be effective in their oversight of the financial reporting process. Indeed, to be considered effective AC members must be capable of raising probing, non-standard questions (Gendron et al. 2004; Gendron and Bédard 2006). In this study, I investigate the extent of AC members' investigation of significant accounting policy decisions when they are (or not) informed that an auditor-client negotiation took place and when a decision results in an aggressive versus a conservative treatment. The hypotheses are developed from recent field studies of auditing and corporate governance practice and the social psychology literature on dissonance theory, both arguing that humans seek comfort and have a preference for stability in their cognitions and self-concepts. The posited existence of this mechanism motivates AC members to reduce discomfort and probe for more information when they encounter questionable accounting policy decisions. The results indicate that knowledge of negotiation influences AC member discomfort but has no effect on AC members' extent of investigation, perhaps because questions have been pre-empted by additional disclosure. I also find that AC members become less comfortable and investigate more extensively as accounting policy decisions become increasingly aggressive. However, I do not observe a pure preference for conservative decisions. The results of this research have important implications to practice and future research.

Key Words: auditor-client negotiation, audit committee, investigation

INTRODUCTION

In the post-Enron environment, audit committee (henceforth AC) members are under increased scrutiny to demonstrate due diligence in their oversight of the firm's financial reporting process (Sarbanes-Oxley Act 2002; Blue Ribbon Committee (BRC) 1999; National Commission on Fraudulent Financial Reporting (Treadway Commission) 1987; Public Oversight Board (POB) 1993). Furthermore, standard setters such as the US Securities and Exchange Commission (SEC) and Ontario Securities Commission (OSC) in Canada now consider the AC a critical monitor of the financial reporting system and a guardian for shareholder interests. One arena where standard setters are expecting audit committee members to become more involved is in effectively evaluating and investigating significant accounting policy decisions.

Prior research demonstrates that material matters in the financial statements are often determined through negotiations between the audit partner and senior client firm management (e.g. Gibbins et al. 2001; Gibbins et al. 2005; Ng and Tan 2003). However, Gibbins et al. (2001) find that ACs are involved in material auditor-client management negotiations less than half of the time and Gibbins et al. (2005) find that ACs are frequently not informed of auditor-client negotiations until management and the auditor agree on the outcome. Gibbins et al. (2005) also report that ACs are routinely informed of new accounting policy choices but not necessarily that they are the result of negotiations. Thus, if knowledge that an auditor-client negotiation took place is a key factor in triggering more in-depth investigations of accounting decisions, AC members may not be capable of demonstrating effectiveness in the boardroom without this information. Indeed, Gendron et al. (2004) and Gendron and Bédard (2006) demonstrate that an important criterion for developing perceptions of AC effectiveness among the various corporate governance actors (i.e. CFO, CEO, external auditors, internal auditors, and AC members) is AC

members' tendency to raise tough, in-depth, probing questions at meetings. The influence of potentially omitted information on AC effectiveness is an unanswered question.

In this study, I experimentally examine differences in AC members' investigation of negotiated accounting policy decisions based upon the information they receive from management and the auditors and the aggressiveness of these decisions. Specifically, I investigate whether the nature and extent of AC members' investigation of accounting policy choices depends on the extent of information that management discloses regarding a negotiated accounting policy choice as well as the relative aggressiveness of the accounting policy choice, in terms of maximizing current income. The hypotheses are developed from recent field studies of auditing and corporate governance practice and the social psychology literature on dissonance theory, both arguing that humans seek comfort and have a preference for stability in their cognitions and self-concepts. The posited existence of this mechanism motivates AC members to reduce discomfort and probe for more information when they encounter questionable accounting policy decisions. In the experiment, I manipulate whether AC members are informed that an accounting policy decision was negotiated between the CFO and audit partner. I also manipulate the accounting policy's relative aggressiveness in terms of maximizing net income in the current period. I measure the extent of AC member investigation through an examination of the number and content of questions AC members generate in anticipation of a forthcoming meeting after having received their normal briefing materials.

A sample of 76 experienced business professionals participated in the experiment. As these participants have varying levels of financial expertise, they provide an opportunity to examine the effects of relative accounting experience/expertise on the investigation of accounting policy decisions. Upon analyzing the results, I find that (1) knowledge of auditor-

client negotiation influences AC member discomfort but does not increase their extent of investigation, (2) AC members are uncomfortable with and have an aversion for aggressive accounting policy decisions and they investigate these decisions extensively with probing questions and (3) AC accounting experts investigate accounting policy decisions more extensively compared to non-experts. The results have implications for standard setters and future research.

In the sections that follow, I first describe prior archival and behavioral research on AC effectiveness followed by the motivation of this study. I then develop my experimental hypotheses from field research in auditing and corporate governance and dissonance theory from social psychology. After constructing the hypotheses, I describe the experimental design and introduce the results of the experiment. Finally, I conclude the study with a discussion of the results and opportunities for future research.

PRIOR RESEARCH

In an attempt to improve AC effectiveness, regulators have implemented recommendations that require corporations to nominate AC members with specific characteristics such as independence and financial expertise. In response to these requirements a substantial body of research has empirically tested AC effectiveness.[2] The vast majority of the AC literature is archival and provides some evidence that characteristics of ACs, such as independence and financial expertise, are associated with higher quality financial reporting. Although this research is important in identifying characteristics of effective AC members, the archival literature has not been able to dig deeper into the process of AC effectiveness (Gendron et al. 2004). Given this limitation of archival research and the enhanced responsibilities of AC members, AC effectiveness is becoming an area of increasing interest for behavioral researchers.

[2] See DeZoort et al. (2002) for an extensive review of the AC effectiveness literature.

Behavioral AC research has focused primarily on the tendency for AC members to support the auditor in auditor-client negotiations. Knapp (1987) finds that AC members tend to support the auditor in auditor-client disagreements when professional standards are objective, and when the client is in financial distress. DeZoort and Salterio (2001) find that AC members with relatively more independent director experience and greater audit reporting knowledge are more likely to support the auditor's position in auditor-client conflict situations. Therefore, the behavioral literature indicates that AC members can be effective monitors of the financial reporting process when they are involved in the auditor-client negotiation process. Other behavioral studies demonstrate that AC financial literates are more (less) likely than experts to be concerned with accounting issues that are (non) recurring and (less) prominent in the business press (McDaniel et al. 2002), and that AC members are less willing to hire auditors for non-audit services to avoid fee disclosures even when these services could enhance audit quality (Gaynor et al. 2006).

While prior research provides insights regarding AC members' performance in auditor-client negotiations when they are consulted, recent research has raised questions regarding AC members' involvement in these negotiations and thus their ability to as act guardians of shareholder interests. In a series of papers that model the negotiation process, Gibbins et al. (2001; 2005) find that both auditors and CFOs consider the AC as playing a small and unimportant role in the negotiation process. In a survey of 93 audit partners' experiences of auditor-client negotiations, Gibbins et al. (2001) construct a negotiation process model that incorporates the negotiation setting and its relationships with accounting contextual features. They find that the AC is involved in auditor-client negotiations of material accounting issues less than half of the time. In a subsequent study of 101 CFOs or equivalent, Gibbins et al. (2005)

assess and compare the CFO's perspective of auditor-client negotiations with the audit partner's responses. Similar to the audit partners, CFOs report that the AC is frequently not informed of negotiations until management and the auditor agree on the outcome. They also find that CFOs routinely inform AC members of new accounting policy choices but not necessarily that they were the result of negotiations with the auditor. Hence, this research suggests that the AC is not involved in negotiated accounting policy decisions and to effectively exercise their due diligence responsibilities, ACs must critically examine the ex post accounting decisions made by management and the audit partner.

