

**AN EXAMINATION OF THE EFFECTS OF AUDITOR RANK ON
NEGOTIATION PLANNING JUDGMENTS**

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ABSTRACT

Auditors often encounter contentious accounting and reporting issues that require resolution with the client. The purpose of the current study is to examine the impact of auditor rank on pre-negotiation judgments. We also examine auditors' use of a concessionary negotiation tactic and levels of persuasion knowledge. To address these issues, 25 managers and 18 partners examine a rich experimental case in which they are asked to consider their position and that of the client on a difficult inventory writedown situation. The results indicate that partners take a harder stand than managers in calling for a higher initial proposed writedown, minimum writedown, and expected writedown than managers. Also partners' estimates of the client's belief of the amount that should be recorded, and that is acceptable to them, is greater than for managers. There was use of a concessionary tactic of bid high/concede later, but this was rarely used by partners. Contrary to expectations, there were no differences in the level of persuasion knowledge between partners and managers.

Key Words: Auditor negotiations, auditor client resolution, experience effects

I. INTRODUCTION

It is widely recognized that negotiations are pervasive in the auditing environment (Gibbins et al. 2001; Nelson et al. 2002; Gibbins et al. 2005; Bame-Aldred and Kida 2007), for instance, in the resolution of proposed audit adjustments (Wright and Wright 1997; Ng and Tan 2003; Trotman et al. 2005; Sanchez et al. 2007) and in disagreements over accounting policies (Kadous et al. 2003). Significant risks and potential costs to investors, the client, and the audit partner and manager heighten the need for auditors to be proficient in dealing with negotiations.

Three distinct phases of this negotiation process have been identified in prior research: pre-negotiation, negotiation and post-negotiation (Lebow 1996; Bame-Aldred and Kida 2007). The purpose of this study is to examine the pre-negotiation planning judgments of both audit managers and audit partners. In this stage of the negotiation process, auditors and clients estimate ranges of possible outcomes and their desired outcomes. They will also consider potential tactics they will use in the negotiation process. Further, pre-negotiation judgments include estimates of the final negotiated amount, minimum writedown that would be accepted, first bid, assessments of the strength of the client's position, anticipated arguments from the CFO, and responses to potential arguments (Brown and Wright 2007). We focus on the expectations and assessments that partners/managers take into the negotiation process. The above types of judgments are important because they have been shown to have a significant impact on negotiation outcomes (Pruitt and Lewis 1975; Raiffa 1982; Neale and Bazerman 1985; Cialdini 1993; Plous 1993; Pruitt and Carnevale 1993; Thompson 2001).

Specifically, we use negotiation theory and persuasion theory to investigate how auditor rank affects the judgments made by auditors in the pre-negotiation process.

Drawing on the general findings from psychology (e.g. Neale and Northcraft 1986), we hypothesize that auditor rank will impact pre-negotiation judgments. We focus on rank, since partners generally have more experience in negotiation than managers but also importantly are likely to negotiate differently due to differences in status, both within their own firm and as perceived by the clients. That is, partners have the authority to provide the final word among the engagement team on the resolution of contentious issues. Further, partners possess ultimate responsibility for the eventual outcome of the engagement should negative repercussions occur such as litigation, loss of client, and/or loss of firm reputation.

Despite the importance of negotiations, there has been only one prior study to directly consider the impact of auditor experience on negotiations (Brown and Johnstone 2007).¹ This is an important issue, since auditor proficiency in negotiations, as discussed, is critical to quality financial reporting. If rank is found to make a difference, it is important to understand what the differences are and what is the cause(s) of those differences. If rank is not found to enhance negotiation skills, then alternative means to enhance auditor proficiency such as the efficacy of training or group processes need to be examined.

In situations where one party is trying to convince another party, as when an auditor advances a position on a contentious accounting issue, persuasion theory is informative in explaining reasons for differences in performance (e.g. Friestad and Wright 1994). Persuasion knowledge refers to schema type functions such as guiding attention to certain evidence produced, providing inferences about possible background conditions that cause the agent (client) to construct the attempt in a particular way, and

¹ See Brown and Wright (2007) for a review of the research on auditor-client negotiations.

generating predictions about the impact of the attempt on people. It also includes persuasion coping knowledge which directs one's own response goals and options, provides situational information relevant to selecting tactics, and predicts which tactics will best achieve one's goals (Rich et al. 1997). As partners and managers have had different amounts of experience in negotiating and in status within the firm (authority and responsibility), we expect differences on this dimension and we provide an exploratory measure of persuasion knowledge.