Given ACs are not involved in significant accounting policy decisions, they are limited to defending shareholders' interests with primarily after-the-fact information.[3] Unfortunately, little is known about how ACs demonstrate their effectiveness with secondary information. To shed more light into the importance and activities of ACs, recent interview research has attempted to explore perceptions of AC effectiveness and the process of AC meetings. In a study of auditor perceptions of corporate governance, Cohen et al. (2002) find that auditors consider ACs generally ineffective and relatively lacking in power while Gendron et al. (2004) and Gendron and Bédard (2006) provide some evidence that firms consider ACs effective when members ask probing, non-standard questions at meetings. Thus, some progress is being made to understand how the AC operates in practice.

Whereas prior behavioral research measures AC effectiveness based upon members' tendency to support the auditor's position in an auditor-client dispute, recent research has posited another measure of effectiveness. According to Gendron et al. (2004) and Gendron and Bédard (2006), a key criterion for attendees' (of AC meetings) perceptions of AC effectiveness in

[3] The audit team can have private meetings with the AC to discuss any problems encountered during the completion of the audit. Hence, the audit team can keep the audit committee up-to-date about the process of determining significant accounting issues with the CFO.

financial reporting oversight is the extent of thoughtful, non-standard questions raised by AC members at meetings. In addition, Ng and Tan (2003) find that auditor's perceived outcome of auditor-client negotiations is partly influenced by the presence (or absence) of an effective AC. In particular, they find that the presence of an effective AC increases the auditor's belief that a negotiated accounting issue will result in an adjustment leading to more conservative accounting income. Therefore, if AC members are frequently not involved in the auditor-client negotiation process (Gibbins et al. 2001) and are often not consulted that a negotiation occurred (Gibbins et al. 2005), then AC members will not be effective monitors of the financial reporting process unless they can overcome these constraints by investigating for further information. Considering the results of prior research, I propose an alternative criterion of AC effectiveness, AC members' extent of investigation with probing, in-depth, non-standard questions (Gendron et al. 2004; Gendron and Bédard 2006). Next, I will describe how auditing and corporate governance can be described as a process of discomfort reduction, and that increases in AC member discomfort with accounting policy decisions leads to more extensive investigations with probing, non-standard questions.

HYPOTHESIS DEVELOPMENT

In an ethnographic study of audit practice, Pentland (1993) concludes that *what auditors do* consists of a process of rituals and routines that relieve discomfort in the accuracy of financial statement information:

> Substantively, auditors are centrally implicated in the social production of trust in financial markets. Auditors give comfort to people who are vulnerable to erroneous, self-interested, and possibly fraudulent financial statements from corporate management (p. 606).

Audit rituals include the evaluation of evidence, the process of completing reports, the management of social relationships (e.g. with the audit team and management) and the

transformation of disorganized or chaotic information into socially acceptable accounting knowledge. The purpose of these rituals is to purify the financial statements from an unclean or potentially biased and disorganized set of information produced by company management to something clean that contributes to instilling social comfort.

Pentland (1993) describes the production of social comfort as beginning at the micro-level (the auditors) and travelling to the macro (the users of accounting information). The auditors commence the audit process feeling highly uncomfortable about the "unclean" financial statements because they are responsible for ensuring that this information is accurate and reliable. To achieve comfort, auditors perform rituals (e.g. evaluating evidence) until comfort is achieved across the entire audit team. In their study of AC effectiveness, Gendron and Bédard (2006) confirm the importance of comfort in the AC meeting setting by demonstrating that AC members seek and achieve comfort with financial reporting by asking challenging questions to management and the auditors.

Pentland's (1993) field observations and Gendron and Bédard's (2006) interview study suggest that the financial reporting process, including auditing and corporate governance, is a process of achieving comfort. Although these authors did not reference dissonance theory in their arguments, their theoretical propositions of audit and AC practice support the notion that auditing and corporate governance is a process of dissonance (discomfort) reduction (Festinger 1957; Aronson 1992). If auditing and corporate governance are indeed processes of reducing discomfort, then features of the AC environment, such as accounting policy aggressiveness, that influence AC member discomfort may have an impact on the extent of AC investigations.

Dissonance Theory

According to dissonance theory, individuals strive to reduce psychological discomfort, to achieve a consistent self-concept and to engage in behaviours to preserve this self-concept (Festinger 1957). Although social psychologists disagree about the assumptions underlying the development of the self-concept, many agree that individuals strive for the following sense of self:

1. To preserve a consistent, stable, predictable sense of self.
2. To preserve a competent sense of self.
3. To preserve a morally good sense of self (Aronson 1992, p. 305).

Hence, individuals prefer to encounter situations, receive feedback and engage in behaviours that support their self-concepts and when the self-concept is threatened or an inconsistency is recognized, individuals experience salient discomfort or dissonance which motivates or "leads to activity toward dissonance reduction just as hunger leads to activity oriented toward hunger reduction" (Festinger 1957, p. 3). Given the generality of its propositions, dissonance theory is capable of describing and explaining a multitude of psychological phenomena. In auditing and corporate governance, Pentland (1993) and Gendron and Bédard (2006) provide support for the notion that auditing and corporate governance can be characterized as a process of dissonance reduction. Applying this conception of corporate governance to dissonance theory, I argue that AC members strive to reduce the psychological discomfort that arises when they are confronted with significant accounting policy decisions, and that AC members strive to preserve a competent sense of self and a morally good sense of self. Armed with this theoretical conception of corporate governance, I investigate the effects of knowledge of negotiation and accounting policy aggressiveness on the questions that AC members ask at meetings.

Knowledge of the Negotiation Process

To generate a perception of effectiveness among management and the audit team, AC members must be capable of investigating or probing for information regarding the outcomes of negotiated accounting policy decisions (Gendron et al. 2004; Gendron and Bédard 2006). In those cases where AC members are not informed that an issue was negotiated, they may not be capable of asking appropriate questions unless they first recognize that management has withheld information about the accounting policy resolution process. According to dissonance theory, AC members ask probing questions to reduce discomfort. Therefore, encountering discomfort increasing situations should increase AC member investigation.