Parties to a negotiation choose tactics based on their pre-negotiation judgments. Previous audit research has asked auditors and clients to assess the likelihood of using various tactics in a negotiation process (Bame-Aldred and Kida 2007) and found that one tactic, bid high and concede later, is more commonly used by clients than auditors. Rather than ask auditors whether they employ such tactics we compare judgments of both managers and partners of pre-negotiation positions to assess whether they are actually using this tactic.

This study makes the following contributions. First, given the importance of the inputs to the negotiation process, this study extends prior studies on auditor-client negotiation by examining auditor pre-negotiation judgments, on a very rich case containing information normally available to auditors using a strategic systems audit approach (Bell et al. 1997). Second, we consider the differences between partners and managers in pre-negotiation judgments and their level of persuasion knowledge. Third, we address differences in the use of a concessionary tactic by managers versus partners in an audit-client negotiation situation. We find that partners take a tougher stand than managers in calling for a higher initial proposed writedown, minimum writedown, and

expected writedown than managers. Also partners' estimates of the client's position as to the amount that should be recorded, and that is acceptable, is greater than for managers. Although there is some evidence of the use of a concessionary tactic of bid high/concede later by managers, this was rarely used by partners. Finally, contrary to expectations, there were no differences in the level of persuasion knowledge between partners and managers.

The remainder of this paper is divided into four sections. Section II contains a discussion of the negotiation and persuasion literatures and the development of hypotheses. Sections III and IV provide a description of the study's method and findings, while section V is devoted to a summary of the key results and a discussion of the implications of the findings.

II. RELEVANT LITERATURE AND HYPOTHESES

Negotiation Strategies

The general negotiation literature provides two widely recognized approaches to negotiation: distributive (or competitive) and integrative (or collaborative) (Putnam 1990; Cialdini 1993). Negotiations characterized by a distributive orientation emphasize differences and the need to win, often utilizing compromise, pressure tactics, and coercive processes. Distributive negotiations also tend to increase conflict, and attempts to gain power frequently lead to withholding information and even the exchange of false information. Furthermore, distributive negotiations increase the possibility of deadlock and hostility, potentially leading to loss of client goodwill. Negotiations characterized by an integrative orientation, on the other hand, seek to maximize information flow and establish trust. These negotiations tend to result in more systematic, open discussions,

potentially increasing an auditor's ability to obtain information and a positive outcome without incurring client ill-will (“win-win” situation) and potential loss of the client. Fundamental to collaborative negotiation is the ability to understand your opponent's position (Pruitt and Lewis 1975).

While most negotiation literature treats the choice of negotiation strategies as either distributive or integrative, in many contexts in auditing there appear to be limited possibilities for an integrative solution and most are likely to fall somewhere along the continuum. For instance, auditor-client negotiations often entail situations where the client would generally prefer not to reduce profit whereas the auditor may have good reasons why profit should be written down. Therefore, for every dollar writedown it can be argued that the client is worse off and the auditor is better off. However, previous research in auditing (e.g. Gibbins et al. 2001; Gibbins et al. 2005; Tan and Trotman 2007) suggests that some of the attributes of distributive negotiations such as hostility and withholding information are not present. Thus, auditor-client negotiation situations appear to be predominately more along the continuum towards being conducive to distributive rather than integrative strategies but cannot be considered as purely distributive. This is important because previous research in the negotiation literature on the impact of experience and the role of strategies has mainly characterized negotiation as purely integrative or purely distributive.

Impact of Audit Rank

An important issue is how rank affects auditors' proficiency in client negotiations. Findings in the general negotiations literature indicate that experience leads to improved negotiation outcomes (Montgomery and Benedict 1989; Murnighan et al. 1999), more

care in establishing an initial position (Bartos 1977), and more demanding positions and less concessionary tactics (Thompson 1990a). However, few studies employ participants with experience in a professional domain.

Much of the negotiation research has placed considerable emphasis on how to help negotiators achieve an integrative solution. To reach an integrative outcome, one important skill is “logrolling” whereby value is created through negotiators making tradeoffs among issues so that each party gets his/her preferred alternative on issues of higher priority, although compromising on less important issues. It has been found that negotiators’ ability to logroll improves as they gain experience in tasks with logrolling potentials, which in turn leads to improvement in negotiators’ integrative outcomes (Thompson 1990a, 1990b; Bereby-Meyer et al. 2004). Moreover, negotiators are found to be able to successfully apply the logrolling skill that they acquired in one negotiation task to a different negotiation context (Thompson 1990b).