The discomfort-inducing effects of negotiation knowledge can result in diverging predictions. The absence of information related to a significant accounting policy decision can make AC members uncomfortable because they may not have adequate knowledge about the decision to ask appropriate questions of management and the auditors. Additional information about a negotiation would also help AC members better understand the process that resulted in the accounting policy decision, which can reduce discomfort. Given that dissonance theory predicts that people seek to maintain a competent sense of self (Aronson 1992), I would expect AC members without negotiation knowledge to be less comfortable with an accounting policy decision compared to those with negotiation knowledge. In contrast, additional information that a significant accounting policy decision was negotiated between the auditors and management indicates that the two parties were initially in disagreement and the resulting outcome may have triggered a strained auditor-client relationship. Since AC members have recently been encouraged to maintain a strong relationship with the auditors and to ensure that the auditors are not constrained by management in conducting quality audits, negotiation knowledge may instill

additional discomfort in AC members who are concerned with the stability of the auditor-client relationship. Given that dissonance theory predicts that people seek to maintain stability (Festinger 1957), I would expect AC members with negotiation knowledge to be less comfortable with an accounting policy decision compared to those without negotiation knowledge. However, this additional discomfort may not necessarily lead to a more extensive investigation because potential questions may be pre-empted by the additional information available about the accounting policy decision. Finally, these competing outcomes may negate each other and result in no difference in AC member comfort as a result of negotiation knowledge.

Of primary interest in this study are factors that influence AC member investigation of significant accounting policy decisions, measured by the number of probing questions asked at AC meetings. Consistent with prior auditing research on the effect of comfort on decision making and dissonance theory, I predict that AC members investigate accounting decisions to reduce discomfort in the financial reporting process. Hence, AC members will ask more probing questions about accounting policy decisions when they are uncomfortable compared to comfortable. I do not propose formal hypotheses for negotiation knowledge because of the divergent predictions for its discomfort-inducing effects. I consider the effect of negotiation knowledge on AC member discomfort and investigation extent as open research questions.

Accounting Policy Aggressiveness

Prior behavioral research considering the role of the AC in auditor-client negotiation focuses on factors that influence AC members' tendency to support the auditor's position. Motivation for such research often stems from calls for improved AC effectiveness. The Blue Ribbon Committee (BRC) report on improved AC effectiveness states that ACs should be

"effective in helping to ensure the transparency and integrity of financial reporting and, thereby, maintain the investor['s] confidence…" (BRC 1999, p. 19). Since auditors typically employ conservative GAAP arguments (Kinney and Martin 1994) to support their position, if AC members support the auditor's position, then they would be less concerned about financial reporting integrity and transparency. However, risk-averse managers frequently take aggressive financial reporting positions as they are motivated to do this from an impression management perspective for a stock market that demands increasing quarterly income and from a personal compensation viewpoint as bonus and stock options are frequently awarded based on accounting income (Guy et al. 1996; Burgstahler and Dichev 1997; Dechow et al. 1995). Defond and Jiambalvo (1993) find that firm specific characteristics such as debt covenants and compensation contracts influence managers to recommend aggressive income increasing accounting policies. These results suggest that AC members, to maintain financial reporting integrity and to support auditor preferences, likely have a preference for more conservative accounting policy decisions.

Gendron et al. (2004) suggest that the construction of AC effectiveness is partly associated with members' ability to constrain management and make them account for rejected auditor recommendations. Constraining management to provide detailed explanations for rejected audit recommendations and supporting auditors in auditor-client negotiations can reduce the incidence of inappropriate, aggressive financial reporting (DeZoort and Salterio 2001). At a typical AC meeting, members would be more concerned or uncomfortable about accounting policies that support aggressive income recognition; hence, I predict that they will be less comfortable with these outcomes and investigate them more thoroughly with probing questions.

> H1: Audit committee members are less comfortable with accounting policy decisions that result in aggressive compared to conservative or neutral outcomes.

H2: Audit committee members investigate accounting policy decisions more extensively when outcomes are aggressive compared to conservative or neutral.

In circumstances where accounting policy decisions are neutral, neither aggressive nor conservative, AC members may either feel comfortable that the outcome is not aggressive or uncomfortable because the outcome is not adequately conservative. Conversely, these effects may occur simultaneously, resulting in no difference between conservative and neutral outcomes. Furthermore, a neutral outcome may imply that a negotiation occurred, possibly resulting in more or less comfort, as described in the previous discussion about the effects of negotiation knowledge. Given these divergent predictions, I do not make a formal prediction for the differential effects of conservative versus neutral outcomes on AC member comfort or investigation extent.

Financial Expertise

AC members with accounting expertise have a substantial body of knowledge regarding technical reporting issues and hence are better equipped, compared with accounting literates, to raise more probing questions regarding negotiated accounting policy decisions (Knapp 1991; McDaniel et al. 2002).[4] These experts have the relevant accounting (both financial accounting and auditing) experience, knowledge and ability necessary to effectively evaluate and question accounting policy decisions (Bonner 1990; Bonner and Lewis 1990; Frederick 1991; Libby and Luft 1993).

In a sample of audit managers and recent EMBA graduates acting as proxies for AC accounting experts and accounting literates, McDaniel et al. (2002) find that experts are more likely than literates to raise concerns about issues that are less prominent in the business press

[4] Financial literates are generally considered capable of reading and understanding the financial statements at a basic level. Financial experts are generally considered to have practical experience in accounting or finance or to have a professional designation in accounting or finance (McDaniel et al 2002).

and recurring in nature. As evidenced with prior research, AC members with accounting expertise are better able to employ stored knowledge to identify issues of concern which enhances their ability to ask tough questions that make management carefully consider their decisions and encourage auditors to investigate appropriately (Levitt 2000). Furthermore, Gendron et al. (2004) propose that the construction of AC effectiveness is dependent upon members' ability to ask challenging questions and that "skills in asking such questions are seen as depending on members having the appropriate technical qualifications as well as inner abilities to detect potentially incoherent data in [the] financial reports." These expert members also tend to make judgements more like auditors which suggests that they would frequently question management regarding aggressive accounting policy decisions that maximize current period net income (DeZoort 1998; DeZoort and Salterio 2001). While I do not expect that accounting experts are less comfortable than non-experts in general, I expect that comfort has some impact on their differential investigation of accounting policy decisions; although I do not have adequate theoretical support to make a specific prediction on the effect of accounting expertise on AC member comfort. Therefore, I will experimentally test the following hypothesis in alternative form:

> H3: Audit committee members with accounting expertise investigate accounting policy decisions more extensively compared to non-experts.

METHOD

Experimental Design and Task

Since AC meetings are private and virtually inaccessible, I examine this issue via an Internet-based experiment. In this experiment I employ a 2 X 3 between-subjects design with the following manipulated independent variables: Negotiation Knowledge (Knowledge vs. No Knowledge) and Outcome Aggressiveness (Conservative vs. Neutral vs. Aggressive). Since I

hypothesize that accounting experience/expertise will affect AC members' information probing abilities, I use years of accounting-related experience as a covariate in the analysis. If accounting-related experience is significantly associated with the main dependent variables, I will then investigate this effect further by separating participants into expert and non-expert groups.

The case materials ask participants to take the role of an AC member and attend an upcoming committee meeting for Simplex Computer Accessories (SCA), a struggling computer accessories firm. [5] The case informs participants that the CEO of SCA has initiated a new marketing strategy to turn the company around after a series of poor financial performances and that some of their sales contracts have expired, thus calling into question the net realizable value of inventory related to the old marketing strategy. SCA's audit partner estimates that 42 percent ($504,000) of total inventory is related to the old strategy, all of which may be obsolete. Since obsolete inventory is a material item for SCA, the audit team asked SCA management for a report showing slow moving inventory to determine an amount for obsolete inventory write-off. However, SCA's accounting system could not adequately track slow-moving inventory, so SCA management conducted a physical count of potentially obsolete inventory and reported that about $97,000 of total inventory is likely obsolete. After addressing the inventory write-off issue during the course of the annual audit, SCA prepares to finalize the financial statements. Thus, an AC meeting is called to discuss and evaluate the adoption of significant accounting policies such as the treatment for inventory write-down.

After reading the case information, participants are presented with 'briefing materials' to prepare for the AC meeting. These 'briefing materials' include the following: excerpts from the

[5] The case employed in this experiment is a modified version of the Johnstone and Muzatko (2002) case. This case is based upon an actual auditor-client negotiation concerning an inventory valuation decision.

proposed audited financial statements, the financial statement impact of three accounting policy alternatives for inventory write-off, and a decision report from management about the accounting policy adopted for inventory write-off using a format by the AICPA (2004) capturing existing 'best practice' in corporate governance.[6] The decision report from management notes that the CFO and audit partner have resolved the inventory write-off issue and that the audit team is prepared to give an unqualified opinion. After reading the case materials participants are asked to generate questions for the upcoming annual AC meeting regarding the obsolete inventory decision for either the audit partner, the CFO or both the CFO and audit partner. The decision report from management is presented in Figure 1.

Independent Variables

The experimental manipulations occur in the decision report from management where participants read a two-paragraph form that details management's summary of a significant accounting estimate. The significant accounting estimate in the case is the amount recorded to account for obsolete inventory.

Negotiation knowledge is manipulated by the extent of information provided by SCA management in the decision report about the accounting for obsolete inventory. In all experimental conditions, participants are provided with a one-paragraph definition of the estimate for obsolete inventory. The manipulations occur in the second paragraph that describes the decision adopted by SCA to account for obsolete inventory. In the no knowledge condition, I informed participants *only* that the CFO and audit partner agreed on a treatment for obsolete inventory and the amount of the write-off. No hint of a disagreement or negotiation is given in

[6] A decision report is a brief document that describes the rationale behind the adoption of a significant accounting policy or estimate. The document is intended to inform the AC of new policies adopted by the firm during the year. The report generally includes a summary of an accounting problem that required a new policy/estimate and the solution to that problem.

this treatment. In the knowledge condition, I stop short of directly informing participants that an auditor-client negotiation has occurred. Rather, they are provided information about an initial disagreement between the audit partner and CFO, that several meetings were required to resolve the issue and that the audit firm's national technical office was consulted on the issue. Participants in the knowledge condition are also provided with the rationale behind the three alternatives considered by the CFO and audit partner to account for obsolete inventory.

Outcome aggressiveness is manipulated simply by the dollar amount of the write-off for obsolete inventory. I assume that a conservative outcome ($504,000), in this context, is the highest possible write-off and an aggressive outcome ($97,000) is the minimum possible write-off. Since the CFO wishes to turn the company around, I assume that participants would consider a low write-off in line with an aggressive strategy by management to maximize net income. I designate the high write-off as conservative since the audit partner raised the issue of obsolete inventory and estimated that $504,000 of inventory is related to the old strategy. The neutral condition ($300,500) is the mid-point between the conservative and aggressive alternatives. In Figure 2, I provide a summary of the manipulations employed in the experiment.

Dependent Variables

I examine AC member comfort by having participants respond to the following question: "Are you "comfortable" with the final accounting for inventory obsolescence?" Participants respond on an 11-point scale (-5 = Very Uncomfortable to +5 = Very Comfortable). I also asked participants about their perceptions of audit partner and CFO comfort with the accounting policy decision. I measure the extent of investigation by analyzing the number and content of questions participants generate for the audit partner and CFO at the AC meeting. After participants read the case and the decision report for the obsolete inventory issue, they are asked to write down

questions in anticipation of the AC meeting. In particular, they are asked the following open-ended question:

> Based upon the information presented, please list any questions, in order that they come to mind, you would ask of the SCA CFO and/or the audit partner regarding the inventory obsolescence decision report.
>
> Please indicate who each question is for by placing one of the following letters before each question: an '**A**' for questions to the **A**udit Partner, a '**B**' for questions to **B**oth the CFO and the Audit Partner, and a '**C**' for questions to the **C**FO.

After writing out questions to ask at the AC meeting, participants responded to debriefing and demographic questions.

I evaluate participants' extent of investigation with two measures: the total number of questions and the number of probing questions. Although I discuss the statistical results for total number of questions, I concentrate primarily on the number of probing questions to investigate the experimental hypotheses since questions asked by members must be challenging if they wish to distinguish themselves from ineffective AC members (Gendron et al. 2004; Gendron and Bédard 2006). I also focus on the number of probing questions as a proxy for AC investigation to enhance the realism of this experimental context. Since the purpose of this study is to determine how AC members investigate for further information regarding an accounting issue, the first logical measure is the actual content of the questions they would ask at a meeting. While this is a previously unused measure of AC effectiveness in behavioral research, academic papers (e.g. Gendron et al. 2004; Gendron and Bédard 2006) and standard setters (e.g. Levitt 2000) have stressed the importance of asking tough, probing questions at AC meetings.

Participant Recruitment and Selection

Participants were identified and recruited from the following sources: (1) an alumni database at a top-tier Canadian business school; (2) corporate governance seminars in Canada;

and (3) professional organizations (e.g. Canadian Institute of Chartered Accountants). I recruited potential participants via email or in person (for the corporate governance seminars only) where I described the importance of the study and encouraged participation. Participants could choose among several mediums to participate in the experiment. Along with the option to complete a web-based version of the experiment, participants could choose to complete the experiment via email, fax or regular mail.[7]

A total sample of 76 business professionals participated in the experiment. One participant did not respond to the main dependent variable question and another participant did not respond to the demographic questions, leaving 74 observations to test the experimental hypotheses. On average, participants are 49.4 years of age, have 16.0 years of business experience, 7.2 years of accounting experience, and 2.4 years of AC experience.

RESULTS

Understanding of Case Information

On average, participants considered the case realistic (mean = 65.07 out of a possible 100, standard deviation = 18.39) and understandable (mean = 78.03, standard deviation = 16.66). When asked to rate materiality on an 11-point scale (-5 = Definitely Not Material to 5 = Definitely Material), participants clearly indicated that they considered the obsolete inventory issue material to SCA's financial statements (mean = 4.38, standard deviation = 1.14). When questioned about whether they would investigate the inventory write-off decision (-5 = I would definitely not investigate this issue, 5 = I would definitely investigate this issue) participants largely indicated that they would investigate (mean = 3.66, standard deviation = 1.69).

[7] Most participants chose to complete the web-based version. I found no significant differences in responses across the mediums of participation.