It is important to note that the above discussion about the value of experience in negotiations refers to integrative negotiation tasks, whereas our task is at the distributive end of the continuum. There has been little research on the impact of experience on a distributive negotiation task. One exception is Thompson (1990b) who considers whether experience in a distributive task may hinder performance in a subsequent integrative bargaining task. He suggests that experience in a purely distributive situation may lead negotiators to develop a fixed pie perception (Thompson and Hastie 1990), that is a perception of an expectation that the other party’s interests are opposed to one’s own interests. While Thompson (1990b) did not find that experience in a distributive task debilitates subsequent performance, he noted that in his experiment the negotiator’s

experience was limited and that more extensive experience may negatively impact future performance.

The only study to examine the impact of negotiation experience on outcomes and tactics in an audit negotiation was conducted by Brown and Johnstone (2007). Auditors negotiate with a computer-simulated client over an ambiguous accounting matter. Less experienced auditors are found to begin with demanding initial positions in a high risk setting but then concede to client demands, while in a low risk setting they adopt a less conservative position. In contrast, more experienced auditors begin and end with demanding positions irrespective of the risk setting. Consistent with this Kadous et al. (2003) found that experienced auditors are more likely to take a tougher stand with respect to aggressive accounting positions. The setting of our case (inventory obsolescence) is one where the CFO's position is relatively weak. That is, it is difficult to defend no writedown of inventory given the facts of the case.

Based on the above discussion we suggest that partners will take a tougher stand than managers and this will show up in their pre-negotiation judgments. The following hypotheses are advanced:

H1a: The estimated expected final recorded writedown is higher for partners than managers

H1b: The estimated minimum acceptable writedown is higher for partners than for managers

H1c: The estimated initial proposed recommended writedown is higher for partners than for managers

Greater judgment accuracy about the other party's interests has been shown to be associated with improvement in negotiation performance. Negotiators who have a

tendency to think about the other party's perspectives are in a better position to predict their opponents' goals, expectations and reservation points (Bazerman and Neale 1982, 1983; Neale and Bazerman 1983; Moran and Ritov 2007). Thompson (1990a) suggests that experience improves judgment accuracy about the other party's interests, which is one of the keys to successful integrative negotiations. However, Moran and Ritov (2007) note that the effects of experience on the understanding of the other party can be limited. They suggest that, consistent with the other negotiation literature, experience improves the estimation of the other party's general interest structure but not their specific offer values (Moran and Ritov 2007). Thus while experience per se may not necessarily increase the accuracy of the estimates, we suggest that the added confidence in their ability to convince the client of the rationale for the need for an adjustment, will lead to higher estimates. This is particularly so in the present experimental case, to be discussed more fully, where the likely writedown is high, given an aging analysis revealing a significant proportion of old inventory.

H2a: Auditor estimates of management's belief of the amount of the writedown that should be recorded are higher for partners than managers

H2b: Auditor estimates of the maximum inventory writedown the client is willing to accept are higher for partners than managers

H2c: Estimates of the strength of the client's position are lower for partners than managers

Negotiation Tactics

Based on pre-negotiation judgments, negotiators select strategies (Lebow 1996) and then tactics consistent with those strategies (Pruitt and Carnevale 1993). Based on earlier literature (e.g. Pruitt 1998), Bame-Aldred and Kida (2007) identify four general

strategies described in the negotiation literature of which two, problem-solving and contending, are particularly applicable to auditor-client negotiations. These problem-solving and contending strategies are similar to the integrative and distributive negotiation tactics respectively. When using a problem-solving strategy the auditor and client attempt to develop solutions that satisfy both their goals. For a contending strategy the auditor and client attempt to obtain better results for themselves regardless of the other's position (Pruitt 1998; Bame-Aldred and Kida 2007).

There has been limited research on tactics that auditors use in negotiations with clients. In a field study Gibbins et al. (2001) find 85% of the time partners describe that they utilize a distributive tactic, rarely considering new solutions (integrative bargaining). Gibbins et al. (2005) also found that both auditors and CFOs indicated that the outcomes were distributive. The negotiations involved one party attempting to get the other party to agree to their position or to split the difference between the two original positions in some way. In contrast, Goodwin (2002) reports auditors predominately believe (both generally and in a case situation) that they use an integrative negotiation style. However, partners indicate they are more likely to use assertive tactics than managers. Gibbins et al. (2007) considered financial officers and audit partner dyads in examining the roles played by each side and the nature of their relationships across negotiations. They find very little evidence of audit partners using 'moves' (concessionary tactics).