Negotiation Knowledge – Manipulation Check

I asked participants several questions to evaluate the effectiveness of the negotiation knowledge manipulation. To explore whether they believed that relevant information was missing, I asked participants to rate, on an 11-point scale (-5 = Definitely not enough information, 5 = Definitely enough information), whether there was enough information in their briefing materials to ask appropriate questions about the inventory issue. Participants in the knowledge condition were more likely than those in the no knowledge condition to indicate that they had sufficient information in their briefing materials to ask appropriate questions (means [standard deviations] are 0.28 [3.23] and -0.09 [4.24], respectively, $t = -1.70$, $p < 0.05$).[8]

To examine their opinion of how the accounting policy decision was achieved, I asked participants to indicate the extent that they believe management and the audit partner discussed the accounting treatment for obsolete inventory and how easily they came to an agreement. Participants' perceived extent of discussion (-5 = Very little discussion, 5 = Very extensive discussion) is higher in the knowledge condition than in the no knowledge condition (means [standard deviations] are 2.19 [2.00] and 1.40 [2.51], respectively, $t = -1.53$, $p = 0.06$). In addition, participants perceived difficulty of agreement (0 = Very easy, 10 = Very difficult and 5 = Somewhat difficult) is higher in the knowledge condition than in the no knowledge condition, but this difference is not statistically significant (means [standard deviations] are 0.06 [2.52] and -0.65 [2.73], respectively, $t = -1.17$, $p = 0.12$). [9]

To observe whether the missing negotiation information was perceived as troubling, I asked participants whether they are "comfortable" (-5 = Very Uncomfortable, 5 = Very Comfortable) with the final accounting decision for obsolete inventory and find that participants

[8] All reported p-values for t-tests are one-sided unless otherwise noted.
[9] For analysis purposes I convert the 0 to 10 scale into a -5 to 5 scale to be consistent with the other debriefing questions.

in the knowledge condition were less comfortable compared to those in the no knowledge condition (means [standard deviations] are -2.86 [2.93] and -1.63 [2.92], respectively, $t = 1.84$, $p < 0.05$). Finally, I find that participants in the knowledge condition indicated that they would be more likely to further investigate the accounting decision for obsolete inventory than those in the no knowledge condition (means [standard deviations] are 3.94 [1.33] and 3.41 [1.94], respectively, $t = -1.41$, $p = 0.08$). These results suggest that the manipulation is in the direction intended and that negotiation knowledge induces AC member discomfort, which encourages additional commitment to investigate the accounting policy decision.

Outcome Aggressiveness – Manipulation Check

I asked participants the following question to test the outcome aggressiveness manipulation: "How would you characterize the accounting treatment for the write-down of obsolete inventory agreed to by SCA management and the audit partner?" Participants responded on an 11-point scale ranging from –5 = Very conservative to 5 = Very aggressive with a mid-point labelled 0 = Balanced or Neutral. Mean responses demonstrate that both the neutral and conservative treatments (means [standard deviations] are -0.30 [3.98], 0.66 [2.38]) are significantly lower than participants' mean responses in the aggressive treatment (3.39 [2.52], $p < 0.01$). However, I find no significant differences between the neutral and conservative conditions, suggesting that AC members have similar preferences for all outcomes other than those that are most aggressive. [10]

I also asked participants questions about whether they believe the audit partner and themselves as AC members are "comfortable" with the final accounting for inventory obsolescence. Responses indicate that participants' comfort level for the audit partner (Conservative 1.58 [3.37], Neutral 0.52 [2.13] to Aggressive -1.30 [2.85]) and for themselves as

[10] Statistical significance was tested using Tukey post-hoc comparisons.

AC members (-1.17 [3.17], -1.93 [2.99] to -3.65 [2.18]) differs significantly across treatment cells (Audit Partner $F = 7.19$, $p < 0.01$ and Themselves $F = 4.75$, $p < 0.05$). Multiple comparisons on audit partner and AC member comfort reveal the same pattern of significant differences as indicated for the accounting treatment aggressiveness question (i.e. no difference between conservative and neutral condition participants). These results demonstrate that the outcome aggressiveness manipulation works in the expected manner, although AC members have no preference between conservative and neutral outcomes, and provides preliminary support for the prediction that AC members are less comfortable with aggressive accounting policy decisions.

Dependent Variable Coding

Investigation extent is measured by the number of total and probing questions that participants generate in anticipation of the AC meeting. To measure the total number of questions, I simply counted all the questions participants generated. These include all statements with a question mark or those that would require a response from the CFO, audit partner or both.[11] I also counted questions with more than one question in a sentence. For example, "How did you account for inventory and why did you do it this way?" would be considered two questions.

While an AC member may ask a large quantity of questions, it is the quality of those questions that demonstrates effectiveness (Gendron et al. 2004; Gendron and Bédard 2006). Hence, as my primary dependent variable, I evaluated how many 'probing' questions participants asked. Along with an independent coder, who was blind to experimental condition, I coded the total number of questions and the number of probing questions. While reading and counting

[11] Statements such as "I question a clean audit" would certainly require a careful response from either the CFO or audit partner.

questions, the independent coder and I took the role of the person who was presented with the question from the AC member (i.e. CFO or audit partner). If by answering the question I (or the coder) would have to divulge sensitive information about the inventory valuation decision or about how the accounting treatment was agreed upon then the question is considered probing. Any questions that asked about the appropriateness of the accounting treatment are also considered probing, for example, "A *(for the audit partner)*: Justify the difference in impairment charge levels between options A *($97,000 write-off)* and C *($504,000)*" (words in italics were added for descriptive purposes). This question clearly challenges the audit partner to justify the difference between the inventory write-off alternatives and hence would be considered probing. In Table 1, I provide several other examples of probing and non-probing questions.

After counting total questions and probing questions I compared my results with the independent coder. Inter-rater reliability tests indicate a strong match between question counts with a Cronbach's Alpha of 0.997 for total questions and 0.969 for probing questions. We later reconciled any differences in our evaluations. In Table 2, I provide a descriptive summary for the main dependent variables across experimental conditions: (1) AC member comfort (Panel A), (2) the number of total questions (Panel B) and (3) the number of probing questions (Panel C). On average, participants generated 6.86 total questions and 5.01 probing questions in preparation for the AC meeting.

Tests of Hypotheses

I ran three ANOVAs on the dependent variables (AC member comfort, the number of total questions and the number of probing questions) with negotiation knowledge and outcome aggressiveness as independent variables and years of full-time accounting experience as a covariate. I present the results of this analysis in Table 3.

With divergent possible predictions from dissonance theory, I did not make a formal hypothesis for the impact of negotiation knowledge on AC member comfort and extent of investigation. The ANOVA results indicate that negotiation knowledge has a main effect on AC comfort ($F = 4.00$, $p < 0.05$) but no significant main effect on either the number of total ($F = 1.12$, $p = 0.29$) or probing questions ($F = 0.42$, $p = 0.52$). These results suggest that negotiation knowledge induces AC member discomfort but this does not translate into additional investigation to reduce this discomfort. This appears to be inconsistent with my predictions regarding the effect of discomfort on AC member investigation of accounting policy decisions but. However, as noted in the manipulation check for negotiation knowledge, participants in the knowledge condition were more likely than no knowledge participants to indicate that they had sufficient information to ask appropriate questions, so questions that they would have asked may have been pre-empted by the greater level of actual and perceived disclosure regarding the accounting policy decision.