Bame-Aldred and Kida (2007) had both auditors and clients rate the likelihood of using six negotiation tactics (three contending and three problem-solving). They found that for some tactics auditors and clients used consistent tactics. Both groups agreed on the need to obtain information about the other party's preferences and provide substantial

rationale to persuade the other party. Both groups rarely expect to threaten the other party. Compared to auditors, clients indicated they are more likely to trade off on various issues and are more inclined to employ a bid/high concede later strategy. That is, while CFOs were willing to use a tactic of suggesting a low revenue writedown and subsequently conceding to a higher number, auditors were less likely to use the equivalent tactic of suggesting a high revenue writedown and then conceding to a lower number. Tan and Trotman's (2007) results examining the impact of auditors' timing of concessions on accounting managers' (CFOs, financial controllers, etc.) negotiation tactics supported the results of Bame-Aldred and Kida (2007). While the most popular tactic was to provide substantial rationale to persuade, many accounting managers also indicated they used a bid high/concede later strategy.

The above evidence relates to participants' perceptions or self-reports of whether they use a particular tactic. In our study, we use quantitative judgments of the proposed estimates to determine if participants' use a bid high/concede later tactic and if so whether this use varies between partners and managers. Thus, we expect partners to engage in less "game playing" than managers. We suggest the partners are more confident in their ability to negotiate than managers and have greater responsibilities. Hence, they do not feel they need to or should engage in such concessionary tactics. In addition, if they are more confident than managers, partners are more likely to expect to negotiate a greater writedown than the minimum acceptable writedown. As such, we propose the following hypotheses:

H3a: The difference between the initial proposed writedown and the estimated expected final writedown is smaller for partners than managers

Above we have suggested that partners are likely to be more confident in their ability to get a larger writedown than managers, in particular, their rank, which reflects both additional experience and power, will lead them to believe they are better negotiators and therefore be able to negotiate more than the minimum acceptable writedown, suggesting our next hypothesis:

H3b: The difference between the estimated expected final writedown and the estimated minimum writedown is larger for partners than for managers

Persuasion Theory

Management is likely to want to persuade auditors that the financial statements do not require adjustment, and auditors are likely to be aware of these persuasion attempts. There is a large body of literature on persuasion, and Rich et al. (1997) apply this literature to the review process in auditing. The main persuasion model identified by Rich et al. (1997) was the Friestad and Wright (1994) Persuasion Knowledge Model (PKM), which emphasizes how persuasion knowledge influences an individual's performance at convincing another party. One contribution of the PKM is to highlight how three types of knowledge (topic knowledge, agent knowledge, and persuasion knowledge) interact to shape and determine the outcomes of persuasion attempts.

In auditing, topic knowledge includes the auditor's understanding of: the industry; the client's systems, strategies, and core business processes (Bell et al. 1997; Bell et al. 2005); and the area or assertion at issue, i.e., write-down of inventory. The case study materials gave extensive information on these issues. Topic knowledge is acquired both during the present audit (e.g. business strategies, core business processes, risks, etc.) and from previous audit experience (e.g. knowledge of errors). For our study it is assumed

that both managers and partners have the necessary topic knowledge to complete the task, based on both the case materials given and previous experience. The issue of inventory obsolescence is general in nature and is one considered on virtually all engagements where inventory is present. Thus, it is expected auditors would obtain task knowledge early on in their careers. Agent knowledge includes knowledge of the traits, competencies, and goals of the person attempting persuasion. In the negotiation process, the agent or preparer of the financial statements is the client. In our experimental study both managers and partners have not previously met the client so we expect no differences on this level of knowledge. However, it is likely that partners will have more knowledge about agents in general including the extent to which they are likely to negotiate, when they will negotiate and the arguments and tactics they will use.

Based on the literature in psychology and auditing we expect that greater auditing experience and status as a partner will enhance the auditor's persuasion knowledge, i.e., anticipating the client's arguments, recognizing what is important to the client (interests, options, alternatives) and responding appropriately. We expect persuasion knowledge will be developed through past negotiations with clients. Specifically we posit that auditing experience and status as a partner will provide insights into (a) clients' motivations in taking a particular position, (b) what tactics (arguments) the client is likely to use and (c) how to respond to these arguments.

H4: The level of persuasion knowledge will be greater for partners than managers.

III. METHOD

Participants

Partners and managers at Big 4 firms in Australia and USA were asked to participate. This was mainly done through personal contacts but in Australia a consultant was hired to contact some of the participants to increase participant numbers. In total there were 25 managers and 18 partners, with 23 participants from USA and 20 participants from Australia. The participants came from three Big 4 firms, split 23, 16, and 4.² The average years of auditing experience was 8.84 for managers and 18.89 for partners. Further, partners (managers) indicated they had been in their current position an average of 7.44 (2.88) years. When asked how would you rate yourself in terms of effectiveness as a negotiator (1=bottom 10%, 5=average, 9=top 10%), the mean rating was close to 7 on the scale (top 30%) with no one indicating a value less than 5. Therefore, participants were confident in their abilities as a negotiator. There were no significant differences between partners (7.0) and managers (6.8) ($t=0.492$; $p=0.625$).

Task

The case was an abbreviated version of the KPMG/University of Illinois 'Virtual Control Corporation' used by Trotman et al. (2005). The case is a disguised version of an actual joystick manufacturer with revenues of about \$13 million and unaudited earnings of \$411,000. The issue is the amount of a writedown of potentially obsolete raw material inventory to the lower of cost or market. The task is, thus, largely distributive; however, there may be some room for compromise and trading off preferences, e.g., a lower writedown along with reconsideration within a short period. The estimate of inventory writedown is inherently subjective and is material, since it could take the client from a profit to a loss at a time when it is contemplating an upcoming initial public offering. Subsequent events revealed that, in fact, a large inventory writedown was warranted.

² There were no significant differences found based on country of participant or firm affiliation ($p > .10$).

The case was a computerized version of the one used in Trotman et al. (2005). The case contains the following details: company strategies, the industry, customers, demographic trends, suppliers, complementary products, economy, the client, core business processes, critical success factors, client provided Key Performance Indicators (KPIs), the inventory situation, entity business model, KPIs non-financial indicators, KPIs financial indicators, income statement, balance sheet, inventory aging and inventory management KPIs. At the end of each page participants had the option of clicking to go back to the previous page or to go to the next page. Also on each page of narrative, participants had buttons that would take them to any of the following detailed schedules: core business processes, critical success factors, entity model, KPIs non-financial, KPIs financial, income statement, balance sheet, inventory aging and inventory management KPIs.

Research Design and Procedures

The experiment entails a 2 x 1 design with the independent variable auditor rank (partner versus manager).³ All participants were told that “You are about to meet with management to discuss the proposed audit adjustment. You have heard from your audit team that management is very upset at the proposed adjustment and has reiterated its strong reservations about any adjustments.” The setting of the case is one where the CFO’s position is relatively weak. That is, it is difficult to defend no writedown of

³ We also manipulated two negotiation facilitation techniques (role playing and practice) along with a control group without a facilitation technique. The two facilitation techniques were adapted from Trotman et al. (2005) but were weaker manipulations. Note that in Trotman et al., participants carried out a detailed role play or practice session with a confederate whereas in this study we tested the limits of those treatments by having participants write one paragraph in either a role playing or practice role. In all ANOVAs the negotiation role treatment and the interaction with experience were not significant ($p > 0.10$). Consequently, all further analyses are carried out with these three treatment groups combined.

inventory given the facts of the case, which indicate that 68% of the inventory is over 6 months old.

Dependent Variables

Participants were next asked the following five questions requiring a judgment between \$0 and \$2,360,000 (i.e. the full cost of the raw material inventory):

- the amount of inventory writedown that they believe will ultimately be recorded (expected final writedown)
- the minimum inventory writedown they would be willing to accept (minimum writedown)
- the proposed audit writedown they would initially recommend to be recorded (initial proposed writedown)
- the inventory writedown management believes should be recorded (management belief)
- the maximum inventory writedown the client is willing to accept (maximum client willing to accept).

As negotiation outcomes and processes are impacted also by the auditor's view of the strength of the client's position, we also asked on a seven-point scale ranging from 'very weak' to 'very strong' "If VCC's CFO indicates no writedown of the inventory is acceptable, how strong do you think this position would be?"

Given the importance of persuasion knowledge (Friestad and Wright 1994; Rich et al. 1997) we asked a question to elicit participants' persuasion knowledge. Participants were asked "Based on your dealings with CFOs and your reading of the information on VCC, what three arguments do you think the CFO of VCC is likely to raise that are

designed to influence your opinion of the amount of inventory that needs to be written down? Please be as comprehensive as possible in your answers.”