In H1 and H2, I predict that AC members' discomfort and extent of investigation increases when accounting policy outcomes are aggressive compared to conservative or neutral. The ANOVA results for AC member comfort demonstrate a significant main effect for outcome aggressiveness ($F = 5.33$, $p < 0.01$). Simple contrasts provide evidence that AC members are significantly more comfortable with conservative ($p < 0.01$) and neutral ($p = 0.01$) compared to aggressive outcomes. I find no significant differences in comfort between the conservative and neutral conditions ($p > 0.30$). The ANOVA results for AC member investigation indicate that outcome aggressiveness has a moderately significant main effect on the number of total ($F = 2.57$, $p = 0.08$) and a significant main effect on the number of probing questions ($F = 4.20$, $p = 0.02$) asked in anticipation of the AC meeting. Simple contrasts among the levels of outcome

aggressiveness indicates that AC members investigate aggressive outcomes significantly more extensively with probing questions compared to either conservative ($p = 0.03$) or neutral ($p < 0.01$) outcomes. Interestingly, the simple contrasts for total questions reveal no significant difference between aggressive and conservative outcomes ($p = 0.14$) and a significant difference between aggressive and neutral outcomes ($p = 0.01$). These results support H2 that more aggressive accounting is associated with extensive investigation by AC members and that the direction of investigation is consistent with AC member discomfort reduction.

Recall in H3 that I expect participants with accounting expertise (i.e. those with accounting or AC experience) to investigate accounting policy decisions more extensively compared to non-experts. Before conducting these tests, I evaluate whether the years of accounting experience covariate included in the previous ANOVA results had a significant impact on AC comfort and on the extent of investigation measures. As expected, the covariate is not significant for AC comfort ($F = 0.69$, $p > 0.40$), suggesting that expert AC members are not generally less comfortable with significant accounting policy decisions compared to experts. However, I find that the accounting experience covariate is significant for total questions ($F = 13.24$, $p < 0.01$) and probing questions ($F = 17.50$, $p < 0.00$). These results suggest that investigating accounting expertise further is a worthwhile exercise.

I construct a binary accounting expertise variable (0 = non-expert, 1 = expert) to further analyze the effect of accounting expertise on AC members' extent of investigation. I define an accounting expert as any individual with either (1) more than one year of accounting-related experience and/or (2) more than one year of audit committee experience. While any criterion for classifying accounting experts is highly subjective, the criteria I employ results in a relatively balanced separation of the sample (36 non-experts and 40 experts) and require experts to have

relevant accounting experience. To ensure that I have experts classified correctly, I conducted t-tests on the debriefing questions, across all experimental cells, with accounting expertise as the grouping variable (0 = literate, 1 = expert). As expected, when I asked participants to rate their degree of accounting knowledge (0 = Low Knowledge to 100 = High Knowledge with a midpoint 50 = Average Knowledge) I find that self-rated financial accounting ($p = 0.00$), financial statement ($p = 0.00$), and audit knowledge ($p = 0.00$) are significantly higher for experts than for non-experts. These results suggest that the binary variable results in an effective separation between experts and non-experts.

After constructing the accounting expertise variable, I conducted a two-way ANOVA with accounting expertise and outcome aggressiveness as the independent variables and the number of total questions and probing questions as dependent variables.[12] The results, presented in Table 4, suggest that accounting experts investigate accounting policy decisions more extensively, with more total ($F = 8.51$, $p < 0.01$) and probing questions ($F = 7.73$, $p < 0.01$), than non-experts. Therefore, I find support for H3 that accounting experts investigate accounting policy decisions more extensively than non-experts.

DISCUSSION AND CONCLUSION

Recent interview studies of AC practice introduce a new measure of AC effectiveness, the number of probing, non-standard questions that AC members generate at meetings (Gendron et al. 2004; Gendron and Bédard 2006). In this study, I apply this new measure to a previously unexplored AC setting by examining the questions that AC members generate in anticipation of a meeting to discuss a significant accounting policy decision. This study is motivated by recent research by Gibbins et al. (2001) and Gibbins et al. (2005) which find that while AC members

[12] Negotiation knowledge is not included in the model because it is not significantly related to the dependent variables. Including negotiation knowledge into the model does not significantly influence the results.

are often informed of significant accounting policy decisions, they are typically not informed that these policies are the result of negotiations between the auditors and management. Thus, I explore how AC members maintain effectiveness in an environment where they are both not involved in significant accounting policy decisions and not informed that these decisions are the result of auditor-client negotiations.

This study employs an experiment to examine the impact of AC members' knowledge that an auditor-client negotiation has occurred and the aggressiveness of the negotiated outcome on their extent of investigation at an AC meeting. This approach is theoretically grounded in the 'auditing as a process of discomfort reduction' literature in auditing and the dissonance theory literature in social psychology, which posits that auditors and AC members conduct procedures and investigate accounting decisions to instil comfort in the financial reporting process and that people have a preference for stability in their cognitions and self-concepts. The posited existence of this mechanism motivates AC members to feel uncomfortable and probe for more information when they encounter instability (e.g. management not disclosing that a proposed accounting policy is the result of an auditor-client negotiation). Applying this research to the AC setting, I predict that AC members investigate accounting policy decisions to reduce discomfort in the financial reporting process.

I evaluate my experimental hypotheses with a sample of 76 experienced business professionals. The results provide evidence that when informed that an accounting policy decision was the result of an auditor-client negotiation, AC members are less comfortable than if they were not informed. However, perhaps since they have more overall information about the accounting policy decision, this discomfort does not lead to additional investigation with probing questions. I also find that AC members have an aversion and are less comfortable with

aggressive accounting policy choices compared to conservative or neutral (i.e. neither aggressive nor conservative) choices. Furthermore, AC members appear to reduce this discomfort in aggressive accounting policy choices by asking progressively more total and probing questions. Finally, I find that while accounting experts are no more likely than non-experts to be uncomfortable with significant accounting policy decisions, they are significantly more likely to investigate by asking more total and probing questions.

The results of this research have important benefits to practice and future research. While the majority of behavioral AC research focuses on AC member support for the auditor's position as a measure of effectiveness, this study introduces a new behavioral measure for AC effectiveness, the number of probing questions asked in anticipation of an AC meeting. This measure was constructed through an examination of interview research on AC practice and the hypotheses were developed from field research in auditing and corporate governance positing that comfort is an important motivator for auditor and AC member activity. To my knowledge, this is the first behavioral auditing study to extensively consult sociology-based field research to inform variable definition and hypothesis development. I encourage future researchers to consider the benefits of integrating the results of field research of auditing and corporate governance practice into in behavioral studies. This study also demonstrates that recent calls for greater disclosure of auditor-client discussions about significant accounting policy decisions may increase AC member concerns about these decisions but not necessarily increase investigation in committee meetings. In fact, as this study suggests, additional information disclosures may pre-empt AC member questioning because the answers are provided in the briefing materials. Still, the results suggest that disclosure is better than no disclosure as AC members do not appear capable of compensating for a lack of negotiation information by increasing their extent of

investigation with probing questions. Finally, the results provide evidence that AC members do not have a clear-cut preference for conservatism as neutral accounting policy decisions have equivalent effects on comfort and the extent of investigation with probing questions. The results appear to suggest that AC members are quite comfortable with any accounting policy decision until they recognize that it is clearly aggressive. This might provide an opportunity for managers to engineer accounting policy decisions that fly just under the AC's radar (just far enough away from an aggressive decision to avoid scrutiny).