Two coders evaluated the level of persuasion of these responses (a nine point scale, with one representing not at all persuasive and nine representing very persuasive). The coders also evaluated these arguments using Klein’s (1999) three criteria for assessing mental simulations: coherence (Does it make sense?); applicability (Will it get what I need?); and completeness (How complete is it?). The persuasion scores were highly correlated with coherence (0.481), applicability (0.623) and completeness (0.883).

The coding was done by two PhD students from a leading USA accounting school. The level of correlation between the two coders was 0.810, $p=0.01$. We used the average ratings of the two coders.

IV. RESULTS

Table 1 provides a summary of the mean scores for managers and partners on each of the variables. For expected final writedown, partners’ estimates (mean=\$688,556) are significantly higher than managers’ estimates (mean=\$342,680) ($t=2.994$; $p=0.003$, one tailed). Thus Hypothesis 1a is supported. For the minimum inventory writedown that the partner/manager was willing to accept, the partners’ estimate was again significantly higher (mean=\$464,833) than the manager’s (\$261,040) ($t=2.067$; $p=0.023$, one tailed). Hypothesis 1b is supported. Partners appear to take a tougher stand in the negotiation; they expect a larger final inventory writedown and have a higher minimum writedown that they would accept.

Next we compared the initial proposed writedown suggested by partners/managers. The partners’ responses (mean=\$742,944) were significantly higher

than managers (mean=\$453,000) ($t=2.524$; $p=0.008$, one tailed). Hypothesis 1c is supported. There are two potential explanations for this result. Partners take a more demanding position in the negotiation and/or partners adopt a tactic outlined by Bame-Aldred and Kida (2007) of starting with an initial high proposed writedown and later moving back from that point. This possibility is discussed below under negotiation tactics.

To test H2a we compared partners' (mean=\$248,222) and managers' (mean=\$48,680) estimates of management's beliefs of the amount of inventory writedown that should be recorded. As predicted, partners' estimates were significantly higher ($t=2.083$, $p=0.022$, one tailed), thus supporting H2a. In the comparison of partner and manager estimates of the maximum inventory writedown that the CFO is willing to accept, partner mean estimates were \$463,444 compared to managers' estimates of \$166,403 ($t=3.026$; $p=0.002$, one tailed). H2b is supported. This suggests that partners may have a better general understanding of the position clients are likely to credibly take in this situation, given the significant amount of inventory that is over six months old. Further, the partner appears to be less influenced by the CFO's initial position in preliminary case information, indicating management disagrees with an inventory writedown. Alternatively, it suggests partners' confidence in their ability to convince the client of the need for a higher writedown.

Participants were asked to assess the strength of the client's argument in the following question: "If VCC's CFO indicates no write-down of the inventory is acceptable, how strong do you think his position would be?" Given the substantial amount of older inventory on hand, a client would have a weak position in arguing for no

write-down. Although responses were in the direction anticipated with partners assessing a weaker argument by the client than managers, (partner=2.56, manager=3.2 on a seven point scale where 1=very weak and 7=very strong), this difference is not statistically significant ($t=1.248$; $p=0.109$, one tailed). Thus H2c is not supported.

As discussed earlier, previous research has documented a concessionary tactic of asking for an initial writedown that is higher (for auditors) or lower (for CFOs) than they anticipate will be the final resolution. We expected that the differences between the estimated initial proposed writedown and the estimated expected final writedown would be lower for partners than for managers. That is, we posited that partners are less likely to use a concessionary tactic than managers. This difference was marginally significant, providing support for H3a (partners=\$54,388, managers=\$127,333; $t=1.616$; $p=0.057$, one tailed).⁴

As further analysis we considered how many participants indicated different positions for the two questions, that is, they use the tactic of beginning with an initial high value and conceding later. Out of the 24 managers 12 used the tactic (50%) and 12 did not. Out of the 18 partners, only five used the tactic (28%) and 13 did not ($X^2=2.108$; $p=0.128$ Fisher's Exact Test). While the difference is not significant, it does show that there is some use of this tactic and it is in the direction of being used more often by managers than partners.⁵

⁴ One manager indicated a “negative concession” (i.e., a lower initial position than the expected final writedown). The participant must have misunderstood one of the two estimates. Since we are looking at the frequency of using either a contending or a concessionary tactic, this response was eliminated.

⁵ To examine whether this insignificant result may be due to a problem of small sample sizes, this test was redone assuming double the sample and the same results. The X^2 value is then statistically significant (4.216, $p=0.033$).

To test H3b we compared the expected final writedown less the minimum writedown that would be accepted for partners (\$223,722) and managers (\$81,640) ($t=1.802$; $p=0.04$, one tailed). The difference is significant suggesting that partners are more confident than managers that they can negotiate a larger amount above the minimum adjustment they require.