In this study, I employ a new measure of AC effectiveness with the questions members generate in anticipation of AC meetings. Since I focus on only one accounting policy issue (inventory valuation) and two independent variables (Knowledge of Negotiation and Outcome Aggressiveness) additional research on the questions that AC members generate is necessary to further extend these findings. Other factors that may influence AC members' information probing include the following: management credibility, knowledge of the industry and relationship with management and audit team. Finally, future research could also consider issues such as interactions between the AC and the CFO/Audit Partner to examine the use and importance of follow-up questions.

This research contains some limitations to take into consideration. First, I did not find a main effect for negotiation knowledge on investigation extent, which is somewhat contrary to my prediction regarding the effect of discomfort on AC member investigation. However, as mentioned earlier, negotiation knowledge participants may have intended to investigate the accounting policy decision more but their questions were answered with the additional information disclosed about the decision. Second, the sample used in this study does not consist completely of audit committee members. Although a significant proportion of the sample has

Board experience (61.80%) and many have AC experience (38.20%), the remainder consist of highly experienced business professionals (i.e. among the population of individuals likely to be called on to serve on Boards or ACs) without Board or AC service. While prior research has employed proxies for AC members (McDaniel et al. 2002) actual members/directors have experience-specific knowledge above-and-beyond business education and general business experience. Third, the binary variable constructed to examine accounting expertise may be criticized as being highly subjective. However, the behavioral AC literature has not yet extensively examined the benefits/effects of accounting expertise and a generally accepted method of identifying AC accounting experts is not available, so I argue that my measurement is at least adequate. Finally, this research is subject to the normal limitations associated with any experimental research that by its very essence stresses internal validity over external validity. Nonetheless, I followed best practice recommendations for the information provided to participants and I employed a realistic case that was based on an actual audit.

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Figure 1: Decision Report From Management

Decision Report From Management
About a Significant Accounting Estimate

1. Definition of the Significant Estimate:

As a result of the new marketing strategy initiated by the CEO and endorsed by the Board of Directors, it is possible that much of the older inventory related to the previous strategy may be of no further use to SCA. The auditor estimates that of the $1,200,000 of inventory, 58 percent ($696,000) of the dollar value included products related to the new marketing strategy, while 42 percent ($504,000) of the dollar value included products related to the old marketing strategy (mostly desk parts that would require additional investment to make into saleable finished products). Hence the issue of adjusting inventory to net realizable value was raised by the auditor. The outcome of this estimate could have a material impact on the financial statements of SCA as shown in Table 2.

2. Alternative Adopted by SCA:

After considering the issue of adjusting inventory to net realizable value, the CFO decided to record a $504,000 write-off. Both the audit partner and the CFO have accepted this accounting treatment and Dartmouth has concluded their audit with a proposed unqualified (clean) opinion to be discussed with the AC. Extracts from the proposed audited financial statements incorporating the effects of the inventory write-off are found in Table 3.

Figure 2: Experimental Manipulations

Experimental Manipulations in the 2X3 design are:

1. AC member knowledge that the negotiation took place: Either Knowledge or No Knowledge.
2. The outcome of the negotiation – Three Values: $504,000 (Conservative); $300,500 (Balanced/Neutral); $97,000 (Aggressive).

Experimental Cells (Wording in Management's Decision Report):

Cell 1: (No Knowledge, Conservative)

After considering the issue of adjusting inventory to net realizable value the SCA CFO decided to record a $504,000 write-off. Both the audit partner and the CFO have accepted this accounting treatment and Dartmouth has concluded their audit with an unqualified opinion. The audited financial statements incorporating the effects of the inventory write-off are available in Table 3.

Cell 2: (No Knowledge, Split-the-Difference)

After considering the issue of adjusting inventory to net realizable value the SCA CFO decided to record a $300,500 write-off. Both the audit partner and the CFO have accepted this accounting treatment and Dartmouth has concluded their audit with an unqualified opinion. The audited financial statements incorporating the effects of the inventory write-off are available in Table 3.

Cell 3: (No Knowledge, Aggressive)

After considering the issue of adjusting inventory to net realizable value the SCA CFO decided to record a $97,000 write-off. Both the audit partner and the CFO have accepted this accounting treatment and Dartmouth has concluded their audit with an unqualified opinion. The audited financial statements incorporating the effects of the inventory write-off are available in Table 3.

The Following is Included in Cells 4 through 6

To resolve the issue of adjusting inventory to net realizable value the Dartmouth audit partner and the SCA CFO considered the following three alternatives:

A. Write-off $97,000 as obsolete inventory. This alternative is based on SCA management's physical inspection of inventory. Given the analysis in Table 1 and the related estimate of obsolete inventory, a write-off of $97,000 is possible. The SCA CFO initially suggested this alternative.
B. Write-off $300,500 as obsolete inventory. This alternative is a result of a "splitting of the difference" between alternatives A and C.

Figure 2: Experimental Manipulations (Continued)

C. Write-off $504,000 as obsolete inventory. This alternative is the maximum write-off amount, which is equal to the total value of the old inventory. The Dartmouth audit partner initially suggested this alternative.

Cell 4: (Knowledge, Conservative)

After an initial disagreement and several meetings to resolve their differences, the CFO and audit partner, in consultation with the audit firm's national technical office, decided to adopt the audit partner's position and record a $504,000 write-off. Both the audit partner and the CFO have accepted this accounting treatment and Dartmouth has concluded their audit with a proposed unqualified opinion to be discussed with the AC. Extracts from the audited financial statements incorporating the effects of the inventory write-off are found in Table 3.

Cell 5: (Knowledge, Split-the-Difference)

After an initial disagreement and several meetings to resolve their differences, the CFO and audit partner, in consultation with the audit firm's national technical office, decided to split their differences and record a $300,500 write-off. Both the audit partner and the CFO have accepted this accounting treatment and Dartmouth has concluded their audit with a proposed unqualified opinion to be discussed with the AC. Extracts from the audited financial statements incorporating the effects of the inventory write-off are found in Table 3.

Cell 6: (Knowledge, Aggressive)

After an initial disagreement and several meetings to resolve their differences, the CFO and audit partner, in consultation with the audit firm's national technical office, decided to adopt the CFO's position and record a $97,000 write-off. Both the audit partner and the CFO have accepted this accounting treatment and Dartmouth has concluded their audit with a proposed unqualified opinion to be discussed with the AC. Extracts from the audited financial statements incorporating the effects of the inventory write-off are found in Table 3.