To test H4 the coders rated the persuasiveness of the three arguments listed by the participants and, following Klein (1999, p. 58), evaluated on a nine point scale for coherence (does it make sense?); applicability (will it get what I need?) and completeness (does it include enough?) of the arguments. Contrary to expectations, there was no significant difference in the scores between partners and managers on any of the above three variables or the combined scores ($p>0.10$). Therefore H4 is not supported.

Additional Analysis

To test the sensitivity of the findings we conducted two additional set of analyses. First, in addition to rank we also obtained data on years of auditing experience and years in current position. These variables may capture other dimensions of auditor knowledge and/or responsibilities that may affect negotiation judgments. Years of experience was highly correlated with rank ($r=0.820$) and years of experience in current position ($r=0.796$), presenting significant multicollinearity issues. However, rank and years in current position were only moderately correlated ($r=0.467$). A series of regression analyses, reported in Table 2, examined the incremental explanatory power of each of these two variables. As shown, years in position was not a significant factor for any of the dependent variables, while rank continues to be significant or marginally significant. Second, given the relatively large standard deviations of the dependent variables, as

reported in Table 1, we also performed a Kruskal-Wallis test of medians. The findings (untabulated) remain qualitatively the same. These additional analyses demonstrate the robustness of the primary findings, suggesting significant differences in the pre-negotiation judgments associated with auditor rank.

As additional tests we also carried out the following correlation analysis. First, we correlated coherence, applicability and completeness of the mental stimulations of the CFOs' arguments with the five estimated writedown amounts. There were no significant correlations ($p > 0.10$). Next we correlated the measure of persuasiveness of the CFO arguments with the five estimated writedowns. For partners there was no significant correlation between the persuasion measure and the estimated writedowns. However, for managers the level of persuasion was positively associated with the estimated expected final writedown (0.463; $p = 0.02$) and the initial proposed writedown (0.366; $p = 0.072$). It appears that managers who had a better understanding of the arguments that were likely to be raised by the CFOs made higher estimates of the expected final writedown and the initial proposed writedown. That is, they behaved more like the partners in terms of pre-negotiation positions.

Finally, we correlated the three dependent variables involving auditors' estimates of writedown with the auditors' estimate of what would be the maximum writedown the client is willing to accept; this association indicates auditors' assessments of how closely aligned their position is with that of the CFOs. For partners, these correlations varied between 0.497 and 0.835 (all $p \leq 0.10$). However, for managers none of these correlations were significant ($p > 0.10$). There are a number of interpretations of this correlation analysis that suggest future research. This finding suggests partners believe their position

is closer to that of the client than do managers. This may also mean that partners are more confident they understand the situation and the stand management is likely to take. Further, partners may be more insistent on their position than managers due to increased personal liability and professional reputation risk. Finally, this result may indicate that partners are overconfident they can convince the client.

V. DISCUSSION

Auditors often face difficult accounting issues and may have different reporting goals than the client. The outcome of the negotiation process may, thus, have a significant impact on financial reporting quality. We examine pre-negotiation judgments of audit partners and managers on a task dealing with a subjective inventory writedown situation. Partners and managers determine their position and an estimate of the client's position on an actual case where a large writedown was necessary, as evidenced by subsequent events. By considering a number of prenegotiation judgments, we are able to examine the frequency of a concession tactic.

We find that partners take a tougher stand than managers in pre-negotiation judgments. Partners propose a larger initial writedown, require a larger minimum writedown, and assess a larger expected recorded writedown than managers. Partners also estimate that management believes a larger writedown should be recorded than did managers and their estimates of the maximum inventory writedown management will accept are higher than for managers. The correlation between the auditor's position and the estimated position of the client is also higher for partners than managers. While we do not have actual client estimates, and therefore cannot make accuracy assessments, it is clear that partners have much higher estimates of management's willingness to accept the

writedown. This may be related to a better understanding of the client's position or to greater confidence in their ability to negotiate the writedown. Since initial positions are found to have a significant impact on the eventual negotiation outcome (Bartos 1977), it appears that the more demanding positions of partners are likely to lead to improved reporting quality given the need for a large inventory writedown in the case studied. It also suggests from a practical perspective that it is better not to have managers involved by themselves at the start of the negotiation. Also, partners must be careful when consulting managers for their recommendations.