Table 1: Examples of Probing and Non-Probing Questions

Type	Question	Evaluation of Content
Probing	B. What third party with acknowledged experience in evaluating Simplex's inventory is available to conduct a non-biased estimate of the salvageable value of the inventory related to the old strategy?	Demonstrates that the AC member is trying to verify the legitimacy of the accounting decision.
Probing	A. Based on your experience and benchmarking other similar businesses how accurate is Table 1 prepared by the VP, CO, and CFO?	Checking the accuracy of reports, estimates, tables, etc. are all considered probing questions.
Probing	C. How would regulatory bodies view manipulation of this kind?	The participant appears to perceive the treatment as a manipulation. This question would make the CFO and audit partner uncomfortable at a meeting.
Probing	A. Can we have some detail to substantiate your estimate of the dollar value of your proposed write-off of 504,000?	The participant wants further proof that the amount is appropriate and the second question challenges the auditor for further information.
Probing	A. Why did you give in to management's position?	An answer to this question would likely require a great deal of disclosure regarding the negotiation process.
Not-Probing	C. What are the cost/benefits of bringing in the owners/managers from the local computer stores to have them buy all or significant chunks of the inventory related to the old strategy at discount prices?	This is a question about strategy, not about the accounting issue. This question could be easily fielded by the CFO.
Not-Probing	C. Will our efforts to market and sell the old inventory hinder our ability to sell the new inventory, thus resulting in a need to write it (i.e., the new stuff) down in the future?	This question fails to dig deep regarding the issue. This is more of a business approach question (i.e. how is the business going to succeed?).
Not-Probing	C. Is the allowance for doubtful accounts adequate?	This question has no real relevance to the inventory valuation decision.
Not-Probing	C. Have there been any returns of inventory since the year end where A/R remained O/S at year end?	This question has no real connection to the inventory valuation decision.
Not-Probing	C. What is the cost to carry the inventory until it is disposed of?	This question is not closely associated with the inventory valuation decision.

Table 2: Descriptive Statistics

Panel A: Audit Committee Comfort

			Outcome Aggressiveness			
			Conservative	**Neutral**	**Aggressive**	**Average**
Negotiation Knowledge	**Absent**	Mean (s.e.) AC Comfort	-1.00 (0.77)	-1.07 (0.75)	-2.85 (0.77)	**-1.64 (0.44)**
		Sample Size	12	14	12	**38**
	Present	Mean (s.e.) AC Comfort	-1.36 (0.84)	-2.73 (0.72)	-4.70 (0.88)	**-2.93 (0.47)**
		Sample Size	11	15	10	**36**
		Average	**-1.18 (0.57)**	**-1.90 (0.52)**	**-3.77 (0.59)**	**-2.27 (0.32)**
			23	**29**	**22**	**74**

Panel B: Total Number of Questions

			Outcome Aggressiveness			
			Conservative	**Neutral**	**Aggressive**	**Average**
Negotiation Knowledge	**Absent**	Mean (s.e.) Total Question	7.86 (1.06)	5.40 (0.98)	8.70 (1.06)	**7.32 (0.60)**
		Sample Size	12	14	12	**38**
	Present	Mean (s.e.) Total Question	5.82 (1.11)	5.98 (0.95)	7.40 (1.16)	**6.40 (0.62)**
		Sample Size	11	15	10	**36**
		Average	**6.84 (0.77)**	**5.69 (0.68)**	**8.05 (0.79)**	**6.86 (0.43)**
			23	**29**	**22**	**74**

Table 2 (Continued): Descriptive Statistics

Panel C: Number of Probing Questions

Knowledge of Negotiation		Outcome Aggressiveness: Conservative	Neutral	Aggressive	Average
Absent	Mean (s.e.) Probing Question	5.13 (0.78)	3.93 (0.72)	6.82 (0.78)	**5.30 (0.44)**
	Sample Size	12	14	12	**38**
Present	Mean (s.e.) Probing Question	4.44 (0.82)	4.35 (0.70)	5.85 (0.85)	**4.88 (0.46)**
	Sample Size	11	15	10	**36**
	Average	**4.78 (0.57)**	**4.14 (0.50)**	**6.34 (0.58)**	**5.09 (0.32)**
		23	**29**	**22**	**74**

Notes:

- Total Questions consist of all the questions and relevant statements that participants generate in preparation of the AC meeting.
- Probing Questions consist of those questions that are non-standard and effectively challenge management and the audit partner to disclose all the information necessary to understand how the financial statements were conceived.
- (s.e.) = Standard error.
- Outcome Aggressiveness is the dollar amount of the inventory write-off decision: Aggressive = $97,000; Split-the-difference = $300,500; Conservative = $504,000.
- Knowledge of negotiation is whether participants have been provided detailed information in management's decision report regarding the negotiated accounting policy decision.

Table 3: Main Hypothesis Tests

Panel A: Univariate ANOVA Results for Audit Committee Comfort

Dependent Variable: Audit Committee Comfort

Factor	***df***	***Mean Square***	***F***	***p-value***
Outcome Aggressiveness	2	41.56	5.33	0.007
Negotiation Knowledge	1	31.17	4.00	0.049
Aggressiveness*Knowledge	2	3.95	0.51	0.604
Error	70			

Panel B: Univariate ANOVA Results for Total Number of Questions

Dependent Variable: Total Number of Questions

Factor	***df***	***Mean Square***	***F***	***p-value***
Outcome Aggressiveness	2	34.61	2.57	0.084
Negotiation Knowledge	1	15.12	1.12	0.294
Aggressiveness*Knowledge	2	11.98	0.89	0.416
Accounting Experience	1	178.59	13.24	0.001
Error	67			

Panel C: Univariate ANOVA Results for Number of Probing Questions

Dependent Variable: Number of Probing Questions

Factor	***df***	***Mean Square***	***F***	***p-value***
Outcome Aggressiveness	2	30.49	4.12	0.019
Negotiation Knowledge	1	3.06	0.42	0.518
Aggressiveness*Knowledge	2	3.52	0.48	0.618
Accounting Experience	1	127.12	17.5	0.000
Error	67			

Notes:

- Total Questions consist of all the questions and relevant statements that participants generate in preparation of the AC meeting.
- Probing Questions consist of those questions that are non-standard and effectively challenge management and the audit partner to disclose all the information necessary to understand how the financial statements were conceived.
- Outcome aggressiveness is the dollar amount of the inventory write-off decision: Aggressive = $97,000; Split-the-difference = $300,500; Conservative = $504,000.
- Negotiation knowledge is whether participants have been provided detailed information in management's decision report regarding the negotiated accounting policy decision.

Table 4: Hypothesis Tests for H3

Panel A: Univariate ANOVA Results for Total Number of Questions

Dependent Variable: Total Number of Questions

Factor	***df***	***Mean Square***	***F***	***p-value***
Outcome Aggressiveness	2	33.15	2.38	0.100
Accounting Expertise	1	118.50	8.51	0.005
Aggressiveness*Expertise	2	22.28	1.60	0.209
Error	70			

Panel B: Univariate ANOVA Results for Number of Probing Questions

Dependent Variable: Number of Probing Questions

Factor	***df***	***Mean Square***	***F***	***p-value***
Outcome Aggressiveness	2	28.52	3.65	0.031
Accounting Expertise	1	60.38	7.73	0.007
Aggressiveness*Expertise	2	13.31	1.74	0.183
Error	70			

Notes:

- Outcome Aggressiveness is the dollar amount of the inventory write-off decision: Aggressive = $97,000; Split-the-difference = $300,500; Conservative = $504,000.
- Total Questions consist of all the questions and relevant statements that participants generate in preparation of the AC meeting.
- Probing Questions consist of those questions that are non-standard and effectively challenge management and the audit partner to disclose all the information necessary to understand how the financial statements were conceived.
- Accounting Expertise is a binary variable where 0 = non-expert and 1 = expert.