While we find some evidence that participants use a negotiation tactic of bidding high and conceding later, this was rarely the case for partners. This is perhaps because concessionary tactics (i.e., starting with an initial high writedown with the intent of then later conceding to achieve a desired writedown) are not considered to be appropriate for a professional auditor (Ng and Tan 2003) and/or effective in continuing relationships with a client. Partners also indicate a larger difference between their estimate of the writedown that will be recorded and the minimum required writedown than managers. Thus, it appears that partners' negotiation planning judgments provide for a larger "margin of safety" that the recorded writedown will exceed the minimum that is acceptable. Again this suggests partner confidence in their ability to successfully negotiate a larger writedown.

Using the PKM Persuasion Model (Friestad and Wright 1994) we expected differences in negotiation persuasion knowledge between partners and managers that are the basis for the more demanding pre-negotiation positions of partners. Our study does not support this result. However, this is the first study in accounting to attempt to

measure persuasion knowledge and it is clear the development of measures of persuasion knowledge and subsequent analysis are challenging. We asked participants about the likely arguments they expected the CFO to raise and then had these arguments coded for coherence, applicability and completeness (Klein 1999). Future research could productively consider additional response variables to measure persuasion knowledge. By providing more opportunities to use agent knowledge, the interaction between persuasion and agent knowledge should be considered. That is, different agents may be expected to use different forms of persuasion.

In all, the findings indicate significant differences in the negotiation planning judgments of partners and managers. Further research is needed to isolate the reasons for the differences found, especially since we find no differences in persuasion knowledge between managers and partners. Are the results due to partners' use of more demanding tactics with their enhanced knowledge of how to negotiate with clients and/or increased authority and responsibilities vis-à-vis managers? Will alternative measures reveal greater persuasion knowledge of partners than managers and how this relates to topic and agent knowledge? These questions provide valuable opportunities for future research. Finally, we examine the negotiation planning phase. Research is needed to investigate the link between pre-negotiation judgments and later phases of the negotiation process. Importantly, how do the differences in pre-negotiation planning judgments found in the current study translate into eventual negotiation outcomes, e.g., adjustments to the financial statements and/or footnote disclosures? Future research also needs to explore the impact of judgments made and the tactics used by management and other parties, including the audit committee, on the current audit and in future relations.

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Table 1
Negotiation Outcome

Variable	Managers (n=25) Mean (SD)	Partners (n=18) Mean (SD)	t-test	p*
H1a: Expected final writedown (wd1)	342680 (285077)	688556 (471255)	2.994	.003
H1b: Minimum writedown (wd2)	261040 (195965)	464833 (437052)	2.067	.023
H1c: Initial proposed writedown (wd3)	453000 (257161)	742944 (489703)	2.524	.008
H2a: Managements belief on the writedown (wd4)	48680 (103595)	248222 (465370)	2.083	.022
H2b: Maximum writedown client willing to accept (wd5)	166403 (161610)	463444 (454191)	3.026	.002
H3a: Initial minus expected final writedown (wd3 – wd1)	127333 (167009)	54398 (125523)	1.616	.057
H3b: Expected – minimum (wd1 – wd2)	81640 (181043)	223722 (332700)	1.802	.04

Notes:

- (1) **Writedown** (\$0-\$2,360,000)
- (2) **Expected final writedown:** amount of the writedown that will be ultimately recorded
- (3) **Minimum writedown:** minimum write-down that will be accepted
- (4) **Initial proposed writedown:** initial writedown that would be recommended
- (5) **Managements belief on the writedown:** the auditor’s belief of the writedown management believes should be recorded
- (6) **Maximum writedown client willing to accept:** the auditor’s belief of the maximum writedown management is willing to accept
- (7) **Concession [wd3 – wd1]** initial proposed writedown minus expected final writedown
- (8) **wd1 – wd2:** expected final writedown minus minimum writedown

(9) * one tailed tests

Table 2
Regression Analyses

Rank	Dependent Variable	Years In Position			
		t value	p	t value	p
	H1a: Expected final writedown (wd1)	-.327	ns	2.772	.004
	H1b: Minimum writedown (wd2)	.506	ns	1.576	.061
	H1c: Initial proposed writedown (wd3)	-.491	ns	2.440	.009
	H2a: Managements belief on the writedown (wd4)	-.375	ns	1.997	.026
	H2b: Maximum writedown client willing to accept (wd5)	-.045	ns	2.777	.004
	H3a: Initial minus expected final writedown (wd3 – wd1)	-.387	ns	1.680	.05
	H3b: Expected – minimum writedown (wd1 – wd2)	-1.125	ns	2.124	.020

Note: P values are one-tailed. Significant values are $p < 0.10$.